

BEFORE THE
POSTAL RATE COMMISSION

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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 XXXVIII
Wednesday, August 23, 2000

The above-entitled matter came on for hearing,
pursuant to notice, at 9:30 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
1	HALSTEIN STRALBERG				
2	BY MR. KEEGAN	17053/17265			
3	BY MR. MCKEEVER		17291		
4	RITA D. COHEN				
	BY MR. MEYERS	17070			
5	STEPHEN E. SIWEK				
	BY MR. PRZYPYSZNY	17085			
6	BY MR. REITER		17108/17133		
	BY MR. STRAUS		17129		
7	BY MS. DREIFUSS		17131/17135		
	RICHARD PATELUNAS				
8	BY MR. REITER	17137		17179	
	BY MR. WIGGINS		17148		
9	LAWRENCE G. BUC				
	BY MR. ACKERLY	17181			
10	BY MR. REITER		17204		
	RALPH L. LUCIANI				
11	BY MR. MCKEEVER	17238			
	BY MR. MAY		17259		
12	CARL G. DEGEN				
	BY MR. KOETTING	17301		17394	
13	BY MR. STRAUS		17355		
	BY MR. MCKEEVER		17360		
14	BY MR. RICHARDSON		17362		
15	DOCUMENTS TRANSCRIBED INTO THE RECORD:				PAGE
	Supplemental Testimony of				
16	H. Stralberg, TW-ST-1				17054
17	Supplemental Testimony of				
	Rita D. Cohen, MPA-ST-1				17071
18	Supplemental Testimony of				
19	Stephen E. Siwek, AAP-ST-4				17085
20	USPS-RT-4, Rebuttal Testimony				
	of Richard Patelunas				17137
21	Supplemental Testimony of				
22	Lawrence G. Buc, DMA-ST-2				17182
23	Written Supplemental Testimony				
	of Ralph L. Luciani, UPS-ST-2				17238
24	Written Rebuttal Testimony of				
25	Halstein Stralberg, TW-RT-1				17266

1	DOCUMENTS TRANSCRIBED INTO THE RECORD:	PAGE
2	Written Rebuttal Testimony of Carl G. Degen, USPS-RT-5	17302
3	Exhibit Number ABM-XE-USPS-RT-5	17358

5 E X H I B I T S

6	NUMBER	IDENTIFIED	RECEIVED
7	Supplemental Testimony of H. Stralberg, TW-ST-1		17054
8	Supplemental Testimony of Rita D. Cohen, MPA-ST-1		17071
9	MPA-LR-12 and MPA-LR-13		17083
10	Supplemental Testimony of Stephen E. Siwek, AAP-ST-4		17085
12	USPS-RT-4, Rebuttal Testimony of Richard Patelunas		17137
13	Supplemental Testimony of Lawrence G. Buc, DM?-ST-2		17182
15	Written Supplemental Testimony of Ralph L. Luciani, UPS-ST-2		17238
16	SEALED: Exhibit Number UPS-ST-2(b), entitled Direct Attribution of Sequencing of Parcels		17258
18	Library Reference Number MPA-LR-14		17265
19	Written Rebuttal Testimony of Halstein Stralberg, TW-RT-1		17266
21	Written Rebuttal Testimony of Carl G. Degen, USPS-RT-5		17302
22	Exhibit Number ABM-XE-USPS-RT-5	17356	17358

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P R O C E E D I N G S

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[9:31 a.m.]

CHAIRMAN GLEIMAN: Good morning. Today we continue hearings in Docket R2000-1 for the purpose of considering the Postal Service's Request for Changes in Rates and Fees.

I have several procedural matters before we begin this morning. Yesterday, the Newspaper Association of America and the Association of Alternate Postal Systems filed a joint motion for removal of the confidential treatment currently accorded Library Reference LR-I-268, the SAI report. Those parties accompanied their motion with a request that the time for responses to this motion be shortened. In support of this request, they indicated that they wished to use this document in cross-examination of witnesses scheduled to appear on Tuesday, the 29th of August.

I will grant the motion to shorten the time for response. Responses to the motion for removal of confidential treatment should be filed by close of business tomorrow.

In a similar vein, the Postal Service yesterday filed a motion to strike portions of the written response of the Office of the Consumer Advocate Witness Smith to Notice of Inquiry Number 4. This testimony has been scheduled to

1 be received into evidence on August 31. Again, I will
2 shorten the time for response to that motion. Answers to
3 the motion to strike portions of Witness Smith's testimony
4 are due on Monday, the 28th.

5 Finally, the Office of the Consumer Advocate filed
6 a motion to compel production of documents in Interrogatory
7 OCA/USPS-ST-44-51. Again, in order to resolve outstanding
8 issues in time to allow completion of the evidentiary
9 record, I will shorten the time for response to this motion.
10 Answers to the OCA motion to compel are to be filed by close
11 of business Friday, the 25th.

12 Two other scheduling issues deserve mention. In
13 response to Commission Order 1300, the Postal Service has
14 designated Witness Degen to respond to questions concerning
15 the behavior of costs associated with the processing of
16 Standard B special mail. The Service has requested that
17 these questions be scheduled for sometime next week, and I
18 will schedule Witness Degen to respond to these questions
19 concerning Standard B special mail as the final witness on
20 Wednesday, the 30th.

21 The Postal Service also gave notice that it would
22 file testimony in rebuttal to the testimony of UPS Witness
23 Sellick concerning the revenue pieces and weights data
24 system. The Postal Service suggests that this testimony,
25 which will be designated as USPS-RT-26, and sponsored by

1 Witness Prescott, will be made, subject to
2 cross-examination, when Witness Prescott appears to testify
3 on USPS-RT-24. Witness Prescott is currently scheduled to
4 appear to testify regarding that testimony, that is RT-24,
5 on Monday, the 28th of August.

6 This suggestion seems reasonable to me, and unless
7 there is some objection to scheduling both pieces of
8 Prescott rebuttal testimony for the 28th, and I don't hear
9 any now -- or do I hear one?

10 I didn't speak fast enough, did I, Mr. McKeever?

11 MR. McKEEVER: Sorry, Mr. Chairman. We would like
12 to do it on the 28th as well, but I do not know, of course,
13 when the testimony will be filed, or how extensive it will
14 be. And that really is the only question I have in my mind.

15 CHAIRMAN GLEIMAN: Ms. Duchek, could you enlighten
16 us and maybe we can wrap this one up, too.

17 MS. DUCHEK: I can't enlighten you right now, but
18 I will as soon as we have a break. I will call back and
19 find out.

20 CHAIRMAN GLEIMAN: We will reserve your rights to
21 object, Mr. McKeever. And Ms. Duchek, we look forward to
22 hearing back at some point before the end of the day today,
23 and then we will close out this issue also.

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

25 CHAIRMAN GLEIMAN: In the absence of an objection,

1 you can assume, however, that we will hear that additional
2 rebuttal testimony from Witness Prescott on the 28th.

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

4 CHAIRMAN GLEIMAN: Does any participant have a
5 matter that they would like to address today?

6 [No response.]

7 CHAIRMAN GLEIMAN: The witnesses are scheduled to
8 present eight pieces of testimony today. It is a mix of
9 rebuttal testimony and supplemental testimony, and the
10 witnesses are Witnesses Stralberg, Siwek, Patelunas, Buc,
11 Luciani, Cohen, Stralberg, again, and Degen.

12 No participant has submitted a request to orally
13 cross-examine two of these eight pieces of testimony and, as
14 is our practice, unless it creates some havoc for the
15 attorneys representing the witnesses in question, we will
16 introduce this testimony first before we receive testimony
17 that is subject to oral cross-examination.

18 Mr. Keegan, will you introduce your first witness?

19 MR. KEEGAN: Thank you, Mr. Chairman, Members of
20 the Commission. My name is Timothy Keegan, appearing on
21 behalf of Time Warner, Inc.

22 Time Warner calls Halstein Stralberg.

23 CHAIRMAN GLEIMAN: You know I am in the Degen
24 mode, so you became "Kegen," I'm sorry. I apologize.

25 MR. KEEGAN: That's all right.

1 Whereupon,

2 HALSTEIN STRALBERG,

3 a witness, having been recalled for examination and, having
4 been previously duly sworn, was examined and testified
5 further as follows:

6 CHAIRMAN GLEIMAN: Counsel, if you would like to
7 proceed.

8 DIRECT EXAMINATION

9 BY MR. KEEGAN:

10 Q Would you please state your name and occupation
11 for the record?

12 A My name is Halstein Stralberg, I am a consultant
13 to Time, Inc. -- Time Warner.

14 Q Mr. Stralberg, do you have before you two copies
15 of a document marked for identification as TW-ST-1, entitled
16 "Supplemental Testimony of Halstein Stralberg on Behalf of
17 Alliance of Nonprofit Mailers, American Business Media,
18 Coalition of Religious Press Associations, Dow Jones &
19 Company, Inc., Magazine Publishers of America, Inc., the
20 McGraw Hill Companies, Inc., National Newspaper Association,
21 and Time Warner, Inc."?

22 A Yes, I do.

23 Q And was that testimony prepared by you or under
24 your supervision?

25 A Yes, it was.

1 Q Do you have any changes or corrections to that
2 testimony that you would like to make?

3 A No.

4 Q If you were testifying here today, would your
5 testimony be the same?

6 A There is one exception. When I prepared the
7 testimony, it was under the assumption that the Postal
8 Service had not yet filed unit costs per pool and subclass
9 with piggyback factors, which is needed for the CRA
10 addressment in the flat mail flow model. They now have
11 filed that, which I found out yesterday, in Library
12 Reference 464, and that would have somewhat simplified one
13 part of my testimony. I don't expect the results will be
14 much different.

15 MR. KEEGAN: Mr. Chairman, I move that Mr.
16 Stralberg's testimony be admitted into evidence and
17 transcribed into the record, and I will provide two copies
18 to the reporter.

19 CHAIRMAN GLEIMAN: Is there an objection?

20 [No response.]

21 CHAIRMAN GLEIMAN: Hearing none, then if counsel
22 would provide those copies to the court reporter, I will
23 direct that the testimony be transcribed into the record and
24 received into evidence.

25 [Supplemental Testimony of Halstein

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Stralberg, TW-ST-1, was received
into evidence and transcribed into
the record.]

TW-ST-I

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

POSTAL RATE AND FEE CHANGES, 2000 :

Docket No. R2000-1

SUPPLEMENTAL TESTIMONY
OF
HALSTEIN STRALBERG
ON BEHALF OF
ALLIANCE OF NONPROFIT MAILERS
AMERICAN BUSINESS MEDIA
COALITION OF RELIGIOUS PRESS ASSOCIATIONS
DOW JONES & COMPANY, INC.
MAGAZINE PUBLISHERS OF AMERICA, INC.
THE McGRAW-HILL COMPANIES, INC.
NATIONAL NEWSPAPER ASSOCIATION
AND
TIME WARNER INC.

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August 14,2000

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2. Piece Sorting Productivity And Machine Accept Rates.....	3
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APPENDICES

APPENDIX A: FY99-Based Unit Costs For Flats Model CRA Adjustment	A-1
APPENDIX B: Development Of FY99-Based Flats Piece Sorting And Accept Rates.....	B-1

EXHIBITS

EXHIBIT 1: Update Per Order No. 1294 Of MPA-LR-2 Presort/ Automation Cost Differentials For Periodicals.....	one page
EXHIBIT 2: FY98 And FY99 MODS-Based Flats Piece Sorting Productivity And FSM Accept Rates.....	one page

1 **AUTOBIOGRAPHICAL SKETCH**

2 My name is Halstein Stralberg. I am a consultant to Time Warner Inc. on issues related
3 to distribution of magazines through the postal system. For a detailed sketch of my
4 autobiography, please see my direct testimony in this docket (TW-T-1).

5 **I. PURPOSE OF TESTIMONY**

6 This testimony addresses the effect that Commission Order No. 1294 (May 26, 2000),
7 requiring incorporation of actual FY99 cost data into cost projections for the test year,
8 has on the recommendations made in my direct testimony (TW-T-1). That testimony
9 addressed two main issues: (1) mail processing cost distribution; and (2) worksharing
10 discounts for Periodicals mail.

11 **II. MAIL PROCESSING COST DISTRIBUTION**

12 My direct testimony proposed several changes in the Postal Service's methodology for
13 distributing mail processing costs among subclasses and special services. Those
14 changes were incorporated in the SAS program filed as MPA-LR-3, which also included
15 cost attribution changes that are proposed in the direct testimony of MPA witness
16 Cohen (MPA-T-1). A new version of the program, which updates the distribution of
17 mail processing costs proposed in TW-T-1 and MPA-T-1 by operating on the FY99
18 IOCS mail processing tallies, is being filed as MPA-LR-12.

19 **III. WORKSHARING DISCOUNTS FOR PERIODICALS MAIL**

20 TW-T-1 described several changes necessary to the flats mail flow model presented by
21 witness Yacobucci (USPS-T-25), focusing in particular on a more appropriate modeling
22 of bundle breakage, based on newer and more accurate breakage data. Witness Glick
23 (PostCom, et al.-T-1) introduced additional model changes. The resulting flats mail
24 flow model spreadsheet **was** filed as MPA-LR-2. The remainder of this supplemental
25 testimony describes changes to the MPA-LR-2 mail flow model that conform it, to the
26 extent possible, with Order No. 1294. The updated version of the model is being filed
27 **as** MPA-LR-14.

1 The MPA-LR-2 mail flow model was filed with the understanding that the worksharing
2 related cost differentials it produces could change, depending on how the Commission
3 decided some related issues. In particular, it was understood that changes in the
4 volume variability factors assumed by the Postal Service at mail processing cost pools
5 would cause the estimated worksharing cost differentials to expand or contract,
6 depending on whether the variability factors are increased **or** decreased. It was
7 likewise understood that changes in mail processing cost distribution, or in expected
8 Periodicals cost reductions in the test year, might narrow or enlarge the worksharing
9 cost differentials. Tr. 24/11444.

10 In the remainder of this testimony I describe changes in the flats mail flow model that I
11 believe are appropriate in light of the use of actual FY99 cost data and of the changes in
12 the Postal Service's test year inflation forecasts described by witness Patelunas (USPS-
13 ST-44). Exhibit 1 shows revised estimates of presort and automation related unit costs
14 and compares them with the corresponding costs presented in MPA-LR-2. The overall
15 impact on worksharing cost differentials is small for both regular rate and nonprofit
16 Periodicals. Note that many model elements were derived from special studies and
17 therefore cannot be updated.

18 **1. The CRA Adjustment**

19 The purpose of the CRA adjustment is to assure that the modeled processing costs for a
20 given subclass match the CRA processing costs attributed to the subclass at the
21 modeled cost pools. The CRA costs against which the modeled costs for each subclass
22 will be compared are computed on spreadsheet page "CRA Cost Pools" in the flats mail
23 flow model. In MPA-LR-2, the combined test year worksharing related **unit** cost, used
24 to normalize the modeled costs, was 7.65 cents per piece for regular rate and 3.768 cents
25 for nonprofit Periodicals.

26 Appendix A documents how I recomputed the CRA adjustment unit costs **using** FY99-
27 based test year costs. The net effect was that the combined worksharing related unit
28 costs declined by 1.1% to 7.563 cents per piece for regular rate Periodicals. For
29 nonprofit Periodicals the worksharing related unit cost grew by 3.3% to 3.892 cents per
30 piece. Stated differently, worksharing related unit cost differentials are slightly smaller

1 for regular rate and slightly larger for nonprofit Periodicals, relative to what they
2 would be using the FY98-based adjustment.’

3 2. Piece Sorting Productivity And Machine Accept Rates

4 The piece sorting productivity rates used in MPA-LR-2 for various manual, mechanized
5 and automated flats sorting modes (entered on spreadsheet pages ”productivities” and
6 “accept rates,” respectively) should be replaced with a set of FY99-based productivity
7 and accept rates. These are shown in Exhibit 2, which also shows the FY98-based rates
8 for comparison. Appendix B explains how the new rates were developed.

9 3. Wage Rates

10 The Postal Service does not appear to have provided updated test year clerk and
11 mailhandler wage rates for use in its worksharing mail flow models. However, given
12 Patelunas’s testimony that the Postal Service’s inflation forecast has increased since the
13 original filing, one must infer that the test year wage rates implicit in the supplemental
14 filing are higher than those forecast earlier.

15 Fortunately, it is not necessary to know which wage rates the Postal Service now
16 forecasts for the test year. As long as the extra wage increase is built into the updated
17 test year unit costs, it will, through the CRA adjustment, also be automatically included
18 in the worksharing cost differentials produced by the model.

19 4. Piggyback Factors

20 The flats mail flow model uses operation-specific piggyback factors that are entered on
21 spreadsheet page “data.” The factors used in MPA-LR-2 should be updated. However,
22 as explained in Appendix A, the updated factors appear not to have been provided in
23 the Postal Service’s supplemental filing. Approximately similar results can be achieved
24 by multiplying, for each subclass, the FY98-based factors by the ratio between the FY99-
25 based and FY98-based subclass-specific factors, which can be found, respectively, in

¹ The unit costs listed in Exhibit 1 include both worksharing related and non-worksharing related costs. The latter category includes, for example, platform costs.

1 LR-I-414 (PRC version: LR-I-427) and LR-1-77, However, since this operation also is
2 performed through the CRA adjustment, applying the same factors to determine
3 modeled costs would have no impact on the resulting worksharing related unit cost
4 differentials and is therefore unnecessary.

5 **IV. SUMMARY**

6 The incorporation of FY99 cost data into projections for the test year costs causes only
7 minor changes to the recommendations made in my direct testimony, which I continue
8 to urge upon the Commission's thoughtful consideration. In this supplemental
9 testimony, I have described, in as much detail as seems potentially helpful to the
10 Commission and as the circumstances make possible, the changes that can and should
11 be made to the MPA-LR-2 mail flow model, which computes worksharing unit cost
12 differentials for flat mail. Some of the model data, such as the various mail flow
13 percentages, could not be changed, because they are based on special studies which
14 have not been updated.

15 Similarly, the recommendations I made in my direct testimony with regard to mail
16 processing cost distribution remain equally valid relative to the FY99 IOCS data.
17 Updated calculations, based on the incorporation of FY99 IOCS data, are provided in
18 MPA-LR-12.

APPENDIX A

FY99-Based Unit Costs For Flats Model CRA Adjustment

1 This appendix documents the development of FY99-based unit costs needed to
2 implement the CRA adjustment for the flats mail flow model. The adjustment requires
3 cost pool and shape-specific test year mail processing unit costs for each modeled
4 subclass. The source of these unit costs in the Postal Service's original filing was USPS
5 LR-1-81, where the relevant FY98-based test year unit costs are found on spreadsheet
6 page "flats(4)" in spreadsheet "mpshusty."

7 The corresponding unit costs derived from FY99 cost data and the revised roll forward
8 assumptions described in USPS-ST-44 are provided in USPS LR-I-415 on spreadsheet
9 page "flats(3)" in spreadsheet SPTY99np. However, unlike the unit costs in LR-1-81,
10 those given in LR-I-415 reflect segment 3 mail processing costs only and do not include
11 piggyback costs. The LR-I-415 costs therefore cannot be used for an FY99 version of the
12 CRA adjustment without first multiplying them with the appropriate pool-specific
13 piggyback factors.

14 In the Postal Service's original filing, LR-1-77 provided all relevant piggyback
15 information, including the pool-specific test year factors, which are given on pages IV-
16 26 through IV-28 of that document. The Postal Service does not appear to have
17 provided the corresponding FY99-based information in its supplemental filing.
18 Subclass-specific piggyback factors are given in library references LR-I-414 and LR-I-
19 427 (PRC version), but cost pool-specific factors are missing. Unable to obtain the
20 updated pool-specific piggyback factors, I have applied the following two-step method
21 of approximation for regular and nonprofit Periodicals. This approach could **also** be
22 carried out for First Class and Standard A flats.

23 First, I multiplied the cost pool and shape-specific unit costs in LR-I-415 with the FY98-
24 based pool-specific test year piggyback costs from LR-1-77. Then, for each subclass, I
25 multiplied the resulting unit costs by the ratio between the FY99-based subclass specific

- 1 mail processing piggyback factor in LR-I-414 and the corresponding FY98-based factor
- 2 in LR-I-77.² I entered the resulting unit costs for regular rate Periodicals in column R of
- 3 the “CRA Cost Pools” spreadsheet page and the corresponding nonprofit unit costs in
- 4 column W.

² Mail processing related piggyback factors appear to have increased for all subclasses as a result of the N99 data. The increase is **1.7%** for regular rate and **1.8%** for nonprofit Periodicals.

APPENDIX B

Development Of FY99-Based Flats Piece Sorting And Accept Rates

1 This appendix documents the development of the FY99-based piece sorting
2 productivity and accept rates shown in Exhibit 2.

3 The rates assumed in MPA-LR-2 for AFSM 100 flat sorting are unchanged. There is no
4 basis for any change in the earlier assumptions, since there exist no empirical AFSM
5 data from either FY98 or FY99. Similarly, the rate assumed for manual incoming
6 secondary flat sorting in non-FSM facilities is unchanged. That rate is based on a
7 special study (LR-1-88) that has not been updated.

8 All other FY99-based rates in Exhibit 2 are derived from MODS data provided by the
9 Postal Service in response to PostCom/USPS-T43-6, redirected from witness Unger
10 (filed May 5, 2000; designated for inclusion in the evidentiary record, August 1, 2000).
11 The data consist of MODS TPF (pieces fed), TPH (pieces handled) and manhours data
12 for each type of flat sorting operation. They exclude the highest and lowest 1%
13 productivity rates for each sorting operation. Except for operations involving use of
14 FSM 881 machines in OCR or BCR mode, the MODS data provided in response to
15 PostCom/USPS-T43-6 were used directly to compute the productivity and accept rates
16 in Exhibit 2. Accept rates were computed as the ratio of TPH/TPF (pieces sorted
17 divided by pieces fed) and productivity rates as TPF divided by manhours.³

18 In the case of the FSM 881 BCR/OCR and FSM 881 OCR operations, a direct application
19 of the MODS data would have been inappropriate, because the distinction between
20 these two terms in MODS is different from the distinction used in the flats mail flow
21 model. This difficulty was discussed in considerable detail by witness Glick in
22 PostCom, et al.-T-1. I have applied the same methodology that Glick used for the FY98

³ For manual flats sorting productivity rates in FSM facilities, I applied an assumed 5% manual productivity increase, corresponding to the 5% increase factor applied to the FY98-based manual productivity rates in MPA-LR-2. The Postal Service expects to realize this improvement in manual productivity through a "local management initiative." USPS LR-1-126, "Increase manual flatproductivity."

1 FSM 881 data. The method, and the reason for its appropriateness, **is** explained briefly
2 below.

3 An FSM 881 essentially operates in two main modes: keying and automated. In the
4 latter mode, the machine's OCR/BCR unit is normally programmed to first look for a
5 barcode on each flat. If a barcode is found, it is used to sort the piece. Otherwise, the
6 OCR attempts to read the address. This allows barcoded and non-barcoded flats to be
7 processed together, even though the accept rate obviously is higher for the barcoded
8 pieces, and helps eliminate the extra allied labor involved in keeping separate
9 mailstreams for barcoded and non-barcoded flats.

10 Two sets of MODS numbers are used to record volumes and manhours for the
11 automated FSM **881** mode. The FSM-OCR mode (MODS numbers 44X) is used the
12 most and includes both barcoded and non-barcoded flats. The FSMBCR mode (MODS
13 numbers 96X) is used much less and generally only for 100% barcoded mail volumes.⁴

14 In the flats mail flow model, the FSM 881 BCR/OCR sorting operations represent
15 automated sorting of pre-barcoded mail, while the FSM 881 OCR operations represent
16 automated sorting of non-barcoded flats. The difference in accept rates between
17 barcoded and non-barcoded flats is important in order to properly determine the costs
18 that are saved when mailers pre-barcode their flats. However, this difference cannot be
19 extracted directly from the MODS data.

20 Both MPA-LR-2 and the update presented here assume the accept rate for non-
21 barcoded flats sorted in automated mode on the FSM 881 to be 75%. Witness Glick
22 showed the reasonableness of this assumption, based on calculations confirmed by
23 witness OTormey. Tr. 21/8353-54. The assumption is also consistent with the Strategic
24 Improvement Guide For Flats (USPS LR-I-193). The acceptance rates for barcoded flats
25 are assumed equal to the TPH/TPF ratios at the FSMBCR MODS operations.

⁴ It is possible, though less common today, to set the machines to look only for barcodes, i.e., not to **use** the OCR. The 96X MODS numbers are used in that case. **An** advantage of this mode is that **3** additional **bins** on each side of the machine become available for sorted mail. See LR-I-193, Chapter 5.

Exhibit 1. P.1 of 1

**UPDATE PER ORDER NO. 1294 OF MPA-LR-2
PRESORT/AUTOMATION COST DIFFERENTIALS FOR PERIODICALS
MAIL**

Updated Presort/Automation Related Costs Regular Rate Periodicals			
Method	Rate Category	Cents Per Piece	
		MPA-LR-2	Updated Estimate
Cost Averages-Actual	Basic, Nonautomation	25.901	25.662
	Basic, Automation	22.765	22.587
	3-Digit, Nonautomation	20.786	20.451
	3-Digit, Automation	18.659	18.860
	5-Digit, Nonautomation	14.309	14.047
	5-Digit, Automation	14.192	13.961
	Carrier Route	7.430	7.249
Cost Averages-Normalized Auto-Related Savings	Basic, Nonautomation	27.145	26.933
	Basic, Automation	23.389	23.197
	3-Digit, Nonautomation	21.588	21.503
	3-Digit, Automation	18.465	18.670
	5-Digit, Nonautomation	14.549	14.272
	5-Digit, Automation	14.038	13.810


Updated Presort/Automation Related Costs Nonprofit Periodicals			
Method	Rate Category	Cents Per Piece	
		MPA-LR-2	Updated Estimate
Cost Averages-Actual	Basic, Nonautomation	17.138	17.987
	Basic, Automation	13.080	13.848
	3-Digit, Nonautomation	13.967	14.429
	3-Digit, Automation	11.524	12.427
	5-Digit, Nonautomation	8.913	9.328
	5-Digit, Automation	8.772	9.212
	Carrier Route	4.220	4.462
Cost Averages-Normalized Auto-Related Savings	Basic, Nonautomation	17.118	18.030
	Basic, Automation	14.620	15.418
	3-Digit, Nonautomation	14.142	14.812
	3-Digit, Automation	11.852	12.721
	5-Digit, Nonautomation	9.014	9.431
	5-Digit, Automation	8.652	9.086

Exhibit 2, P1 of 1

FY98 And FY99 MODS-Based Flats Piece Sorting Productivity And FSM Accept Rates				
Sorting Operation:	Productivity Rate (Pcs/Hr)		Accept Rates (%)	
	FY98	FY99	FY98	FY99
Outgoing Primary (includes OS)				
FSM 881 BCR/OCR	724	980	93.90%	91.52%
FSM 881 OCR	724	980	75.00%	75.00%
FSM 881 Keying	664	468	99.70%	99.34%
AFSM 100 BCR/OCR/NCS	3,000	3,000	98.00%	96.00%
AFSM 100 OCR/NCS	1,667	1,667	97.00%	97.00%
FSM 1000 BCR	724	794	94.00%	93.85%
FSM 1000 Keying	664	578	97.90%	98.28%
Manual	452	407	100.00%	100.00%
Area Distribution Center, ADC				
FSM 881 BCR/OCR	837	797	92.20%	90.17%
FSM 881 OCR	837	797	75.00%	75.00%
FSM 881 Keying	531	410	99.40%	99.30%
AFSM 100 BCR/OCR/VCS	3,000	3,000	96.00%	96.00%
AFSM 100 OCR/NCS	1,687	1,667	97.00%	97.00%
FSM 1000 BCR		1,347	94.00%	83.47%
FSM 1000 Keying		540	97.90%	98.08%
Manual		360	100.00%	100.00%
ic. Primary (includes SCF)				
FSM 881 BCR/OCR		816	92.80%	92.42%
FSM 881 OCR	990	816	75.00%	75.00%
FSM 881 Keying		468	99.60%	99.34%
AFSM 100 BCR/OCR/NCS	3,000	3,000	96.00%	96.00%
AFSM 100 OCR/NCS	1,667	1,667	97.00%	97.00%
FSM 1000 BCR		1,097	94.00%	85.71%
FSM 1000 Keying	556	600	97.90%	98.14%
Manual	545	484	100.00%	100.00%
ic. Secondary & Box Section				
FSM 881 BCR/OCR	798	760	93.40%	93.11%
FSM 881 OCR	798	760	75.00%	75.00%
FSM 881 Keying	488	401	99.40%	99.00%
AFSM 100 BCR/OCR/NCS	3,000	3,000	96.00%	96.00%
AFSM 100 OCR/NCS	1,867	1,667	97.00%	97.00%
FSM 1000 BCR		1,293	94.00%	83.62%
FSM 1000 Keying		721	98.40%	98.00%
Manual, FSM Zones	457	409	100.00%	100.00%
Manual, Non-FSM Zones	846	846	100.00%	100.00%

CERTIFICATE OF SERVICE

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



Timothy L. Keegan

August 14, 2000

1 CHAIRMAN GLEIMAN: No party has requested oral
2 cross-examination of Witness Stralberg with respect to this
3 testimony. Is there any participant that does indeed wish
4 to cross-examine on this testimony?

5 [No response.]

6 CHAIRMAN GLEIMAN: If not, then there is a
7 question with regard to questions from the bench, and I
8 don't believe there are any.

9 That being the case, there won't be any redirect.
10 Mr. Stralberg, we thank you. We will see you a little bit
11 later on today. We appreciate your appearance in this
12 context and your contributions to the record, and you are
13 excused for the time.

14 THE WITNESS: Thanks.

15 [Witness excused.]

16 CHAIRMAN GLEIMAN: Our next witness, Mr. Myers,
17 would you like to introduce your witness?

18 MR. MYERS: Mr. Chairman, Pearce Myers on behalf
19 of the Magazine Publishers of America. I would like to call
20 Rita D. Cohen.

21 Whereupon,

22 RITA D. COHEN
23 a witness, having been recalled for examination and, having
24 been previously duly sworn, was examined and testified
25 further as follows:

1 DIRECT EXAMINATION

2 BY MR. MYERS:

3 Q Ms. Cohen, would you state your name for the
4 record?

5 A Rita Dershowitz Cohen.

6 Q Ms. Cohen, I have given --

7 CHAIRMAN GLEIMAN: **Ms.** Cohen is already under
8 oath. Since we have had some problems along the way with so
9 many people testifying in hearings in this case, I just want
10 to make sure that, for the record, Ms. Cohen you are already
11 under oath in the proceedings and, therefore, we will not
12 need to swear you in again.13 MR. MYERS: And **I** will confirm that, Mr. Chairman.

14 BY MR. MYERS:

15 Q Ms. Cohen, I have given you a document designated
16 MPA-ST-1 and entitled "Supplemental Testimony of Rita D.
17 Cohen on Behalf of the Magazine Publishers of America, Inc.
18 and Other Members of the Periodicals Coalition," and I ask
19 you was that testimony prepared by you or under your
20 supervision?

21 A Yes, it was.

22 Q And do you adopt that as your testimony in this
23 proceeding today?

24 A I do.

25 MR. MYERS: Mr. Chairman, with that, I would move

1 that the testimony of Rita Cohen be admitted into evidence
2 and transcribed into the record.

3 CHAIRMAN GLEIMAN: Is there an objection?

4 [No response.]

5 CHAIRMAN GLEIMAN: Hearing none, counsel, if you
6 would please provide two copies of that testimony to the
7 court reporter, I will direct that the material be
8 transcribed into the record and received into evidence.

9 [Supplemental Testimony of Rita D.
10 Cohen, MPA-ST-1, was received into
11 evidence and transcribed into the
12 record.]

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RECEIVED
MPA-ST-1
AUG 14 2 22 PM '00
POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON DC 20268-0001

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

SUPPLEMENTAL TESTIMONY
OF
RITA D. COHEN
ON BEHALF OF
MAGAZINE PUBLISHERS OF AMERICA, INC.
ALLIANCE OF NONPROFIT MAILERS
AMERICAN BUSINESS MEDIA
COALITION OF RELIGIOUS PRESS ASSOCIATIONS
DOW JONES & COMPANY, INC.
THE **McGRAW**-HILL COMPANIES, INC.
NATIONAL NEWSPAPER ASSOCIATION
TIME WARNER INC.

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1 Autobiographical Sketch

2 My name is Rita Dershowitz Cohen. My autobiographical sketch can be
3 found in my direct testimony on behalf of Magazine Publishers of America,
4 Alliance of Nonprofit Mailers, American Business Media (formerly American
5 Business Press), Coalition of Religious Press Associations, Dow Jones &
6 Company, The McGraw Hill Companies, Inc., National Newspaper Association,
7 and Time Warner Inc., whom I will refer to collectively as "Periodicals mailers."
8 Tr. 2411126243 (MPA-T-1 at 1-2).

9 I. Purpose and Scope of Testimony

10 This testimony also is sponsored by the Periodicals mailers. It updates
11 my direct testimony, MPA-T-1, by providing Test Year After Rates (TYAR) costs
12 for Periodicals using Government Fiscal Year (GFY) 1999 as the Base Year.
13 Section II provides updated estimates of the TYAR cost savings that will result
14 from joint Postal Service/Periodicals industry efforts to reduce costs. Section III
15 discusses the updates made to Periodicals mailers-proposed costing methods to
16 incorporate GFY 1999 data. Section IV provides an update on annual
17 Periodicals Ride-Along revenues based upon the availability of actual data.
18 Section V discusses the need for a final adjustment to TYAR Periodicals costs to
19 account for differences in mail mix between the GFY 1999 Base Year for costs
20 and the Hybrid Year FY 1999 Q3 - FY 2000 Q2 Base Year for revenues. Section
21 VI discusses the appropriate contingency for the Periodicals class and estimates
22 TYAR costs by subclass. Section VII explains why a system-wide average rate
23 increase for Periodicals mail is reasonable.

24 I find that M A R costs for Periodicals are \$1.9 billion, more than \$500
25 million less than the costs projected by Postal Service witness Patelunas (USPS-
26 ST-44). As a result, the record in this case supports a rate increase for
27 Periodicals that does not exceed the system average and certainly is in the
28 "single digits" – a goal espoused by William J. Henderson, Postmaster General
29 and CEO, United States Postal Service. See, e.g., Tr. 24111279, fn. 1 (excerpt

1 from testimony of Postmaster General Henderson before the Subcommittee on
 2 Treasury, Postal Service and General Government, **U.S.** House of
 3 Representatives (April 4, 2000); Tr. 35/16816 (Statement of Postal Rate
 4 Commission Chairman Edward J. Gleiman, characterizing testimony of
 5 Postmaster General Henderson before the Subcommittee on International
 6 Security, Proliferation and Federal Service, Governmental Affairs Committee,
 7 United States Senate (July 13, 2000)).

8 **II. Joint Postal Service Industry Efforts to Reduce Cost**

9 In the **TYAR cost** estimates that it provided in response to PRC Order No.
 10 1294 (May 26, 2000), the Postal Service incorporated \$77 million in cost savings
 11 for Periodicals that that will result from the joint initiatives that I discussed in my
 12 direct testimony.¹ The Postal Service also incorporated additional savings for
 13 Periodicals from breakthrough highway transportation productivity and from
 14 increased investment in and improved performance from the flats automation
 15 program. There are, however, three additional cost savings that I identified in my
 16 direct testimony that the Postal Service did not incorporate into the TYAR cost
 17 estimates contained in its response to Order No. 1294. The simplified roll
 18 forward I present in this testimony incorporates these three additional cost
 19 reduction programs that were not included by the Postal Service:

- 20
- 21 • **Bundle Breakage** – As described on pages 14-15 of MPA-T-1, I and
 22 witnesses Stralberg (TW-T-1) and Glick (MPA-T-2) developed data that
 23 demonstrate that efforts to reduce the breakage of periodicals bundles will
 24 result in **\$21** million in cost savings in the test year, rather than the **\$15**
 25 million the Postal Service is now projecting for the test year – an increase
 26 of **\$6** million. Tr. 24/11275-11276.

27

¹ Table 1 in my direct testimony provides the savings from each initiative. Tr. 24/11264. I provided additional detail regarding these initiatives on pages 11-19 of my testimony. Tr. 24/11272-11280.

1 • AFSM 100 Correction – On page 17 of MPA-T-1, I described DMA
2 Witness Buc’s (DMA-T-I) re-estimation of TYAR cost savings from
3 implementation of the flats automation program. Tr. 24/11278. The
4 Postal Service has now updated its cost savings estimates in its response
5 to Order No. 1294. Witness Buc has reviewed the Postal Service’s
6 updated estimates and still finds that the Postal Service has
7 underestimated the test year cost savings from improvements in
8 automation. See DMA-ST-I. Utilizing the same methodology as in MPA-
9 T-1, I use witness Buc’s updated estimates to calculate the true TYAR
10 cost savings for Periodicals. This adds \$24 million to the savings now
11 projected by the Postal Service.

12

13 • Rail Transportation – Based on analysis performed by witness Nelson,
14 MPA-T-3, my direct testimony identified \$22 million in test year **cost**
15 savings related to the rail and highway transportation of Periodicals. Tr.
16 24/1 1279-11280 (MPA-T-1 at 18-19). While the Postal Service has now
17 acknowledged highway transportation cost savings, it has not yet
18 incorporated savings from easily achievable efficiencies in rail
19 transportation. This yields \$16 million more in cost savings for Periodicals
20 than estimated by the Postal Service.

21

22 These costs savings are reflected in Exhibits 5.1 and 5.3 in library
23 reference MPA-LR-13.

24 **III. Update Costing Methods With FY 1999 Data**

25 The **TYAR** costs that I presented in my direct testimony reflected changes
26 in costing methods in addition to the cost savings that **will** result from joint Postal
27 Service/Industry initiatives. In this testimony, I update the effect of adopting
28 these costing methods on GFY 1999 and Test Year **costs** by subclass. The GFY
29 1999 and Test Year cost impacts by segment that result from these methods are
30 shown in library reference MPA-LR-13, Exhibits 3.1-3.4, and are summarized in

1 Table 1 below. I have also included the SAS programs used to calculate GFY
 2 1999 mail processing costs by subclass in library reference MPA-LR-12. The
 3 estimates for the impact of Periodicals mailers' proposed changes in the
 4 variability of driving time for park and loop routes and highway transportation
 5 have not been updated due to time constraints. Tr. 24/1 1291-93 (MPA-T-1)

6

7 **Table 1. Impact of Proposed Cost Attribution and Distribution**
 8 **Improvements on Periodicals Costs (Millions of Dollars)**
 9

Cost Segment	Base Year 1999 Cost Reductions (Without Piggybacks)
Mail Processing	\$126
City Carriers	\$59
Rural Carriers	\$9
Transportation	\$96
Total	\$290

10 Source: MPA-LR-13. Exhibits 3.1-3.4

11 **IV. Periodicals Ride-Along Revenue**

12 In my direct testimony, I noted that in Docket No. MC00-1, Postal Service
 13 witness Taufique estimated that Periodicals Ride-Along pieces would generate
 14 approximately \$10 million in annual revenue. Tr. 24/11296 (MPA-T-1 at 35).

15 Data collected by the Postal Service indicate that, even without taking
 16 seasonality and ramp up time into account, actual Periodicals Ride-Along
 17 revenues are in line with Taufique's \$10 million estimate. Response to
 18 MPA/USPS-69. Therefore, I believe that the Commission should include at least
 19 \$10 million in Ride-Along revenue in its TYAR revenue estimate for Periodicals.

20 **V. Final Adjustments to N A R Periodicals Costs**

21 In response to Order No. 1294, the Postal Service estimated TYAR costs
 22 by subclass using GFY 1999 as the Base Year. In response to P.O. Information
 23 Request No. 16 (July 14, 2000), the Postal Service estimated TYAR revenues by
 24 subclass using the Hybrid Year FY 1999 Q3 – FY 2000 Q2 as the Base Year. As
 25 the Postal Service indicated in its Motion of the United States Postal Service for
 26 Clarification or Reconsideration of Presiding Officer's Information Request No. 18

1 filed August 1, 2000 (Motion), using different base years is not necessarily
2 incorrect, as long as "these estimates intersect appropriately in the test year."
3 Motion at 7.

4 As the Postal Service further notes in that Motion, to ensure that the
5 estimates do intersect appropriately in the test year, "the roll forward model
6 incorporates 'final adjustments' for many subclasses permitting additional means
7 by which to more closely align costs with mail mix." *Id.* at 7, fn. 1. Performing
8 final adjustments to WAR cost estimates is clearly an appropriate way to take
9 into account the cost consequences of differences in mail mix. For this reason,
10 the Postal Service correctly performed final adjustments for First-class Mail,
11 Priority Mail, Standard (A) Mail, and Standard (B) Mail. USPS-LR-I-419.

12 The Postal Service, however, did not perform a final adjustment to its
13 TYAR cost estimates for Periodicals despite the fact that the mail mix underlying
14 the TYAR revenue estimates (the Hybrid Year mail mix) is different from the mail
15 mix underlying the WAR cost estimates (the GFY 1999 mail mix). To correct for
16 this omission, I used the Postal Service's method to calculate a final adjustment
17 for the Periodicals Regular and Nonprofit subclasses. Using the Periodicals
18 mailers' mail processing cost avoidance model, MPA-LR-2, witness Stralberg's
19 DDU cost avoidance estimate, Tr. 24/11405, and the Postal Service's unit
20 delivery and transportation costs for Periodicals, the final adjustment for the
21 Periodicals Regular subclass reduces costs by \$31 million, and the Periodicals
22 Nonprofit final adjustment reduces costs by \$8 million. MPA-LR-13, Exhibits 7.1
23 and 8.1. For the reasons discussed above, these final adjustment reductions
24 should be made to TYAR Periodicals costs.

25 VI. Contingency and TYAR Costs by Subclass

26 Witness Buc describes in his supplemental testimony four reasons why
27 the contingency to accompany witness Patelunas' revised **cost** estimates for
28 TYAR should be less than the one percent he recommended **in** his direct
29 testimony. Tr. 22/9528 et seq. (DMA-T-1). He concludes that the proper
30 contingency to accompany witness Patelunas' TYAR cost estimate is one quarter

1 of one percent. I agree with witness Buc insofar as an overall level of
2 contingency is concerned.

3 Nevertheless, for reasons expressed in my initial testimony and in the
4 testimony of William Morrow, Tr. 29/543-60 (ABM-T-1), there should be no
5 contingency added to estimated Periodicals costs. Nothing that has happened
6 since the filing of that testimony, including the updating of costs and revenues,
7 detracts from witness Morrow's reasoning and conclusions. In fact, as late as
8 August 3rd, the Postmaster General wrote to the coalition of publishers and
9 stated that "we continue to look for new cost reduction opportunities" beyond
10 those reductions to Periodicals costs included in the latest updates. Letter dated
11 August 3, 2000, from Postmaster General and **CEO**, William J. Henderson,
12 United States Postal Service to Periodicals Rate Case Coalition (Attachment A).
13 Because I believe that this effort will succeed, I have used zero contingency in
14 my Periodicals cost estimates. Table 2 below provides TYAR costs by subclass
15 based upon this contingency, the cost reduction programs described in Section
16 II, the costing methods described in Section III, and the final adjustments
17 discussed in Section V.
18

1 Table 2. TYAR Costs by Subclass (Dollars in Thousands)

2

Class	Subclass	USPS	MPA
		Attributable Cost	Attributable Cost
		[1]	[2]
First-Class	Letters & Parcels	\$13,565,268	\$12,530,949
First-Class	Presort Letters & Parcels	\$5,081,634	\$4,561,869
First-Class	Private Postcards	\$543,567	\$518,665
First-Class	Presort Private Postcards	\$173,866	\$154,835
Priority Mail	All	\$3,194,542	\$2,781,406
Express Mail	All	\$467,914	\$416,881
Mailgrams	All	\$854	\$720
Periodicals	Within County	\$86,222	\$72,277
Periodicals	Regular Rate	\$1,947,554	\$1,514,239
Periodicals	Nonprofit	\$383,833	\$301,610
Periodicals	Classroom	\$14,311	\$11,027
Standard (A)	Enhanced Carrier Route	\$2,629,439	\$2,199,516
Standard (A)	Regular	\$6,512,735	\$5,618,753
Standard (A)	Nonprofit ECR	\$199,829	\$167,809
Standard (A)	Nonprofit Regular	\$1,363,390	\$1,194,867
Standard (B)	Parcels Zone Rate	\$1,077,003	\$771,074
Standard (B)	Bound Printed Matter	\$498,658	\$392,303
Standard (B)	Special Standard	\$357,987	\$288,285
Standard (B)	Library Rate	\$54,015	\$41,117
Free Mail	All	\$31,833	\$26,709
International Mail	All	\$1,570,744	\$1,488,264
Special Services	All	\$1,546,107	\$1,454,149

3 [1] Exhibit USPS-ST-44W at 1-2.

4 [2] MPA-LR-13, Exhibit 1

5 VII. Rate Proposal

6 The cost data required by PRC Order No. 1294 (May 26,2000) has
7 permitted the Postal Service to provide for the record additional cost savings that
8 will be achieved for Periodicals. Based upon these savings, the additional cost
9 savings described in Section II of this testimony. and the methodological changes
10 reflected in the record, I continue to believe that the record in this case **supports**
11 a rate increase for Periodicals that is no more than the system average.

MPA-ST1

WILLIAM J. HENDERSON
POSTMASTER GENERAL, CEO

Attachment A



August 3, 2000

Periodicals Rate Case Coalition
1211 Connecticut Avenue, Suite 610
Washington, DC 20036-2705

Dear Coalition Members:

This is in response to your June 19 letter regarding the proposed Periodicals postage rate increase. We remain committed to identifying cost savings and refining our costing methodologies in a manner that enables the Postal Rate Commission to recommend a single-digit Periodicals increase. So far, we have identified over \$170 million of changes in that effort.

I recognize the desire to obtain more cost savings. However, I cannot let this desire result in changes that would undermine the service improvements the industry and the Postal Service have worked so hard to achieve. In addition, these savings must be documented and be able to be implemented in the upcoming year as required by the rate case process.

Our efforts are by no means complete. We will continue to look for new cost reduction opportunities and work with the industry throughout the rate proceeding to ensure that our mutual objective of a single digit increase is achieved.

Sincerely,

A handwritten signature in black ink that reads "William J. Henderson".

William J. Henderson

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document upon all participants of record in this proceeding in accordance with the Commission's Rules of Practice.



James Pierce Myers

Washington DC
August 14, 2000

1 CHAIRMAN GLEIMAN: Something in the back of my
2 mind makes me ask a question about Category 2 Library
3 References at this point.

4 MR. MYERS: You are correct, Mr. Chairman, and if
5 I may proceed on that.

6 BY MR. MYERS:

7 Q Ms. Cohen, you have there two Library References
8 designated MPA-LR-12 and MPA-LR-13, and I ask you if those
9 Library References were prepared by you or under your
10 supervision?

11 A Yes, they were.

12 Q And is it correct that those Library References
13 update MPA-LR-3 and MPA-LR-4 which were sponsored by you
14 previously in this proceeding?

15 A Yes, they do.

16 Q And are those Library References true and correct
17 to the best of your knowledge and belief?

18 A Yes.

19 MR. MYERS: With that, Mr. Chairman, I would move
20 that the Library References be admitted into evidence but
21 not transcribed into the record.

22 CHAIRMAN GLEIMAN: Without objection, it is so
23 ordered.

24 [MPA-LR-12 and MPA-LR-13 were
25 received into evidence.]

1 CHAIRMAN GLEIMAN: There were no parties who
2 requested oral cross-examination in advance of today's
3 proceedings. Is there any party who wishes to cross Witness
4 Cohen?

5 [No response.]

6 CHAIRMAN GLEIMAN: If not, my understanding is
7 that there are no questions from the bench. And that being
8 the case, Ms. Cohen, that completes your appearance here
9 today. We appreciate your testimony, your contributions to
10 the record. We thank you and you are excused.

11 [Witness excused.]

12 CHAIRMAN GLEIMAN: Mr. Przepyszny, I think you
13 have the next witness.

14 MR. PRZYPYSZNY: Mr. Chairman, the Association of
15 American Publishers called Stephen E. Siwek as its witness.

16 CHAIRMAN GLEIMAN: Mr. Siwek, I think you are one
17 of the few people who we haven't heard from before, so that
18 being the case, I could get you to please stand, raise your
19 right hand.

20 Whereupon,

21 STEPHEN E. SIWEK,
22 a witness, having been called for examination by and, having
23 been first duly sworn, was examined and testified as
24 follows:

25 CHAIRMAN GLEIMAN: Counsel, you can proceed when

1 you are ready.

2 DIRECT EXAMINATION

3 BY MR. PRZYPYSZNY:

4 Q Mr. Siwek, I have handed you a copy of the
5 Supplemental Testimony of Stephen E. Siwek on Behalf of the
6 Association of American Publishers. It is designated
7 AAP-ST-4. I would like to ask, was this testimony prepared
8 by you or under your direct supervision?

9 A Yes, it was.

10 Q And do you adopt this testimony today?

11 A Yes, I do.

12 Q Do you have any corrections to the testimony?

13 A No, I don't.

14 MR. PRZYPYSZNY: With that, Mr. Chairman, I would
15 like to move that Witness Siwek's testimony be entered into
16 the record.

17 CHAIRMAN GLEIMAN: Is there an objection?

18 [No response.]

19 CHAIRMAN GLEIMAN: Hearing none, if counsel would
20 please provide two copies of the witness' testimony to the
21 court reporter, I will direct that the material be received
22 into evidence and transcribed into the record.

23 [Supplemental Testimony of Stephen
24 E. Siwek, AAP-ST-4, was received
25 into evidence and transcribed into

the record.]

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AAP-ST-4

**Before The
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001**

POSTAL RATE AND FEE CHANGES, 2000

DOCKET NO. R2000-1

**Supplemental Testimony of
Stephen E. Siwek**

On Behalf of the

ASSOCIATION OF AMERICAN PUBLISHERS

DATED: August 14, 2000

Communications with respect to this document should be sent to:

**Mark L. Pelesh
John R. Przepyszny
Drinker Biddle & Reath LLP
1500 K Street, NW
Suite 1100
Washington, DC 20005**

AAP-ST-4

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1 **I. SUMMARY**

2 My name is Stephen E. Siwek. On May 22, 2000, I filed Direct Testimony in this
3 proceeding on behalf of the Association of American Publishers (“AAP”). In that testimony
4 (“AAP-T-2”), I addressed the Postal Service’s proposed rate increase for Bound Printed Matter
5 (“BPM”) and I recommended both an alternative rate level and rate structure for the BPM
6 subclass.

7 On May 26, 2000, this Commission issued Order No. 1294 in which the Commission
8 directed the United States Postal Service (“Postal Service” or “USPS”) to prepare a “basic
9 update” to the test year forecasts that had previously been filed in this case as part of the Postal
10 Service’s case-in-chief. On May 26, the Presiding Officer also issued Ruling No. R2000-1/71
11 that set out a revised procedural schedule to accommodate the receipt of **the** new test year
12 information that the Postal Service would produce in response to Order No. 1294. That revised
13 procedural schedule also permitted the parties to file changes in their cases in **chief** in order to
14 incorporate the revisions in the test year information filed by the USPS. **This** Supplemental
15 Testimony updates AAP’s case in chief in **response** to the test year information that has now
16 been filed by the Postal **Service**.

17 In this Supplemental Testimony, I conclude that despite its efforts to secure the most
18 current data available, *the* Postal Rate Commission does not now have before it reliable and well-
19 tested cost updates in support of the Postal Service’s proposed test year in **this** case. **The** Postal
20 Service has failed to respond fully and adequately to interrogatories that were submitted by
21 intervenors such as AAP because, among other things, USPS witness Patelunas did not have

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1 time.¹ **In** addition, the Postal Service's updated cost information incorporates wholly
 2 unsupported changes in assumptions and methodologies that cannot be fully tested at this stage
 3 of **the** proceeding. For all of **these** reasons, I recommend that the Commission afford little if any
 4 weight to the updated information filed by the Postal Service in response to Order No. 1294.

5 Assuming, however, that the Commission decides to consider the Postal Service's
 6 updated information, **the** Commission should **also** recognize that the updating of Postal Service
 7 costs reduces the **risk** of forecast error in the **test** year. **This** reduction of forecast **risk** in **turn**
 8 permits a corresponding downward adjustment in the Postal Service's proposed provision for
 9 contingencies. The Postal Service originally proposed a test year provision for contingencies
 10 **equal** to two and one-half percent (2.5%) of the Postal Service's total segment expense including
 11 **final** adjustments.² **In** its update in response to Order No. 1295, the Postal Service retained the
 12 **use** of **the** 2.5% provision **for** contingencies? The Postal Service's decision to retain the same
 13 provision for contingencies even **as** it **was** updating its test year information **was** in **error**. **As**
 14 shown in **this** testimony, I recommend that the provision **for** contingencies **of** 2.5% that is
 15 embodied in the Postal Service's update be reduced.

16 Finally, assuming again that the Commission decides to consider the Postal Service's test
 17 year revisions, the Commission should **also** recognize that the Postal Service's estimate **of** the
 18 own price elasticity of the Bound Printed Matter **subclass** **has** itself been revised downward. The

¹ USPS **Response** to AAPNSPS-ST-44-9 (b), Tr. 35/16626-29.

² USPS Witness Tayman, USPS-T-9 at 43.

³ USPS Witness Patelunas, USPS-ST-45 at 7.

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1 Postal Service's new coefficient of the own price elasticity for BPM (-0.280) is 28.6% percent
 2 lower than the own price elasticity for BPM that was contained in **the** USPS's original filing in
 3 **this** proceeding (-0.392). This change in **the** price elasticity of BPM clearly supports a lower cost
 4 coverage for the BPM subclass. For these reasons, even assuming the Commission were to
 5 consider the Postal Service's ill-founded updates, **the** Commission should still adopt the BPM
 6 rate structure and rate levels that were recommended in my Direct Testimony for AAP in **this**
 7 case.

8 **11. The Postal Service's Cost and Revenue Updates**

9 USPS Responses to AAP

10 **The** Postal Service's response to Order No. 1294 included a variety of exhibits that were
 11 sponsored by USPS witness Patelunas. **These** exhibits set out the **results** of the Postal Service's
 12 cost updates for individual subclasses and for individual cost segments. Generally, however,
 13 these exhibits did not explain why the costs **reported** for a particular **subclass** such **as** Bound
 14 Printed Matter had increased **as** claimed by the Postal Service.

15 **In** order to develop a **better** understanding of why the costs of Bound Printed Matter in
 16 the test year had increased **as** claimed by the Postal Service, AAP submitted a number of
 17 interrogatories to **the** Postal Service that focused on specific cost segments.' **These** questions
 18 generally requested the Postal Service to **confirm** a change in costs that had occurred since the
 19 Postal Service's original filing and to "explain fully why BPM costs in **the test** year before rates
 20 have increased since the Postal Service's original request and explain each major cause of this

⁴ See AAP/USPS-ST44-9-26.

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1 increase.” In response to these questions, Mr. Patelunas’ response was that he had “not made
2 this comparison because I have not had time and it is not necessary for my testimony.”
3 (emphasis added). While Mr. Patelunas did go on to describe the resources that “could be used”
4 to perform the requested comparison, he could not find the time to explain large and seemingly
5 paradoxical changes in the test year costs set forth in this update.

6 For example, the Postal Service claims that TY2001 Operating Equipment Maintenance
7 costs (1.1.2) from C/S-11 for Bound Printed Matter have increased by 22.5% since the Postal
8 Service original filing.’ By contrast, according to the Postal Service, the TY2001 Operating
9 Equipment Maintenance costs (1.1.2) from C/S-11 for Standard Mail (A) have decreased by 5.2%
10 since the USPS original filing.’ At **this** writing, there is no explanation for **this** anomaly and for
11 other anomalies that were highlighted in AAP interrogatories. Mr. Patelunas cited his lack of
12 time in his responses to the following interrogatories from AAP: AAP/USPS-ST-44-9-22, 23,
13 24, 25, 26. Since the Postal Service chose not to respond in a timely fashion to these questions,
14 the cost updates that were the subject of these questions cannot be thoroughly and adequately
15 tested by the parties, including AAP. For **this** reason alone, these cost updates should not be
16 considered in the Commission’s ultimate deliberations in **this** case.

⁵ See AAP/USPS-ST-44-9.

⁶ USPS Response to AAP/USPS-ST-44-9(b), Tr. 35/16626-29.

⁷ USPS Response to AAP/USPS-ST-44-17, Tr. 35/16695.

⁸ USPS Response to AAP/USPS-ST-44-23, Tr. 35/16701.

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1 Changes in Test Year Wage Levels

2 **In** its test year updates that were filed by the Postal Service in response to Order No.
 3 1294, the Postal Service also increased the key inflation indexes that it **uses** to project costs into
 4 the test year. **These** key inflation indexes included the Employment Cost Index (ECI). **As** shown
 5 in Exhibit **USPS-ST-44AB**, the Postal Service now **uses an** ECI value of 4.63% for FY 2001.
 6 This value is 0.76 percentage points higher than the ECI value of 3.87% that was used in the
 7 USPS' original filing in **this** case.

8 The Postal Service appears to have changed more ~~than~~ the value of the ECI in deriving its
 9 updated test year costs. **As** noted in Interrogatory OCNUSPS-ST-44-31, the Postal Service's
 10 original witness on **this** issue, Mr. Tayman (USPS-T-9 at 19), had applied the following formula:
 11 Employment Cost Index for Wages and Salaries for Private Industry, less one percent (ECI
 12 minus 1) for bargaining units that do not have contracts effective in the test year.⁹ (emphasis
 13 added). In contrast to Mr. Tayman's **use** of ECI minus 1, the Postal Service's updated filing
 14 effectively **uses** ECI minus 0.

15 USPS **witness** Patelunas conceded **this** change. In **response** to OCA/USPS-ST-44-31, Mr.
 16 Patelunas testified that "the test year labor contract assumption has been refined."¹⁰ **Other** than
 17 describing the mathematical application of this change, however," **the** Postal Service offered no

⁹ See OCA/USPS-ST-44-31.

¹⁰ USPS Response to OCNUSPS-ST-44-31, Tr. 35/16673-74.

¹¹ Tr. 35/16786.

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1 explanation whatsoever as to why it had now become necessary to abandon the ECI-minus 1
2 standard so late in this proceeding.

3 In questioning Mr. Patelunas on **this** issue, the Presiding Officer cited Postal Rate cases
4 **and** Postal arbitrations dating back to 1984 in which ECI minus 1 served **as** a limit on Postal
5 Service wage increases.¹² The Presiding Officer and Commissioner LeBlanc also attempted to
6 elicit an explanation **from** Mr. Patelunas as to why this change had now been proposed. **Mr.**
7 Patelunas' response was that he had been instructed to do it."

8 The Postal Service's cost updates thus appear to embody a major change in the standards
9 used in the past to project Postal wage levels in postal rates. **This** change **is** without factual
10 support in the current record and should not be accepted by the Commission without extensive
11 testimony and evidentiary review.¹⁴ For **this** reason too, the Postal Service's cost updates, which
12 incorporate ECI minus 0, should not be considered by the Commission in **this** case.

13 Increases in PESSA Costs

14 When the Postal Service updated its test year costs in **response** to Order **No.** 1294, it also
15 revised certain costs **known** as "PESSA" costs. The PESSA acronym stands **for** plant, equipment,
16 servicewide and selected administrative costs." In the Postal Service's cost models, PESSA
17 costs are first reported as non-volume variable "other" costs and then **shifted** by the Postal

¹² Tr. 35/16796-800.

¹³ Tr. 35/16800.

¹⁴ On August 9, 2000, Chairman Gleiman wrote to Postmaster General Henderson requesting confirmation that the Postal Service had abandoned its longstanding ECI-Minus One wage growth policy.

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1 Service to the volume variable category. In FY 1999, for example, the Postal Service shifted
 2 \$5,675.2 million from the “other” category reported in the Postal Service’s “A” report to
 3 “volume variable” category reported in the “B” report.“

4 In attempting to explain fully why these costs were shifted to the volume variable
 5 category, witness Patelunas explained that “PESSA costs are assumed to be volume variable over
 6 a longer period **of time** than a particular year **or** years under construction.”” (emphasis added).
 7 These costs however, seem largely indistinguishable from other institutional costs of the Postal
 8 Service. PESSA costs include, for example, Cleaning and Protection Personnel, Imputed Rents,
 9 Retiree Health Benefits, Imputed Building Depreciation **and** Retirement Interest. While these
 10 costs may vary with volume over the longest of long runs, **so** would many other “fixed” costs
 11 that the Postal Service traditionally treats **as** institutional costs. **For this** reason, it **was** critical for
 12 the Postal Service to provide any cost studies or other data that it relied on to conclude that
 13 PESSA costs were and **are** indeed volume variable. **This** support was simply not provided by the
 14 Postal Service in connection with the PESSA cost increases that appear in the USPS’s test year
 15 cost updates.

16 In AAP/USPS-ST-44-32, AAP requested that the Postal Service “provide and explain
 17 fully any logical or empirical calculations or studies relied on by **the** Postal Service” to conclude
 18 that a number of specific PESSA costs should indeed **be** considered volume variable. In its

(..continued)

¹⁵ USPS Response to AAP/USPS-ST-44-31(b).

¹⁶ USPS Response to AAPRTSPS-ST-44-30.

¹⁷ USPS Response to AAP/USPS-ST-44-31(c).

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1 response, the Postal Service provided no logical or empirical calculations or studies and simply
2 referenced its originally filed *Summary Description of USPS Development of Costs by Segments*
3 and Components. **This** response is simply inadequate at **this** stage of **this** proceeding. The USPS
4 claims that its PESSA costs have increased in its test year updates and those claims cannot be
5 assessed and evaluated by the parties including *AAP*. For this reason, **as** with other aspects of the
6 Postal Service's filing, these cost updates, which include PESSA costs, should not be considered
7 by the Commission in its deliberations in **this** case.

8 **III. Provision for Contingencies**

9 As part of its case in chief in this proceeding, the Postal Service requested a provision for
10 contingencies equal to *two* and one-half percent of the total USPS Test **Year** segment expense
11 including final adjustments. **As** shown in Exhibit **USPS-9A**, *the* recommended provision for
12 contingencies was equal to \$1.701 billion in the test year (**B/R**) and **\$1.680** billion in the test year
13 (**A/R**). USPS witness Tayman testified that "[t]his mid-range contingency balances the Postal
14 Service's desire to keep rate increases **as low as** possible with management's assessment of *the*
15 degree of financial **risk** that currently faces the Postal Service." According to Mr. Tayman, the
16 recommended provision for contingencies is "judged as reasonable against unforeseen events and
17 forecasting errors, given **the** magnitude of the Postal Service's operations and expenses."¹⁹

18 Mr. Tayman's testimony makes clear that *the* Postal Service developed its recommended
19 provision for contingencies based on management's assessment of *the* degree of financial risk

¹⁸ USPS-T-9 at **43**.

¹⁹ USPS-T-9 at **43**.

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1 that it perceived at the time **this** rate case **was** filed. At that time, the Postal Service did not have
2 available much of the information that is now contained in the test year updates presented by *Mr.*
3 Patelunas. For example, in Exhibit USPS-ST-44AB, **Mr.** Patelunas compared the Postal
4 Service's original "key inflation indices" for FY 2000 and FY 2001 (Test Year) with the new
5 values that **are** reflected in the Postal Service's updates. As shown in the source references on
6 this Exhibit, the Postal Service's original filing reflected inflation projections **as** of November
7 1999. By contrast, the Postal Service's revised filing incorporates inflation projections from
8 more recent periods. The revised "trend" forecast shown in **USPS-ST-44AB**, which is updated
9 quarterly, was released on February 29, 2000 while the revised "control" forecast was released on
10 May 8, 2000.²⁰ Assuming that the **Postal** Service's rate case presentation was finalized in
11 November 1999, the "control" forecast now used by **Mr.** Patelunas incorporates forecast
12 information that may be **as** much **as** six months more recent **than** **the** information that was
13 available when the USPS finalized this rate case.

14 **While** the inflation projections (and other data) now used by the **Postal** Service are more
15 current than the projections that were contained in the **Postal** Service's case in chief, the **Postal**
16 Service's forecast target has not changed at **all**. In its current filing, the **Postal** Service is still
17 attempting to project its costs and revenues in **the** FY 2000 and 2001 **Test Years**. In other words,
18 **the** Postal Service's forecast targets have not changed even **as** the **Postal** Service **has** moved
19 **closer** to them.

²⁰ USPS Response to OCA/USPS-ST-44-9 (c), Tr. 35/16648.

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1 It is reasonable to expect that **as** the Postal Service moves closer to its forecast targets, the
 2 accuracy of its cost projections should improve. **In** general, the further that one projects into **the**
 3 future, the more uncertainty there is. For example, economic conditions three years into the
 4 future are typically more difficult to predict than conditions *two* years out. **In this** instance,
 5 however, **the** Postal Service faces **less** forecast uncertainty rather than more. **In** its original filing,
 6 the Postal Service needed to predict costs and revenues in a test year that was approximately
 7 three years beyond Base Year 1998. **Now**, as a consequence of its updated information, the
 8 Postal Service needs only to peer two years into the future (Base Year 1999 to Test Year 2001)
 9 rather than three. For this reason, one has every right to expect that the Postal Service's need to
 10 collect additional funds from Postal ratepayers to be maintained solely in the event of forecast
 11 errors has also declined correspondingly.

12 Accordingly, I recommend that the Commission reduce the recommended contingency
 13 provision, with respect to BPM, to account for test year costs. Such a reduction assumes that the
 14 Postal Service's forecast updates from FY 98 to FY 99 **are** to be considered and that they reduce
 15 forecast risk in a linear fashion? It is also important to note that my recommendation is based
 16 solely on the reduction in risk associated with the fact that the Postal Service has updated its test
 17 year projections. **The** purpose of my discussion on this issue is **only** to explain that if the FY99
 18 cost data is used, the contingency must be reduced. Nothing in my recommendations should
 19 preclude the Commission from reducing the contingency provision based on the **arguments** of

²¹ **There** is **no** evidence to suggest that the Postal Service's original projections were particularly **risky** in any given forecast year. For this reason, **there** is no basis to suggest that the reduction in USPS risk associated with the Postal Service's projection updates is non-linear.

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1 DMA witness Buc. It is my understanding that witness Buc recommends a one percent
2 contingency provision for the USPS based **on** other factors that **are not** considered **here**.²² I
3 believe that his proposal is worthy of serious consideration by the Commission.

4 There is one final issue to be addressed that relates to the contingency provision in **this**
5 **case**. This issue is motivated by certain USPS responses to interrogatories from the OCA. In
6 response to OCA/USPS-ST44-28-29, witness Patelunas **confirms** the basic notion than the
7 “revised cost level changes based on a later DRI forecast are likely to be more accurate.”²³
8 However, in the case of **FY** 2001, he also states that “other updates were made to test year costs
9 such as cost reductions related to breakthrough productivity,” and that “I have been informed that
10 the accomplishment of these cost reductions will be challenging and has a **higher** degree of
11 **risk**.”²⁴ As the Commission deliberates the Postal Service’s test year updates, it is critical that it
12 avoid any misunderstanding regarding the possible significance of these **sorts** of unsupported
13 claims.

14 It is important to note first of all that Mr. Patelunas himself was “informed” that the cost
15 reductions would be challenging but that he professed no **personal** knowledge of the alleged
16 “higher degree of **risk**” associated with these programs. For **this** reason alone, these suggestions
17 are without probative value. More importantly, however, the magnitude of greater **risk** associated
18 solely with the new Postal Service’s cost reduction programs is dwarfed by the magnitude of

²² See DMA Witness Buc, **DMA-T-1** at 11, 17.

²³ USPS Responses to OCA/USPS-ST-44-28 and 44-29, Tr. 16670-71.

²⁴ USPS Response to OCA/USPS-ST-44-29 (b), Tr. 16671.

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1 overall risk reduction that results from updating all of the Postal Service' accrued cost
 2 projections for the test year. For example, in FY 2001, the Postal Service now claims that it will
 3 achieve cost reductions in the amount of \$1.118 billion.²⁵ By contrast, in its original filing, the
 4 Postal Service claimed cost reductions in the amount of \$0.654 billion.²⁶ Thus, the USPS now
 5 asserts that it will achieve an additional \$0.464 billion in cost reductions but that there is
 6 allegedly a "higher degree of risk" associated with these programs.

7 When compared to the entire accrued cost of the Postal Service, these additional savings
 8 are trivial. According to the USPS' update, total accrued costs (A/R) in the test year will be
 9 \$67.642 billion? Assuming the Commission wishes to consider the Postal Service's FY99
 10 updated costs, I recommend that the provision for contingencies for BPM be reduced to account
 11 for the reduction in forecast risk.

12 **IV. Postal Service's Revised Price Elasticity for BPM**

13 In attempting to determine the institutional cost coverage to be applied to a subclass, **the**
 14 Postal Service generally considers the nine ratemaking criteria that are listed in Section 3622(b)
 15 of the Postal Reorganization Act. In my Direct Testimony in **this** case, I described these criteria
 16 in more detail, and I attempted to relate them to **the** Bound Printed Matter subclass. Under
 17 criterion 2, the USPS is supposed to consider the value of the mail to **both** sender and recipient.
 18 As noted in my Direct Testimony, **the** "value" of **the** mail that is contained in a given subclass is
 19 often established by reference to the "own price elasticity of demand" for that mail service. Own

²⁵ Exhibit USPS-ST-442.

²⁶ Exhibit USPS-ST-44Z.

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1 price elasticity is measured as **the** percentage decline in mail volume that results from a one
 2 percent increase in price. The lower (in absolute value) **the** own price elasticity, the higher the
 3 value of **the** service.

4 As noted in my Direct Testimony, USPS witness **Mayes** originally reported the **own** price
 5 elasticity for BPM subclass as -0.392 .²⁸ **This** BPM value was lower than **the** own price elasticity
 6 for all of the following Postal subclasses: First Class Cards-Stamped, First Class Cards-Private,
 7 Priority Mail, Express Mail, Standard **A** Regular Mail, Standard **A** ECR mail and Parcel **Post**.²⁹
 8 Since **the** BPM subclass **has** a lower own price elasticity coefficient than any of these subclasses,
 9 BPM should have **been** considered a much more highly valued **subclass** than any of them under
 10 criterion 2. Nevertheless, the Postal Service **has** proposed a rate increase for BPM that is higher
 11 **than** the rate increase proposed for any of **these** lower valued subclasses.

12 **Among** the materials produced by the Postal Service in support of its cost updates in this
 13 case, **the** USPS filed **the** Supplemental Testimony of Thomas **Thress**. In that testimony, Dr.
 14 **Thress** explained that since **the** filing of the USPS' original **case**, certain underlying growth rates
 15 that had been relied **upon** by **the** Postal Service to project explanatory variables that were used in
 16 the USPS's forecasting models had changed." He noted that because of these changes, "**the**

(..continued)

²⁷ Exhibit USPS-ST-44A.

²⁸ AAP Witness Siwek, AAP-T-2 at 27.

²⁹ USPS Response to AAP/USPS-T32-1, Tr. 11/4178.

³⁰ USPS-ST-46 at 6, lines 2-17.

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1 estimated elasticities associated with these variables will likely be different using the new U.S.
2 Commerce Department data than they were using the old Commerce Department data.””

3 AAP asked Dr. Thress to provide all new elasticities for Bound Printed Matter that he had
4 calculated using the new Commerce Department data that had been described in his
5 Supplemental testimony.³² In response to **this** request, **Dr.** Thress re-estimated the Bound Printer
6 Matter elasticities using the new Commerce Department **data**, a sample period through 2000Q3
7 and the same specifications that had been used in his direct testimony. Dr. Thress now reported
8 own price elasticity for Bound Printed Matter **as** -0.280 .³³ The updated value is more than 28%
9 lower than the BPM own price elasticity previously estimated by the Postal Service.

10 **As** noted above, in Postal ratemaking, a lower **own** price elasticity is associated with
11 higher value for a **postal subclass**. Using the USPS’s updated information, the reported **own** price
12 elasticity for BPM is now 28% lower than it was in the **Postal** Service’s original filing. **All else**
13 equal, BPM should now be granted a cost coverage markup that is even lower than the coverage
14 that I previously recommended for BPM. For **this** reason, should the Commission decide to
15 consider the Postal Service’s cost updates, it should also consider the revised elasticity **for** BPM
16 that was produced using the Postal Service’s updated growth estimates. For BPM, **this** revision
17 clearly implies a lower markup in BPM rates than the markup previously suggested for **this**
18 subclass.

³¹ USPS-ST-46 at 6, lines **17-20**.

³² USPS **Response** AAP/USPS-ST-46-5, Tr. 35116842.

³³ USPS Response to AAP/USPS-ST-46-5, **Tr. 35/16842**.

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1 V. Conclusions and Recommendations

2 **As** noted above, I have recommended that, for a variety **of** reasons, *the* Commission
3 should afford little if any weight to the updated information filed by the Postal Service in
4 response to Order No. 1294. Assuming, however, that the Commission decides to consider **this**
5 data, I have also recommended that the Commission reduce both the Postal Service's
6 recommended provision for contingencies and the cost coverage markup to be imposed on
7 Bound Printed Matter. As a result, even assuming that the Commission decides to consider the
8 Postal Service's updates, the Commission can and should still adopt the BPM rate structure and
9 rate levels that were recommended in my Direct Testimony on behalf of AAP.

10 **In** Attachment 1 of my supplemental testimony, I have prepared several calculations that
11 illustrate the effects of the recommendations that I have advanced in **this** Supplemental
12 Testimony. **As** shown in Attachment 1, even if the Commission decides to consider the Postal
13 Service's updates, the Commission can still adopt the BPM rate structure and rate levels that
14 were recommended in my Direct Testimony.

15 On page 1 of Attachment 1, I show the BPM test year revenues and volumes that were
16 included in the Direct Testimony of USPS **witness** Kiefer (Row I) and in my Direct Testimony
17 (Row II). **These** figures reflect the test year BPM costs originally filed in **this** case by the Postal
18 Service. In Row III, I show the contribution to institutional costs that would obtain **from** the
19 BPM rates proposed in my Direct Testimony at the USPS's original test year costs. **In** Row III,
20 one can also divide **TYAR** revenue by TYAR costs in order to yield the cost coverage ratio of
21 105% that I recommended for Bound Printed Matter.

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1 As can be seen in the last column of page 1, BPM test year revenues in my Direct
2 Testimony were based on **the** same (A/R) test year piece volume (524,742,871 pieces) as that
3 shown by Mr. Kiefer. This convention was adopted to reduce complexity and because Mr.
4 Kiefer's Excel work sheet (which I altered) did not include a interactive feature by which volume
5 responses to price changes would be calculated automatically. It is *true* that the BPM rates that I
6 have proposed in this case are lower than the BPM rates proposed by the Postal Service. For this
7 reason, it is likely that the BPM rates that I recommend would stimulate higher piece volumes
8 than the piece volumes shown by Mr. Kiefer. However, in this event, the volume variable costs
9 for BPM would also be higher than they would have been if **the** Postal Service's BPM rate
10 proposal had been adopted. Since piece volumes, revenues and volume variable costs would **all**
11 be higher at my proposed rates, **the** resulting BPM cost coverage set forth in my Direct
12 Testimony was not affected by the **use of** Mr. Kiefer's underlying (A/R) piece volumes. For **the**
13 same reason, the implicit **use of** Mr. Kiefer's volumes in **the** USPS cost updates does not affect
14 the basic conclusions that flow from page 2 of Attachment 1.

15 In Row I of page 2 of Attachment 1, I show **the** updated **test** year BPM costs now claimed
16 by the Postal Service **in** Mr. Patelunas' Exhibits. In Row II of page 2, I estimate the updated test
17 year BPM costs excluding **the** USPS' proposed contingency provision of 0.025. In Row III of
18 page 2, I derive **the** effect of a reduced contingency provision on test year BPM costs. In Row IV,
19 I solve for total BPM costs including a reduced contingency provision. **This** calculation yields
20 updated test year BPM costs. **This** figure is then compared to **the** test year BPM revenue in **the**
21 amount of \$503.3 million that was derived in my Direct Testimony. As shown in Row V, **this**

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1 comparison suggests that even if the Commission were to consider the **USPS** cost updates, the
2 **BPM** rates proposed in my Direct Testimony need not be adjusted.

3 As suggested in Attachment 1, my recommended **BPM** rates would now appear to yield a
4 lower cost coverage (under the updated costs) than the **BPM** cost coverage shown in my Direct
5 Testimony (at the original costs). However, even **this** lower cost coverage **is** clearly appropriate
6 for **BPM**. Recall that the updated costs that are considered in Attachment 1 still include the
7 effects of various unsupported **Postal** Service changes including the abandonment **of** the ECI
8 minus 1 index. **These** updated costs would have been considerably lower had I also adjusted
9 wage costs to reflect ECI minus 1. **More** importantly, however, a cost coverage ratio for **BPM**
10 that is lower than **105%** is appropriate on the **merits** and consistent with the corresponding
11 decrease in the own price elasticity for **BPM** that **was** recently reported by **USPS** witness **Thress**.
12 For all of these reasons, the **BPM** rate proposal set forth in my Direct Testimony can still be
13 adopted by the Commission in this case even if the Commission **were** to decide to consider the
14 Postal Service' recent test year cost updates.

**BOUND PRINTED MATTER
AAP PROPOSED RATES
ORIGINAL TEST YEAR COSTS**

AAP-ST-4
ATTACHMENT 1
PAGE 1 OF 2

	REVENUE PER PIECE	REVENUE	VOLUME
I. KIEFER †			
Before Rates	\$0.91	\$492,553,800	541,975,772
After Rates	\$1.07	\$563,442,826	524,742,871
Per Piece Changes	18.1%	14.4%	-3.2%
II. SES ‡			
Before Rates	\$0.91	\$492,553,800	541,975,772
After Rates	\$0.96	\$503,325,239	524,742,871
Per Piece Changes	5.5%	2.2%	-3.2%
III. RESULTING REVENUE & COST (ORIGINAL TEST YEAR COSTS)			
TYAR REVENUE	\$503,325,239		
TYAR COST	\$479,203,900		
PROPOSED CONTRIBUTION	\$24,121,339		

NOTES:

† USPS-T-37, WP-BPM-29

‡ AAP-T-2, ATTACHMENT-7, WP-BPM-29

**BOUND PRINTED MATTER
AAP PROPOSED RATES &
UPDATED TEST YEAR COSTS**

AAP-ST-4
ATTACHMENT I
PAGE 2 OF 2

I.	ORIGINAL COST	REVISED COSTS
USPS	\$479,203,900	\$498,658,000 •
II. ESTIMATED COSTS EXCLUDING CONTINGENCY		
		$\$498,658,000 = X + .025(X)$
		X= \$486,495,609.76
III. ADJUSTED CONTINGENCY		
		$.01667 * \$497,679,394$
		\$8,109,881.81
IV. TEST YEAR BPM COSTS INCLUDING CONTINGENCY		
		,605,492
V. RESULTING REVENUE & COST (UPDATED TEST YEAR COSTS)		
	TYAR REVENUE	\$503,325,239
	TYAR COST	\$494,605,492
	PROPOSED CONTRIBUTION	\$8,719,748

• EXHIBIT USPS-ST-44 W

1 CHAIRMAN GLEIMAN: This brings us to oral
2 cross-examination. The Postal Service is the only party
3 that has requested oral cross-examination. Is there anyone
4 else who wishes to cross-examine this witness?

5 [No response.]

6 CHAIRMAN GLEIMAN: If not, then, Mr. Reiter, you
7 may begin as soon as you finish swallowing.

8 MR. REITER: Thank you, Mr. Chairman.

9 CROSS-EXAMINATION

10 BY MR. REITER:

11 Q Good morning, Mr. Siwek.

12 A Good morning.

13 Q I am Scott Reiter on behalf of the Postal Service.
14 would you look at your testimony on page 6, specifically
15 lines 9 and 10?

16 A Yes, I have it.

17 Q You say there that the basis of the wage
18 calculations used by Witness Patelunas in the test year
19 update is "without factual support in the current record,"
20 is that right?

21 A That is what is stated there, yes.

22 Q And that is your testimony?

23 A Yes.

24 Q And by this, do you mean Lo contrast Witness
25 Patelunas' wage calculations with those filed by the Postal

1 Service with its request in January, is that right?

2 A That is not strictly correct. If one were to
3 compare the two cost filings, I would include in the
4 analysis of the Postal Service's original filing, the Postal
5 Service's extensive responses to interrogatories. So, a
6 fair comparison would be the Postal Service's original cost
7 filings and its responses and Library References in
8 comparison to what Mr. Patelunas has filed here.

9 Q Specifically with respect to the labor assumption,
10 is that also your testimony?

11 A I don't know that I have looked in full detail at
12 the support for the Postal Service's original labor filing,
13 so I don't know if this particular statement extends to that
14 exact calculation. It may, I just haven't looked at it.

15 Q Your statement, if you look at your testimony on
16 page 6, at lines 8 to 9, seems, to me at least, since it
17 follows this statement specifically applied to it where you
18 are talking about a major change in the standards used to
19 project Postal wage levels.

20 A Well, I am specifically talking about the ECI
21 minus 1 versus ECI change, and that is in the previous
22 paragraph of the previous section of this testimony. And as
23 I have read the record on this case, it seems to me that
24 this is a change in Postal policy that dates back a number
25 of cases. That is specifically what I am talking about in

1 this section.

2 Q What do you mean by Postal policy?

3 A The policy, as I understand it, the policy of the
4 Postal Service in coming before this Postal Rate Commission
5 was to limit projected increases as a standard at ECI minus
6 1. So, in other words, there was a standard, I would
7 characterize it as a regulatory standard that would serve
8 the purpose of maintaining a reasonable balance between cost
9 projections that the Postal Service might want and the
10 Postal Rate Commission's function to serve, in some sense,
11 as a substitute for the dictates of a free market.

12 Q And you associate that with a particular cost
13 level?

14 A I am talking about a standard; I'm talking about,
15 as I understand it from the questioning of, I guess it was
16 Mr. Patelunas on this issue, there has been a history of
17 using ECI-1 as a standard in cost updates for the Postal
18 Service in prior rate proceedings.

19 And that standard appears to have been changed as
20 a function of this supplemental testimony.

21 Q And I think you just said that the basis of your
22 understanding were the questions asked of Mr. Patelunas; is
23 that right?

24 A Well, as well as Mr. Patelunas's testimony and his
25 responses to interrogatories.

1 Q So, is it your testimony that those responses do
2 not provide factual support, whereas the original filing of
3 the Postal Service did provide factual support for the labor
4 assumption?

5 A My testimony is that there appears to be a change
6 in the policy **of** the Postal Service with respect to this
7 standard, and there is no factual support for the basis of
8 that policy change, as best as I could tell from everything
9 I've read on this.

10 Q Oh, so your testimony is that there is factual
11 support for the change, as opposed to factual support for
12 the actual calculations?

13 A Well, we're talking about the cost updates that
14 reflect that change.

15 And we're talking about that change as a change in
16 Postal policy in coming before this Commission.

17 And I really could find no definitive
18 understanding or statement as to why that happened.

19 I think Mr. Patelunas's testimony was something
20 along the lines of, I was told to do this. I don't recall
21 the exact wording.

22 Q And in the filing in January, what was the factual
23 support that was provided?

24 A Well, if we're talking specifically about this
25 question of the ECI standard, the factual support would have

1 been that that is the tradition of the Postal Service in
2 prior cases that date back ten or 15 years.

3 Q So, in other words --

4 A So, in other words, the Postal Service came
5 forward with its usual way of addressing cost projections as
6 it has done in prior cases.

7 And now in its supplemental testimony, it has
8 changed the standard for looking at these costs, and there
9 is no basis for explaining that change in policy, as best as
10 I can tell.

11 Q So you're saying that the support for the original
12 assumption was basically precedent; that it had been done
13 before?

14 A Well, as I testified earlier, I have not gone back
15 to the original record and tried to find each and every
16 place where the Postal Service responded to an interrogatory
17 on this question.

18 So I don't know that I can attest to the full
19 completeness of the support, but what we're talking about
20 here is a change.

21 And one would certainly expect that there would be
22 a discussion of the basis of that change, and there really
23 has not been.

24 Q Well, in either case, we're talking about an
25 assumption; aren't we, as opposed to something we know?

1 A Well, we're talking about a standard that would be
2 applied to the Postal Service in projecting its costs, and,
3 in effect, projecting the expectation that it has in dealing
4 with its costs, including its labor costs.

5 I mean, one can't assume that the Postal Service
6 is completely outside of any control over these costs.

7 Q My question was, we're talking about an
8 assumption, though, not a fact, right?

9 A Well, we're talking about an assumption that is
10 going to be used to set rates in this case, and once those
11 rates are set, those rate increases will be a fact.

12 Q But you do agree, it is an assumption?

13 A Well, I think of it as a standard. I think of it
14 as a change in a standard, so I don't know that it's an
15 assumption.

16 Q Is it a fact that we know?

17 A It is not a fact until it is implemented by the
18 Postal Service.

19 In other words, the Postal Service is saying we
20 now cannot control our labor costs to the same extent that
21 we were able to do in the past in accord with this standard.
22 That is implicitly what it's saying.

23 Q Does the Postal Service implement labor contracts?

24 A Well, the Postal Service certainly has authority
25 to sign labor contracts with its employees.

1 Q And the Postal Service can control the terms of
2 those, unilaterally?

3 A Not unilaterally, but certainly we're talking
4 about a bargaining position, so the Postal Service certainly
5 has some responsibility over what those likely future labor
6 costs will be.

7 Unless the Postal Service would simply abandon any
8 attempt to negotiate in good faith with the unions.

9 Q Has there been any testimony in this case about
10 the Postal Service's bargaining position?

11 MR. PRZYPYSZNY: Mr. Chairman, I'd have to object
12 here. I think that the Postal Service's questions are going
13 beyond the scope of Mr. Siwek's testimony here. It was a
14 limited scope to talk about ECI-1, and not to talk about
15 every issue regarding labor costs before the Postal Service.

16 MR. REITER: I didn't bring them up; the witness
17 did. And I'm trying to follow up on his testimony.

18 CHAIRMAN GLEIMAN: Mr. Przepyszny, I think we'll
19 let it go for a while longer, and see what develops.

20 I wish I could testify and answer questions. I
21 know the answers to some of the questions, including the
22 last one.

23 [Laughter.]

24 MR. PRZYPYSZNY: Okay.

25 MR. REITER: Well, let's see if the witness does,

1 if we may.

2 THE WITNESS: Can I have the question again?

3 BY MR. REITER:

4 Q Yes. Has there been any testimony regarding the
5 Postal Service's bargaining position in the labor
6 negotiations that you are aware of?

7 A I don't believe that I have seen testimony, but
8 there may very well be.

9 Q Would you look at your testimony at page 10,
10 please, lines 10 and 11?

11 [Pause.]

12 A I have it.

13 Q You state your conclusion that as a result of the
14 availability of cost estimates more recent than those filed
15 in January, the need for a contingency to cover forecast
16 errors has declined; is that right?

17 A That is, in substance, what I say. I can't locate
18 your exact quote, though.

19 Q I wasn't quoting you; I was paraphrasing you, but
20 that is an accurate paraphrase?

21 A *Yes.*

22 Q In other words, you believe then that it is easier
23 to predict the so-called known unknowns, the actual cost
24 level of events that we know are going to happen, but don't
25 yet know the actual amounts; is that right?

1 A That's not what I say.

2 Q What do you say then?

3 A What I am saying is that the target period over
4 which we are forecasting has not changed, but we are in a
5 position where we now are reflecting updated information.

6 So the Postal Service has been given the gift of
7 additional information, and that additional information is
8 reflected in the test year updates that have been filed.

9 So the Postal Service, therefore, does no longer
10 need to reflect the same uncertainty that it previously had,
11 because it now has new information.

12 This is why, in effect, interest rates and
13 discount rates change over periods of time. **All** else equal,
14 a dollar two years from now is less certain than a dollar a
15 year from now, and it's the same concept here

16 Q Let's step back a minute. The contingency is
17 designed to cover generally two types of things, and **I'll**
18 specify them and then ask you if you agree with me.

19 One is sort of what I referred to as known
20 unknowns where we know that something is going to happen,
21 whether it's labor costs or a thousand other things, and we
22 need to predict, based on the information we have, what
23 those costs are going to be.

24 And the other are sometimes called unknown
25 unknowns, things that you don't even know what they are that

1 may happen.

2 Do you agree that the contingency covers both
3 types of eventualities?

4 A Well, I don't know that I have read that
5 characterization anywhere previously, but I would accept
6 that that's a fair characterization.

7 Q And the testimony that I called your attention to
8 earlier, your testimony, was addressed at forecast errors;
9 is that right?

10 A Yes.

11 Q And would you say that that testimony of yours
12 applies to the type of events that we know are going to
13 happen; we just don't know exactly how much? And I believe
14 you said we now have more information that can help us
15 estimate those; is that -- is my understanding of what
16 you're saying correct there?

17 A Yes.

18 Q Now, with respect to the other category, the
19 things that are completely unknown, is it more or less
20 likely now than it was in January, that such things can
21 happen, and has our knowledge of them changed in any way?

22 A Well, we're talking about forecasting the future,
23 and you're asking me whether it is now more or less likely
24 that these future events will happen.

25 We can only determine whether they happen, after

1 the fact. We make projections before the fact to give us
2 comfort that should a reasonable expectation of these
3 unknowns occur, the Postal Service is covered

4 So we're only talking about a reasonable
5 expectation of what those forecasts and known unknowns and
6 unknown unknowns might be.

7 And what I'm talking about is, from a forecasting
8 point of view, the risk, the expected risk of those unknowns
9 has now declined because we're closer in time to the target
10 date of the test year.

11 Q Has the risk of unknown unknowns declined?

12 A Your predictive -- your ability to predict that
13 risk and your comfort with your prediction of those unknowns
14 has increased. You are more comfortable with your
15 predictions, so all else equal, you need less contingency
16 because the forecast risk has fallen.

17 Q Is it more or less likely now as compared with
18 last January, that, say, legislation that adversely affects
19 the Postal Service's financial position will be introduced
20 in January, let's say?

21 A I haven't studied that question. I don't know.

22 Q If I read your testimony correctly, your
23 recommendation regarding the contingency is limited to bound
24 printed matter; is that correct?

25 A No, that's not correct. My calculations focused

1 on bound printed matter, but the contingency overall affects
2 all mail classes. So my recommendations apply equally to
3 all mail classes.

4 Q On page 10, lines 12 and 13, you say, "I recommend
5 that the Commission reduce the recommended contingency
6 provision with respect to bound printed matter."

7 A Yes, I do.

8 Q And I believe you said something similar in
9 another place; I don't have the cite right here.

10 Are you now changing your testimony to say you
11 recommend that it be used across the board?

12 A Well, I am focusing on bound printed matter
13 because that is the class with which I am interested in, and
14 my calculations are aimed at that class. But I also
15 recognize that the contingency applies to other cases and
16 there certainly is no reason to distinguish the arguments
17 that I am raising here for bound printed matter to any other
18 class. The contingency applies to all classes and it's the
19 same risk reduction in the contingency that would apply to
20 every other class.

21 Q And what is the recommended level of the
22 contingency that you **make**?

23 A Well, I'm not recommending a specific level. I am
24 writing this supplemental testimony responding to the Postal
25 Service's updated costs. What this testimony says is that

1 if this Commission is to consider these updated costs, then
2 correspondingly the Commission should reduce the
3 contingency.

4 But I am saying that there is a reduction from
5 whatever level the Commission would otherwise find
6 reasonable. I am not at this point recommending a specific
7 number, although I am, of course, aware that other parties
8 have recommended other numbers.

9 Q There seem to be a number in your attachment 1,
10 page 2 of 2. Did I misinterpret that?

11 A I don't know what your interpretation was.

12 Q Where it says adjusted contingency.

13 A Well, this is assuming the Postal Service's
14 contingency were accepted by the Commission. Bear in mind
15 that the Postal Service has produced updated test year costs
16 and yet has maintained the same contingent level of 2.5
17 percent, and I think that's an error. And so the
18 calculation I show reduces that projected contingency.

19 But in my testimony in some other place, I say
20 that nothing in my testimony would preclude the Commission
21 from coming up with a lower contingency for other factors
22 that are not considered in my testimony.

23 Q What level do you show here?

24 A Well, again, I'm reducing from 2.5 to 1.667
25 percent. But again, that is solely in the context of

1 accepting the test year costs without accepting any other
2 reason to adjust the contingency, and I, for one, am not
3 saying that that is all that one should look at.

4 Q Is it your understanding that Witness Patelunas'
5 updated projected an after rate deficiency of about a half a
6 billion dollars -- specifically \$475 million?

7 A I don't recall what that number was.

8 Q Did you read the response to Presiding Officer's
9 Information Request Number 14?

10 A I don't believe I did. I may have, but I don't
11 recall.

12 Q Do you take that change into account in your
13 recommendation that the contingency be reduced?

14 A Since I don't recall if I read that response, I
15 would have to say that I have not taken that response into
16 account to the best of my recollection.

17 Q Thinking about it now, would it indicate to you
18 that with the estimate of a half-billion-dollar deficiency,
19 that extra risk has occurred since the Postal Service has
20 filed its case?

21 A No.

22 Q Could you explain that?

23 A We're talking about forecasting the test year cost
24 level, and we are now closer in time to that point. **All**
25 else equal, the risk of that forecast being in error has

1 fallen.

2 Q Isn't the purpose of the contingency to protect
3 against deficits, at least in the test year?

4 A I understood from your earlier question that it
5 had two purposes. It was to predict -- protect the Postal
6 Service against known unknowns and unknown unknowns. **So**
7 this would be yet another purpose that you're suggesting.

8 Q To what end does it protect the Postal Service
9 against those types of unknowns, though? Isn't it to
10 protect it against failing to break even?

11 A Yes, I would accept that.

12 Q And so if there's a half-billion-dollar projected
13 deficiency, wouldn't that increase the risk of failing to
14 break even?

15 A Well, that would only happen if the Postal Service
16 didn't then take the Commission's recommended decision here
17 and work a little harder to cut costs.

18 In other words, what's going on in part here is
19 that this Commission is attempting to set rates and it's
20 attempting to substitute for the workings of a competitive
21 market.

22 In other words, all businesses face unknowns and
23 face uncertainties, and all managers of any business would
24 like to have huge contingencies to protect them in the event
25 of unknowns that they hadn't predicted. They are unable to

1 have huge contingencies because a competitive market
2 prevents that from happening.

3 In my view, this Commission to some extent is
4 acting for a substitute for a competitive market, and so the
5 fact is that these unknowns may or may not occur, but the
6 Postal Rate Commission is attempting, as I have read, for
7 example, Mr. Buc's testimony, the Postal Rate Commission has
8 traditionally attempted to balance the subjective
9 considerations of the management of the Postal Service with
10 other more objective considerations that might serve to have
11 a limit on the contingency, because there has to be a limit.

12 Q I think at page 10 of your testimony, you seem to
13 indicate your belief that FY '99 cost data were not used in
14 originally developing the Postal Service's test year
15 forecast. Is that correct?

16 A Well, there was a great number of items used to
17 develop the Postal Service's original case, and as I recall,
18 some of the information used by the Postal Service I believe
19 did reflect Fiscal '99 information. But what I'm talking
20 about here is my recollection that the base year for costing
21 was Fiscal '98.

22 Q Were you aware that the preliminary '99 costs were
23 only 8.6 million less than the final audited costs?

24 A I don't recall that number.

25 Q If you accept that hypothetically, that's about a

1 difference of .01 percent. Would you believe that shifting
2 to the actual '99 final costs which differed by such a small
3 amount would materially increase the accuracy of the Postal
4 Service's test year forecast?

5 A Well, my testimony is that using the '99 cost data
6 as well as the updates to all of the forecasts, you are now
7 reflecting far more current information than you previously
8 had, and it is that activity which is serving to reduce the
9 risk in the forecast of the test year costs, all else equal.

10 Q Can you identify any specific information that the
11 Postal Service now has that reduces the risk in the
12 forecast?

13 A Certainly. I would point you to Mr. Patelunas'
14 Exhibit ST-44-AB, and I would suggest that a comparison
15 between the originally filed inflation projections that the
16 Postal Service used in its filing and the revised
17 projections in the test year that are shown on that exhibit,
18 that all of those changes reflect a reduction in the risk of
19 forecast error in the test year, because now the Postal
20 Service has reflected the new information and has not needed
21 to project the test year any further into the future.

22 Q And that new information also reflects increases
23 in cost, does it not?

24 A Which is in part why the risk of failing to make
25 the appropriate test year cost has declined, because, in

1 other words, if the test year cost updates are adopted, the
2 Postal Service's costs are higher than they were previously.
3 So that means that, all else equal, the additional
4 uncertainty associated with those risks has fallen.

5 Q So your conclusion that the contingency should be
6 reduced is based on your expectation that the Postal Service
7 has more information?

8 A And has used more information in these
9 projections.

10 Q How did you actually calculate the 1.67 percent
11 that you used?

12 A I simply used an approximate risk reduction
13 decline of 33 percent, basically taking account of the fact
14 that if you're moving from Fiscal '98 to the test year,
15 2001, you're approximately -- were moving three years into
16 the future and now, if the Fiscal '99 data were to be
17 considered, you're moving two years into the future. So
18 assuming a linear function for risk, that would reduce the
19 contingency by one-third.

20 I have considered whether or not a non-linear type
21 reduction was appropriate and I don't think there is any
22 evidence suggesting there is, it should have been any
23 different than that.

24 Q Would you look at page 12 of your testimony,
25 please?

1 [Pause]

2 A I have it.

3 Q There, you say that additional savings of \$464
4 million are trivial, to quote you, compared to the Postal
5 Service's total costs. I think that's a line 8.

6 A Well, I'm comparing .464 billion to 67.6 billion,
7 so maybe trivial overstates it a bit, but it's certainly
8 very small compared to the Postal Service's total costs.

9 Q Well, shouldn't it be compared to the total test
10 year cost reductions which are 1.118 billion?

11 A No, it shouldn't be.

12 Q But that's what it's an additional amount with
13 respect to; is it not?

14 A Not in this calculation. What I am comparing is
15 the amount of risk reduction that would apply to all of the
16 Postal Service's costs as a direct function of the cost
17 updates.

18 So you are reducing the risk for the entire body
19 of Postal costs projected in the test year, and you're
20 comparing that to the additional savings associated with the
21 productivity improvements.

22 So that's why you have to look at the overall
23 costs.

24 Q Do you know what amount **of** FY 2000 assumed cost
25 reductions the 1.118 billion is built on top of?

1 A I don't know what you mean by "built on top of."

2 Q Do you remember looking at Patelunas Exhibit
3 ST-44-Z, and there I think you'll see that FY 2000 cost
4 reductions are 904 million.

5 [Pause.]

6 A In Patelunas Exhibit 44-Z, the cost reductions in
7 Fiscal 2000, as I understand this exhibit, previously were
8 980 billion, and now they're 940 -- I'm sorry, 980 million,
9 and now they're 904 million.

10 Q So we have 904 million in FY 2000, and 1.118
11 billion in the test year; is that right?

12 A Oh, I see. So, you're saying built on means cost
13 savings in Fiscal 2000?

14 Q Well, these are cumulative, correct?

15 A Yes, I assume they are.

16 Q So, over a two-year period, Witness Patelunas is
17 showing cost reductions of over \$2 billion; is that right?

18 A I believe that is the case, yes.

19 Q And --

20 A I guess I haven't explored in detail, whether each
21 and every one of these Fiscal 2000 cost reductions are
22 continuing cost reductions. Some of them may be one-time
23 cost reductions, so, in other words, would not **be**
24 cumulative.

25 As I sit here, I don't know, but there is that

1 possibility.

2 Q And this level is what you're criticizing as
3 trivial?

4 A Well, as I said, perhaps trivial overstated it. I
5 was comparing less than one-half billion to 67 billion;
6 that's the numbers, however one characterizes them.

7 Q And you don't think that \$2 billion in cost
8 reductions over the two years is relevant to that judgment?

9 A No, I believe it's relevant; that's why I wrote
10 this testimony that says that it is relevant to consider
11 this, but when you consider these cost reductions in
12 comparison to the overall reduction in cost forecasting risk
13 that has occurred, that these productivity offsets are
14 relatively small and need not be seen as any sort of offset
15 here.

16 Q So, cost savings of 1.118 billion in the test year
17 is not significant, but a contingency of 1.7 billion is; is
18 that what you're saying?

19 A Well, I'm looking at why we need the contingency
20 in the first place. And we need the contingency in the
21 first place because the Postal Service predicts all of its
22 costs between now and the test year, and there is the
23 possibility that the Postal Service will mis-forecast all of
24 its costs.

25 And the contingency is simply a way to compensate

1 the Postal Service for that forecast error possibility.

2 But it is, after all, over all of the costs of the
3 Postal Service.

4 Q I'm not sure you answered my question. Once
5 again, would you agree that as a whole, the Postal Service's
6 test year cost savings programs are not trivial amounts?

7 A Yes, I would agree that they are not trivial
8 amounts.

9 MR. REITER: That's all I have, Mr. Chairman.

10 CHAIRMAN GLEIMAN: Is there any followup? There
11 appears to be some followup.

12 MR. STRAUS: David Strauss for American Business
13 Media.

14 CROSS EXAMINATION

15 BY MR. STRAUS:

16 Q I wish I could read the transcript before I do
17 this, but I think that in your discussion with the counsel
18 for the Postal Service, you were discussing the
19 appropriateness of a contingency as applied to a particular
20 class.

21 My question to you is, in that discussion, were
22 you stating that you examined the contingency on an overall
23 basis, and merely applied it to bound printed matter, or
24 were you testifying that it would never be appropriate for a
25 multi-product entity to look at separate contingencies for

1 the various products?

2 A Well, I didn't really address the question of
3 whether there might be separate and distinct contingencies
4 for different products. I haven't addressed that question.

5 All I'm saying is, I looked at the overall
6 contingency projected by the Postal Service, and I concluded
7 that if the Commission were to consider the Fiscal '99 data,
8 that that overall contingency was consequently overstated.

9 And then I took the effect of that overstatement
10 and applied it to bound printed matter.

11 And I'm not saying that that reduction should not
12 occur to other classes, but, similarly, I haven't studied
13 whether or not there ought to be sort of a different
14 contingency for each class. I just haven't studied that.

15 MR. STRAUS: Thank you; that as the right answer.
16 I have no more questions.

17 [Laughter]

18 CHAIRMAN GLEIMAN: That means that the two of you
19 must agree. I think there's a Disraeli quote that defines
20 an agreeable person as someone who agrees with me **or** him, as
21 the case may be. You must be an agreeable person from Mr.
22 Straus's point of view.

23 Is there any further followup?

24 MS. DREIFUSS: The OCA does have a followup
25 question, Mr. Chairman.

1 CHAIRMAN GLEIMAN: Ms. Dreifuss?

2 CROSS EXAMINATION

3 BY MS. DREIFUSS:

4 Q Mr. Reiter was questioning you about the cost
5 reduction plans of the Postal Service, both in FY 2000 and
6 FY 2001, if you recall. That took place just a couple of
7 minutes ago.

8 A Yes, I recall.

9 Q Since the Postal Service had a chance to assess
10 its ability to achieve cost reductions for FY 2000 very
11 recently, would you agree that their expectation about the
12 ability to achieve cost reductions in FY 2000 is much
13 stronger or based on much more information now than it was
14 when they first filed the case in January of this year?

15 A I would agree that that would generally be true.
16 I would agree, as economists like to do, ceterus paribus,
17 that that would be true.

18 The possibility exists that there is some
19 particular specific uncertainty that has now surfaced that
20 was not predicted earlier. That possibility exists, but
21 certainly absent any particular discussion and revelation of
22 this sort of uncertainty, I would think that that would
23 generally be true.

24 Q So, it would appear that for any cost reductions
25 that they had planned for FY 2000, there is much less

1 uncertainty about their ability to achieve them now than
2 there was when they first filed the case; does that sound
3 right?

4 A Well, but again, they may have changed the basis
5 of the cost reductions; in other words, the possibility
6 exists that they have come forward in Fiscal 2000 and have
7 projected cost reductions that, all else equal, are more
8 difficult to achieve.

9 That doesn't mean that the uncertainty is not
10 reduced, but the initial projection going forward may have,
11 in effect, raised the bar. I don't know that.

12 Q Right.

13 I'm not really speaking **of** the test year at the
14 moment; I'm just talking about **FY** 2000. Since we are very
15 near the end of FY 2000, there is much less uncertainty for
16 FY 2000 about their ability to achieve the cost reductions
17 that Witness Patelunas reports than there was when they
18 first filed the case; does that sound correct to you?

19 A I would expect so, absolutely.

20 MS. DREIFUSS: Thank you.

21 CHAIRMAN GLEIMAN: Is there any further followup?

22 MR. REITER: If I could follow up that last
23 answer?

24 CHAIRMAN GLEIMAN: You bet.

25 FURTHER CROSS EXAMINATION

1 BY MR. REITER:

2 Q What further information is there on the record to
3 support your last response to counsel?

4 A Well, the further information, I suppose, is the
5 fact that we are a good bit through Fiscal 2000, or at least
6 have entered 2000 -- soon, I'm sorry -- but we are much
7 closer in time to that period.

8 Q But, specifically, though, is there any
9 information on the record with regard to how successful or
10 not the Postal Service has been in the cost reduction
11 programs forecast for FY 2000?

12 A I don't know whether there is or is not evidence
13 of that type.

14 Q So, what was the basis for your opinion?

15 A The basis for my opinion was that, again, the
16 forecast -- the need to consider uncertainty because of the
17 time period is certainly markedly reduced for Fiscal 2000 as
18 we sit here in late August of the year 2000.

19 Q So that's based on that general assumption, rather
20 than any specific information?

21 A Well, and based on the fact that we are or we
22 should be having reports coming into the Postal Service as
23 we speak, about the effects of these cost reduction
24 proposals, because without getting specific, my suspicion is
25 that a large number of them don't get implemented immediate;

1 that there is a run-up sort of period and there is a time
2 over which you can begin to assess how reasonable they are,
3 even now.

4 And so I would think that you simply have much
5 more information available to you now as to these cost
6 reduction programs.

7 I guess, in other words what I'm saying is that
8 they don't simply begin from scratch on the first day of
9 Fiscal 2000.

10 They don't begin that way; they begin to be geared
11 up, to at least some of them would be, and you would have
12 information on this.

13 Q And, similarly, they don't necessarily end at the
14 last day of FY 2000 at the level projected; do they?

15 A Yes, I agree that that probably is the case. That
16 gets to my point earlier about whether they are cumulative
17 savings or one-time savings.

18 I would expect some of them to continue, so they
19 would be cumulative.

20 Q No, I meant that they wouldn't necessarily amount
21 to the full forecasted level of cost savings at the end of
22 the Fiscal Year for the reason you said earlier?

23 A That's possible.

24 MR. REITER: Thank you.

25 CHAIRMAN GLEIMAN: Ms. Dreifuss?

1 FURTHER CROSS EXAMINATION

2 BY MS. DREIFUSS:

3 Q Conversely, following up on Mr. Reiter's point, I
4 suppose it's possible that cost reductions could even exceed
5 the Postal Service's initial projections; couldn't they, by
6 the end of FY 2000?

7 A I would expect that's possible, yes.

8 MS. DREIFUSS: Thank you.

9 CHAIRMAN GLEIMAN: Anybody else? Mr. Przepyszny,
10 would you like some time with your witness to prepare for
11 redirect?

12 MR. PRZYPYSZNY: Yes, I would, Mr. Chairman.

13 CHAIRMAN GLEIMAN: I think then that we will try
14 to make good use of our time this morning. I didn't want to
15 ignore any of my colleagues. My recollection is that no one
16 had questions from the bench?

17 COMMISSIONER OMAS: No.

18 CHAIRMAN GLEIMAN: I just wanted to make sure.
19 We'll take ten minutes now, and that will be our mid-morning
20 break, and you can use it to prepare for redirect.

21 MR. PRZYPYSZNY: Thank you.

22 CHAIRMAN GLEIMAN: Mr. Przepyszny?

23 MR. PRZYPYSZNY: We'll have no redirect.

24 CHAIRMAN GLEIMAN: That being the case, Mr.
25 Siweck, that completes your testimony here today. We

1 appreciate your appearance and your contributions to our
2 record. We thank you, and you are excused.

3 THE WITNESS: Thank you.

4 CHAIRMAN GLEIMAN: I am running a fast clock this
5 morning, so I'll give you a moment to round up your witness.

6 Mr. Reiter, do you want to introduce our next
7 witness? Would you, whether you want to or not, --

8 MR. REITER: Yes.

9 CHAIRMAN GLEIMAN: -- would you?

10 MR. REITER: Yes, I will introduce our next
11 witness, who is Richard Patelunas.

12 CHAIRMAN GLEIMAN: Mr. Patelunas, you have been
13 here before, so you're already under oath in this
14 proceeding, and in theory, there's no need to swear you in
15 again, although it has been suggested that I do that and ask
16 you to raise both hands this time so we can make sure you
17 don't have any fingers crossed behind your back.

18 No, we know that your testimony was under oath
19 last time; it just wasn't as helpful as some of us would
20 have liked it to have been. We will not swear you in again
21 today. We know you're a man that's good to his word.
22 Whereupon,

23 RICHARD PATELUNAS,
24 a witness, having been previously duly sworn, was further
25 examined and testified as follows:

DIRECT EXAMINATION

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BY MR. REITER:

Q Mr. Patelunas, I'm handing you two copies of a document entitled Rebuttal Testimony of Richard Patelunas on behalf of United States Postal Service, USPS-RT-4.

A Uh-huh.

Q Was this testimony prepared by you or under your direction?

A Yes, it was.

Q And if you were testifying orally today, would your testimony be as written?

A Yes.

Q Thank you.

MR. REITER: Mr. Chairman, I will hand these two copies to the reporter and ask that they be entered into the record as the rebuttal testimony of Richard Patelunas.

CHAIRMAN GLEIMAN: Is there an objection?

[No response.]

CHAIRMAN GLEIMAN: Just to make sure that nobody is going to object to putting testimony into the record.

Hearing none, I'll direct that counsel provide those copies to the court reporter and your testimony **will** be transcribed into the record and received into evidence.

[USPS-RT-4, Rebuttal Testimony of Richard Patelunas, was received in

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USPS-RT-4

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON DC 20268-0001

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

REBUTTAL TESTIMONY OF
RICHARD PATELUNAS
ON BEHALF OF THE
UNITED STATES POSTAL SERVICE

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Rebuttal Testimony
of
Richard Patelunas

AUTOBIOGRAPHICAL SKETCH

1 My name is Richard Patelunas. I am a Financial Analyst with the U. S.
2 Postal Service and I began as a career employee in 1977. Before coming to
3 Headquarters in 1986, I held the craft positions of city carrier, **ISM** Operator,
4 distribution clerk and window clerk. Prior to that, I had several temporary
5 appointments between 1974 and 1977.

6 I presented testimony before the Postal Rate Commission in Docket Nos.
7 R90-1, MC93-1, R94-1, MC95-1, MC96-3, R97-1 and in this docket. I have a
8 **B.A.** in Economics from the State University of New York at Binghamton (1978)
9 and an M.B.A. from Syracuse University (1986).

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1 **i. Purpose of Testimony**

2 Witness Buc (DMA-T-1) discusses what he terms as two errors in the
3 Postal Service's estimated test year expenses. First, he argues that he corrects
4 a flaw in the rollforward methodology concerning the cost reduction treatment of
5 supervisors. Tr. 22/9547-48. Second, he argues that he corrects an
6 understatement of the savings from the AFSM 100 program. Tr. 22/9549-52.
7 Below I show why witness Buc's analysis should be rejected.

8

9 **ii. Supervisor Cost Savings**

10 **A. Witness Buc's Mechanical Adjustment to Supervisor Costs**
11 **Ignores Operating Reality**
12

13 Witness Buc testifies that supervisor costs should be reduced by \$92
14 million to maintain the pre-cost reduction program supervisor ratio. Witness Buc
15 argues that cost reductions for clerks and mailhandlers, and city carriers should
16 be accompanied by reductions in costs for their supervisors. Tr. 22/9547. He
17 points out that the rollforward model adjusts supervisor costs for changes in
18 clerk, mail handler, and city carrier costs due to mail volume and non-volume
19 workload changes, but not for cost reductions. *Id.*

20 Maintaining the pre-cost reduction supervisor ratio is not appropriate.
21 That ratio does not reflect the program managers' expert assessment of what
22 supervisor savings can or can not be captured in conjunction with each distinct
23 program. Because the introduction of automation equipment and other
24 programs changes the configuration of postal operations, the ratio of

1 supervisors to the employees they supervise also changes. For instance, I am
2 informed that with more machines, an on-line keying room, the speed of the new
3 machines, the additional number of sort plans, etc.. maintaining the same ratio of
4 supervisors would mean that each supervisor would be responsible for a
5 considerably larger portion of the flow of mail. There is, however, a limit on what
6 each individual supervisor can be responsible for. The approach used in the rate
7 case is consistent with the way the Postal Service's operating budgets are
8 determined. Savings calculated by a mathematical formula, but not considered
9 in the formulation of field budgets, will not be realized and are therefore false
10 savings.

11 Witness Buc's proposed adjustment is improper. His method is purely
12 mechanical, ignoring the reality that most cost reduction programs change the
13 operating environment and result in additional supervisory complexities and
14 responsibilities. This limits the opportunity to reduce supervisor **costs** in direct
15 proportion to craft **workhour** savings. In fact, witness Buc agreed that supervisory
16 workhours would only vary directly with clerk workhours in an environment where
17 all things remain equal. Tr. 22/9595. Witness Buc further testified that "if
18 management changes the supervisory requirements of the new operating
19 environment, the ceteris paribus conditions **will** no longer hold." *Id.* I am
20 informed by our program managers that this is in fact the case: most cost
21 reduction programs change the operating environment and consequently, the
22 Postal Service does not budget for proportional supervisor savings.

1 **B. Actual Events Provide Evidence That Witness Buc's**
 2 Supervisor Argument is Invalid

3
 4 In addition to the facts outlined above, there is other compelling evidence
 5 that witness Buc's logic is flawed. The table below clearly shows that actual PI
 6 98 supervisor costs were very close to the Postal Service's original estimates
 7 presented in the Docket No. R97-1 filing. In fact, most of the difference between
 8 those actual results and the Commission's recommended amount for supervisors
 9 in Docket No. R97-1 can be accounted for by the Buc adjustment. Witness Buc
 10 confirms that without his adjustment the Commission would have recommended
 11 \$3.521 billion supervisor costs, which is within \$9 million or 0.3% of actual
 12 supervisor costs. Tr. 22/9575. This shows clearly that both the Commission
 13 estimate without the Buc adjustment and the Postal Service's estimate in the last
 14 docket were very close to actual results, while the Buc adjusted estimate
 15 resulted in a much larger variance.

16
 17 Table 1
 18 PI 98 Cost Segment 2
 19 Supervisor Costs
 20 \$(Millions)
 21

	PRC Estimate	PRC Estimate ¹	USPS Estimate
R97-1 Rate Case	3,420	3,420	3,515
Buc Adjustment		101	
Rate Case Without Buc Adj		3,521	3,515
Actual	3,512	3,512	3,512
Over/(under)Actual	-92	-9	-3
% Over/(under) Actual	-2.6	-0.3	-0.1%

22

¹ Adjusted to remove impact of Buc adjustment on PRC estimate of supervisor costs.

1 In sum, witness Buc's adjustment should be rejected. Supervisor cost
2 savings opportunities should be reviewed in terms of the functions, obligations
3 and environment of supervision – not merely mechanistically piggybacked on
4 direct labor costs. Witness Tayman's direct testimony, USPS-T-9, uses the
5 correct approach to identify supervisor **cost** savings; witness Buc's testimony
6 does not.

7

8 **III. AFSM 100 Savings**

9 Witness Buc contends that his calculations of the savings from the AFSM
10 100 program are conservative estimates representing at least \$199.933 million
11 more savings than that those calculated by the Postal Service. Far from being
12 conservative, witness Buc's calculations rely on unrealistic and unattainable
13 assumptions.

14 Witness Buc confirms that he ignored piggyback costs in his calculations.
15 Tr. 22/9579. Likewise, he confirms that the AFSM 100 requires more floor space
16 (square feet) than either the FSM 881 or the FSM 1000 and that he made **no**
17 adjustments to the **Postal** Service's estimate of floor space. Tr. 22/9580.
18 **Additionally, witness Buc confirms that he has not included allied labor costs, Tr.**
19 **22/9581.** By ignoring piggyback costs, additional required floor space, and allied
20 labor **costs** in his analysis, witness Buc focuses attention on only the cost
21 savings portion of the operating environment that results from the AFSM 100.
22 Focusing on only the cost savings portion of the environment does not result in a
23 conservative estimate.

1 In terms of practice or implementation, witness Buc is not as conservative
2 **as** he argues because his analysis rests on an ideal world where all of his
3 assumptions are fully **realized**. Witness Buc confirms that his analysis assumes
4 that the Postal Service will realize 100 percent of the Test Year cost savings that
5 he has calculated. Tr. **22/9582**. **To** achieve this, witness Buc assumes a
6 deployment of 166.5 machines in the test year, Tr. **22/9588**, and further assumes
7 that each and every machine will operate twenty hours per day, six days per
8 week. It is my understanding that this assumption **is** not attainable because not
9 all Phase I machines will be deployed for the entire test year.

10 Even when all ~~of~~ the machines are deployed, these assumptions are
11 unduly optimistic because they inherently assume that as the deployment of this
12 new **AFSM 100** environment evolves, change can be precisely planned for and
13 results perfectly anticipated. Not only that, witness Buc assumes that the
14 savings are instantaneously realized and continue uninterrupted. Witness Buc's
15 formulaic application of a set of assumptions to an evolving deployment schedule
16 is unrealistic. I understand that the real world operating environment faced by
17 program managers **is** much more complex; for instance, there are differing
18 facility sizes and configurations. I further understand that the mail volume
19 needed to optimize machine utilization may not be present at **all** facilities. *Also*,
20 the volume that does exist at a facility is currently processed on other than an
21 **AFSM 100**. These variables demonstrate that the change to **AFSM 100**
22 processing, and realizing the full savings, are not **as** easy as flipping a switch.
23 **As** such, the deployment of any new program undergoes a learning curve

1 reflecting the uneven progress of implementation. It is my understanding that
2 the program managers consider as many variables as is reasonable, given the
3 complexity of their task, in estimating the AFSM 100 program savings used in the
4 Postal Service's filing.

5 Furthermore, the savings **used** in the filing are budget savings; thus, they
6 are the result of the Postal Service's 'Catchball' process used in developing the
7 operating budget. In this process, the savings estimated by the program
8 managers are presented to the field, negotiations ensue and budgeted savings
9 are agreed upon. **As** such, the savings have been subjected to the judgment of
10 the field managers who must realize the savings and who are in the best position
11 to determine their reasonableness — these are the operations managers who
12 must move the mail. Much like the supervisor cost savings discussed earlier,
13 savings calculated over and above the savings considered in the formulation of
14 field budgets will not be realized and are therefore false savings.

15 Assuming that **all of** the assumptions are realized and 100 percent **of** the
16 highest theoretically possible savings are recognized in the test year **is** not a
17 conservative analysis. Witness **Buc's** conclusion that there are additional **AFSM**
18 cost savings in the **test** year should be rejected because the assumptions
19 underlying that conclusion are simply not realistic.

1 CHAIRMAN GLEIMAN: One party has requested oral
2 cross examination, the Association of Postal Commerce. Is
3 there any other party that wishes to cross examine this
4 witness?

5 [No response.]

6 CHAIRMAN GLEIMAN: If not, Mr. Wiggins, you may
7 begin.

8 MR. WIGGINS: Thank you, Mr. Chairman.

9 CROSS EXAMINATION

10 BY MR. WIGGINS:

11 Q Mr. Patelunas, I'm Frank Wiggins, here for the
12 Association for Postal Commerce.

13 Beginning at page 4 of your testimony, you discuss
14 Witness Buc's testimony about AFSM 100 savings, and I think
15 it's fair to say that you're critical of what Mr. Buc had to
16 say. Is that the basic gist of it?

17 A That's correct.

18 Q Take a look with me, if you would, please, at
19 attachment C to Mr. Buc's testimony. Do you have that
20 handy?

21 A His direct testimony -- I don't have that, no.
22 What I have here is rebuttals and supplementals. I didn't
23 bring his --

24 Q You didn't bring what you're criticizing.

25 A That's true.

1 MR. WIGGINS: Mr. Chairman, if I could provide the
2 witness with a copy of that segment of Mr. Buc's testimony.

3 CHAIRMAN GLEIMAN: You most certainly may.

4 MR. WIGGINS: And if I could also stand up here
5 close to him so we can both talk about the same piece of
6 paper of which I do have a copy, but only one?

7 CHAIRMAN GLEIMAN: If that is a good way to
8 proceed, we can proceed that way. If you would like, we can
9 break for about a minute and a half and -- actually, I think
10 there's someone who's willing to offer you another copy,
11 which I was going to do if we took a short break.

12 BY MR. WIGGINS:

13 Q Have a look at page 1 of 3 of attachment C with
14 me, if you would, please, Mr. Patelunas.

15 I take it that your criticism is that the number
16 reflected there in column 1 as AFSM cost savings as
17 calculated by Mr. Buc is too high; is that right?

18 A That's correct.

19 Q And consequently, that the number over in column
20 3, the difference between the Buc calculation and the Postal
21 Service calculation, that number also is too high?

22 A Yes, it is.

23 Q How about the number in the middle, which you will
24 see calculated on page 2 of 3. Did you have occasion to
25 study on that? That's the Postal Service calculation as

1 recast by Mr. Buc.

2 A I believe that is Witness Tayman's amount
3 recalculated by Witness Buc.

4 Q So the middle number is probably about right, the
5 first number is too high, and consequently the third number
6 is too high?

7 A Yes.

8 Q Okay. Now turn over with me to page 3 of 3, and
9 let's talk about some of the constituent elements of Mr.
10 Buc's calculation.

11 Let's look first at column 4. This is the number
12 of AFSM machines that are going to be in place during the
13 test year; is that your understanding? 166.5.

14 A My understanding is that that is the -- that is
15 the mid-point or that is the equivalent of the number of
16 machines that will in effect be deployed during the test
17 year, it is not the complete number of machines, which there
18 is 175, but because that deployment is now ongoing and just
19 started, the -- I believe the source of that number is the
20 equivalent during the test year. It's an estimate of the
21 equivalent during the test year.

22 Q Okay. There are 173 machines total that will be
23 out there before the end of the test year; is that your
24 understanding?

25 A That's my understanding.

1 Q And the 166.5, do you remember how that was
2 calculated?

3 A I didn't calculate that. I don't --

4 Q Did you -- I'm sorry.

5 A No, I don't know how that was calculated.

6 Q Did you look at the source that Mr. Buc refers to
7 there in Footnote 4?

8 A No, I didn't.

9 Q That library reference 83 is something sponsored
10 by Postal Service Witness Smith, and I talked with Mr. Smith
11 some about that when he was on the stand. Let me just read
12 you a little bit of that colloquy and then ask you a
13 question.

14 And I say -- Mr. Smith was trying to calculate the
15 space requirements for the AFSM 100 machines.

16 A Okay.

17 Q And I said to him: "Is there any space in the
18 test year in addition to that in 2000 for the first 173 AFSM
19 100s?"

20 And he answers: "Yes, there is. There is --
21 those additional 173 for the most part will be deployed most
22 of the year. So they are -- based on the average numbers --
23 average numbers amount of deployment time. I am counting
24 166, approximately 166 of those 173 in my facility space
25 calculation."

1 Question: "166.5, wasn't it, to be precise?"

2 Answer: "That sounds right."

3 Did you have an understanding of the use to which
4 Mr. Smith was putting the calculation that has just been
5 described to you?

6 A After you just described it, I have an idea of
7 what he was doing that for. I didn't read that before, I
8 didn't follow Mr. Smith's testimony, but I think I followed
9 what you just read.

10 Q Say what your understanding **of** that is.

11 A I think that it is basically what I just said,
12 that for his calculations, the test year equivalent is 166.5
13 machines. That would be my understanding of what you just
14 read to me and that's what I said initially.

15 Q And do you have an understanding of the use to
16 which Mr. Smith put that number?

17 A In general, if you're telling me it's facility
18 space cost, yes; but anything other than that, no. I didn't
19 examine his testimony nor that library reference.

20 Q And what is your belief if I confirm to you that
21 is facility space cost, how would that number be used? Do
22 you have a sense of that? By Mr. Smith.

23 A I -- it could have been used for any number of
24 reasons. I don't know what Mr. Smith was testifying to at
25 that point. I just don't know. I have a vague idea of what

1 the facility space cost is. It's basically the -- for
2 instance, it is the rental space that would be allocated,
3 distributed to the various components that make up space, of
4 which the AFSM 100 would be one. That's one example of it.

5 Q And those were counted in the test year costs to
6 the Postal Service; is that your understanding? Those space
7 costs for the new machines, the AFSM 100s.

8 A If Mr. Smith calculated 166.5 machines and he
9 provided space calculations for the test year, they would be
10 in the test year cost.

11 Q But you don't know whether that's what he did
12 because you didn't look.

13 A That's the only reason I can't say it's not in
14 there is because I didn't look. I'm fairly confident it's
15 in there.

16 Q You criticized Mr. Buc -- and I'm looking at page
17 4 of your testimony now in lines 15 through 17 -- by saying,
18 "Likewise, he -- Mr. Buc -- confirms that the AFSM 100
19 requires more floor space, square feet, than either the FSM
20 881 or the FSM 1000, and that he made no adjustments to the
21 Postal Service's estimate of floor space."

22 I'm trying to understand what Mr. Buc did wrong
23 here. We've just assumed that Mr. Smith already counted
24 that cost. Should Mr. Buc have counted it again?

25 A I am not sure how you're characterizing Mr. Buc

1 has already counted it.

2 Q I'm sorry. Perhaps I misspoke.

3 A Okay.

4 Q What I just said to you is Mr. Smith has already
5 counted it. That's the Smith testimony, Smith library
6 reference that you didn't look at.

7 A Okay.

8 Q Okay. Take it from me that that's what Mr. Smith
9 was doing. Assume that with me, would you, please?

10 A I will assume that.

11 Q Okay. And now I'm asking you, you're being
12 critical of Mr. Buc for not doing some sort of adjustment,
13 and I'm trying to understand --

14 A Right.

15 Q -- what kind of adjustment Mr. Buc should have
16 made.

17 A By that statement, I was pointing out that his
18 conservative calculation was not conservative. There are
19 additional costs that go along with deploying a new program.
20 Mr. Buc focused merely on the cost savings aspect of the
21 AFSM 100.

22 I mentioned the floor space, allied labor,
23 maintenance costs need to be included to get the entire
24 picture.

25 Q I think you actually don't talk about maintenance

1 cost; you talk about piggyback costs; isn't that right?

2 A Yes. And that's the example I was thinking of.

3 Q Okay. I would like you to focus on a narrow part
4 of that. We're going to have an opportunity to talk about
5 each of those elements, so if you would focus with me first
6 on just the space costs, okay?

7 A Uh-huh.

8 Q And tell me how you would have had Mr. Buc alter
9 his calculation to correctly reflect what you're criticizing
10 him for not reflecting here. What should he have done
11 differently? Look back at page 3 of 3 and tell me what
12 numbers should have changed.

13 A I don't know if I can sit here and provide a
14 correction to this particular methodology. What I am
15 critiquing here, what I'm criticizing is the combination of
16 numerous optimistic ideal assumptions into one model. I
17 can't -- I don't have a correction to provide to this page
18 that would somehow correct all these ideal assumptions that
19 have gone into it.

20 One of the ideal assumptions is assuming.
21 Basically by not including any space costs, you're assuming
22 that there are no additional space costs.

23 Q I thought we just agreed that we could assume on
24 my representation to you that the additional space costs are
25 indeed included. They were included by Mr. Smith.

1 A They were included in Mr. Smith's calculations.

2 Q So Mr. Buc should include them again?

3 A I don't know how he would include them again. I'm
4 trying to make a distinction here between what Mr. Buc did
5 and what Mr. Smith did. If I understand things correctly,
6 Mr. Smith calculated his space factors. They went into the
7 roll forward. They are in the Postal Service's test year
8 costs. I don't know how they are incorporated into
9 attachment C. I don't see space cost incorporated into the
10 attachment C.

11 Q Look back at page 2 of 3 in attachment C with me,
12 would you, please?

13 A Okay.

14 Q And look at the -- the number that's being
15 calculated there is the Postal Service calculation of cost
16 savings, correct?

17 A Calculated one way, yes.

18 Q Yes. And you told me **you** thought that got it
19 about right.

20 A Yes.

21 Q Does that number include space costs for the AFSM
22 100?

23 A Those savings do not include the space cost. The
24 space cost is -- this is a representation of how they are
25 calculated by the program managers and the additional space

1 costs, maintenance costs are calculated and put into the
2 roll forward as other programs.

3 Q Right. So the Buc number is comparable to the
4 number there displayed for the Postal Service savings, so if
5 one were focused on the differential between the Buc number
6 and the Postal Service number, we would be comparing
7 comparable things; is that right? Neither includes space
8 costs.

9 A Insofar as neither includes space cost, what I'm
10 criticizing is the way the differential is determined.

11 Q Well, if neither of them includes space cost and
12 you subtract one of them from the other, why isn't the
13 differential a perfectly valid number?

14 A It's a perfectly valid number for any number of
15 the assumptions there. Excuse me.

16 Q Just this one now. This one assumption is all
17 we're talking about at this time. With respect to space
18 cost, isn't the comparison that Mr. Buc is making perfectly
19 valid?

20 A Neither one has space cost.

21 Q Look back at page 3 of 3 now with me. You also
22 didn't like the number in column 5 where **Mr.** Buc reports
23 operational hours per work day and tells you that **the** number
24 is 20, 20 hours per work day for the AFSM 100.

25 Did you look at the source for that number? It's

1 down in Footnote 5.

2 A Yes. At one time, I verified that as a 20, yes.

3 Q You're critical of it, however. That's Ms.

4 Kingsley --

5 A I understand it's Witness Kingsley's 20 hours per
6 day, and the point I'm making in the entire calculation on
7 this attachment C, page 3, is that the 20 hours a day is the
8 goal of the Postal Service. This is, you know, a goal of
9 phase 1 implementation, and that, in combination with any of
10 the other assumptions, is an ideal assumption. The maximum
11 20 hours a day to realize instantaneously the first day of
12 the test year for all of the machines for the entire test
13 year is an optimistic outlook.

14 Q Well, Ms. Kingsley was very careful with me when I
15 talked with her about that number. I expressly asked her
16 for the number, and she was telling me about different kinds
17 of numbers that were involved, and she said, and I'm reading
18 now, "Well, the goal for the AFSM that we provided in
19 training -- I'm reading from Volume V, page 1961 of the
20 transcript -- training to the field has been that it should
21 run 20 hours a day." And I said, "Do you think that's a
22 reasonable goal?" "For the phase 1 machines, yes," said Ms.
23 Kingsley.

24 Now you're saying that Ms. Kingsley **is** wrong about
25 that; is that correct?

1 A I'm not saying that Ms. Kingsley is wrong. What I
2 am saying, that that is a goal. Ultimately, the Postal
3 Service hopes to get to that sort of operating environment,
4 but I don't see that as happening the very first day.

5 My understanding is that because a lot of these
6 machines aren't even in place yet, that 20 hours a day for
7 every machine right from the start of the test year **is** an
8 optimistic assumption.

9 Q Do you know when the last of the 173 machines will
10 be in place?

11 A I believe it's early next year, early 2001, not
12 the test year, the calendar year 2001.

13 Q Do you have any reason to think that Ms. Kingsley
14 didn't know when that deployment would be concluded? She
15 testified about it.

16 A I wouldn't question her one minute.

17 Q And so whatever she testified to is probably
18 right.

19 A Probably right.

20 Q Do you have a substitute assumption for which you
21 have evidence that you think would be a better number than
22 20 hours a day? Have you studied on this?

23 A I haven't studied this.

24 Q So you know 20 is wrong, but can't tell us what's
25 right?

1 A I'm just saying that 20 is optimistic.

2 Q Okay. And how about the next column over, column
3 6, which tells you operational days per year of 313. Did
4 you look at the source for that number?

5 A I believe I did.

6 Q Do you recall what it is?

7 A I could cheat and look at the footnote. If it's
8 her testimony, yes, I went back and looked at the
9 transcript.

10 Q Sure. And what Ms. Kingsley said at the point
11 cited in that footnote is that for the phase 1 machines,
12 they would be operational at least six -- and she used the
13 words "at least" -- six days a week, 52 weeks a year, and
14 that comes out to be -- you do the arithmetic, that's 313
15 days. Yet, you're critical of that number as well, aren't
16 you, Mr. Patelunas?

17 A Right now, I'm critical of that number in terms of
18 developing, of calculating the estimated cost reductions in
19 the test year.

20 Q Why? Do you mistrust **Ms.** Kingsley --

21 A It's not a matter of mistrust; it's a matter of
22 putting a lot of -- all of the optimistic operating
23 assumptions in place at the beginning of the test year.
24 They're instantaneous, they last for the entire test year.

25 Q Well -- go ahead. I'm sorry.

1 A The 169 million that originally appeared in
2 Witness Tayman's testimony was calculated by the program
3 managers who have to move the mail and have a -- have to
4 move the mail and realize what is achievable out there.

5 Taking every optimistic assumption and combining
6 it into a calculation may provide a nice goal. Prototypes
7 may provide nice goals. But as these -- as anything is
8 deployed, there, as I mentioned in my testimony, is a
9 learning curve time, that the assumption that everything is
10 going to operate optimally, get the maximum savings for the
11 full year is just overly optimistic.

12 Q Do you know how many of the AFSM 100s will be
13 deployed at the end of FY 2000?

14 A No, I don't.

15 Q Well, it's reported on page 1-12 of Library
16 Reference -- 1-83, Mr. Smith's library reference, that 158
17 of these machines will be in place at the end of FY 2000,
18 the beginning of the test year, in other words. Does that
19 change your assessment of the extent to which this notion
20 that everything is going to work instantaneously at the
21 beginning of the test year is over optimistic?

22 A No, it doesn't.

23 Q And explain to me why you think those 158 machines
24 that are in place at the beginning of the test year won't be
25 operating efficiently.

1 A They will still be experiencing the learning curve
2 development of integrating the AFSM 100 into the operating
3 environment.

4 Q And do you have specific facts that lead you to
5 that conclusion, or are you just operating on sort of a
6 Gestalt understanding that it takes time for things to
7 happen?

8 A I have spoken with the program managers and that
9 is their explanation, and it is not a Gestalt, but it seems,
10 to me, a reasonable assumption. As I mentioned at the
11 bottom, I believe -- yes, on the bottom of page 5, at line
12 22, even if you take all 173 machines and put them out there
13 in the world, you don't instantaneously flip a switch and
14 realize those savings. They do need to be integrated into
15 the entire national network of moving the mail.

16 Q But you can't quantify the extent to which there
17 will be lag?

18 A I can't quantify that.

19 Q We have been talking about 173 machines in place
20 by the end of the test year, by the end of November of 2000,
21 I believe is the testimony. Let me suggest to you that
22 there are probably more than that, and I am reading again
23 from the testimony of Ms. Kingsley. I will read just a
24 snippet of it. "So we would, in fact, have some machines
25 from Phase 2 deployed before the end of the test year."

1 Were you familiar with that testimony from Ms. Kingsley?

2 A I probably heard it. If you want to read on, I
3 can probably remember. I vaguely remember it.

4 Q "Well, can you tell me about when that would be in
5 the test year?

6 "Well, they pick up right after Phase 1, completed
7 in December of 2000. So we would envision at that time,
8 then we would go right into Phase 2."

9 The 173 is Phase 1, an additional 44 in Phase 2.

10 A Right.

11 Q So there are going to be more machines than those
12 on which Mr. Buc makes his calculation in the field during
13 the test year, is that your understanding?

14 A There will be more machines. But it is also my
15 understanding that, come November, that those 173 machines
16 will not be deployed. I believe that the entire Phase 1 is
17 not completed till early calendar year of 2001. And I am
18 not disputing what Ms. Kingsley said. I may, I am not sure
19 of this, but I may be pointing out part of the problem with
20 a deployment schedule, that things just don't march along as
21 if you were producing widgets off of a production line.

22 Q Well, now wait a minute. I thought we agreed that
23 whatever Ms. Kingsley said, you accepted as right. Are you
24 retrenching on that now?

25 A I don't know that we discussed 173 machines being

1 in place by November of 2000. We didn't discuss that
2 before, and I am not retrenching from anything, I didn't
3 agree to that before.

4 Q But if that were her testimony, would you agree to
5 it? Or do you think she has got it wrong in this
6 particular, too?

7 A I don't know that she is wrong. I will say that
8 it is my understanding that the 173 machines, the entire
9 Phase 1 deployment, isn't completed.

10 Q I am not asking your understanding, I am asking
11 you whether if your understanding were contradicted by the
12 testimony of Ms. Kingsley?

13 A If my understanding is contradicted by that? If I
14 am saying early 2001 calendar year and she is saying
15 November of this year, they would be in conflict, and I
16 don't -- I am not trying to override what she testified to.

17 Q Well, no, you know, we are trying to formulate a
18 record here. Figure out what is likely to happen. We are
19 projecting into the future a little bit.

20 A Okay.

21 Q And in that exercise, should we believe you or Ms.
22 Kingsley?

23 A Like I said, it is my understanding that the 173
24 machines will not be deployed **until** early 2001, and I think
25 that is the correct statement.

1 Q Look at the number in Column 3 of page 3 of 3 of
2 Mr. Buc's Attachment C. Do you have that?

3 A I see it, 15,000, yes.

4 Q Yes. Do you think that is a good number, 15,000
5 units per hour as the sorting capacity of the AFSM 100, do
6 you think that a good number?

7 A I don't have a reason to dispute that number. I
8 understand that there are different descriptions of what a
9 productivity is. I don't -- I am not going to dispute that
10 15,000.

11 Q Ms. Kingsley testified, and I am looking now at
12 page 1965 of Volume 5, she testified to me that it is closer
13 to 17,000, this is her testimony. She talked to me about a
14 theoretic maximum of 21,600, but said, you know,
15 realistically -- and she and I had quite a long colloquy
16 about the various measures of productivity, that you can
17 have an engineering measure, and then you get a real worldly
18 measure. She said, 21,600 is the engineering measure,
19 17,000 is a more real number.

20 Does that lead you to conclude, if I have accurate
21 characterized your testimony, that Mr. Buc's use of 15,000
22 is a conservative approach?

23 A I don't know that I would characterize it as
24 conservative. I am not quite sure how that measure is
25 compared to the 17,000 or the 21,000. I don't know that the

1 17,000 that Ms. Kingsley referred to is the full-up,
2 complete, you know, optimum real world, as opposed to
3 clinical world 21,000 operating environment.

4 I will say 15,000 is less than 17,000. I don't
5 know if I would characterize it as conservative or not
6 conservative.

7 Q I will settle for less than. Move now with me
8 over to Column 1 of page 3 of 3. These are the handling
9 costs that Mr. Buc uses in order to compare how much it
10 costs to do something either manually, in the case of
11 incoming secondary and AFSM 100, or in the case incoming
12 primary on the 881, as compared to the 100. Is that your
13 understand of what is going on here?

14 A Yes.

15 Q And do you have any reason to doubt the integrity
16 of any of those numbers? Are those good numbers?

17 A Within the context with which they were developed,
18 I wouldn't challenge the integrity of those numbers.

19 Q And what is your understanding of the context in
20 which they were developed?

21 A I believe those are used in the mail flow models.

22 Q Those are Postal Service numbers?

23 A They are Postal Service numbers.

24 Q They come out of the Yacobucci model, do they not?

25 A It is my understanding that they did. I have not

1 verified that, but I don't have reason to disagree with that
2 either. But being -- what they are developed for in that
3 context of the mail flow model is for particular rate case
4 situations. I won't disagree with those numbers in
5 particular. What I am trying to stress is that the program
6 managers who need to calculate the \$169 million used by
7 Witness Tayman try and include all the information they have
8 at their disposal, their experience and it is -- which lends
9 itself something more complex than these calculations.

10 These calculations aren't wrong in terms of the
11 mail flow model. I am questioning whether one applies mail
12 flow models to what the program managers calculated for the
13 cost savings for this program.

14 Q But I mean I was perplexed when you said these
15 numbers are in this funny context of a rate case. I mean
16 Mr. Buc's numbers are in the context of this rate case,
17 aren't they? I am not sure I take your point.

18 A My point is that both of those, these numbers, Mr.
19 Buc's numbers are in a rate case environment. Program
20 managers do not develop their cost savings for a rate case
21 environment. They are trying to operate in a real world in
22 which they have to move the mail.

23 Q Look back at page 2 of 3 of Attachment C.

24 A Yes.

25 Q That is the calculation of the Postal Service

1 estimation of cost savings. Do you have any understanding
2 of whether those numbers were developed with the input of
3 the field people that you are talking about?

4 A May I ask the question again?

5 Q Sure. Where did those numbers come from, and were
6 they informed at all by this real world, practical vision
7 that you have just been talking with me about, do you know?

8 A Yes.

9 Q Okay. Page 5 of your testimony, on lines 18 and
10 19, there appears this sentence, "I further understand that
11 the mail volume needed to optimize machine utilization may
12 not be present at all facilities." I take it you mean
13 during the test year, is that right?

14 A Yes.

15 Q And what is the source? You don't have a footnote
16 or anything there, so I am hard put to know where you
17 learned that.

18 A Discussions with program managers, experience in
19 how these programs need to go through Catch-ball process,
20 and get put into the budget.

21 Q Did you talk, per chance, with Postal Service
22 Witness Unger about this question?

23 A No, I didn't.

24 Q Do you think Mr. Unger might know what he's
25 talking about, if he talked about this question?

1 A I have no reason to think that he wouldn't know
2 what he's talking about.

3 Q Well, I ask the question because he had a
4 substantially different answer to the issue of the presence
5 of mail volume.

6 PostCom asked him a question about that. It's
7 PostCom/USPS-ST-43-7, which appears in Volume 21 at page
8 8180 and 8181 of the transcript.

9 And we asked him a question that said, what do you
10 think about the volume? Again, I have enough nice, clean
11 volume out there in the test year to efficiently run the
12 AFSM-100.

13 And his answer is this: Yes, during the initial
14 deployment -- and the subpart (c) of that interrogatory --
15 yes, during the initial deployment of the AFSM-100s -- this
16 is not even test year, but pre-test year -- the potential
17 volume of suitable mail will be greater than the capacity of
18 the machines to be deployed.

19 Do you think he was wrong about that?

20 A I don't think that he was wrong. I think that
21 that said the initial deployment. What I'm looking at is
22 the entire test year in all of the machines in all of their
23 operations.

24 And it would be reasonable to deploy a machine, a
25 number of machines, where there is excess capacity, to try

1 and -- or excess volume, and try and use all of that volume.

2 As you get down towards the end of the deployment,
3 that same, that initial volume may not be in all of those
4 facilities.

5 Q You've talked a lot about the budget process. Can
6 you explain to me how that works?

7 And that's how you get the input from the field
8 folks and all that, right?

9 A Yes.

10 Q You refer in your testimony at page 6 on line 6 to
11 something called the Postal Service's, quote, "Catch-ball,"
12 end quote, process.

13 Can you describe that, that process?

14 A The next sentence pretty much describes it. It's
15 negotiations between the field, program managers,
16 headquarters, on, for example, the AFSM-100s deployment in
17 2001; how it can be deployed; what its deployment schedule
18 is; what the possible savings might be; what the additional
19 costs may be.

20 And through those negotiations, the Postal Service
21 arrives at an agreement that results in the budget items,
22 for instance, the savings in the cost of the AFSM-100.

23 Q Let me read you just a sentence from an
24 interrogatory, and institutional answer to an interrogatory
25 directed to you that you handed back off to the Postal

1 Service.

2 Just tell me whether you know anything about what
3 this sentence means: Earning a net income is a critical
4 component of the Postal Service's FY 2000 incentive
5 compensation plan.

6 Does that ring any bell at all with you; could you
7 explain to me what that means?

8 A I've read the response. I'm not an expert on
9 incentive programs.

10 But it's my understanding that if managers achieve
11 part of the incentive program, the pay will -- is relative
12 to achieving a net income.

13 Q They're going to -- the managerial kind of folks
14 are going to be gauged against the extent to which they
15 successfully meet or exceed budgetary objectives; isn't that
16 the way it works?

17 A I'm not sure what the standard by which they meet
18 or exceed; I don't know if it's they meet or exceed a budget
19 or another standard. As I said, I'm not an expert; I just
20 understand there's an incentive system at work.

21 Q Well, suppose with me, just hypothetically, that
22 there is some compensation that is contingent on meeting or
23 exceeding budgetary standards; is that a concept that you
24 can grasp?

25 A I can grasp the concept. I don't know that I can

1 make that hypothetical because I just -- I don't know that
2 there's a budget standard in which this incentive system
3 works.

4 Q That's why we have hypotheticals, Mr. Patelunas.
5 Just grasp that hypothetical for me.

6 A I'll do my best.

7 Q Okay.

8 And let me ask you, would there be an incentive to
9 a manager helping to formulate the budget, if that
10 hypothetical compensation standard were in place, to
11 under-estimate the productivity **of** the AFSM-100, because by
12 that under-estimation, if the machine really performed as
13 well as it's supposed to, he would exceed budget? He'd have
14 greater cost savings than the budget anticipated?

15 Now, that's a hypothetical in a hypothetical.

16 A I understand it's a hypothetical and a
17 hypothetical. If they were double negatives, they'd cancel
18 each other out.

19 That's probably a good reason not to have an
20 incentive system tied to a budget system in which the person
21 receiving the incentive builds the budget.

22 And that's what I -- I understand your
23 hypothetical. I can grasp the idea. I just don't think
24 that that's what's in place, for the very reason that I
25 stated; that the person making the budget would be rewarded

1 relative to that budget.

2 Q And that would be a bad managerial plan, is what
3 you're saying?

4 A It could be.

5 Q But if it did exist, is the suggestion that I made
6 a reasonable one; that there would be?

7 I'm not saying anybody's going to overtly cheat or
8 anything like that, because I happen to have a great lot of
9 respect for Postal Service folks.

10 But isn't there just an innate incentive for that
11 to happen? Because you want to look good at the end of the
12 day?

13 A So this is an innate -- this is a human nature
14 question, and assuming that this is a hypothetical on a
15 hypothetical, if the person building the budget was incented
16 on achieving that budget, there certainly would like a
17 psychological propensity at least consider that incentive
18 when they built the budget.

19 Q And when we were talking not about savings items,
20 but about cost items like supervisor costs, wouldn't that
21 same incentive lead the budget-making manager to tend to
22 understate those supervisory costs?

23 A We're back in the same situation of making this
24 hypothetical that I don't know that it exists.

25 But assuming that the hypothetical holds all

1 across the line, you would have the same argument there.

2 MR. WIGGINS: Thank you, Mr. Patelunas. Mr.

3 Chairman, I have nothing further.

4 CHAIRMAN GLEIMAN: Followup?

5 [No response.]

6 CHAIRMAN GLEIMAN: There may be a question from
7 the Bench.

8 Do you have your testimony with you, your rebuttal
9 testimony?

10 THE WITNESS: I believe I do.

11 CHAIRMAN GLEIMAN: Well, how about opening up to
12 page 2 and reading me the sentence that starts in the middle
13 of line 6, "The approach..."

14 THE WITNESS: "The approach used in the rate case
15 is consistent with the way the Postal Service's operating
16 budgets are determined.

17 CHAIRMAN GLEIMAN: Now, let me ask you a question:
18 Are Postal Service operating budgets developed in the real
19 world?

20 THE WITNESS: Yes.

21 CHAIRMAN GLEIMAN: Thank you. Now, when you were
22 last here -- and this doesn't relate to the rebuttal
23 testimony per se, but perhaps it does in light of the fact
24 that there is a statement about operating budgets in the
25 rebuttal testimony.

1 You an object, if you want, and I'll rule in your
2 favor.

3 [Laughter]

4 CHAIRMAN GLEIMAN: We asked about operating
5 budgets. Do you know whether we have gotten the operating
6 budget for this year in the detail that we asked for it, or
7 the operating budget for last year in the detail that we
8 asked for it? Forget about next year's for the moment.

9 THE WITNESS: I believe there was a response that
10 referred to financial operating statistics, et cetera.

11 CHAIRMAN GLEIMAN: Counsel, could you check to see
12 if we've gotten a response? I get a lot of paper across my
13 desk, and sometimes I get confused about what I've seen and
14 what I haven't seen.

15 But I don't recall having received the operating
16 budgets for last year or the year before, and I do believe
17 we did request them.

18 And not in the detail or the lack of detail that
19 they were included in an interrogatory response to an OCA
20 interrogatory.

21 MR. REITER: My recollection, generally, is that
22 there was a response to the question. I don't have the
23 exact citation right in front of me.

24 CHAIRMAN GLEIMAN: Well, perhaps you can enlighten
25 me when next we break and then return, because I don't

1 recall having seen an operating budget.

2 But as I said, there is a lot of paper flowing
3 around, and maybe I just missed it.

4 But it's good to know that operating budgets are
5 developed in the real world and with the approaches used in
6 rate cases.

7 I don't have any further questions. Does anyone
8 else?

9 COMMISSIONER OMAS: No.

10 CHAIRMAN GLEIMAN: Followup to questions from the
11 Bench?

12 [No response.]

13 CHAIRMAN GLEIMAN: Would you like some time with
14 your witness to prepare for redirect?

15 MR. REITER: Yes, Mr. Chairman.

16 CHAIRMAN GLEIMAN: How about ten minutes?

17 MR. REITER: I think that will be sufficient.

18 CHAIRMAN GLEIMAN: Thank you, you've got it.

19 [Recess.]

20 CHAIRMAN GLEIMAN: Mr. Reiter, before you get
21 started, I have solve the mystery. We did indeed get a
22 response, and I guess that I didn't think of it as -- it
23 wasn't what I thought we would be getting, because it
24 basically said, as I now recall, that we get accounting
25 period reports and, in effect, the accounting period reports

1 are the operating budget.

2 And if I am correct in my understanding of it is
3 that we got in the way of a response, what I would like to
4 know is whether the Postal Service can provide us with an
5 actual copy of a piece of paper that went to the Governors
6 that had the accounting period reports with a whole bunch of
7 blanks, except for the top line, which is, you know, the
8 thing, I guess, -- you know, I am not sure how I can figure
9 -- I can back in to what the budget is because it says
10 actual and variance of the budget. And I guess if I know
11 the actual and I know the actual and I know the variance of
12 the budget, having taken a basic arithmetic course, I can
13 figure out what the budget was.

14 But I am just kind of curious as to what it is
15 that goes in that book to the Governors. This year I
16 understand it won't go to the Governors until October, which
17 may be the latest that the budget has ever gone to the
18 Governors for approval. It is certainly not on their agenda
19 for the meeting next week, or the one, the next meeting that
20 is coming up.

21 But, you know, perhaps just to satisfy my
22 curiosity, if somebody at the Postal Service can find an
23 actual document that represents what it was in the
24 accounting period reports that actually went to the
25 Governors and that they approved, not for next year, because

1 they haven't done that yet, but for the current year, that
2 -- I mean it would just make my life a lot easier. I mean I
3 would have to go through all those arithmetic calculations
4 to figure out what the budget actually was. I mean
5 inquiring minds want to know. Do the Governors really get a
6 detailed budget that has a whole lot of blank spots in
7 there, you know, that then get filled in and become
8 accounting period reports?

9 MR. REITER: I believe there was -- I don't have
10 that answer in front of me, but the one that you looked up
11 did say something about what goes to the Governors.

12 CHAIRMAN GLEIMAN: No, I don't want it to say what
13 goes to the Governors. I want to see what goes to the
14 Governors. There is a difference. I am a touchy-feely kind
15 of person, I want a piece of paper, not an explanation of a
16 piece of paper that exists somewhere else.

17 MR. REITER: I will see what I can find out.

18 CHAIRMAN GLEIMAN: And I don't want any
19 predecisional documents at this point. I just want to see,
20 you know, a decisional document, you know, what they made
21 the decision on for the current year. That would be great,
22 just to help me understand and put into perspective some of
23 the statements that have been made about how things are real
24 world or not real world.

25 MR. REITER: I will bring that question back and

1 we will let you know what we can do.

2 CHAIRMAN GLEIMAN: It sure would make my life a
3 little easier and maybe, in turn, make everyone else's life
4 on your side a little easier.

5 Now, having given you a hard time, it is your turn
6 for redirect.

7 MR. REITER: If I remember the question.

8 CHAIRMAN GLEIMAN: I am sure you do. And that
9 wasn't a ploy to make you forget either.

10 REDIRECT EXAMINATION

11 BY MR. REITER:

12 Q Mr. Patelunas, earlier you made a reference, I
13 believe, to real world numbers and it may have appeared that
14 you were making a distinction between the real world and the
15 rate case. Would you like to clarify your remark?

16 A I will clarify that remark. Those comments were
17 in the context of a mail flow model that was in one of the
18 exhibits. And the mail flow models make simplifying
19 assumptions across the national average, whereas, the cost
20 reduction savings calculated by the program managers are
21 able to take advantage of additional information,
22 site-specific information for example.

23 MR. REITER: That's all I have, Mr. Chairman.

24 CHAIRMAN GLEIMAN: Sorry, Mr. Wiggins.

25 MR. WIGGINS: I have no questions, Mr. Chairman.

1 CHAIRMAN GLEIMAN: If that is the case, then if no
2 one else has any recross, then, Mr. Patelunas, that allows
3 you to escape yet again.

4 Do you know, do you have any significance that you
5 could assign to the number of 472? Does that mean anything
6 to you?

7 THE WITNESS: 472?

8 CHAIRMAN GLEIMAN: Four. Four.

9 THE WITNESS: 472.

10 CHAIRMAN GLEIMAN: Yes.

11 THE WITNESS: Not off the top of my head.

12 CHAIRMAN GLEIMAN: Somebody told me that was the
13 number of times you have said "I don't know" in the
14 proceedings in R2000-1, although, you know, I wouldn't
15 necessarily agree that the number was that high.

16 THE WITNESS: I don't think it is that low.

17 [Laughter.]

18 CHAIRMAN GLEIMAN: You may be right. And I am not
19 sure you want to -- maybe if it is a higher number, you can
20 justify one of those bonuses that you don't know how they
21 are calculated.

22 But, in any event, that completes your testimony
23 here today. We thank you for your contributions as they are
24 to our record, and you are excused.

25 [Witness excused.]

1 CHAIRMAN GLEIMAN: Mr. Ackerly, I believe you have
2 the next witness.

3 MR. ACKERLY: I call Lawrence G. Buc to the stand.

4 CHAIRMAN GLEIMAN: Whenever you are ready. Mr.
5 Buc is already under oath, we don't to swear him in. So you
6 may proceed, counsel.

7 Whereupon,

8 LAWRENCE G. BUC,
9 a witness, having been recalled for examination and, having
10 been previously duly sworn, was examined and testified
11 further as follows:

12 DIRECT EXAMINATION

13 BY MR. ACKERLY:

14 Q Mr. Buc, I am handing you a copy of a document
15 entitled "The Supplemental Testimony of Lawrence G. Buc on
16 Behalf of Direct Marketing Association," and a relatively
17 long list of other Intervenors. It is identified as
18 DMA-ST-2. Did you prepare this testimony **or** was this
19 testimony prepared under your direction or control?

20 A I did prepare it.

21 Q Do you adopt this testimony as your testimony in
22 this proceeding?

23 A I do.

24 MR. ACKERLY: Mr. Chairman, I am handing two
25 copies of this document to the reporter. I ask that it be

1 transcribed in the record and admitted into evidence.

2 CHAIRMAN GLEIMAN: Is there objection?

3 [No response.]

4 CHAIRMAN GLEIMAN: Hearing none, the testimony
5 will be transcribed into the record and received into
6 evidence.

7 [Supplemental Testimony of Lawrence
8 G. Buc, DMA-ST-2, was received into
9 evidence and transcribed into the
10 record.]

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DMA-ST-2

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON DC 20268-0001

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

SUPPLEMENTAL TESTIMONY
OF
LAWRENCE G. BUC

ON BEHALF OF

DIRECT MARKETING ASSOCIATION, INC.
ADVO, INC.
ALLIANCE OF INDEPENDENT STORE OWNERS AND PROFESSIONALS
ALLIANCE OF NONPROFIT MAILERS
AMERICAN BUSINESS MEDIA
ASSOCIATION FOR POSTAL COMMERCE
ASSOCIATION OF PRIORITY MAIL USERS, INC.
DOW JONES & COMPANY, INC.
FLORIDA GIFT FRUIT SHIPPERS ASSOCIATION
GREETING CARD ASSOCIATION
MAGAZINE PUBLISHERS OF AMERICA
MAJOR MAILERS ASSOCIATION
THE MCGRAW-HILL COMPANIES, INC.
PARCEL SHIPPERS ASSOCIATION
TIME WARNER INC.

Communications Concerning This
Testimony Should **Be** Addressed **To:**

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202-662-5296

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1 **Autobiographical Sketch**

2 My name is Lawrence G. Buc. My autobiographical sketch appears in my direct
3 testimony in this case: DMA-T-1.

4 **I. Purpose and Scope of Testimony**

5 For this testimony, I reviewed the supplemental testimony of Richard
6 Patelunas on behalf of the Postal Service in response to Postal Rate
7 Commission Order No. 1294. (USPS-ST-44) Although the Postal Service has
8 stated that Patelunas' estimates do not constitute a revision to its proposed cost
9 and revenue estimates (and, by extension, to its revenue requirement)
10 (Response of the United States Postal Service to OCA/USPS-ST44-8 redirected
11 to the Postal Service), witness Patelunas provides the most current estimates of
12 Test Year costs. Thus, it is important to review them and correct any errors and
13 omissions. Further, if Patelunas' cost estimates are the basis for a revised
14 revenue requirement, it is also necessary to explore the appropriate contingency
15 to accompany these cost estimates.

16 In this testimony, I review the appropriate contingency given the method
17 and timing of witness Patelunas' cost estimates and re-estimate the savings for
18 the Advanced Flat Sorting Machine 100 (AFSM 100) that I presented in my direct
19 testimony, based on flat sorting productivities for FY 1999. I conclude that the
20 appropriate contingency to accompany the new Test Year estimates is one
21 quarter of one percent and that savings from deploying the AFSM 100 are
22 \$402.4 million, an increase of \$30.9 million over my previous estimate. The
23 details of my analysis follow.

24 **II. The Contingency Should be One Quarter of One Percent**

25 My direct testimony in this case demonstrated that a one percent
26 contingency was both reasoned and reasonable, given the evidence supporting
27 the Postal Service's Revenue Requirement. I reviewed witness Patelunas'
28 testimony to determine if he provided additional information which would change
29 my analysis of the proper contingency. In light of his new cost estimate for the

1 Test Year, I believe that an even lower contingency – one quarter of one percent
2 - is warranted. There are four reasons for reducing the contingency to this level.

3 First, shifting the basis of the wage increase for all employees whose
4 contracts will expire during the Test Year and for non-bargaining unit employees
5 from one percentage point less than the Employment Cost Index (ECI) to the ECI
6 reduces the risk of unforeseen and unforeseeable expenses. Because the
7 purpose of the contingency is to defray these unforeseen and unforeseeable
8 risks, this reduction in risk should be reflected in a reduced contingency.

9 Second, the Postal Service's additional cost reductions reflect neither the full
10 savings that the Postmaster General has committed to achieving nor, following
11 the Postal Service's revised response to Presiding Officer's Information Request
12 14, the full cost reductions in the FY 2001 budget. Thus, the risk of not achieving
13 the expected cost reduction savings in the **TYAR** estimate is reduced.

14 Consequently, there is a high probability that costs in the Test Year will be less
15 than those the Postal Service has estimated. This should be reflected in a
16 reduced contingency. Third, the simple timing of the new cost estimate reduces
17 some of the risk inherent in the Postal Service's original cost estimate. This, too,
18 should reduce the contingency. Fourth, the very exercise of the recalculation of
19 W A R costs shows that a smaller contingency is warranted. Following, I address
20 each of these issues.

21 **A. The Use of ECI for Wage Settlements Rather than ECI-1 Warrants a**
22 **Smaller Contingency**

23 In its original filing, the Postal Service used a percentage point lower than
24 the ECI as an estimate of the percentage increase in pay that employees will
25 receive whose contracts expire during the Test Year and for non-bargaining unit
26 employees. Witness Patelunas has revised this estimate of the percentage
27 increase to the ECI (**USPS-ST-44** at 3), although he has provided no rationale for
28 doing so.

29 Since estimates of inflation have increased between the time of the
30 original and the revised filing (see Exhibit **USPS-ST-44 AB**). witness Patelunas is
31 conceptually correct to use more recent estimates of the ECI as the basis of his

1 forecast of TYAR costs. And costs that result from increases in the ECI, in
2 contrast to those from changing the basis of the estimate from ECI-1 to ECI, are
3 valid costs in revised TYAR estimates. By increasing the basis for the wage
4 settlement and including these increases in the costs of the various cost
5 segments, however, the Postal Service has reduced the risk to which it is
6 exposed in new wage settlements by the same amount **as** it has increased its
7 estimate of labor costs. Thus, the contingency should be reduced by this
8 amount.

9 **As** an illustration, assume that the Postal Service had originally estimated
10 that labor cost increases for those employees with agreements expiring in the
11 Test Year would be \$500 million. Because there is uncertainty in this estimate,
12 part of the contingency can be thought of as reflecting this risk. Now, further
13 assume that using the ECI assumption instead of the ECI-1 assumption, the
14 revised labor cost increase for these employees is \$700 million, or \$200 million
15 more than was previously estimated. Finally, now assume that the actual
16 settlement will be \$800 million.

17 Under the original request based on ECI-1, the actual settlement will be
18 \$300 million more than the estimate, **so** the Postal Service would have had
19 unforeseen costs of \$300 million. Under a revised request based on ECI, the
20 settlement will be only \$100 million more than estimated. Thus, unforeseen
21 costs under a revised request are \$200 million less than under the original
22 request (the precise increase in labor costs) and the contingency should be
23 reduced by this same amount.

24 I used Library Reference 421 to explore the cost consequences of using
25 ECI rather than ECI-1. Specifically, I calculated cost level changes using both
26 ECI and ECI-1, keeping everything **else** constant. Cost level changes appear in
27 **Acc_0r.xls**. After establishing links between **Uncst_est.xls** and **Input_0r.xls**, the
28 cost level changes using both ECI and ECI-1 flowed through to **Acc_0r.xls**.
29 Results from this analysis are in Attachment DMA ST2-A. Table 1, below, shows
30 that changing from ECI to ECI-1 increases costs by \$246.6 million. The
31 contingency must be reduced by this amount to reflect the reduction in risk.

1 TABLE 1: SUMMARY OF ANALYSIS OF CHANGES IN TYAR PERSONNEL
 2 COST LEVELS BETWEEN ECI AND ECI-1

3 (\$000)

Total Cost Level At ECI-1	Total Cost Level At ECI	Difference
[1]	[2]	[3]
\$2,290,167	\$2,536,809	\$246,642

[1] Attachment DMA ST2-A.xls, 'Summary', cell C27.

[2] Attachment DMA ST2-A.xls, 'Summary', cell D27.

[3] Attachment DMA ST2-A.xls, 'Summa?', cell E27.

4 B. Because **Postal** Service Cost Reduction Estimates are Lower than those
 5 the **PMG** has Committed to, the Contingency should be Reduced

6 Although the Postmaster General has committed in public to reducing costs in
 7 the Test Year by an additional one billion dollars over the amount in the Postal
 8 Service's January filing (See "Breaking Through to a New Golden Age of Mail"
 9 Remarks by William J. Henderson, Postmaster General/CEO United States
 10 Postal Service at the National Postal Forum, Nashville, Tennessee – March 20,
 11 2000, Attachment DMA-ST2-B), witness Patelunas includes only an additional
 12 \$544 million of cost reductions in his estimates. (Revised Response of United
 13 States Postal Service to Presiding Officer's Information Request No. 14, Item
 14 2(b) and (e) Errata, response b) Thus, the Postal Service's cost reductions are
 15 \$456 million less than those the Postmaster General has announced. When
 16 asked from the bench whether it was possible that the savings could be larger
 17 than reflected in his TYAR estimates, witness Patelunas responded, "It is
 18 possible. I said in one of the responses, it continues to evolve." (Tr. 35/16811)

19 Further, although cost reduction programs reflect many draft **FY** 2001 budget
 20 decisions, the cost reductions witness Patelunas has used in his cost forecast for
 21 TYAR as reflected in his Errata to POIR 14, are \$200 million less than the cost
 22 reductions in the budget. If he had used the budget estimates of cost reductions,
 23 Patelunas confirmed that the revenue requirement would have been \$200 million
 24 less. (Tr. 35/16812)

25 The purpose of the contingency is to provide for unforeseen and
 26 unforeseeable events; it is important to recognize that these events could have
 27 positive effects on costs rather than only negative effects. Given that the Postal

1 Service is committed to reducing costs beyond those levels estimated in its cost
 2 forecasts, as manifested in speeches by the Postmaster General and in the
 3 budget, the risk of actual costs that exceed estimates should be correspondingly
 4 less and the contingency should be reduced to reflect this fact. At a minimum,
 5 the contingency should be reduced by the \$200 million of cost reductions that
 6 appear in the draft budget but not in the Postal Service's response to Order No.
 7 1294. Phrased another way, the contingency should be reduced by \$200 million
 8 of the \$456 million that the Postmaster General has announced that the Postal
 9 Service will save but that are not in the Postal Service's filing in response to
 10 Order No. 1294.

11 **C. The Timing of the New Cost Estimate Warrants a Smaller Contingency**

12 The Postal Service filed the Supplemental Testimony of Richard
 13 Patelunas on July 7, 2000. Since the original request was filed on January 12,
 14 2000, the original filing was about 8.5 months before the start of the Test Year
 15 while the Supplemental Testimony was filed less than three months before its
 16 start.

17 **As** forecasting horizons become longer, outcomes become more uncertain
 18 and the risk of an outcome lying well outside of the forecast increases. **As**
 19 forecasting horizons become shorter, outcomes become more certain and the
 20 risk of an outcome lying outside of the forecast decreases. The contingency
 21 should be reduced to reflect the reduction in risk given the new forecast.

22 **D. The Postal Service's Re-estimation of N A R Cost Shows that a Lower**
 23 **Contingency is Warranted**

24 In a sense, Patelunas' revised TYAR cost estimate provides an
 25 experiment to determine the sensitivity of the deficiency with respect to changes
 26 in inflation rates. The experiment **shows** that the deficiency **is** not very sensitive
 27 to changes in inflation rates. **As** he shows, it is almost inconceivable that inflation
 28 could change enough to warrant even the 1 percent contingency I recommended
 29 in my direct testimony, much less the 2.5 percent contingency that the Postal
 30 Service requested. Consequently, the contingency should be reduced.

1 As witness Patelunas shows in Exhibit USPS-ST-44AB, there have been
 2 substantial increases in key inflation indices since the original filing (although ~~the~~
 3 changes in the CPI-W and the ECI are not large enough to change the
 4 conclusions I drew in my original testimony.) Notwithstanding these changes in
 5 inflation rates and the choice of an upward revision in the wage settlement to ECI
 6 from ECI-1, the effect on net income is almost trivial.

7 In his testimony as originally filed, Patelunas calculates "a test year after
 8 rates deficiency of \$275.3 million. This compares to ...a test year after rates
 9 deficiency of \$21.8 million, reflected in the Request." (USPS-ST-44 at 8-9) Thus,
 10 the net effect of the re-estimation of TYAR costs, after adjusting to include the
 11 additional \$200 million of Field Reserve as cost reductions, is to increase the
 12 TYAR deficiency by \$253.5 million dollars. With an estimate of \$67.190 billion for
 13 the Postal Service's original TYAR cost estimate (USPS-T-9 at 22). the increase
 14 in the revenue deficiency represents only 0.38 percent of the original TYAR cost
 15 estimate.

16 **III. Using Updated Sorting Productivities from FY 1999 Increases AFSM 100**
 17 **Cost Savings by an Additional \$30.9 Million**

18 In my direct testimony, as revised in response to USPS/DMA T-1-13. I
 19 estimated savings of \$371.5 million in the Test Year from deploying the AFSM
 20 100. In contrast, the Postal Service estimated savings of \$169.4 million. (Tr. 22/
 21 9553)

22 I have revised my estimate of AFSM savings in the Test Year using
 23 available information on sorting productivities in FY 1999. Using exactly the
 24 same method as I used previously, but replacing sorting productivities from 1998
 25 with those from 1999 (PostCom/USPS-ST43-6a redirected to USPS, Attachment
 26 1 at 1). yields savings of \$402.4 million, an increase of \$30.9 million over my
 27 previous estimate. Attachment DMA ST2-C provides the derivation of my revised
 28 estimates. My estimate of savings remains conservative for all the reasons I
 29 cited in my direct testimony; further, I have not increased the estimate for the
 30 increased clerk and mailhandler wage rates in the Test Year.

SUMMARY OF ANALYSIS OF CHANGES IN TYAR PERSONNEL COST LEVELS

EEN ECI AND ECI-1

(\$ 000)

COST SEGMENT	TOTAL COST LEVEL AT ECI-1	TOTAL COST LEVEL AT ECI	DIFFERENCE
	[1]	[2]	[3]=[2]-[1]
1 Postmasters	\$ 73,689	\$ 74,038	\$ 349
2 Supervisors and Technical Personnel	137,436	138,082	646
3 Clerks & Mail Handlers, CAG A-J (Incl SDMsgs)	854,859	1,033,369	178,510
4 Clerks, CAG K Post Offices	430	524	94
6&7 City Delivery Carriers	861,413	862,416	1,003
8 Vehicle Service Drivers	21,375	26,005	4,630
10 Rural Carriers	181,496	217,178	35,683
11 Custodial & Maintenance Services	107,547	128,916	21,369
12 Motor Vehicle Service	13,815	16,485	2,671
13 Miscellaneous Local Operations	2,066	2,146	81
14 Purchased Transportation of Mail	-	-	-
15 Building Occupancy	-	-	-
16 Supplies and Services	712	811	99
17 Research & Development	-	-	-
18 Headquarters and Area Administration	35,210	36,717	1,507
19 Equip. Maintenance & Mgt Tng. Spl.	121	122	1
20 Depreciation, Write-offs, Losses, & Interest	-	-	-
Total	\$ 2,290,167	\$ 2,536,809	\$ 246,642

[1] - USPS-LR-I-421 Order No. 1294/Rollforward Expense Factors (Patelunas), Acc_Or.xls, 'Est. Year 2'. Change made in Uncst_est.xls, 'COLA-ECF', cell D53 to decrease the value of the FY 2001 Percent Change by 1.0%.

[2] - USPS-LR-I-421 Order No. 1294/Rollforward Expense Factors (Patelunas), Acc_Or.xls, 'Est. Year 2'.

ANALYSIS OF CHANGES IN PERSONNEL COST LEVELS BETWEEN ECI AND ECI-1
(\$ 000)

COST SEGMENT	SALARIES										
	CARRYOVER COSTS - PAY			PAY			STEP/MERIT		CHANGE		
	ECI-1	ECI	CHANGE	ECI-1	ECI	CHANGE	ECI-1	CHANGE	ECI-1	CHANGE	ECI-1
	[1]	[2]	[3]=[2]-[1]	[4]	[5]	[6]=[5]-[4]	[7]	[8]=[7]	[9]=[8]-[7]		
1 Postmasters	12,245	12,245	-	39,917	40,211	294	-	-	-		
2 Supervisors and Technical Personnel	22,648	22,648	-	73,779	74,322	543	-	-	-		
3 Clerks & Mail Handlers, CAG A-J (Incl SDMsgtrs)	23,303	23,303	-	214,370	344,698	130,328	-	-	(309)		
4 Clerks CAG K-Dist Offces	12	12	-	116	100	70	-	-	40		
8 Vehicle Service Drivers	622	622	-	5,517	8,961	3,444	-	-	623	(22)	
10 Rural Carriers	12,751	20,777	8,027	33,636	55,412	21,776	-	-	5,421	61	
11 Custodial & Maintenance Services	4,292	4,292	-	29,962	45,893	15,931	-	-	2,884	(101)	
12 Motor Vehicle Service	607	607	-	3,953	5,944	1,991	-	-	361	(13)	
13 Miscellaneous Local Operations	271	271	-	944	1,005	61	-	-	10	(0)	
14 Purchased Transportation of Mail	-	-	-	-	-	-	-	-	-	-	
15 Building Occupancy	-	-	-	-	-	-	-	-	-	-	
16 Supplies and Services	55	55	-	256	330	74	-	-	13	(0)	
17 Research & Development	-	-	-	-	-	-	-	-	-	-	
18 Headquarters and Area Administration	4,430	4,430	-	15,617	16,753	1,135	-	-	185	(6)	
19 Equip. Maintenance & Mgt Tng. Spt.	20	20	-	67	67	0	-	-	-	-	
20 Depreciation, Write-offs, Losses, & Interest	-	-	-	-	-	-	-	-	-	-	
Total	128,321	136,347	8,027	720,030	896,465	176,435	99,120	(391)			

[1], [4], [7], [10], [13], [16] - USPS-LR-1-421 Order No. 1294/Rollforward Expense Factors (Patelunas), Acc. Dr. xis, 'Est. Year 2'. Change made in Urnst_est.xls, 'COLA-ECI', cell D53 to decrease the value of the FY 2001 Percent Change by 1.0%.

[2], [5], [8], [11], [14], [17] - USPS-LR-1-421 Order No. 1294/Rollforward Expense Factors (Patelunas), Acc. Dr. xis, 'Est. Year 2'.

ANALYSIS OF CHANGES IN PERSONNEL COST LEVELS BETWEEN ECI AND ECI-1 (CONT.)
(\$ 000)

ROLLUP PREMIUM		ROLLUP LI, RET, TSP		ROLLUP SS, MED		TOTAL CHANGE	
ECI-1	CHANGE	ECI-1	CHANGE	ECI-1	CHANGE	ECI-1	CHANGE
[10]	[12]=[11]+[10]	[13]	[15]=[14]+[13]	[16]	[18]=[17]+[16]	[19]=[3]+[6]+[9]+[12]+[15]+[18]	
2,418	2,432	5,372	5,402	4,134	4,145	11	349
4,472	4,498	9,936	9,992	7,754	7,775	21	646
99,096	123,276	62,018	77,321	36,494	45,503	9,009	178,510
42	52	33	41	17	22	5	94
100,429	100,567	72,259	72,259	40,825	40,902	77	1,003
2,034	2,565	1,666	2,101	929	1,172	243	4,630
5,415	6,431	10,253	12,906	9,665	11,814	2,149	35,683
9,666	12,116	8,335	10,351	4,598	5,672	1,073	21,369
1,221	1,527	1,073	1,325	598	731	134	2,671
84	93	141	148	102	105	4	81
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
52	63	53	63	32	37	5	99
-	-	-	-	-	-	-	-
1,449	1,614	2,357	2,497	1,695	1,768	74	1,507
4	4	9	9	7	7	0	1
-	-	-	-	-	-	-	-
226,382	255,238	173,504	194,414	106,849	119,654	12,804	246,642

ATTACHMENT DMA ST2-B

March 20, 2000 - REMARKS BY POSTMASTER GENERAL AND CEO WILLIAM HENDERSON AT THE POSTAL FORUM - NASHVILLE. TN

FOR **IMMEDIATE** RELEASE

Breaking Through to a New Golden Age of Mail

Remarks by William J. Henderson,
Postmaster General/CEO United States Postal Service
at the National Postal Forum
Nashville, Tennessee - March 20, 2000

At National Postal Forum in Chicago, I told you that my job is to make you successful. I also talked about the Postal Service's trusted presence **as** the Gateway to the Household. And we talked about what we call the mail moment - the time when the mail arrives and everybody stops what he or she is doing to read it.

I promised you that - even under the pressures of the digital age - we would do everything in our power to keep the mail relevant. I promised that we would focus **on** the quality and value **of our** core products. That we would reduce costs and manage efficiently. That we would ensure that the mail moment does not lose its power and value to our nation.

We have delivered. We delivered more than **200** billion pieces **of** mail to 130 million households and businesses over the past year, the most in our history. Our standard **of** service has never been higher. Everyone from America's established business community to its emerging dotcoms continues to rely **on** our ubiquitous presence and universal service to promote their images, improve their sales, and secure their revenues.

Mail is relevant in the digital age because it reaches every address. Michael Dell, the founder and chief executive **of** Dell Computer, recently told me that his catalog mailings account for the largest percentage of his sales of personal computers. He understands the power and value of **our** Gateway. **So** do many others.

Studies by Pitney Bowes say that two-thirds of the e-business companies they surveyed believe that mail is the best medium for developing long-term customer relationships. Seven out of 10 **use** direct mail to promote their web sites and **to** attract new customers.

K-Mart -- another of **our** partners represented in this Forum -- has rediscovered **success** by revitalizing its direct mail marketing programs to drive customers into their stores and traffic to their Website.

All of these companies - and you -- value our tradition, trust, reliability, reach, ability to meet needs, and affordability. Those **are** the pillars **on** which the Gateway rests and **on** which you in the mailing industry have built your businesses. They make the mail powerful. Significant. Relevant.

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The Three Challenges: Affordability, Mail Industry Growth, and Reforming the Regulatory Environment

But, as we **look** for ways to leverage the successes of the Postal Service and the mailing industry in the future, we have arrived at a crossroads.

Keeping the mail and our businesses relevant in the future is not guaranteed.

Our continued relevancy will require new ideas, new business models, and a commitment to the traditions that helped turn the **90s** into a "Golden Age of Mail."

Together, we must master three critical challenges:

- First, keep the mail affordable.
- Second, grow the mail industry.
- Finally, reform the regulatory environment.

Let me expand on these challenges - and more important - what the Postal Service is doing to meet them.

We have to continue our transformation of the Postal Service into the supplier of choice for high-quality, low-cost products and services. We have to be affordable.

We have to bring our internal cost structure down and restrain prices. That is the only way we will survive as key segments of our letter mail volume migrate to electronic messaging.

Of all the pillars supporting our Gateway, affordability is the **one** that threatens to bring the whole house down.

But, this is not just a Postal Service issue. It is not just about the price of postage. It is about your businesses, too. It is about the combined cost of conceiving, producing, preparing, collecting, and delivering that mail piece.

When the total investment in that moment costs AT&T **\$1.75** a piece, or Safeway **\$1** a piece, who can blame them for looking to the promise of e-business for lower transaction costs? We have to be concerned about that.

Cost cutting alone, however, will not secure our future. No company, **no** industry, will grow solely **on** its ability to cut costs. **So, our** second challenge is to create new business models, new products, and new streams of revenue to assure that the mailing industry grows. Opportunities for growth lie in the global embrace of e-commerce; there is **no** question about that. But don't write off hard copy mail just yet.

There is **still** tremendous value and visibility in First-class Mail. People still want to touch and read their publications. Advertising mail, for the reasons we have already talked about, is a strong medium. E-business presents growth opportunities for Express Mail,

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Priority Mail, and packages. And, the worldwide economy is an invitation to greater use of international mail products.

The third challenge we face is regulatory reform. Regulation constrains us from fully realizing our potential to operate in a businesslike manner. Our ratemaking process supports a cost-based, rigid pricing system that keeps us from being able to reward customers for their loyalty, cooperation and confidence in the mail. It stimulates unrest and dissatisfaction within the mailing community.

Nearly five years of debate about postal reform - in the Congress, in the Postal Service, and in the mailing industry - has failed to get us the flexibility we need. We also need freedom to invest our income, and some way to bring the voice of the customer into labor arbitration. We needed reform five years ago; we need it today.

Breakthrough Productivity: The **Key to Cost Control**

Saying that we face tough challenges is not the same as having a plan to address them. We have a plan, and we have been aggressively pursuing it for the past five years.

We will continue to take bold actions.

We are building a culture of operational excellence. We have been at it for several years, and we already have driven billions of dollars of costs out of the system. Looking forward, I have instructed my team to launch additional initiatives that will reduce our expenses by at least \$4 billion by 2004. This is above the billion dollars we cut in 1999, and it is a target for which we will all be accountable.

Some of the savings will come from overhead reductions, about \$100 million a year. We have completed a comprehensive study of activities and transactions, and over the next several months will be moving to centralize support functions, to eliminate duplication, and to achieve reductions in administrative staffing.

One hundred million dollars annually will come from more efficient paperwork and purchasing. Another \$100 million a year will come from reducing transportation costs. We will use more ground transportation, and better deploy the contract capacity we have. We also can reduce steps in the distribution and handling of mail.

But the lion's share of these reductions -- some \$700 million a year -- will come from dramatic, breakthrough productivity in our processing system.

Breakthrough productivity means reducing costs through everything from machine utilization, to standardized processes, to staffing and scheduling, and to resource management.

Breakthrough productivity means tracking mail throughout the system. It means benchmarking, measuring performance, and understanding the costs of every activity. Over the course of this year, you will see the introduction of more key features of our

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Information Platform, including Confirm/Planet Codes for letter mail and flats, Signature Confirmation to augment Delivery Confirmation, and other systems to allow both of us to manage the mail and reduce costs.

Breakthrough productivity also means managing our capital investments in line with changes in our volume patterns. We need to create new products and channels, and investing in the next generation of automation for flats and parcels to offset the cost of labor.

Our breakthrough has begun. Our present rate of total factor productivity improvement is ten times higher than the annual average we achieved for the past decade. Total factor productivity rose to 2.3 percent in the final quarter of 1999. It is 2.1 percent year to date, and 2.6 percent in the second quarter.

At the same time, over the past two years, we have slashed more than \$1.5 billion in expenses to compensate for lagging revenue. The hallmark of that effort has been carefully controlling the size of our workforce. Already, 11,000 career vacancies have been absorbed through attrition, and that number will reach at least 20,000 as we move forward.

To put that in perspective, we will eventually eliminate positions from our organization equal to the combined workforces of a Quad/Graphics and a Fingerhut. Or, to pose it another way, the jobs that will disappear are roughly equivalent to the total number of postal workers in the state of Tennessee, plus Rhode Island.

Growing the Mail industry: The Source of New Revenue

Even with productivity-boosting measures this extreme, we are barely keeping our heads above water. We are facing declining margins, and we have presented you with a rate case.

This was an agonizing decision for us, and it was traumatic for many of you. But perhaps more importantly, it is clear that cutting costs is not a stand-alone strategy for preventing rate increases in the future.

We must help you to grow your industry. Our efficiency and our productivity are volume-driven. We have to have volume and its associated revenue to thrive in the future. There simply isn't any other way. You have my commitment that we will continue to strengthen our core products. We will leverage what we have, and we will work to put the new technologies of e-commerce to work for you.

Already -- all day, every day -- our customers can use our on-line services to buy stamps and postage, confirm delivery and arrange for package returns. get ZIP Code information, locate post offices, and order Priority Mail and Express Mail supplies.

But, we also are confronted with the disruptive side of technology. Technology lowers the hurdle rate for competition to enter any market. It cannibalizes for-fee services, and

offers them to consumers for nothing. It creates new business models. Its potential for global ease of access in our markets challenges our very understanding of universal service.

So, we intend to introduce Web-based services consistent with our mission and financial prudence. We are evaluating several now. We have talked about them before. Electronic postmarks, bill presentment and payment, and electronic mailboxes for those who want them are all technically feasible. These **are** electronic services that enhance our core products, keeping mail -- and the mailing industry -- relevant, reliable, and vital.

Regulatory Reform: **An** Absolute Requirement

For all **of** the promise that **is** there, we are going to wind up with an inferior Postal Service in the future if we do not change the regulatory environment. If you read current business literature -- or a weeks worth of the Wall Street Journal -- you know that there **are** others who can move faster, can act more agilely and can better respond to changes in the marketplace.

We need commercial freedoms, including market-based pricing and the ability to generate income for investment.

Whether we call it deregulation, privatization, or liberalization -- whatever label you choose -- the lines between public and private providers of postal products and services **are** blurring. We must be able to compete fairly and to act in concert with the needs of our customers, or somebody else will.

Other posts are already realizing the potential of commercial freedoms. In Canada and Germany, in the Netherlands and Sweden, in New Zealand and Australia, commercial freedoms are allowing postal services to aggressively come to terms with our new business environment. They **are** free to invest, able to enter into forward-looking pacts with labor and encouraged to seek out partnerships, alliances and new markets.

Now, we cannot talk about costs and growth and reform and pretend that there's not an elephant in the room. H.R. **22** is a balanced approach to postal reform. **We** support it. But it does not address your voice in the labor process.

Under the law, your voice **is** represented in ratemaking by **14** members of the presidentially appointed Board of Governors and Postal Rate Commission. As a practical matter it is often an independent arbitrator, who is called on to make wage decisions that affect **hundreds** of **millions** of **dollars** in labor costs.

Let me **be** clear that I am not being critical of our unions. They, like we, **are** operating within the law -- and frankly, sometimes things **go** labor's way, sometimes they go management's way.

ATTACHMENT DMA ST2-B

How we resolve this problem is uncertain, but we remain open to a dialogue **with our** unions about this and other ways that we can create incentives for employee innovation and breakthrough productivity without breaking the bank. I think our union leadership understands the stakes. They know we cannot forge a new "Golden Age of Mail" if we kill the golden **goose** that is our core business.

Success Requires Commitment and Partnership

To summarize, we have an aggressive plan for tackling the challenges we face. It recognizes that without affordability and growth, your businesses will suffer with **ours**. It recognizes the importance of commercial freedoms.

I don't want to **be** flippant **about** this, but **you're** either with **us**, or you're against yourselves.

Our futures, our **successes** are that **entwined**.

Obviously, some **of the** changes we seek will not come easily. But the stakes **are** high, and we must continue to put stakes in the ground **as** a Postal Service, **as** an industry, and **as** committed partners.

I say again, our job is to keep you successful, and keep the mail relevant. We will do our part. That is a commitment I make to you on behalf of our Management **Committee**, our Officers and **our** organization.

We will deliver.
You have my word on **it**.

Attachment DMØ ST2-C

AFSM 100 Savings Comparison

AFSM 100 Cost Savings Comparison - REVISED 06/16/2000
(all numbers in thousands)

	DMA	USPS	Difference
	[1]	[2]	[3]=[1]-[2]
Total Savings	\$ 402,421	\$ 169,379	\$ 233,042

Sources:

[1] Attachment C, pg 2.

[2] Attachment C, pg 3.

Attachment DMA ST2-C

USPS AFSM 100 Clerks TY Savings

USPS AFSM 100 Clerks Test Year Savings

Clerks Workhour Savings (hours)	Hourly Clerk Wage Rate	Clerks Workhour Cost Savings (thousands)
[1] 6,052,003	[2] 27.99	[3]=[1]*[2] 169,379
	\$	\$

Sources:

[1] Docket No. R2000-1, Tayman, Tr. 2/322.

[2] Docket No. R2000-1, USPS-LR-1-126, PRG_ANAL-revised.xls, 'Data'. Hourly wage rate obtained from dividing Clerk/Mailhandler Avg. Personnel Cost (60,125) by Workhours Per Workyear (1,791).

Attachment DMA ST2-C

DMA AFSM 100 Clerks TY Savings

DMA AFSM Clerks Test Year Savings - REVISED 07/31/2000 - Using PFY 1999 Data

	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]
	Direct Cost per Handling (cents)	Plant/Delivery Unit Manual IS Factor	AFSM Productivity (units/hour)	Number of Machines	Operational Hours per Workday	Operational Days per Year	Total Sorts per Year (millions)	Allocated Sorts (millions)	Total Cost Savings
IS - Manual, Plant	7.261	26.10%							
IS - Manual, Delivery Unit	3.339	73.90%							
IS - AFSM 100	0.941	N/A							
Difference*	3.421		15,000	166.5	20	313	15,634	5,882	\$ 201,210

	Direct Cost per Handling	IP - AFSM 100	Difference**	AFSM Productivity (units/hour)	Number of Machines	Operational Hours per Workday	Operational Days per Year	Total Sorts per Year (millions)	Allocated Sorts (millions)	Total Cost Savings
IP - FSM 881 OCR/BCR	3.005									
IP - AFSM 100	0.941									
Difference**	2.063			15,000	166.5	20	313	15,634	9,752	\$ 201,210

TOTAL SAVINGS

\$ 402,421

Sources:

- Difference (IS only) is calculated by taking 26.10% of the difference between IS - Manual, Plant and IS - AFSM 100 added to 73.90% of the difference between IS - Manual, Delivery Unit and IS - AFSM 100 per Docket No. R2000-1, LR+90, R2000_1_Flats Cost Model_Final USPS.xls, 'Data', Plant/Delivery Unit Manual IS Factor.
- * Difference (IP only) selected as conservative estimate as smallest difference between cost of current sort and cost of AFSM 100 sort.
- 1] Docket No. R2000-1, LR+90, R2000_1_Flats Cost Model_Final USPS.xls, 'Mailflow Model Costs', Cents per Piece Handling, with a modification to set a volume variability factor equal to 1.00.
- 2] Docket No. R2000-1, LR+90, R2000_1_Flats Cost Model_Final USPS.xls, 'Data', Plant/Delivery Unit Manual IS Factor.
- 3] Docket No. R2000-1, LR+90, R2000_1_Flats Cost Model_Final USPS.xls, 'Productivities', Footnotes [7] and [8]
- 4] LR-83, page 1-12
- 5] Kingsley, TR.5/1961.
- 6] Kingsley, TR.5/1960.
- 7] = [3]*[4]*[5]*[6]
- 8] = Allocated Sorts is the number of sorts allocated to each scenario to yield equal cost savings, Kingsley, TR.5/1960.
- 9] = [8]*[1]

1 CHAIRMAN GLEIMAN: That brings us to oral
2 cross-examination. The Postal Service is the only party
3 that asked to cross-examine Witness Buc. Is there anyone
4 else who wishes to cross-examine Witness Buc?

5 [No response.]

6 CHAIRMAN GLEIMAN: If not, Mr. Reiter.

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

8 CROSS-EXAMINATION

9 BY MR. REITER:

10 Q Good morning, Mr. Buc.

11 A Good morning, Mr. Reiter.

12 Q Although it feels like afternoon already. I am
13 going to start out by asking you for a prediction, and in
14 making the prediction, I would like you to assume, even if
15 it is farfetched, that your recommended contingency of .25
16 percent is used to develop rates. Are you with me?

17 A I am with you.

18 Q Looking at the Postal Service's total financial
19 situation, and considering your best estimate of all the
20 uncertainties related to that, in FY 2001, do you think the
21 Postal Service will earn a net income or experience a loss?

22 A Well, the Postal Service says that they are going
23 to have a loss. I guess my prediction is conditional, it
24 depends on how hard they work. If they work real hard, it
25 wouldn't be very hard to break even, even make a lot of

1 money. If they don't work hard, their prediction says they
2 are going to lose money.

3 Q How do you define "working hard"?

4 A Working hard is implementing breakthrough
5 productivity, finding some of the savings that Henderson has
6 said that they can get, the billion dollars of savings.
7 They do that, they are in great shape.

8 Q Is there a certain total factor productivity level
9 that you would associate with that?

10 A Well, you know, total factor productivity is going
11 real well right now. Let me see if I can find those
12 numbers. I printed them, or I did a little spreadsheet on
13 where the Postal Service is in total factor productivity,
14 which I seem to be having trouble finding, but my counsel
15 has provided me with a copy. And as best I understand, for
16 the last four quarters, total factor productivity has been
17 positive.

18 In the Fourth Quarter of '99, it was 2.10 percent,
19 in the First Quarter of 2000, it was 1.70 percent. In the
20 Second Quarter of 2000, it was 2.70 percent, and in the
21 Third Quarter, it was 1.70 percent. So many people in the
22 mailing community are hopeful that the Postal Service has
23 turned the corner and that they are now achieving the factor
24 productivity that people, including the Postal Service, have
25 been hoping that they will get all along.

1 Q Earlier you referred to if they work harder in the
2 test year, are you saying at higher levels that those, the
3 same?

4 A You know, I haven't run it all the way through a
5 model. As a matter of fact, because I know the kind of
6 questions you will ask, I haven't run it through a model at
7 all. But it seems to me that if the Postal Service is
8 getting more productive these days, most people think there
9 is a lot of room to get a whole lot more productive.

10 Q Are you one of those?

11 A I believe they could get a whole lot more
12 productive.

13 Q So then you believe the Postal Service will have a
14 net income in the test year?

15 A No, remember I said it depends on how hard they
16 work. I mean in some ways this is a tautology. If they
17 have a net income, a positive net income, I guess I would
18 say they have worked real hard, and if they don't, I would
19 say they haven't worked so hard.

20 Q Didn't you just say you thought that they were
21 going to work real hard?

22 A Well, I am hoping that these total factor
23 productivity numbers show that they are going to work real
24 hard, that they are going to continue and maybe even
25 increase.

1 Q And if they do, do you have an estimate range of
2 what the net income could be?

3 A No, I don't.

4 Q So there is some uncertainty connected with that?

5 A Yes, there is uncertainty connect with that.

6 Q And is it correct that the Postal Service has a
7 labor contract through the test year with only one major
8 craft, the carriers, right?

9 A That's correct.

10 Q And with respect to your hope or expectation of a
11 net income and your recommended .25 percent contingency,
12 what assumption did you make for labor contracts for other
13 crafts?

14 A I didn't actually make an assumption, I just
15 assumed that what the Postal Service had used in their
16 estimating forecasts was the right thing to use for the
17 forecast. So, in my suggestion, I used ECI. I also
18 suggested that the difference between ECI and ECI minus 1 be
19 removed from the contingency because you have put it in the
20 estimate and, therefore, it doesn't properly belong in the
21 contingency anymore.

22 Q Have you examined how much city carrier test year
23 cost levels are increasing relative to ECI?

24 A I have not.

25 Q Is there some reason you didn't look at that?

1 A There are many things that I didn't look at. You
2 could go on a long time with me.

3 Q Well, I didn't ask you about all those other
4 things, I asked you about this one.

5 A There is no particular reason why I didn't look at
6 this one.

7 Q If you were involved in negotiating contracts for
8 the other labor unions, isn't that something you would like
9 to know?

10 A Yes.

11 Q And would it surprise you if you were to learn
12 that test year city carrier cost levels increased by
13 substantially over ECI?

14 A That wouldn't surprise me. Let me point out,
15 however, that if you are going to make the point that that
16 should be in the contingency, because you guys think that
17 you are going to sign that kind of a contract, that is not
18 the purpose of a contingency. That would be a misestimate
19 -- well, it is not even a misestimate, you just wouldn't
20 have taken advantage of the best information that you had in
21 preparing your estimate.

22 What you are supposed to have done is prepared
23 your best estimate possible, and then a contingency protects
24 you against misestimates and unknown unknowns.

25 Q Isn't it possible that the Postal Service could

1 attempt to do what you are suggesting and end up having no
2 contract signed and it goes to arbitration and then it
3 becomes out of the Postal Service's control at all, isn't
4 that right?

5 A That is possible.

6 Q And wouldn't the city carrier contract be
7 something that the arbitrators would look at?

8 A I suspect that they would. Although I would point
9 out I am *not* an expert on labor negotiations.

10 Q I didn't ask, but thank you. Do you agree that in
11 light of the carrier contract, it will be a challenge, a
12 major challenge for the Postal Service to achieve agreements
13 with the other unions that are below that level?

14 A Well, you know, that really depends. I mean in
15 some ways the unions at some point may have to accept the
16 John L. Lewis solution in the coal fields, where the unions
17 realized that they could have higher wages, but there were
18 going to be a lot less of them. And it depends on how the
19 Postal Service positions and what the union leadership is.

20 At some point if mail volume goes down, which you
21 guys predict that it will, there are going to wind up being
22 fewer employees, and it could be that they just decide that
23 that is going to happen and they are going to get higher
24 wages, but there are going to be fewer of them, and more
25 efficient.

1 Q Is mail volume going down yet?

2 A No.

3 Q Is it projected to go down in the near future?

4 A It is not projected to go down in the test year.

5 Your strategic plan lays out scenarios for past the test
6 year where it goes down.

7 Q In the life of the labor contracts?

8 A The three year labor contract, perhaps. If not,
9 it is right on the edge.

10 Q If you'd look at your testimony, pages 2 and 3,
11 there you talk about the switch from an ECI to an -- I'm
12 sorry -- from an ECI minus one assumption to an ECI
13 assumption between the time of the Postal Service's request
14 and Witness Patelunas' update; is that right?

15 A Yes.

16 Q Do you know what group of Postal Service employees
17 that assumption applies to?

18 A Well, I think it applies to the clerks, to the
19 mail handlers, to non-bargaining unit people, I believe, and
20 it may apply to rural carriers.

21 Q Besides the shift in the assumption, do you know
22 what else has changed that has affected test year cost
23 levels for those other craft employees?

24 A Yes. You forecast an increase in the ECI.

25 Q Do you remember by how much?

1 A Well, let me go see if I can find it. I believe
2 the number is about 19.6 percent, if I did my calculations
3 correct.

4 Q And do you know how much of an impact that change
5 had on test year costs --

6 A I didn't do that calculation.

7 Q What about carry-over costs from the old
8 contracts?

9 A I didn't do that calculation.

10 Q So you don't know if those significantly
11 increased?

12 A That's correct.

13 Q Is that something that's important to know in
14 entering into labor negotiations even though you're not an
15 expert?

16 A I would want to know that, yes.

17 Q Do you understand what carryover costs include?

18 A I went through the analysis or I went through the
19 spreadsheets, but you could surprise me.

20 Q All right. I'll try, but I doubt it.

21 What about the COLA increases that go into effect
22 partway through FY 2000?

23 A If you tell me that those are part of carryover,
24 I'll accept that subject to check.

25 Q And are you aware that since those are not in

1 effect for all of FY 2000, part of their impact carries into
2 the test year?

3 A Yes.

4 Q So if carryover costs from 2000 increase and all
5 else remains equal, doesn't that mean there will be less
6 money left over after accounting for carryover costs to fund
7 the new labor contracts?

8 A That's absolutely correct.

9 Q And If there is less money to fund a new contract,
10 isn't there a greater risk that the new contract won't be
11 negotiated or arbitrated at a cost that's less than or equal
12 to the assumed terms?

13 A Yes.

14 Q At page 3 of your testimony, you say that the
15 Postal Service has reduced the risk to which it is exposed
16 by shifting from ECI minus one to ECI. I think we agreed on
17 that earlier. And then you follow that observation with a
18 discussion with a hypothetical labor contract; is that
19 right?

20 A That's correct.

21 Q Does your discussion of this hypothetical contract
22 include or not include a discussion of the impact of
23 carryover costs from the previous contract?

24 A I don't think it's relevant to the discussion.

25 Q Is it your testimony that, in general, the Postal

1 Service now has less financial risk than when the case was
2 filed in January?

3 A Yes.

4 Q And would you agree that when the Postal Service
5 filed the case, that it expected no after-rates deficiency
6 in the test year?

7 A That's correct, or a very small one, or a very
8 small positive/negative.

9 Q And that the Postal Service now expects an
10 after-rates test year deficiency of \$475 million?

11 A That's correct.

12 Q Does this movement from a break-even rate request
13 to one that is expected to generate a half-billion-dollar
14 loss, give or take, reflect a reduction in risk?

15 A I think that it doesn't matter to the contingency.
16 The contingency is supposed to be for forecasting errors,
17 which this is not, and unforeseen unforeseens, which this is
18 not, and just like the fact that rates may go into effect
19 partway through a test year is not a reason for a
20 contingency according to the Commission, I bet the
21 Commission might find that this isn't a reason for a
22 contingency, either.

23 Q Is it possible that certain risks have been borne
24 out even before the test year began?

25 A Yes.

1 Q And does the fact that some risks have become
2 reality mean that other risks don't remain?

3 A Well, if you think about unforeseen unforeseens,
4 if that's where we're going, you would have to think that
5 they have an equal probability of happening in each time
6 period; otherwise they wouldn't be unforeseen unforeseens,
7 okay?

8 Now, if you accept that, it's got to be that the
9 more time goes by, the less probability there is that you're
10 going to get nailed by one of these things because some of
11 the probability of it having happened is already gone.

12 Q I'm sorry. That's of the unforeseen unforeseens?

13 A Of the unforeseen unforeseens.

14 Q The unknown unknowns I think is the term.

15 A Yes.

16 Q You're saying there is less probability of that
17 happening now than there was in January?

18 A No. There's less probability of their happening
19 in the period of time from when you made the forecast to the
20 end of the test year than there now is from now until the
21 end of the test year because time has elapsed and they
22 happen randomly through time. If you can predict them, I
23 would submit to you that they're not unforeseen unforeseens.

24 Q No. Just --

25 A Or unknown unknowns.

1 Q I'm confused about what you're talking about, the
2 time period there. I think we should be looking just at the
3 test year, right?

4 A Well, no, because when you make your forecast,
5 there are things that can happen before the test year that
6 wind up with bad consequences for you in the test year, and
7 now you've eliminated all those from happening in the last
8 six months. I mean, that's basically what happens when you
9 update your inflation estimates.

10 Remember, the test year starts at the end of 2000,
11 so if something affects 2000 cost, it affects 2001 costs.

12 Q It may, but it may not; isn't that right?

13 A Well, I guess if you like to argue that higher
14 inflation in 2000 won't affect your 2001 costs, I'd be glad
15 to take that.

16 Q Well, thank you.

17 At page 5, lines 18 through 20, if you'll look at
18 that, you say that as forecasting horizons become shorter,
19 outcomes become more certain and the risk of a forecast
20 outcome lying outside of the forecast decreases. I think
21 that's basically what we've just been talking about, right?

22 A Yes. That's correct.

23 Q Is that always true?

24 A Events sometimes turn out different than the
25 probabilities would tell you that they're going to turn out

1 because the probabilities are probabilities. But I'm fairly
2 comfortable standing by this as a general proposition if
3 those unknowable things are actually distributed randomly,
4 which again they have to be to be unknowable.

5 Q As the time period you're trying to predict for
6 becomes closer, isn't it true that you may become better
7 aware of the risks inherent in the forecast or you might
8 learn of new risks that you didn't consider when the
9 forecast period was farther -- was more distant?

10 A You might, but on the other hand, if you think
11 that there is a risk, one would think that you would -- and
12 it's knowable, you would put it into your estimate.

13 That's exactly what you did with ECI as opposed to
14 ECI minus one. That's exactly what you did with all the
15 inflation indices that you updated.

16 Q Those aren't the unknown unknowns.

17 A No. But again, the unknown unknowns I believe are
18 unknown.

19 Q Let's look at it differently.

20 A Okay.

21 Q Let's say that you're an industry analyst and
22 you're forecasting Firestone tires calendar year 2000 profit
23 and loss right now, and you had also produced a P&L for them
24 in January of this year.

25 Given the recent news, would you agree that there

1 could very well be a greater risk attached to the current
2 forecasts than there were to the previous ones even though
3 they're later?

4 A Absolutely. And I thought that that was my point,
5 that, you know, the analyst who said "Buy Firestone" six
6 months ago doesn't look real good compared to the analyst
7 who would say "Don't buy Firestone" today. Some events have
8 transpired, he has more information in making his
9 assumptions or making his predictions and therefore the
10 predictions are better.

11 Q Well, I wasn't just talking about the level of
12 predictions, but the risk of things that weren't expected,
13 whether they are unknown or knowns at this point or however
14 you want to characterize them, wouldn't a projection done
15 for them right now have more risk inherent in it given
16 recent events than an earlier one?

17 A I think maybe you should define for me risk
18 mathematically as you choose to express it, and then I can
19 answer that question.

20 Q How about variations around the profit and loss
21 estimate in this case.

22 A I would think that somebody making an estimate
23 today would probably estimate that there are more
24 variations, but he would also estimate a lower mean profit,
25 which is also very important in this discussion.

1 Q But focusing just on the risk, on the possibility
2 of variation, at least in this case is greater with more
3 information or more recent information than it was before;
4 would you not agree with that?

5 A I believe that's true.

6 Q page 4 of your testimony, you say that the
7 contingency should be reduced because certain cost reduction
8 estimates in Witness Patelunas' testimony are lower than the
9 cost reductions that you say that the Postmaster General has
10 committed to.

11 A I do say that.

12 Q Okay. I believe your quote is that he has
13 committed in public to reducing costs in the test year by an
14 additional billion dollars over the amount in the Postal
15 Service's January filing. That's page 4, line 6 through 8.
16 Is that correct?

17 A That's correct. Additionally, I believe it's in
18 the draft strategic plan.

19 Q Your attachment B has a copy of the PMG speech.
20 Could you take a look at that and tell me where you find
21 this commitment that you refer to.

22 A Well, he says, 100 million annually will come from
23 more efficient paperwork and purchasing; another 100 million
24 a year will come from reducing transportation costs. Let's
25 see. He says the lion's share, 700 million, will come from

1 dramatic breakthrough productivity in our processing system.
2 And I still need to find you another 100 million. I believe
3 that I've seen other -- no, that's purchasing. I think it's
4 transportation. I guess in this particular manifestation, I
5 don't see the 100 million.

6 Q Are those test year numbers?

7 A Well, what I did is I said he has committed to
8 four billion or he has committed to a billion annually. I
9 have annualized those numbers.

10 Q Okay. So the speech says four billion by 2004; is
11 that correct?

12 A Although he does say 100 million annually will
13 come from -- another 100 million will come from, oh,
14 overhead savings, about 100 million a year, and 700 million
15 a year, the lion's share of these reductions. So I guess I
16 was -- I might have been swayed by his language where he
17 gave me an annual number to actually believe that he thought
18 about this in an annual way. I mean, to me, that was a
19 plain-English reading. He didn't say nothing will happen
20 for two years and then these numbers will double; he said
21 annually.

22 Q But he didn't specifically commit to an additional
23 billion dollars: of savings in the test year, did he?

24 A I don't believe in anything in here, he says
25 anything about the test year.

1 Q Or in 2001.

2 A I believe that's correct. But he does say 100
3 million annually, 700 million annually.

4 Q How much has the Postal Service included in FY
5 2001 for the breakthrough productivity savings? Do you
6 remember?

7 A I don't remember.

8 Q 550 million ring a bell?

9 A I'd accept that subject to check.

10 Q Is the \$4 billion in additional savings by 2004
11 that is referred to in that speech the only part of the
12 speech you took into account in recommending a contingency
13 provision of .25 percent?

14 A Yes.

15 Q So did you look at the middle of page 4 where the
16 Postmaster General says, quote, "Even with productivity
17 boosting measures this extreme, we are barely keeping our
18 heads above water." Do you see that?

19 A I did read that, yes.

20 Q And how does your recommended contingency reflect
21 that statement?

22 A Well, it -- you know, these are very interesting
23 topics and I must admit that I disagree with Mr. Siwek in
24 saying that a billion dollars is hard to hit, two billion
25 dollars is hard to hit. This is a major, major

1 organization, and if you carve a billion dollars of cost out
2 of it, on the one hand that sounds like an enormous amount
3 of money, okay? On the other hand, that's a 1.4 percent
4 budget hit.

5 Now, I submit that many people in many
6 organizations, if somebody came to them and said they were
7 going to have to take a 1.4 percent budget hit, they
8 wouldn't say that that's a major, major, major
9 accomplishment. Many organizations have taken those sorts
10 of hits over the years.

11 Q Those organizations have increased workload?

12 A Many of them do.

13 Q Why don't you look at page 5 of the speech toward
14 the bottom? Do you see where it says, quote, "As a
15 practical matter, it is often an independent arbitrator who
16 is called on to make wage decisions that affect hundreds of
17 millions of dollars in labor costs."

18 A I see that.

19 Q And how did you take that into account in
20 developing your --

21 A Well, again, if the Postal Service wants to
22 forecast that their labor costs are going up, then that
23 should be included in their estimate, not in their
24 contingency.

25 Q How do you suggest that the Postal Service

1 forecast the result of an arbitration?

2 A Well, you obviously came up with something,
3 although what you do is you just use ECI minus one usually
4 so that you're consistent in your approach.

5 Q And your contingency of a quarter of a percent,
6 does that amount to about \$170 million?

7 A Yes.

8 Q Did I do that math right?

9 A Yes.

10 Q Would the \$170 million be a reasonable cushion in
11 light of that uncertainty that we just spoke about?

12 A Well, I believe it's reasonable.

13 Q So your both suggesting --

14 A Remember, you've already padded the estimate in
15 the cost. You have used ECI rather than ECI minus one,
16 which I think you say that you continue to believe in, and
17 so you've padded the estimate there, and you haven't built
18 in the 200 million of losses, and so in a sense the estimate
19 is padded there.

20 Q 200 million?

21 A I'm sorry. You haven't built in the additional
22 200 million of cost reduction programs that I say is in the
23 budget but not in the rate case.

24 Q Aside from issues of the result of any labor
25 arbitration, do you believe that 170 million is adequate

1 protection for everything else that could go wrong in the
2 test year?

3 A Yes.

4 Q Are you taking account in your recommendation of
5 the possibility of things going better than expected?

6 A Things go better sometimes. Very often in cost
7 estimating, things go worse.

8 Q Do you know whether the contingency is adjusted to
9 account for the possibility of good things happening, or is
10 it just there to protect you against adverse eventualities?

11 A Well, my presumption is that when the Postal
12 Service thinks about what the contingency ought to be, they
13 think about good things as well as bad things. On the other
14 hand, the testimony always seems to reflect bad things.
15 There doesn't seem to be much mention usually in the
16 contingency section on good things.

17 Q And is it your testimony that it should reflect
18 that?

19 A Well, I think my testimony was, you know, that the
20 Rate Commission should start with what the variance analysis
21 shows and then should add something for general economic
22 conditions and something for the financial conditions of the
23 Postal Service.

24 Q Is it your testimony that the contingency should
25 be adjusted to take into account the possibility of good

1 things happening?

2 A Well, it seems to me that unknown unknowns have to
3 have good things in them as well as bad things and somebody
4 needs to make a subjective judgment as to how often those
5 unknown unknowns are good and how often those unknown
6 unknowns are bad.

7 Q And your testimony is that is how the contingency
8 should be developed?

9 A Excuse me?

10 Q Is it your testimony that that is how the
11 contingency should be developed?

12 A No. Again, my testimony was that the contingency
13 should be developed by first thinking about what range the
14 variance analysis shows the contingency should be in, and
15 then we should think about the general economic conditions,
16 and then we should think about the Postal Service's
17 financial conditions, and as a result of all that, we should
18 come up with a reasonable contingency.

19 Q And are you purposely leaving out the possibility
20 of unknown events adversely affecting the Postal Service's
21 financial condition?

22 A No. Adverse events could affect the Postal
23 Service's financial condition.

24 Q You didn't mention those just now, though.

25 A Well, I said the general financial condition of

1 the Postal Service, and I guess we could go from there to
2 some thinking about what it will be in the test year.

3 Q Thinking about what it will be in light of the
4 possibility that unknown adverse events will occur?

5 A Well, adverse unknown events I think are unknown
6 unknowns.

7 Q Right.

8 A And therefore unknown unknowns should be
9 considered in thinking about the contingency.

10 Q And should they be offset in any way by the
11 possibility of good unknown unknowns.

12 A Yes. Yes. Occasionally good things happen. I
13 believe the Postal Service made more than its net income,
14 more than they were estimating, because good things
15 happened. There was less inflation than people had
16 estimated. Things were good. Good things do sometimes
17 happen in economies.

18 MR. REITER: That's all I have, Mr. Chairman.
19 Thank you, Mr. Buc.

20 CHAIRMAN GLEIMAN: Is there any followup?

21 [No response.]

22 CHAIRMAN GLEIMAN: Questions from the Bench?

23 COMMISSIONER COVINGTON: I have two.

24 CHAIRMAN GLEIMAN: There are some questions from
25 the Bench. Commissioner Covington?

1 COMMISSIONER COVINGTON: Good afternoon, Mr. Buc.

2 THE WITNESS: Good afternoon.

3 COMMISSIONER COVINGTON: Welcome again. I was
4 looking at your recently submitted supplemental testimony,
5 and I think back when you presented us with your direct
6 testimony, you felt that the Postal Service was probably due
7 a one-percent contingency; is that correct?

8 THE WITNESS: That's correct, sir.

9 COMMISSIONER COVINGTON: And so now we're down to
10 .25 percent.

11 THE WITNESS: Yes.

12 COMMISSIONER COVINGTON: And I guess if we give
13 you the opportunity to come in again, it will be zero?

14 THE WITNESS: I don't think so.

15 COMMISSIONER COVINGTON: Okay. I notice that this
16 is your eighth time testifying here before as it relates to
17 rate cases.

18 I think that in your prior testimony you stated
19 that we, the Commission, has always accepted all contingency
20 requests from the Postal Service, with the exception of one
21 time. Can you tell me what one time that was?

22 THE WITNESS: I don't remember which time it was,
23 I'm sorry. I obviously have it in a spreadsheet, but I
24 don't have **the** spreadsheet with me.

25 COMMISSIONER COVINGTON: Okay. In your initial

1 testimony that you gave us, I think you kind of analyzed or
2 more or less looked at figures that Witness Tayman had
3 presented, you know, here for our consideration.

4 When you did your supplemental testimony, what was
5 the basis for your arriving at that .25 percent?

6 THE WITNESS: Well, I started by realizing or by
7 saying that I had recommended one percent before, and I went
8 through numbers. I said that they have put \$246 million
9 into the estimate for the ECI, instead of ECI-1, and since
10 they've put that in the estimate, it doesn't belong in the
11 contingency, so I pulled that out.

12 I pulled out the \$200 million of cost reductions
13 that were in the budget, but not in the estimate here, the
14 cost reduction estimate here.

15 And a little bit more -- well, I also said those
16 were the quantitative ones. I also said that we are closer
17 in time to when this will all happen, and so the risk is
18 reduced.

19 And I also looked at Witness Patelunas's rewrite
20 or his redo of numbers, and said, you know, the additional
21 deficiency here is .37 percent of what their total cost was,
22 and I took that as a thought experiment.

23 And so I took those last two things and I just
24 subjectively adjusted downward to get about a quarter.

25 COMMISSIONER COVINGTON: This is a question for

1 you, Mr. Buc: Do you think, since you're outlining cost
2 reductions, do you think anyone at USPS is looking at these
3 ideas, or have you personally tried to share some of these
4 cost reduction ideas with the Postal officials?

5 THE WITNESS: Well, there is such a thing called
6 MTAC, the Mailers Technical Advisory Council **or** whatever,
7 and we sometimes go to those meetings and work with Postal
8 Service people on things like better productivity for flat
9 sorting.

10 The mailing community and the Postal Service do
11 work together on these issues.

12 COMMISSIONER COVINGTON: Okay. I'd like you to
13 turn to your supplemental testimony. I found something
14 interesting in here. It's on page -- I believe it's page 5,
15 under (c) where you have the timing of the new cost estimate
16 warrants a smaller contingency.

17 Now, if you would, Mr. Buc, would you explain,
18 beginning with line 17, and I read: "As forecasting
19 horizons become longer, outcomes become more uncertain, and
20 the risk of an outcome lying well outside of the forecast
21 increases.

22 As forecasting horizons become shorter, outcomes
23 become more certain, and the risk of an outcome lying
24 outside of the forecast decreases."

25 Can you simplify that for me?

1 THE WITNESS: Yes. In common sense -- it's not
2 really common sense -- it's much easier to predict, at least
3 it always is for me, what's going to happen tomorrow,
4 because I have more current information than what's going to
5 happen in one year or five years or ten years.

6 And there's just a general presumption that things
7 that are close to you are easier to predict or forecast than
8 things that are further away.

9 COMMISSIONER COVINGTON: Okay, we know about the
10 revenue requirement and what the Commission's role is there.
11 What -- how, if revenue shortfall occurs and the Postal
12 Service cannot foresee it, how do you propose they be
13 prepared to deal with that, if there is no contingency?

14 THE WITNESS: Well, I guess I can go through the
15 litany of things: First of all, they can file another rate
16 case; that's number one.

17 Number two, there are provisions for prior year
18 losses, and so they can go back and collect.

19 But more importantly, they can try to manage a
20 little tighter, manage a little better, cut their costs a
21 little bit, get a little bit more efficient, and even
22 prevent that from happening.

23 COMMISSIONER COVINGTON: Okay, because I notice
24 also in the statute where it says that we as Commissioners,
25 we're supposed to look at the contingency.

1 It does state that there should be honest,
2 efficient, and economical management over at the USPS, and I
3 guess we'll all reserve judgment on what your opinion would
4 be about that.

5 But I did want you to clarify that paragraph I
6 have just read, and I thank you for your comments.

7 That's all I have, Mr. Chairman.

8 CHAIRMAN GLEIMAN: Any other questions?
9 Commissioner LeBlanc?

10 [No response.]

11 CHAIRMAN GLEIMAN: Mr. Buc, do you know whether
12 every arbitration agreement that has ever been handed down
13 has been a negative for the Postal Service relative to what
14 might have otherwise come out of negotiations?

15 THE WITNESS: I don't know.

16 CHAIRMAN GLEIMAN: Would it surprise you if I told
17 you that the Postal Service fared better, not in this last
18 arbitration decision, but fared better in the two preceding
19 arbitration decisions than its going in position?

20 THE WITNESS: That would not surprise me.

21 CHAIRMAN GLEIMAN: So you might conclude then that
22 not every arbitration decision was a negative?

23 THE WITNESS: That's correct.

24 CHAIRMAN GLEIMAN: Or a -- I am sure I am going to
25 get the terminology right, a negative unknown unknown, or

1 unforeseen unforeseen, or whatever terminology we are using.

2 THE WITNESS: Good things can happen.

3 CHAIRMAN GLEIMAN: Interestingly enough, when good
4 things do happen, do you have any sense, and you mentioned a
5 bit ago that you thought there were some good things that
6 happened in the way of lower than anticipated rates of
7 inflation and perhaps higher volumes of mail, although you
8 didn't mention that, that was anticipated -- than were
9 anticipated, perhaps as a consequence of the hot economy.
10 Do you know whether mailers had a direct benefit as a
11 consequence of the positive unforeseen unforeseens?

12 THE WITNESS: I guess mailers have a positive
13 benefit in that the time between rate cases is longer, and
14 perhaps if the Postal Service is in better financial
15 condition, the cost, the contingency could be less and the
16 rate increases could be less.

17 CHAIRMAN GLEIMAN: Was indeed the time between
18 rate cases, during that period was waxing rich, shorter --
19 longer or shorter than generally had been the case?

20 THE WITNESS: I think it is a little bit longer.

21 CHAIRMAN GLEIMAN: I don't know.

22 THE WITNESS: Well, again, I will look it up and
23 **get** back.

24 CHAIRMAN GLEIMAN: Well, I was kind of curious.
25 My recollection was that we had some testimony about the

1 Postal Service, from Intervenors about the Postal Service
2 using the fruits of the positive unforeseens to pay down
3 debt, which does have a positive impact in a sense, albeit
4 not as direct an impact as lengthening out rate cases.

5 THE WITNESS: Yes, when prior year losses, -- when
6 equity builds and prior year losses get lower, but at the
7 rate of a ninth, because we spread the prior year losses
8 over nine years.

9 CHAIRMAN GLEIMAN: All right. I was just kind of
10 curious about that. I appreciate it. Thank *you*. And I
11 think that my colleague has collected his thoughts and has a
12 question or two.

13 COMMISSIONER LeBLANC: Mr. Buc, you made a
14 comment, I think I wrote it down right, about -- you were
15 talking about unknown unknowns, again, I think that is going
16 to be our new word for this case, but anyway, and you said
17 "are distributed equally" in the context, I took that, of
18 the contingency.

19 THE WITNESS: Well, what I was thinking,
20 Commissioner, was that if it really is an unknown unknown,
21 then these things have to come about randomly in time, and
22 that would mean that they are distributed equally through
23 time.

24 COMMISSIONER LeBLANC: Okay.

25 THE WITNESS: Or at least that is the way to think

1 about them as being distributed, because what I went on to
2 try to say is that if you know that they are not distributed
3 equally in time, you know something about them and,
4 therefore, they are not unknown unknowns.

5 COMMISSIONER LeBLANC: They are not unknown.

6 THE WITNESS: They are kind of known unknowns, or
7 you at least have some information.

8 COMMISSIONER LeBLANC: In your deliberations, did
9 you give any consideration to possibly keeping the
10 contingency where it is and reducing prior year losses to
11 some degree over time?

12 THE WITNESS: I didn't think about in that way. I
13 didn't think about spreading prior year losses over 11 years
14 or 12 years.

15 COMMISSIONER LeBLANC: Even shortening it?

16 THE WITNESS: Or shortening it, no, I didn't think
17 about that.

18 COMMISSIONER LeBLANC: You didn't look into any of
19 that?

20 THE WITNESS: No, I didn't.

21 COMMISSIONER LeBLANC: The law says that we have
22 to give a reasonable amount for a contingency.

23 THE WITNESS: Yes.

24 COMMISSIONER LeBLANC: How do we know what is
25 reasonable?

1 THE WITNESS: Well, it is a very hard question.
2 It seems to me, and, again, I am not an attorney, and my
3 attorneys sometimes get on my case for acting like I may be,
4 but I believe that you have said that it has to be reasoned.
5 There has be some reasoning there that you go through and
6 that you find that there is some logic, there is some
7 reasoning, some sort of balance of evidence.

8 COMMISSIONER LeBLANC: But in your scenario -- I
9 will let it stay there. Thank you.

10 THE WITNESS: Okay.

11 COMMISSIONER LeBLANC: Thank you, Mr. Chairman.

12 CHAIRMAN GLEIMAN: I just want to make sure, kind
13 of to summarize things. As I understand the point you are
14 trying to make here in terms of the timeline on all this,
15 the Postal Service filed a case last January, they had
16 certain projections in there, and they thought they needed a
17 contingency of a certain size. Here we are closer to the
18 point in time when the test year will start, and along the
19 way we have asked the Postal Service to provide some more
20 recent data.

21 THE WITNESS: Yes.

22 CHAIRMAN GLEIMAN: And they have done that. They
23 have told us that their cost savings are probably going to
24 be a little bit less than what has been advertised in some
25 speeches by some senior officials, and that we ought to take

1 that into account. They have told us that while they
2 haven't abandoned their policy on ECI minus 1 as a labor
3 negotiating tool, they have decided to play what I think
4 some people call -- it is Indian?

5 COMMISSIONER LeBLANC: Indian poker.

6 CHAIRMAN GLEIMAN: Indian poker, where you put the
7 card on your forehead and let everybody else see it, and the
8 card they put up there says ECI and not ECI minus 1, and
9 that we should take into account the card that they put on
10 their forehead and not the one that they are holding in
11 their hand. And they have said that, you know, these
12 situations have changed, that when they filed the case, you
13 know, it wasn't quite known -- it was an unknown unknown
14 that maybe they were going to need to go with higher labor
15 costs, and it was an unknown unknown that they weren't going
16 to be able to achieve savings that they had hoped to
17 achieve, or that someone had outlined publicly.

18 So they want us to take all those changes into
19 account, but they also want us to assume that there still
20 are many out there that are likely to occur that are all
21 going to be negative, even though we have a shorter
22 timeline. Is that kind of what they are saying to us?

23 THE WITNESS: That sounds like a fair
24 characterization.

25 CHAIRMAN GLEIMAN: And you don't think we should?

1 THE WITNESS: I don't think you should.

2 CHAIRMAN GLEIMAN: Okay. I just was trying to get
3 it sorted out in my own mind. Thank you.

4 Is there any follow-up to questions from the
5 bench? Would you like some time with your witness to
6 prepare for redirect?

7 MR. ACKERLY: Just a quick moment **or** two, Mr.
8 Chairman, please.

9 CHAIRMAN GLEIMAN: Five minutes.

10 [Recess.]

11 MR. ACKERLY: Mr. Chairman, we do not have any
12 redirect for the witness. However, I believe it was
13 Commission Covington who asked the question about the one
14 case in which the Commission did reduce the contingency.
15 This is working off of memory, but I am pretty sure that if
16 you look in the R80 decision, that you will find it, and
17 what is more, that you will find it discussed in the
18 Newsweek appeal by the Second Circuit which dates from 1983.
19 Is that right? 1983 or 1984 in any event.

20 COMMISSIONER COVINGTON: Thank you, Mr. Ackerly.

21 CHAIRMAN GLEIMAN: That is the one that brings to
22 mind, if you haven't loss, you haven't been to court.

23 Since there is no redirect, Mr. Buc, that
24 completes your testimony here today. We appreciate your
25 appearance, your contributions to the record. We thank you,

1 and you are excused.

2 [Witness excused.]

3 CHAIRMAN GLEIMAN: We are going to try and squeeze
4 one more witness in before we get to lunch, and depending on
5 how fast this goes, maybe even another, but we will see.

6 Mr. McKeever, I think you have the next witness.

7 MR. MCKEEVER: Mr. Chairman, United Parcel Service
8 calls to the stand, Ralph L. Luciani.

9 CHAIRMAN GLEIMAN: Mr. Luciani is already under
10 oath as I recall. That's a question I always ask now. I
11 still think we have one witness floating around here that
12 may not be under oath yet, but I'm not sure, or has already
13 been on the stand a couple of times.

14 MR. MCKEEVER: Mr. Chairman, we again have a
15 situation where we have unsealed and sealed testimony here,
16 so I would propose first to introduce the unsealed testimony
17 and then to introduce a sealed exhibit.

18 CHAIRMAN GLEIMAN: I think that is the proper way
19 to proceed.

20 Whereupon,

21 RALPH L. LUCIANI,
22 a witness, having been previously called for examination,
23 and, having been previously duly sworn, was recalled to the
24 stand, continued to be examined and continued to testify as
25 follows:

DIRECT EXAMINATION

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BY MR. McKEEVER:

Q Mr. Luciani, I have just handed you a copy of a document entitled Supplemental Testimony *of* Ralph L. Luciani on Behalf *of* United Parcel Service, and marked UPS-ST-2.

If you were to testify here orally today, Mr. Luciani, would your testimony be as set forth in that document?

A Yes, it would.

MR. McKEEVER: Mr. Chairman, I move that the Supplemental Testimony **of** Ralph L. Luciani on Behalf of United Parcel Service, and marked UPS-ST-2, be admitted into evidence and transcribed into the record. This is the unsealed testimony.

CHAIRMAN GLEIMAN: Is there any objection?

[No response.]

CHAIRMAN GLEIMAN: Hearing none, if you would please provide copies to the Court Reporter, I will direct that the material be received into evidence and transcribed into the record.

[Written Supplemental Testimony *of* Ralph L. Luciani, UPS-ST-2, was received into evidence and transcribed into the record.]

UPS-ST-2

**BEFORE THE
POSTAL RATE COMMISSION**

POSTAL RATE AND FEE CHANGES, 2000 : DOCKET NO. R2000-1

**SUPPLEMENTAL TESTIMONY
OF
RALPH L. LUCIANI
ON BEHALF OF
UNITED PARCEL SERVICE**

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1

INTRODUCTION

2 My name is Ralph L. Luciani. I am submitting this Supplemental Testimony at
3 the request of United Parcel Service. My background is set forth in my Direct
4 Testimony filed previously in this proceeding, UPS-T-5. See Tr. 25/11774-75.

5

BACKGROUND

6 A number of costing and revenue projection changes were recommended in my
7 direct testimony and in the direct testimony of other UPS witnesses, using FY1998 as
8 the base year. Since the filing of my testimony, the Postal Service has provided a
9 projection of Test Year revenue, volumes, and costs using FY1999 as the base year for
10 costs, and FY1999, Quarter 3, through FY2000, Quarter 2, as the source of billing
11 determinants ("Base Year 1999 Update"). In this supplemental testimony, I have
12 applied the following recommendations of the UPS witnesses to the Base Year 1999
13 Update:

14 1. The correction to FY1999 costs to distribute city carrier regular route
15 elemental load costs by weight is provided in Exhibit UPS-ST-2A.

16 2. The correction to FY1999 costs to assign the cost of sequencing of
17 parcels by city carriers to parcels is provided in Exhibit UPS-ST-2B (filed under seal).

18 3. The correction **to** FY1999 costs *to* assign to Parcel Post the specific fixed
19 costs for Exclusive Parcel Post Special Purpose Routes is provided in Exhibit UPS-ST-
20 2c.

1 4. The correction to the Parcel Post Alaska Bypass and OMAS TYBR and
2 TYAR revenue in the Base Year 1999 Update is provided in Exhibit UPS-ST-2D.'

3 Due to a change in the final adjustment process for Parcel Post in the Base Year
4 1999 Update, my recommended correction to the Parcel Post final adjustments under
5 the Base Year 1998 rollforward is not applied here. Also, in my direct testimony I
6 adopted the changes to Test Year advertising costs contained in the errata filed by
7 Postal Service witness Kay on March 13,2000. In the Base Year 1999 Update, Test
8 Year advertising costs have dropped considerably, and the share of advertising costs
9 for each subclass has also changed, as shown in Table ST-I, below.

-
1. In Library Reference **USPS-LR-1-445**, the Postal Service erroneously continues to project a significant increase in revenues from the Base Year to the Test Year for Alaska Bypass and OMAS mail at the same time that Alaska Bypass and OMAS mail volume is projected to decrease significantly. Exhibit UPS-ST-2D contains a simple, straightforward method that can be used to project Test Year Alaska Bypass and OMAS revenues using any year as the base year.

1

Table **ST-I**

2

Change in Test Year Advertising Costs in Base Year 1999 Update

	Advertising Costs in Original Filing (M\$)		Advertising Costs in Base Year 1999 Update (M\$)		Change in TY 2001 Advertising Costs
	BY 1998	TY 2001	BY 1999	TY 2001	
Priority Mail	79.3	71.2	82.8	54.9	-23%
Express Mail	1.0	0.9	0.0	0.0	-100%
Parcel Post	20.1	18.0	0.8	0.6	-97%
Other	200.4	180.1	157.9	104.5	-42%
Total	300.8	270.2	241.5	160.0	-41%

3

Source: USPS-LR-I-150, C/S 16.3.5, and USPS-LR-I-407, C/S 16.3.5

4

I have not made any modifications to the Test Year advertising costs contained in

5

the Base Year 1999 Update. However, I note that there is no support for the 41% drop

6

in Test Year advertising costs contained in the Base Year 1999 Update other than the

7

Postal Service's contention that "the Postal Service has identified Advertising as a

8

portion of the budget in which planned expenditure levels can and should be reduced."

9

Response of the United States Postal Service to interrogatory UPS/USPS-52 (filed

10

August 7, 2000). Uncertainty about the Test Year advertising costs attributable to each

11

of the various mail classes should be a component in the Commission's cost coverage

12

considerations.

1
2
3

**CHANGES TO PARCEL POST,
PRIORITY MAIL, AND EXPRESS MAIL
REVENUES AND COSTS BY UPS WITNESSES**

4

A. Base Year 1999

5

UPS witnesses Sellick, Neels, and I recommend a number of changes to Parcel

6

Post, Priority Mail, and Express Mail costing for Base Year 1998 that also apply to the

7

Base Year 1999 Update, including:

8

1. Use of the Domestic RPW system as the sole source of Base Year

9

Revenue, Pieces, and Weight estimates for Parcel Post (Sellick, UPS-T-4);

10

2. Use of Postal Service witness Degen's proposed improvements to the

11

Commission's Cost Segment 3 cost allocations (Sellick, UPS-T-2);

12

3. 100% volume variability for mail processing labor costs (Neels, UPS-T-1,

13

and Sellick, UPS-T-2);

14

4. Reallocation of dedicated air network costs in Cost Segment 14 (Neels,

15

UPS-T-3);

16

5. Reallocation of certain purchased highway transportation costs in Cost

17

Segment 14 (Neels, UPS-T-3);

18

6. Allocation of city carrier elemental load costs by weight for parcels

19

(Luciani);

1 I have calculated the combined impact for FY1999 on Parcel Post, Priority Mail,
 2 and Express Mail of all of the changes recommended by the UPS witnesses to the
 3 Commission's costing method. As a simplification, piggyback factors are used to
 4 capture the impact of the recommended changes on cost segments other than Cost
 5 Segments 3, 7, and 14.² The results are summarized in Table ST-3, below.

6 **Table ST-3**
 7 **FY1999 Revenue and Attributable Cost**
 8 (Commission's Costing Method, Millions of Dollars)

	As Filed			As Corrected		
	Revenue	Attributable cost	cost Coverage	F		Coverage
Priority Mail	4,533.3	3,132.4	145%	4,533.3	3,305.2	137%
Express Mail	942.0	655.4	144%	942.0	520.7	181%
Parcel Post	1020.9	938.0	109%	883.4	1,079.3	82%

9 Source: March 14, 2000, Cost and Revenue Analysis, Fiscal Year 1999 – PRC Version;
 10 UPS-Luciani-WP-Supp-2.

11 **B. Test Year After Rates Results Under Postal Service Proposed Rates**

12 Based on a simplified roll forward process, I have estimated the results of rolling
 13 forward FY1999 costs to the Test Year Afler Rates under the Postal Service's proposed

2. The Postal Service did not provide FY1999 piggyback factors. Thus, I have used Base Year 1998 piggyback factors.

1 rates. Additional changes to the Base Year 1999 Update changes noted on pages 4-5,
2 above, include:

3 1. A revised Parcel Post Test Year volume projection, based on corrected
4 Base Year volumes; and

5 2. Corrected Parcel Post OMAS and Alaska Test Year Revenue.

6 The resulting cost coverages under the Postal Service's proposed rates are shown in
7 Table ST-4, below.

8 **Table ST-4**
9 **TYAR Revenue and Attributable Cost**
10 *(BY 7999 Update, Commission's Costing Method, Postal Service Proposed Rates)*

	As Filed (\$000)			As Corrected (\$000)		
	Revenue	Attributable cost	Cost cov.	Revenue	Attributable cost	Cost cov.
Priority Mail	5,662	3,641	155%	5,662	3,842	147%
Express Mail	1,055	743	142%	1,055	590	179%
Parcel Post	1,211	1,104	110%	1,023	1,240	83%

11 Source: UPS-Luciani-WP-Supp-2-1.2. 1.3. and 1.4; Response to POIR No. 16, page 4
12 (July 27, 2000); USPS-LR-I-442.

13 Two initial corrections were made to the Express Mail Test Year revenue and
14 costs as filed by the Postal Service in the Base Year 1999 Update. First, in USPS-LR-I-
15 436 the Postal Service inadvertently used R97-1 rates to derive the Express Mail
16 revenue in the Test Year After Rates. Using the Postal Service's proposed R2000-1

1 rates increases Express Mail TYAR revenue from \$1,016.1 thousand to \$1,054.9
2 thousand. Second, the total Test Year Before Rates attributable cost for Express Mail
3 in Cost Segment 3 under Commission costing in USPS-LR-1-424 does not include \$23.1
4 million of "Fixed Attributable (PRC)" costs in Cost Segment 3 listed in the library
5 reference as attributable to Express Mail. Including this fixed attributable cost increases
6 Express Mail TYBR attributable costs by \$23.1 million, before contingency. These Cost
7 Segment 3 Express Mail fixed attributable costs are included in the Express Mail costs
8 in the Test Year After Rates (albeit in the "Expedited Delivery" -- CS 3.4 -- total). See
9 UPS-Luciani-WP-Supp-2-1.9 for details.

10 **C. Test Year After Rates – Revised Cost Coverages**

11 I have calculated the Priority Mail and Parcel Post rate increases that would
12 result from the cost coverage recommendations made by UPS witness Sappington, as
13 shown in Table ST-5, below. Table ST-5 also shows the rate increase needed for
14 Express Mail to cover its revised costs using the Postal Service's proposed markup ratio
15 normalized to the systemwide coverage.

1 Table **ST-5**
 2 TYAR Revenue and Attributable **Cost**
 3 (*BY 1999 Update, Commission's Costing Method, Revised Cost Coverages*)

	As Filed (\$000)			As Corrected and Revised (\$000)			
	Revenue	Attributable cost	Rate Increase	Revenue	Attributable cost	Cost Coverage	Rate Increase
Priority Mail	5,662	3,641	15%	5,914	3,435	172%	43%
Express Mail	1,055	743	4%	1,223	616	199%	17%
Parcel Post	1,211	1,104	3%	1,047	943	111%	38%

4 Source: UPS-Luciani-WP-Supp-2-11

5 **D. Parcel Post Volumes**

6 In my direct testimony, I updated Postal Service witness Tolley's analysis of
 7 Parcel Post volumes to reflect Mr. Sellick's recommendations by correcting the actual
 8 Parcel Post volume data for Base Year 1998 and rerunning Dr. Tolley's model to predict
 9 Parcel Post volume by rate category for the Test Year Before and After Rates. I have
 10 rerun Dr. Tolley's model to predict Parcel Post volume by rate category for the Test
 11 Year After Rates with the "As Corrected and Revised" Parcel Post revenues and costs
 12 noted in Table ST-5. The results for both the Test Year before and after rates are
 13 summarized in Table ST-6, below. See UPS-Luciani-WP-Supp-2-2for further details.

1 Table ST-6
 2 Corrected Projection **of** Parcel Post Volumes
 3 (BY 1999 Update, in thousands)

	Postal Service As Filed		As Corrected	
	TYBR	TYAR	TYBR	TYAR
Intra-BMC	28,817	26,254	34,402	24,547
Inter-BMC	51,620	47,638	56,035	40,386
DBMC	298,009	300,203	220,429	169,860
Total	378,447	374,096	310,865	234,793

4 Source: UPS-Luciani-WP-Supp-2-2, page 5; UPS-Luciani-WP-3-2.1, page 4

5 **CONCLUSION**

6 The changes recommended by UPS's witnesses to the costs, revenue, volumes,
 7 and cost coverages of Parcel Post, Priority Mail, and Express Mail, coupled with the
 8 actual FY1999 results (which differ significantly from the originally projected FY1999
 9 estimates), lead to significant changes in the rate increases necessary for these
 10 subclasses. The impact of these changes on the revenues, volumes, attributable
 11 costs, and resulting cost coverages and rate increases for Parcel Post, Priority Mail, and
 12 Express Mail are indicated in the main body of my supplemental testimony.

Distribution of Elemental Load for Parcels by Weight
Weight of Parcels by Class/Subclass of Mail for Each City Carrier Stop Type
Base Year 1999, Commission Costing Method

CLASS TITLE	AVG WEIGHT	SDR				MDR			BAM		
	WEIGHT	PARCELS	% of		PARCELS	% of		PARCELS	% of		
	PARCEL	(000)	LBS (000)	WEIGHT	(000)	LBS (000)	WEIGHT	(000)	LBS (000)	WEIGHT	
FOOTNOTE	A	B	C	D	B	C	D	B	C	D	
FIRST-CLASS MAIL:											
SINGLE-PIECE LETTERS	0.28	119,034	33,460	1.89%	38,876	10,923	1.06%	68,637	19,293	3.12%	
PRESORT LETTERS	0.14	9,334	1,264	0.07%	2,611	358	0.06%	1,977	268	0.04%	
TOTAL LETTERS		128,368			41,487			70,614			
SINGLE-PIECE CARDS		0			0			0			
PRESORT CARDS		0			0			0			
TOTAL CARDS		0			0			0			
TOTAL FIRST-CLASS		128,368	34,723	1.96%	41,487	11,281	1.94%	70,614	19,561	3.17%	
PRIORITY MAIL	2.80	178,349	498,706	28.13%	63,023	176,227	30.38%	99,001	276,830	44.82%	
EXPRESS MAIL	7.98	1,583	12,637	0.71%	1	2,483	0.43%	695	5,548	0.90%	
MAILGRAMS		0		0.00%	0		0.00%	0	0	0.00%	
PERIODICALS:											
IN-COUNTY	0.33	1,988	653	0.04%	1,045	344	0.06%	1,145	377	0.06%	
OUTSIDE COUNTY:											
REGULAR	0.60	16,018	9,596	0.54%	8,421	5,045	0.87%	9,229	5,529	0.90%	
NON-PROFIT	0.33	4,717	1,554	0.09%	2,480	817	0.14%	2,718	896	0.14%	
CLASSROOM	0.62	132	82			44	0.01%	76	47	0.01%	
TOTAL PERIODICALS		22,855	11,887	0.67%	12,016	6,251	1.08%	13,168	6,849	1.11%	
STANDARD A											
SINGLE PIECE RATE	0.55	1,724	955	0.05%		336	0.06%	298	165	0.03%	
COMMERCIAL STANDARD:											
ENHANCED CARR RTE	0.20	16,306	3,207	0.18%	4,169	820	0.14%	1,657	326	0.05%	
REGULAR	0.55	236,138	130,746	7.38%	80,796	44,735	7.71%	41,771	23,128	3.74%	
TOTAL COMMERCIAL		252,444			84,965			43,428			
AGGREGATE NONPROFIT											
NONPROF ENH CARR RTE	0.38	1,457	550	0.03%	1	164	0.03%	307	116	0.02%	
NONPROFIT	0.37	14,863	5,429	0.31%	4,788	1,749	0.30%	2,581	943	0.15%	
TOTAL AGGREG NONPROFIT		16,320			5,222			2,888			
TOTAL STANDARD A		270,488	140,885	7.85%	90,193	47,803	8.24%	46,614	24,877	3.99%	
STANDARD MAIL (B):											
PARCELS ZONE RATE	6.04	120,512	727,385	41.03%	33,822	204,142	35.20%	27,025	163,117	26.41%	
BOUND PRINTED MATTER	3.07	86,052	264,392	14.91%	33,504	102,940	17.75%	31,873	97,928	15.85%	
SPECIAL STANDARD	1.65	39,575	65,222	3.68%	14,041	23,141	3.99%	8,308	13,692	2.22%	
LIBRARY MAIL	2.09	3,586	7,501	0.42%	896	1,874	0.32%	3,730	7,802	1.26%	
TOTAL STANDARD (B)		249,725	1,064,499	60.05%	82,263	332,097	57.26%	70,936	282,540	45.74%	
US POSTAL SERVICE	0.43	245	106	0.01%	309	134	0.02%	249	108	0.02%	
FREE MAIL	0.87	8,090	7,033	0.40%	2,941	2,557	0.44%	440	382	0.06%	
INTERNATIONAL MAIL	0.43	5,336	2,319	0.13%	2,730	1,187	0.20%	2,792	1,214	0.20%	
TOTAL MAIL											
TOTAL SPECIAL SERVICES			0		0	0		0	0		
TOTAL VOLUME		865,039	1,772,797	100.00%	295,873	580,019	100.00%	304,509	617,710	100.00%	

Notes:

- [A] UPS-Luciani-WP-2-D, p. 2, Summary.
- [B] USPS-LR-I-444, CS06&7.xls, tab 7.0.8, parcel volumes (from City OCS 1999).
These data include only a total volume for periodicals. In USPS-LR-I-444, RPW data are used to distribute the total volume to subclass for periodicals. USPS-LR-I-444, CS06&7.xls, tab 7.0.8, column 1.
- [C] Total Weight is the product of number of parcels and average weight per piece.
- [D] The percentage of weight is the number of pounds for each respective mail class divided by total weight for all mail classes.

Distribution of Elemental Load for Parcels by Weight
City Carrier Load Costs for Parcels by Stop Type
Base Year 1999, Commission Costing Method

LINE NO.	CLASS, SUBCLASS, OR SPECIAL SERVICE	As Filed				As Corrected				Difference
		PARCELS LOAD SDR	PARCELS LOAD MDR	PARCELS LOAD BAM	TOTAL LOAD	PARCELS LOAD SDR	PARCELS LOAD MDR	PARCELS LOAD BAM	TOTAL LOAD	
	COLUMN NUMBER	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	UNITS	\$(000)	\$(000)	\$(000)	\$(000)	\$(000)	\$(000)	\$(000)	\$1000	\$(000)
	FOOTNOTES	A	B	C	D	E	F			I
	COLUMN SOURCE/NOTES									
1	FIRST-CLASS MAIL:									
2	SINGLE-PIECE LETTERS	20.007	7,665	4,562	32,235	2,744	1,099	632	4,475	(27,759)
3	PRESORT LETTERS	1,569	515	131	2,215	104		9	148	(2,067)
	TOTAL LETTERS	21.576	6,180	4,693	34,450	2,848	1,135	641	4,623	(29,826)
5	SINGLE-PIECE CARDS	-	-	-	-	-	-	-	-	-
6	PRESORT CARDS	-	-	-	-	-	-	-	-	-
	TOTAL CARDS	-	-	-	-	-	-	-	-	-
8	TOTAL FIRST-CLASS	21.576	8,180	4,693	34,450	2,848	1,135	641	4,623	(29,826)
9	PRIORITY MNL	29,977	12,427	6,580	48,984	40,902	17,725	9,070	67,697	18,713
10	EXPRESS MNL	266	51	46	374	1,036	250	182	1,468	1,094
11	MAILGRAMS	-	-	-	-	-	-	-	-	-
12	PERIODICALS:									
13	IN-COUNN				-	54	35	12	101	101
14	OUTSIDE COUNN									
15	REGULAR				-	787	507	181	1,476	1,476
16	NON-PROFIT				-	127	92	29	239	239
17	CLASSROOM				-	7	4	2	13	13
18	TOTAL PERIODICALS	3,641	2,369	875	7,086	975	629	224	1,828	(5,258)
19	STANDARD A:									
20	SINGLE PIECE RATE	290	119	20	429	78	34	5	117	(312)
21	COMMERCIAL STANDARD:									
22	ENHANCED CARR RTE	2,141	822	110	3,673	263	62	11	356	(3,317)
23	REGULAR	39,690	15,931	2,716	58,397	10,723	4,500	758	15,980	(42,417)
24	TOTAL COMMERCIAL	42,431	16,753	2,686	62,070	10,986	4,582	768	16,337	(45,734)
25	AGGREGATE NONPROFIT:									
26	NONPROFENH CARR RTE	245	86	20	351	45	16	4	65	(286)
27	NONPROFIT	2,496	944	172	3,814	445	176		652	(2,962)
28	TOTAL AGGREG NONPROFIT	2,143	1,030	192	3,965	490	192		717	(3,247)
29	TOTAL STANDARD A	45,464	17,902	3,098	66,464	11,555	4,808	809	17,111	(49,293)
30	STANDARD MAIL (B):									
31	PARCELSZONE RATE	20,256	6,669	1,796	28,721	59,657	20,533	5,344	85,534	56,813
32	BOUND PRINTED MATTER	14,464	6,606	2,118	23,188	21,684	10,354	3,209	35,246	12,058
33	SPECIAL STANDARD	8,652	2,769	552	9,973	5,349	2,327	449	8,125	(1,847)
34	LIBRARY MAIL	603	177	248	1,027	615	188	256	1,059	32
35	TOTAL STANDARD (B)	41,974	16,220	4,715	62,909	87,305	33,403	9,257	129,965	67,056
36	US POSTAL SERVICE	41	41	17	119	9	14	4	26	(93)
37	FREE MAIL	1,360	580	29	1,969	577	251		846	(1,122)
38	INTERNATIONAL MNL	897	538	186	1,621	190	119	40	349	(1,271)
39	TOTAL MAIL	145.3%	58,339	20,239	223,974	145,396	58,339	20,239	223,974	-
51	TOTAL SPECIAL SERVICES									
52	TOTAL VOLUME VARIABLE	145.396	56,339	20,239	223,914	145,396	58,339	20,239	223,974	-
53	OTHER									
54	GRANDTOTAL									

Notes:

- [A] USPS-LR-I-444, CS06&7.xls, tab 7.0.6.5, column 3. The cost of periodicals is distributed to subclass using RPW data. USPS-LR-I-444, CS06&7.xls, tab 7.0.8, column 1.
- [B] USPS-LR-I-444, CS06&7.xls, tab 7.0.6.6, column 8. The cost of periodicals is distributed to subclass using RPW data. USPS-LR-I-444, CS06&7.xls, tab 7.0.8, column 1.
- [C] USPS-LR-I-444, CS06&7.xls, tab 7.0.6.7, column 8. The cost of periodicals is distributed to subclass using RPW data. USPS-LR-I-444, CS06&7.xls, tab 7.0.8, column 1.
- [D] [A] + [B] + [C]
- [E] UPS-Luciani-WP-Supp-1-B-1, p. 19, WS 7.0.6.5, Distrib. of LTR SDR Load VVC, column 3.
- [F] UPS-Luciani-WP-Supp-1-B-1, p. 21, WS 7.0.6.6, column 8.
- [G] UPS-Luciani-WP-Supp-1-B-1, p. 23, WS 7.0.6.7, column 8.
- [H] [E] + [F] + [G]
- [I] [H] - [D]

Distribution of Elemental Load for Parcels by Weight

**Total City Carrier Load and Street Support Costs
Base Year 1999, Commission Costing Method**

LINE NO.	CLASS, SUBCLASS, OR SPECIAL SERVICE	As Filed	As Corrected	Difference	As Filed	As Corrected	Difference	Difference
		TOTAL LOAD	TOTAL LOAD	TOTAL LOAD	TOTAL STREET SUPPORT	TOTAL STREET SUPPORT	TOTAL STREET SUPPORT	TOTAL LOAD AND STREET SUPPORT
	COLUMN NUMBER	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	UNITS	\$(000)	\$(000)	\$(1000)	\$(000)	\$(000)	\$(000)	\$(000)
	FOOTNOTES	A	B	C	D	E	F	G
	COLUMN SOURCE/NOTES							
1	FIRST-CLASS MAIL:							
2	SINGLE-PIECE LETTERS	356,553	328,793	(27,759)	306,682	301,819	(4,863)	(32,622)
3	PRESORT LETTERS	325,373	323,306	(2,067)	175,211	174,848	(362)	(2,429)
4	TOTAL LETTERS	681,926	652,100	(29,828)	481,693	476,667	(5,226)	(35,052)
5	SINGLE-PIECE CARDS	21,923	21,923	-	16,634	16,634	(0)	(0)
6	PRESORT CARDS	16,036	16,036	-	6,664	6,684	(0)	(0)
7	TOTAL CARDS	37,956	37,958	-	23,318	23,318	(0)	(0)
8	TOTAL FIRST-CLASS	719,884	690,058	(29,826)	505,211	499,965	(5,226)	(35,052)
9	PRIORITY MAIL	54,046	72,760	18,713	28,016	31,295	3,278	21,992
10	EXPRESS MAIL	24,924	26,016	1,094	7,083	7,275	192	1,286
11	MAILGRAMS	116	116	-	62	62	(0)	(0)
12	PERIODICALS:							
13	IN-COUNTY	7,886	7,429	(457)	3,832	3,752	(80)	(537)
14	OUTSIDE COUNTY:							
15	REGULAR	63,553	59,866	(3,685)	44,547	43,902	(646)	(4,331)
16	NON-PROFIT	18,716	17,631	(1,085)	10,766	10,576	(190)	(1,275)
17	CLASSROOM	526	495	(30)	303	297	(5)	(36)
18	TOTAL PERIODICALS	90,681	85,423	(5,258)	59,447	58,526	(921)	(6,179)
19	STANDARD A:							
20	SINGLE PIECE RATE	790	478	(312)	1,990	1,935	(55)	(366)
21	COMMERCIAL STANDARD:							
22	ENHANCED CARRRTE	327,899	324,582	(3,317)	129,966	129,385	(581)	(3,898)
23	REGULAR	330,970	288,553	(42,417)	187,639	180,208	(7,431)	(49,848)
24	TOTAL COMMERCIAL	658,869	613,135	(45,734)	317,605	309,593	(8,012)	(53,745)
25	AGGREGATE NONPROFIT:							
26	NONPROF ENH CARR RTE	17,222	16,936	(286)	7,973	7,923	(50)	(336)
27	NONPROFIT	78,014	75,053	(2,962)	37,910	37,391	(519)	(3,480)
28	TOTAL AGGREG NONPROFIT	95,236	91,989	(3,247)	45,883	45,314	(569)	(3,816)
29	TOTAL STANDARD A	754,894	705,601	(49,293)	365,478	356,843	(8,635)	(57,928)
30	STANDARD MAIL (B):							
31	PARCELS ZONE RATE	29,349	86,162	56,813	11,304	21,256	9,952	66,766
32	BOUND PRINTED MATTER	25,189	37,247	12,058	11,070	13,163	2,112	14,171
33	SPECIAL STANDARD	10,520	8,672	(1,847)	5,011	4,686	(324)	(2,171)
34	LIBRARY MAIL	1,115	1,147	32	817	823	6	38
35	TOTAL STANDARD (B)	66,173	133,229	67,056	28,202	39,949	11,747	78,803
36	US POSTAL SERVICE	1,439	1,346	(93)	3,091	3,075	(16)	(109)
37	FREE MAIL	2,118	996	(1,122)	685	489	(197)	(1,319)
38	INTERNATIONAL MAIL	5,564	4,292	(1,271)	4,411	4,188	(223)	(1,494)
39	TOTAL MAIL	1,719,839	1,719,839	-	1,001,686	1,001,685	(1)	(1)
51	TOTAL SPECIAL SERVICES	106,426	106,426	-	25,605	25,805	0	0
52	TOTAL VOLUME VARIABLE	1,826,265	1,826,265	-	1,027,291	1,027,290	(1)	(1)
53	OTHER	22,164	22,164	0	625,626	825,626	0	0
54	GRAND TOTAL	1,848,429	1,848,429	-	1,852,917	1,852,916	(1)	(1)

Note:

- [A] USPS-LR-1-444, CS06&7.xls, lab 7.0.3.1, column 2.
- [B] UPS-Luciani-WP-Supp-1-B-1, p. 16, WS 7.0.3.1, Letter & SPR, column 2.
- [C] [B] - [A]
- [D] UPS-Luciani-WP-Supp-1-A, column 15.
- [E] UPS-Luciani-WP-Supp-1-B-1, p. 8, lab CS 7 Detail, column 17.
- [F] [E] - [D]
- [G] [C] + [F]

EXHIBIT UPS-ST-2B:
DIRECT ATTRIBUTION OF
SEQUENCING OF PARCELS --
FILED UNDER SEAL
ON AUGUST 14, 2000

**Calculation of SPR Specific Fixed Costs
Without Revisions in Elemental Load and Street Support
Base Year 1999, Commission Costing Method**

LINE NO.	CLASS, SUBCLASS, OR SPECIAL SERVICE	TOTAL SPR (EXCLUDING STREET SUPPORT)	STREET SUPPORT IN-OFFICE DIRECT LABOR	STREET SUPPORT LOAD	STREET SUPPORT ACCESS	STREET SUPPORT ROUTE	TOTAL SPR	TOTAL IOCS COSTS: EXCLUSIVE PARCEL POST ROUTES	SPR SPECIFIC FIXED COSTS
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	COLUMN NUMBER CALCULATIONS FOOTNOTES UNITS COLUMN SOURCE/NOTES	A \$(000) WS 7.0.3 C23	B \$(1000) WS OUTPUTS TO CRA	B \$(000) WS OUTPUTS TO CRA	B \$(000) WS OUTPUTS TO CRA	B \$(1000) OUTPUTS	C \$(000)	D \$(1000) WS INPUTS/IOCS	E \$(000)
1	FIRST-CLASS MAIL:								
2	SINGLE-PIECE LETTERS	36.330	3.565	1,426	1,867	304	43.493		
3	PRESORT LETTERS	1.788	1.638	1,302	68		5.077		
4	TOTAL LETTERS	38.117	5.203	2,728	1,934	587	48.570		
5	SINGLE-PIECE CARDS	1,926	196	88	98		2,313		
6	PRESORT CARDS	102	53	64	4		4		
7	TOTAL CARDS	2,028	249	152	103		2,537		
8	TOTAL FIRST-CLASS	40,145	5,452	2,880	2,037	593	51,107		
9	PRIORITY MAIL	29.817	133	216	1,122	614	31,907		
10	EXPRESS MAIL	10.145	12	100	325	51	10,631		
11	MAILGRAMS	79	-	0	3	-	85		
12	PERIODICALS:								
13	IN-COUNTY	299	29	32	11	60	431		
14	OUTSIDE COUNTY:								
15	REGULAR	2,410	471	254	90		3,711		
16	NON-PROFIT	710	98	75	26		1,052		
17	CLASSROOM	20	3	2	1		30		
18	TOTAL PERIODICALS	3,439	601	363	128	694	5,224		
19	STANDARD A								
20	SINGLE PIECE RATE	2.687	17	3	115	38	2,860		
21	COMMERCIAL STANDARD:								
22	ENHANCED CARR RTE	2,036	887	1,312	76	800	5,110		
23	REGULAR	2,424	1,845	1,324	90	657	6,340		
24	TOTAL COMMERCIAL	4,459	2,731	2,636	166	1,451	11,449		
25	AGGREGATE NONPROFIT:								
26	NONPROF ENH CARR RTE	181	72	69	7	27	355		
27	NONPROFIT	680	365	312	25	111	1,493		
28	TOTAL AGGREG NONPROFIT	862	437	381	32	137	1,849		
29	TOTAL STANDARD A	8,008	3,184	3,020	314	1,631	16,158		
30	STANDARD MAIL (B):								
31	PARCELS ZONE RATE	10.967	21	117	412	343	11,860	39,247	27,386
32	BOUND PRINTED MATTER	16.711	24	101	623	256	17,715		
33	SPECIAL STANDARD	6,757	12	42	252	144	7,207		
34	LIBRARY MAIL	965	2	4	36	41	1,049		
35	TOTAL STANDARD (B)	35.400	59	265	1,322	784	37,830		
36	US POSTAL SERVICE	215	45	8	11	12	289		
37	FREE MAIL	30	4	8	2	5	49		
38	INTERNATIONAL MAIL	4.338	40	22	159	31	4,591		
39	TOTAL MAIL	131.617	9,530	6,880	5,423	4,416	157,867		
40	SPECIAL SERVICES:								
41	REGISTRY	331	7	20			359		
42	CERTIFIED	-	91	370			461		
43	INSURANCE	-	3	26			29		
44	COD	84	3	8			74		
45	SPECIAL DELIVERY	-	-	-	-	-	-		
46	MONEY ORDERS	-	-	-	-	-	-		
47	STAMPED ENVELOPES	-	-	-	-	-	-		
48	SPECIAL HANDLING	-	-	-	-	-	-		
49	POST OFFICE BOX	-	2	-	-	-	2		
50	OTHER	569	13	2	-	-	585		
51	TOTAL SPECIAL SERVICES	964	120	426	-	-	1,510		
52	TOTAL VOLUME VARIABLE	132.581	9,651	7,306	5,423	4,416	159,376		
53	OTHER	190.050	1,247	89	45,844	44,621	281,850		
54	GRAND TOTAL	322,630	10,898	7,395	51,267	49,037	441,227		

Notes:

- [A] UPS-Luciani-WP-Supp-1-B-2, p. 9, SPR Specific Fixed Costs. UPS-Luciani-WP-1-B-2 contains revisions to letter route street support. These revisions do not affect SPR street support. Therefore, the values shown here represent those that would be calculated directly from USPS-LR-1-444, CS06&7.xls.
- [B] Total IOCS costs for Exclusive Parcel Post routes is obtained from USPS-LR-1-444, CS06&7.xls, tab Input IOCS, line 7.
- [C] SPR Specific Fixed Costs is the difference between IOCS Total Accrued costs and the amount distributed to SPR Parcel Post.
- [D] Total IOCS costs for Exclusive Parcel Post routes is obtained from USPS-LR-1-444, CS06&7.xls, tab Input IOCS, line 7.
- [E] SPR Specific Fixed Costs is the difference between IOCS Total Accrued costs and the amount distributed to SPR Parcel Post.

Calculation of SPR Specific Costs
Revised Elemental Load and Street Support
Base Year 1999, Commission Costing Method

LINE NO.	CLASS, SUBCLASS, OR SPECIAL SERVICE	TOTAL SPR (EXCLUDING STREET SUPPORT)	STREET SUPPORT IN-OFFICE DIRECT LABOR	STREET SUPPORT LOAD	STREET SUPPORT ACCESS	STREET SUPPORT ROUTE	TOTAL SPR	TOTAL IOCS COSTS: EXCLUSIVE PARCEL POST ROUTES	SPR SPECIFIC FIXED COSTS
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
		A \$(000) WS 7.0.3 C23	A \$(000) WS OUTPUTS TO CRA	A \$(000) WS OUTPUTS TO CRA	A \$(000) WS OUTPUTS TO CRA	A \$(000) WS OUTPUTS TO CRA	A \$(000)	O \$(000) WS INPUTS TO IOCS	C \$(000)
1	FIRST-CLASS MAIL:								
2	SINGLE-PIECE LETTERS	36,330	3,565	1,315	1,867	304	43,361		
3	PRESORT LETTERS	1,766	1,638	1,293	68	283	5,069		
4	TOTAL LETTERS	38,117	5,203	2,609	1,934	587	48,450		
5	SINGLE-PIECE CARDS	1,926	196	RR	99	4	2,313		
6	PRESORT CARDS	102	53	64	4	1	224		
7	TOTAL CARDS	2,026	249	152	103	6	2,537		
6	TOTAL FIRST-CLASS	40,145	5,452	2,761	2,037	593	50,987		
9	PRIORITY MAIL	29,817	133	291	1,122	614	31,978		
10	EXPRESS MAIL	10,145	12	104	325	51	10,636		
11	MAILGRAMS	79	-	0	3	2	85		
12	PERIODICALS:								
13	IN-COUNTY	299	29	30	11	60	428		
14	OUTSIDE COUNN:								
15	REGULAR	2,410	471	240	90	486	3,697		
16	NON-PROFIT		98	71	26	143	1,048		
17	CLASSROOM		3	2	1	4	29		
18	TOTAL PERIODICALS	3,429	601	342	120	094	5,203		
19	STANDARD A:								
20	SINGLE PIECE RATE	2,667	17	2	115	38	2,659		
21	COMMERCIAL STANDARD:								
22	ENHANCED CARR RTE	2,036	887	1,239	76	800	5,096		
23	REGULAR	2,424	1,845	1,154	90	657	6,170		
24	TOTAL COMMERCIAL	4,459	2,731	2,453	166	1,457	11,266		
25	AGGREGATE NONPROFIT:								
26	NONPROF ENH CARR RTE	181	72	68	7	27	354		
27	NONPROFIT	680	365	300	25	111	1,482		
26	TOTAL AGGREG NONPROFIT	862	437	368	32	137	1,836		
29	TOTAL STANDARD A	8,008	3,184	2,623	314	1,631	15,961		
30	STANDARD MAIL (B):								
31	PARCELS ZONE RATE	10,967	21	345	412	343	12,088		
32	BOUND PRINTED MATTER	16,711	24	149	623	256	17,763	39,247	27,159
33	SPECIAL STANDARD	6,757	12	35	252	144	7,200		
34	LIBRARY MAIL			5	36	41	1,049		
35	TOTAL STANDARD (B)	35,400		533	1,322	784	36,099		
36	LIB POSTAL SERVICE			5	11	12	288		
37	FREE MAIL			4	2	5	45		
38	INTERNATIONAL MAIL	4,338	40	17	159	31	4,586		
39	TOTAL MAIL	131,617	9,530	6,880	5,423	4,416	157,867		
40	SPECIAL SERVICES:								
41	REGISTRY	331	7	20	-	-	359		
42	CERTIFIED		91	370	-	-	461		
43	INSURANCE		3	26	-	-	29		
44	COD	64	3	8	-	-	74		
45	SPECUL DELNERY		-	-	-	-			
46	MONEY ORDERS		-	-	-	-			
47	STAMPED ENVELOPES		-	-	-	-			
48	SPECUL HANDLING		-	-	-	-			
49	POST OFFICE BOX		2	-	-	-	2		
50	OTHER	568	13	2	-	-	585		
51	TOTAL SPECIAL SERVICES	964	120	426	-	-	1,510		
52	TOTAL VOLUME VARIABLE	132,581	9,651	7,306	5,423	4,416	159,378		
53	OTHER	190,050	1,247	89	45,844	44,621	281,650		
54	GRAND TOTAL	322,630	10,898	7,395	51,267	49,037	441,227		

Notes:

- [A] UPS-Luciani-WP-Supp-1-B-3, p. 9, SPR Specific Fixed Costs. UPS-Luciani-WP-1-B-2 contains revisions to letter route street support. These revisions do not affect SPR street support. Therefore, the values shown here represent those that would be calculated directly from USPS-LR-1-444, CS06&7.xls.
- [B] Total IOCS costs for Exclusive Parcel Post routes is obtained from USPS-LR-1-444, CS06&7.xls, tab Input IOCS, line 7.
- [C] SPR Specific Fixed Costs is the difference between IOCS Total Accrued costs and the amount distributed to SPR Parcel Post.

Exhibit UPS-ST-20

Correct Method for Projecting Parcel Post Test Year Alaska and OMAS Revenue

-> The test year revenue estimation for Alaska and OMAS volume in USPS-LR-I-445 fails to account for the decrease in the Alaska and OMAS volume from the Ease Year to the Test Year.

	<u>Intra-BMC</u>	<u>Inter-BMC</u>	<u>DBMC (a)</u>	<u>Source</u>
[1] Base Year RPW Revenue	106,464,668	283,408,101	569,070,560	USPS-LR-I-445, excludes OMAS/Alaska (b)
[2] Ease Year Volume	30,930,271	53,850,479	195,834,852	USPS-LR-I-445, excludes OMAS/Alaska (b)
[3] Base Year Revenue Per Piece	3.44	5.26	2.91	[2]/[3]
[4] TYER Revenue	94,559,682	266,375,081	736,556,634	USPS-LR-I-445, excludes OMAS/Alaska (b)
[5] TYBR Volume	27,495,992	50,614,551	253,836,747	USPS-LR-I-445, excludes OMAS/Alaska (b)
[6] TYBR Revenue per Piece	3.44	5.26	2.90	[4]/[5]
[7] Percent Increase from BY	-0.1%	0.0%	-0.1%	[6]/[3]-1
[8] TYAR Revenue	94,921,638	268,835,344	750,435,924	USPS-LR-I-445, excludes OMAS/Alaska (b)
[9] TYAR Volume	25,050,582	46,710,097	255,706,190	USPS-LR-I-445, excludes OMAS/Alaska (b)
[10] TYAR Revenue per Piece	3.79	5.76	2.93	[8]/[9]
[11] Percent Increase from BY	10.1%	9.4%	1.0%	[10]/[3]-1

	<u>Intra-EMC Alaska</u>	<u>inter-EMC OMAS</u>	<u>DEMC OMAS</u>	<u>Total OMAS</u>	
[12] Ease Year Revenue	12,965,722	11,872,544	3,162	11,875,706	USPS-LR-I-435, PPHybridp.xls, H-1, p. 13
[13] Ease Year Volume	1,892,812	2,397,612	1,156	2,398,768	USPS-LR-I-435, PPHybridp.xls, H-1, p. 8 (c)
[14] Base Year Revenue Per Piece	6.85	4.95	2.73		[12]/[13]
[15] TYBR Volume	1,321,376	1,005,768	-	1,005,768	USPS-T-36, Att. D (d)
[16] TYER Revenue Per Piece	6.84	4.95	2.73		[14]*(1+[7])
[17] TYER Revenue	9,043,374	4,980,332	-	4,980,332	[15]*[16]
[18] TYAR Volume	1,203,857	928,182		928,182	USPS-T-36, Att. D (d)
[19] TYAR Revenue per Piece	7.54	5.42	2.76		[14]*(1+[11])
[20] TYAR Revenue	9,077,991	5,026,330	-	5,026,330	[18]*[19]

Correction Needed to As Filed:

[21] TYBR Revenue As Filed	14,954,495	13,697,285		13,697,285	USPS-LR-I-445
[22] Correction to TYBR Revenue	(5,911,121)	(8,716,953)		(8,716,953)	[17] - [21]
[23] Total TYBR Revenue Correction				(14,628,074)	
[24] TYAR Revenue As Filed	15,175,963	13,900,135		13,900,135	USPS-LR-I-445
[25] Correction to TYAR Revenue	(6,097,972)	(8,873,805)		(8,873,805)	[20] - [24]
[26] Total TYAR Revenue Correction				(14,971,777)	

Notes:

The use of Ease Year in this Exhibit refers to the USPS-LR-I-445 base year period of 1999Q3 to 2000Q2.

(a) - DBMC excludes DSCF and DDU volumes and revenues.

(b) - PPHybridRevr.xls, tab Revenue Calc.

(c) - USPS-LR-I-445 does not provide the OMAS volume breakdown between Inter-BMC and DBMC. The base year OMAS volume breakdown herein was estimated assuming that the OMAS revenue per piece would be proportional to base year revenue per piece for the inter-BMC and DBMC. If the actual base year OMAS volume breakdown becomes available it should be substituted.

(d) - All Test Year OMAS volume is assumed to be inter-BMC in USPS-T-36. Since the sum of inter-BMC and OMAS volume matches total inter-BMC volume in Attachment D of USPS-T-36.

1 BY MR. McKEEVER;

2 Q Mr. Luciani, I have just handed you a copy of a
3 document entitled Exhibit UPS-ST-2(b), and entitled Direct
4 Attribution of Sequencing of Parcels, with the additional
5 notation, Filed Under Seal on August 14, 2000.

6 Do you sponsor that exhibit as part of your
7 testimony today?

8 A Yes, I do.

9 MR. McKEEVER: Mr. Chairman, I move that that
10 Exhibit, UPS-ST-2(b), entitled Direct Attribution of
11 Sequencing of Parcels be admitted into evidence and
12 transcribed into a sealed version of today's proceedings.

13 CHAIRMAN GLEIMAN: If you would please provide
14 that material to the Reporter, that material will be
15 received into evidence and transcribed into the record in a
16 separate volume, and also included in that volume will be
17 any cross examination that relates to the sealed material.

18 [Exhibit Number UPS-ST-2(b),
19 entitled Direct Attribution of
20 Sequencing of Parcels, was received
21 into evidence and transcribed in a
22 sealed volume of the record.]

23 CHAIRMAN GLEIMAN: And I will rely on your good
24 offices and that of Mr. May to tell me when we have to **pull**
25 the curtain down, or if we have to pull the curtain down.

1 One party has requested cross examination, the
2 Parcel Shippers Association. Is there anyone else who
3 wishes to cross examine this witness?

4 [No response.]

5 CHAIRMAN GLEIMAN: If not, then, Mr. May, you may
6 begin.

7 CROSS EXAMINATION

8 BY MR. MAY:

9 Q Mr. Luciani, I have a couple of questions about
10 your allocation of city carrier elemental load costs, which,
11 as you characterize it on page 4 of your testimony, you
12 allocate those costs by weight for parcels; isn't that
13 correct?

14 A That's correct.

15 Q Now, just briefly, what is an elemental load cost;
16 what function is being performed?

17 A Loading is the practice of putting the mail into
18 the box or handing it to the customer.

19 Q Okay. Would you -- and you do -- and you want to
20 spread these costs on the basis of the weight of the parcel;
21 is that correct?

22 A For parcels.

23 Q Yes, now, if you will refer to page 1 of Exhibit
24 UPS-ST-2(a) that's attached to your testimony --

25 A Yes.

1 Q Would you confirm there that you list the average
2 weight per parcel zone rate? And if you look down the
3 column of different kinds of mail there, you see under
4 Parcel Zone Rate, under Standard Mail B; do you see that?

5 A Yes.

6 Q And you say that that is -- the average is 6.04
7 pounds per parcel; is that correct?

8 A For parcels.

9 Q Now, above that, under Standard A Regular, you
10 have the average weight would be .55 pounds per parcel; is
11 that correct?

12 A That's correct.

13 Q Now, does that mean then that under your method
14 for distributing elemental load costs for parcels to
15 subclass, that that method distributes more than ten times
16 as much cost per parcel, zone rated parcels, as for Standard
17 A Regular parcels?

18 A On a per-piece basis, yes.

19 Q If you will, I have what I hope is as close as I
20 can get to a Standard A parcel average, which is .55 pounds,
21 and a Standard B parcel which is as close as I can get it to
22 the 6.04 pounds.

23 So these are the average weights for Standard B
24 parcel, and this is the average weight for Standard A
25 parcel. And if I may, I would just like to give these to

1 the witness.

2 CHAIRMAN GLEIMAN: You can give it to the witness,
3 just don't ask us to transcribe them into the record.

4 BY MR. MAY:

5 Q Now, you've handled both of these parcels. Do you
6 really believe that this one parcel would cost more than ten
7 times as much as the other parcel to load by carrier?

8 A I wouldn't think that these two particular parcels
9 would have a ten times relationship for the loading process.

10 I wouldn't necessarily believe that this would be
11 the typical size and shape for a .55 pound Standard A
12 parcel.

13 Q This would not be?

14 A That would be my presumption, yes.

15 Q Well, excuse me, but I have another .55 parcel I'd
16 like to show you.

17 [Pause.]

18 That parcel, is it not, is exactly the same shape
19 and dimensions as the parcel that weighed 6.04 pounds?

20 A Yes, it is.

21 Q So, there, they look exactly the same. One is
22 heavier than the other?

23 A That's correct.

24 Q Would you think that the one that is heavier would
25 cost more than ten times as much to load as the one that's

1 lighter, even though they have the same dimensions?

2 A Not in this instance, no.

3 MR. MAY: That's all I have, Mr. Chairman.

4 CHAIRMAN GLEIMAN: True to your word, as usual.

5 Are there any followup questions?

6 [No response.]

7 CHAIRMAN GLEIMAN: Questions from the Bench?

8 [No response.]

9 CHAIRMAN GLEIMAN: Would you like some time to
10 prepare for redirect?

11 MR. McKEEVER: One minute, Mr. Chairman.

12 CHAIRMAN GLEIMAN: One minute, it is.

13 [Recess.]

14 MR. McKEEVER: Not having brought any boxes, Mr.
15 Chairman, we will not have any redirect.

16 MR. MAY: Mr. Chairman, can I make one -- just for
17 the record -- that Mr. Glick is testifying Friday on his --
18 he is a PSA rebuttal witness, T-1.

19 But he also -- and I was reminded by Mr. McKeever
20 -- he also has testimony under seal, which is RT-T-3, and
21 that does not appear on your schedule of witnesses. I
22 assume that we will -- that the record can disclose that he
23 will be putting both in at the same time.

24 CHAIRMAN GLEIMAN: That's probably the most
25 efficient way to do things, so we will do it then. There

1 doesn't appear to be any concern.

2 MR. McKEEVER: That's acceptable, Mr. Chairman.

3 CHAIRMAN GLEIMAN: Mr. Luciani, that completes
4 your testimony here today. We appreciate your appearance
5 and contributions to our record.

6 [Witness Luciani excused.]

7 CHAIRMAN GLEIMAN: And I would consider breaking
8 for lunch right now, but I want to ask a question which will
9 govern whether we do that or not.

10 Our next witness is Time Warner Witness Stralberg,
11 and I notice that only United Parcel Service has requested
12 cross examination.

13 I'm just wondering, Mr. McKeever, if you could
14 give us a guesstimate of the length of your cross
15 examination?

16 MR. McKEEVER: About 15 minutes.

17 CHAIRMAN GLEIMAN: That being the case, I think
18 I'd like to push ahead with one more witness, and that would
19 put us out of here at roughly 1:00 for a lunch break.

20 MR. McKEEVER: I might mention, Mr. Chairman, too,
21 that we have less for Mr. Degen, maybe just a few minutes
22 for Mr. Degen, so may we can do them both.

23 I don't know if anybody else has any. But I guess
24 there is other cross for Mr. Degen. I apologize.

25 CHAIRMAN GLEIMAN: I'm checking, and --

1 MR. STRAUS: I submitted a request for cross of
2 Degen.

3 CHAIRMAN GLEIMAN: We do have other parties, Mr.
4 Straus, for American Business Media, and the OCA, who wish
5 to cross Mr. Degen.

6 MR. STRAUS: I would have about five minutes.

7 CHAIRMAN GLEIMAN: And the OCA?

8 MR. COSTICH: Mr. Chairman, I'm not handling Mr.
9 Degen, so I can't estimate.

10 CHAIRMAN GLEIMAN: Well, if there is someone
11 somewhere on the other end of a squawk box who might be
12 listening, perhaps they'd be kind enough to let us know
13 before we finish with Mr. Stralberg's testimony, what the
14 situation looks like for Mr. Degen, and then we can make a
15 decision at that point in time on whether we want to plow
16 right through or whether we want to break for lunch at that
17 point.

18 Yes, sir, you're ready to proceed?

19 MR. KEEGAN: Yes, thank you, Mr. Chairman.

20 CHAIRMAN GLEIMAN: Mr. Stralberg is already under
21 oath numerous times in this proceeding.

22 MR. KEEGAN: Mr. Chairman, if I may, I'd like to
23 take care of another procedural matter first.

24 This morning, I neglected to move into evidence, a
25 Library Reference, Category TI, sponsored by Mr. Stralberg.

1 That Library Reference is MPA-LR-14, and if I
2 could do that at this time?

3 CHAIRMAN GLEIMAN: Certainly.

4 Whereupon,

5 HALSTEIN STRALBERG,
6 a witness, having been previously called for examination,
7 and, having been previously duly sworn, was recalled to the
8 stand, continued to be examined and continued to testify as
9 follows:

10 DIRECT EXAMINATION

11 BY MR. KEEGAN:

12 Q Mr. Stralberg, was that Library Reference prepared
13 under your supervision, and do you sponsor it as your
14 testimony?

15 A Yes, I do.

16 MR. KEEGAN: Mr. Chairman, I move that that
17 Library Reference be accepted into evidence, but not
18 transcribed into the record.

19 CHAIRMAN GLEIMAN: All right, without objection,
20 it is so ordered.

21 [Library Reference Number MPA-LR-14
22 was received into evidence.]

23 BY MR. KEEGAN:

24 Q Mr. Stralberg, I have just handed you a document
25 that is marked for identification as TW-RT-1, and entitled

1 Rebuttal Testimony of Halstein Stralberg on Behalf of Time
2 Warner, Inc., and a number of other parties constituting the
3 Periodicals Coalition.

4 Was this testimony prepared by you or under your
5 supervision?

6 A Yes, it was.

7 Q And if you were to testify today, would your
8 testimony be the same?

9 A Yes.

10 MR. KEEGAN: Mr. Chairman, I move that Mr.
11 Stralberg's testimony be accepted into evidence and
12 transcribed into the record, and I will hand two copies to
13 the Reporter.

14 CHAIRMAN GLEIMAN: All right, if you will do that
15 then, sir, then I will direct that the material be
16 transcribed into the record and received into evidence.

17 [Written Rebuttal Testimony of
18 Halstein Stralberg, TW-RT-1 was
19 received into evidence and
20 transcribed into the record.]

21
22
23
24
25

TW-RT-1

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

POSTAL RATE AND FEE CHANGES, 2000 :

Docket No. R2000-1

REBUTTAL TESTIMONY
OF
HALSTEIN STRALBERG
ON BEHALF OF
ALLIANCE OF NONPROFIT MAILERS
AMERICAN BUSINESS MEDIA
COALITION OF RELIGIOUS PRESS ASSOCIATIONS
DOW JONES & COMPANY, INC.
MAGAZINE PUBLISHERS OF AMERICA, INC.
THE MCGRAW-HILL COMPANIES, INC.
NATIONAL NEWSPAPER ASSOCIATION
AND
TIME WARNER INC.

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August 14,2000

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1 AUTOBIOGRAPHICAL SKETCH

2 My name is Halstein Stralberg. I am a consultant to Time Warner Inc. on issues related
3 to distribution of magazines through the postal system. For a detailed sketch of my
4 autobiography, please see my direct testimony in this docket (TW-T-1).

5 **I. PURPOSE OF TESTIMONY**

6 The purpose of this testimony is to address the much-debated question of how mail
7 processing costs vary with mail volume, in rebuttal to witness Neels (UPS-T-1). I will
8 focus on two areas where the present record urgently needs clarification.

9 First, I will explain why total piece handlings, TPH in MODS terminology, indeed is
10 the appropriate workload measure for analyzing economies of scale at mail processing
11 piece distribution operations. Contrary to repeated assertions by witness Neels, MODS
12 estimates of first handling pieces, FHP, have no useful interpretation related to
13 economies of scale or the variability of mail processing costs with volume.

14 Second, I will explain, based on my own observations and knowledge, why I believe
15 there are economies of scale in mail processing and why the variability of costs with
16 regard to mail volume therefore must be less than 100%.

17 **II. SUMMARY**

18 In this docket, witness Bozzo (USPS-T-15) has presented an econometric analysis of
19 certain MODS cost pools, which indicates that mail processing costs at those pools **vary**
20 substantially less than 100% with variations in mail volume. The cost pools analyzed
21 by Bozzo share *two* characteristics that distinguish them from most other mail
22 processing cost pools: (1) near uniformity in the shape of mail handled (e.g., letters,
23 flats or parcels); and (2) availability of work load measures, called “total piece
24 handlings” (TPH) produced by the MODS system. *Id.* at 42. Bozzo uses a “panel data”
25 approach (regression over data representing multiple facilities and multiple time
26 periods). *Id.* at 67-71. While his method is similar to that used by witness Bradley in
27 Docket No. R97-1, Bozzo has modified Bradley’s approach in response to the

1 Commission's criticism in its R97-1 Opinion, and makes a painstaking effort to address
2 the specific points raised by the Commission. *Id.* at 16-31.

3 Witness Degen (USPS-T-16) has presented various operational arguments, based on his
4 knowledge of mail processing operations, that support Bozzo's econometric findings.

5 On the other hand, witnesses Neels and Smith (OCA-T-4) have produced, as they did
6 in Docket R97-1, a seemingly endless list of objections. My rebuttal focuses on witness
7 Neels, as witness Smith has added little of substance to his R97-1 testimony. Neels
8 introduces new claims and purported new "findings" that, if left unchallenged, would
9 leave the record on this issue seriously distorted.

10 **A** most interesting aspect of Neels's current testimony is that he appears to confirm
11 Bozzo's finding that the variability of costs (strictly speaking, clerk/mailhandler
12 manhours) with regard to piece handlings (TPH) is substantially less than 100%. In
13 fact, he presents this conclusion as having a high degree of statistical confidence. Tr.
14 27/12830-32. The catch, according to Neels, is that volume should be represented not
15 by piece handlings (TPH) but by FHP (first handling pieces), estimated in MODS as the
16 number of mail pieces entering a plant that receive at least one individual piece
17 handling in that plant. He further claims to have found, using a "reverse regression"
18 that on Postal Service cross-examination was shown to be a non-reversible regression
19 (Tr. 27/13052-56), that TPH has a very high (substantially more than 100%) variability
20 relative to FHP. Combining this with an estimated variability of **hours** relative to **TPH**.
21 Neels claims to have proven a larger than 100% variability of manhours with respect to
22 'volume.'" Tr. 27/12805-08, 12832-35.

¹ Neels also attempts to prove much more than 100% variability through a time series analysis which he claims will 'capture the effects of structural changes in the underlying technology and organizational design of the postal system.' Tr. 27/12835-43. This analysis can be characterized both in terms of the extremely poor statistical confidence intervals it produces (in fact these confidence intervals include variabilities much higher as well as much lower than 100%, i.e., the results are totally useless [Tr. 27/13061-64]) and in terms of the variables Neels assumes did not vary over the 20 year period he claims to have analyzed. Tr. 27/13058-60, 13064-65.

1 Section III below focuses on the most seriously misleading claim presented by Neels,
 2 namely that FHP, an archaic and essentially meaningless byproduct of the MODS
 3 system, is the most appropriate workload measure for mail processing operations. That
 4 section also discusses how Neels arrived at the highly counterintuitive conclusion that
 5 TPH varies much more than 100% with FHP, and the relative merits of analyzing
 6 variability by more narrowly defined cost pools, as done by Bozzo, versus the analysis
 7 by shape category proposed by Neels.

8 Neels's rebuttal of Degen makes some valid points in that not all the conditions Degen
 9 cites by themselves prove economies of scale. For example, his observation that the
 10 existence of peak load conditions in itself proves nothing regarding economies of scale
 11 (Tr. 27/12825) is well taken but is hardly dispositive. Some of Neels's other arguments,
 12 however, reveal a serious lack of understanding and knowledge of mail processing in
 13 Postal Service facilities. In section IV, below I analyze these arguments and explain
 14 why my own observations of mail processing lead me to conclude that the variability of
 15 costs with volume must be substantially less than 100%.

16 **III. TOTAL PIECE HANDLINGS (TPH) IS THE MOST APPROPRIATE "COST**
 17 **DRIVER" IN THE STUDY OF COST/VOLUME VARIABILITY AT MAIL**
 18 **PROCESSING PIECE SORTING OPERATIONS**

19 Most of the cost pools analyzed by witness Bozzo are piece sorting operations that
 20 operate on mail with uniform shape.² In the following I will explain why I believe TPH
 21 indeed is the proper cost driver and the proper variable to use in the analysis of
 22 economies of scale and variability of costs relative to volume for those operations.

² The only exceptions are: (1) the meter prep/cancellation pool; and (2) the 'SPBS Other' pool. The latter normally sorts flats bundles rather than individual pieces. These two pools were included in Bozzo's analysis because, as with the proper piece sorting operations, TPH data provide a well defined cost driver, whereas the proper cost drivers are unknown at allied operations.

1 **A. TPH IS PRIMARILY A FUNCTION OF MAIL VOLUME AND DEGREE OF**
 2 **PRESORTATION PERFORMED BY MAILERS**

3 Total piece handlings (TPH) is essentially a function of: (1) the number of letters, flats
 4 or parcels entered into the postal system; and (2) the degree of presort with which those
 5 pieces are entered. The relationship between pieces, presort and total piece handlings
 6 is quite simple for higher degrees of presort and somewhat more complex for pieces
 7 with little or no presort. Taking flats pieces as an example, it is generally accurate that:

- 8 (1) pieces with carrier route presort incur no piece handling:
 9 (2) pieces with a 5-digit presort incur exactly one piece handling, commonly
 10 referred to as "incoming secondary" sortation; and
 11 (3) pieces with a 3-digit presort incur two piece handlings, commonly referred to
 12 as "incoming primary" and "incoming secondary" sortations.³

13 For lower presort levels, the relationship is somewhat more complex.⁴

14 The relationship between pieces, presortation and TPH is relatively unaffected by
 15 network changes. This is because the number of sorting steps needed to bring mail
 16 from its original sort level to a carrier route sort level is the same whether the actual
 17 sorting occurs in one facility or is divided between several facilities.

18 The relationship between pieces entered at various presort levels on one hand, and
 19 piece handlings and costs on the other hand, is explicitly recognized in the various
 20 worksharing models that the Commission and the Postal Service use to determine cost
 21 savings produced by degrees of worksharing, and to set presort discounts. These
 22 models estimate costs of **mail** with given characteristics in terms of the number of piece

³ By "piece handlings" I am referring to sortations performed by clerks, not to the additional handling performed by mail carriers after the mail already is sorted by carrier route.

I say "generally accurate" because there are, of course, exceptions, such as occur in cases of machine rejects, missorting or bundle breakage, which may cause extra piece handlings. Additionally, flats addressed to a P.O. box may receive an additional sort, usually at the delivery units. But such exceptions, which occur with measurable probabilities, do not change the fact that piece handlings fundamentally are a function of pieces and presortation.

⁴ Generally, the number of **sorts** required to finish pieces with a given presort level **will** be less if the pieces originate and destinate in the same city or at least in the same area.

1 sorts and bundle sorts such mail requires. To the extent that such results *are*
 2 incorporated in the rate structure, one could say that postal rates for categories within a
 3 subclass are based on the number of piece handlings mail requires, and that piece
 4 handlings required therefore indeed represent the most appropriate measure of
 5 'volume" at mail piece sorting operations.

6 Just as in a study of transportation costs cubic-foot miles is a more relevant workload
 7 measure than cubic feet alone, in mail processing total piece handlings, which is a
 8 function of presortation. is more relevant as a workload measure than pieces alone.

9 Another MODS volume measure is "total pieces fed" (TPF). The difference between
 10 TPF and TPH at a mechanized or automated sorting operation is the number of pieces
 11 that *are* rejected by the machine. The ratio TPH/TPF is the machine accept rate.
 12 Bozzo's analysis of machine driven operations is actually based on TPF. rather than
 13 TPH. For simplicity, I focus in this testimony on TPH, however, the arguments made
 14 here for **use** of TPH apply also to TPF.⁵

15 Because TPH is a function of presortation. a variability analysis using TPH as the
 16 independent variable has the considerable advantage that it already is adjusted for
 17 differences in presort levels over time and among facilities. This **is** certainly far
 18 superior to the feeble attempt at adjusting for 'worksharing" in Neels's time-sharing
 19 analysis. Neels uses just a single variable, which he claims represents the changes in
 20 'worksharing" for all mail classes over the twenty year period he analyzed. Tr.
 21 27/12838-39. In fact, there are numerous degrees of presortation for different classes of
 22 mail, some of which are recognized in the rate structure and therefore reported in the
 23 billing determinants and others that *are* not. An analysis attempting to adjust for
 24 changes in all these presort levels using separate explanatory variables would be

⁵ The difference between pieces fed and pieces handled (read) **is** most relevant for sorting operations **that** employ OCR technology. Since that technology is improving. leading to higher accept rates over time, Bozzo is in my opinion correct in choosing to focus on TPF at such operations.

1 extremely complex and probably impossible to carry out. But the adjustment is made
2 automatically when one focuses on total piece handlings.⁶

3 Besides presort, sorting costs are affected by the sorting technology used, which again
4 is affected by mail piece characteristics and decisions made by facility managers. In my
5 opinion, this speaks in favor of analyzing separately the economies of scale in pools
6 that represent different technologies, e.g., separate analyses of the FSM and manual
7 flats cost pools. Neels appears to prefer combining the pools that sort mail of similar
8 shapes, on the ground that these cost pools are not truly independent of each other. **As**
9 discussed further in Section IV.E, my preference would be to stay with the pool-by-pool
10 analysis of volume variability, in spite of the considerable interactions between these
11 pools. One reason to prefer pool-by-pool analysis is that it is consistent with the way
12 the Postal Service and the Commission currently distribute costs.

13 **B. ESTIMATES OF FIRST HANDLING PIECES (FHP) ARE IRRELEVANT FOR**
14 **THE STUDY OF ECONOMIES OF SCALE IN POSTAL FACILITIES**

15 Considerable confusion has been generated in this case by Neels's insistence that the
16 proper measure of "volume" in mail processing is so-called FHP (first handling pieces),
17 defined as the number of letters, flats and parcels that receive piece sorting at least once
18 in a given facility. FHP estimates do not necessarily reflect the workload in a facility,
19 since each piece is counted only once, even if it requires several sorts. Nor do they
20 represent total mail volume, since they exclude pieces that **bypass** all piece **sorts**. Tr.
21 27/13056-58.⁷

⁶ For example, assume that from one year to another in the time period analyzed a significant proportion of First Class Presort and Standard **A** mail pieces shifted from 3-digit to 5-digit presort. Since 3-digit and 5-digit pay the same postal rates both in First Class and Standard **A**, billing determinants would not reflect the change and the Postal Service would have no way of detecting the change except through a special survey. But there would be a major impact on costs, since 5-digit mail requires one less sort per piece than does 3-digit mail. This change would not affect the accuracy of a study that focuses on TPH, which is adjusted for presortation changes, but it would cause major and undetectable distortions in a study that focuses on costs versus number of pieces.

⁷ The only real purpose of FHP estimates is for use in estimating the TPH at manual sorting operations. The practice of pushing all mail that comes out of opening units destined for piece sorting across scales

1 Additionally, FHP counts in postal facilities can be affected in a dramatic fashion by
 2 network changes that have little or no impact on TPH. For example, consider mail
 3 going to a 3-digit ZIP code area served by a small SCF that is in turn served by a larger
 4 plant, an ADC (area distribution center). Suppose that mail in 3-digit trays or bundles
 5 to the smaller SCF is sorted at that SCF and therefore gets counted as FHP. However,
 6 at a certain point in time, it is decided that the sortation of the 3-digit mail from then on
 7 will be done at the larger ADC.⁸ The result is that these pieces no longer are counted as
 8 FHP at the smaller SCF. But since many of them already were being counted as FHP at
 9 the larger ADC as well, there is no corresponding increase in FHP at that facility. The
 10 total FHP count in the Postal Service thereby drops, while the TPH count remains
 11 unaffected by network changes of this type.

12 **C. NEELS'S PURPORTED FINDING THAT TPH VARIES MUCH MORE THAN**
 13 **100% WITH FHP CONTRADICTS COMMON SENSE AND IS BASED ON AN**
 14 **IMPROPER STATISTICAL METHOD**

15 1. Neels's Finding Contradicts Common Sense

16 A puzzling aspect of Neels's testimony is his claim to have "proven" that TPH varies
 17 much more than 100% with variations in FHP. If one believes this, one must conclude
 18 that an increase in FHP would lead to a much higher percent increase in TPH. For
 19 letters, the increase in TPH would be more than twice the FHP increase. Tr. 27/12835,

in order to convert recorded weights into FHP estimates seems archaic in facilities with only a few remaining manual letter and flats cases. In fact, they serve only to estimate a small fraction of the manually sorted volume, since most such volume tends to come from mechanized, automated or other manual operations. I suspect that the Postal Service could realize substantial cost avoidances by eliminating the useless practice of estimating FHP at operations where TPH is determined by machine counts anyway.

⁸ Such consolidations into larger facilities have been occurring in the Postal Service for many years, evidently because Postal Service operations managers believe that there indeed are economies of scale in mail processing.

1 13049-52. Based on these 'findings," Neels claims to demonstrate major diseconomies
2 of scale in mail processing.⁹

3 In fact, if there were diseconomies as large as Neels's results seem to suggest, then a
4 large drop in volume, caused for example by migration of First Class mail and
5 advertising to the internet, would cause a much larger drop in piece handlings, leading
6 to lower unit processing costs for the remaining mail.

7 I believe econometric results should always be tested against common sense and
8 known facts. With the exception of network changes or changes in the degree of
9 presort, as discussed above, Neels's finding regarding the relationship between
10 changes in FHP and TPH fails such a test. It is very unlikely that a percent change in
11 FHP in a facility would lead to a much larger percent change in TPH, which Neels
12 claims to have discovered. Since the piece handlings required for a given number of
13 pieces is a function of presortation, an increase in FHP, assuming it is distributed
14 proportionately among the different presort categories, will tend to give the same
15 percent increase in TPH.¹⁰

16 2. Neels's Counterintuitive Result Is Based On A Highly Questionable "Reverse"
17 Remission Method

18 How then did Neels arrive at his counterintuitive results? A possible simple
19 explanation is offered below. It is my understanding that Postal Service rebuttal
20 testimony will provide a more in-depth evaluation of Neels's statistical method,
21 demonstrating that it is not well founded in statistical theory and that his results
22 therefore are worthless.

⁹ Upon questioning, Neels retreated to his and his client's official position that volume variability in mail processing is exactly 100%. Apparently, even Neels himself doesn't really believe in his results. Tr. 27/13028, 13068-69.

¹⁰ The assumption that the added volume is distributed proportionately among the different presort categories is necessary to conform with the definition of volume variability as the change in costs in response to a volume change with all other factors being constant.

1 Essentially, the ratio TPH/FHP indicates the degree of re-handling that occurs in a mail
 2 processing plant. If the ratio is one, then each piece that is handled in the given plant is
 3 handled only once. This is unlikely, since plants will always have at least some mail
 4 with local destination that requires more than one handling."

5 Large facilities are likely to have larger TPH/FHP ratios, i.e., more re-handling than
 6 small facilities. This is due not to diseconomies of scale but to network characteristics,
 7 as I explain below. But first, let us simply assume it is true that large facilities have
 8 more re-handlings. Then assume that one performs a regression on "panel" FHP and
 9 TPH data, including cross-sectional as well as time series data, as Neels did. Unless
 10 such a regression is properly and fully adjusted for "fixed effects" such as network
 11 related variations in the TPH/FHP ratio, it would end up showing precisely the type of
 12 results that Neels reports, i.e., TPH growing faster than FHP.

13 Neels's regression is unusual in several respects. He chose TPH as the independent
 14 variable and FHP as the dependent variable, purportedly to reduce the impact of less
 15 reliability in the FHP data. Tr. 27/13052-53. The regression he chose is, as Neels
 16 admits, not reversible, i.e., it does not produce the reverse results of what would be
 17 obtained if he had used FHP as independent and TPH as dependent variable, as one
 18 normally would do if the objective were to study how TPH is affected by variations in
 19 FHP. Tr. 27/13055. In fact, Neels is not able to specify the functional form by which
 20 the real dependent variable, TPH, is presumed related to the real independent variable,
 21 FHP, in his analysis. *Id.* He claims it is given implicitly as the inverse of the functional
 22 form which he assumed expresses FHP as a function of TPH. Tr. 27/13053.
 23 Consequently, it is not even possible to evaluate the properties of the presumed TPH to
 24 FHP relationship, and it is not clear what, if anything, his results mean - except that
 25 they appear to reflect network characteristics that he did not properly correct for.

¹¹ However, in *the* case of flats with a 5-digit presort, such as the majority of non-carrier route presorted Standard **A** and Periodicals flats, the ratio TPH/FHP is exactly one, **since** such flats require one and only one sort to carrier route.

1 In fact, as I understand will be fully demonstrated in a Postal Service rebuttal
 2 testimony, Neels's method does not prove that the variance of TPH with FHP is
 3 different from one, which is where it would be based on the test of common sense.¹²

4 3. Variations In TPH/FHP Are Caused By Network Characteristics

5 The reason larger facilities generally perform more re-handlings than small facilities
 6 has to do with the way the Postal Service has assigned sorting responsibility in its
 7 network. Generally, a plant is required to perform a finer sort (e.g., to the 5-digit or
 8 even carrier route level) on the mail that destines within its SCF service area.

9 Consider first unsorted mail that originates in a plant's SCF service area. The plant
 10 must sort this mail at least once, and the portion of it that also destines to its service
 11 area must then be sorted one or two more times. But if one compares a small and a
 12 large plant, say one serving an area with 100,000 people and the other serving an area
 13 with 5,000,000 people, it is clear that mail originating at the larger area has a higher
 14 probability of also destinating within the same area. In other words, there will be a
 15 higher percent of re-handling of the originating mail at the larger plant. Additionally,
 16 most larger plants are ADC's. The ADC service area is wider than the service area of
 17 an individual SCF. A plant that is an ADC must do further sorting not only on its own
 18 SCF mail, but on the mail destinating anywhere within its ADC area.

19 Now consider incoming mail. A small plant that is not an ADC receives only incoming
 20 mail that already is sorted to the 3-digit or 5-digit ZIP code levels, requiring
 21 respectively two and one additional sorts. But an ADC, generally a larger facility, will
 22 also receive mail sorted only to the ADC level, which requires an additional sort. In
 23 some cases, ADC's also perform additional sorts **on** behalf of the smaller SCF's that
 24 they serve, generally because the Postal Service tends to concentrate most of its sorting
 25 operations in large plants, believing as it does that there indeed are economies of scale.

¹² More specifically, it **will** be demonstrated that: (1) a "direct" regression using TPH as the dependent variable gives a TPH to FHP variability close to one, as one would expect; (2) the FHP error component is too small to have justified Neels's decision to rely on a reverse, rather than direct, regression; and (3) all that can be concluded from Neels's reverse regression is that the variability lies in a certain wide interval that includes the value of one.

1 To summarize, due to network characteristics there is more re-handling in larger
2 facilities. But it would be fallacious to therefore conclude that the number of re-
3 handlings would grow faster than the arriving volume, if the volume did grow, in
4 either small or large facilities. An analysis properly adjusted for all network-related
5 reasons why larger facilities have more re-handlings would show what really should
6 be obvious, namely that a percent change in FHP, spread proportionately over all
7 categories of mail, would cause approximately the same percent change in TFH.

8 **IV. LOGIC AND OPERATIONAL REALITIES INDICATE THAT VOLUME**
9 **VARIABILITY MUST BE LESS THAN 100 PERCENT**

10 The operational reasons for concluding that there must be economies of scale in mail
11 processing, and that increasing volumes therefore will lower the average unit costs, are
12 in my opinion overwhelming. I doubt if any Postal Service operations manager would
13 disagree with this view. But witness Neels still raises a number of reasons to question
14 this conclusion, even suggesting that volume variability might be more than 100%. Tr.
15 27/12822, 13030-32. Many of his points are in response to witness Degen, whose direct
16 testimony presents various operational reasons for concluding that economies of scale
17 do exist.

18 In the following sections, I address the specific points raised by Neels. The discussion
19 is organized as follows:

- 20 (a) setup times and equipment utilization;
- 21 (b) effect of peak load conditions;
- 22 (c) automation and mechanization of mail processing plants
- 23 (d) why volume variabilities are lower at manual sorting operations: and
- 24 (e) the real significance of Neels's shape-based analysis.

25 **A. SETUP TIMES AND EQUIPMENT UTILIZATION**

26 Degen referred to the extensive setup times required before utilizing some sorting
27 equipment as indicating economies of scale, since adding more mail volume would not
28 add to the setup costs. Neels replies that this would occur only in certain narrow
29 volume ranges, after which a facility would need to acquire another machine of the

1 same type, for which it would also incur setup costs, etc. Figure 8 in Neels's testimony
2 illustrates how he imagines the Postal Service's setup problem, with more and more
3 machines requiring setup and take-down as mail volume grows. Tr. 27/12822-23.

4 Neels apparently does not realize that the Postal Service's sorting machines are used for
5 multiple sorting schemes, each of which requires separate clearing from one scheme
6 and setup for the next scheme. The Postal Service has far more sorting schemes than it
7 has machines with which to perform those schemes. This leads to non-productive time
8 in between schemes. With larger volumes, the runs of each scheme would be longer.
9 This might eventually require acquisition of more machines, but would not lead to any
10 more setups and take downs. The cost of the same number of setups would be spread
11 over more mail pieces, leading to lower average costs.

12 Consider, for example, the effect of setup times for two types of machines commonly
13 used in mail processing: (1) small parcel and bundle sorters (SPBS); and (2) flat sorting
14 machines (FSM's).

15 Small Parcel and Bundle Sorters (SPBS). These machines have various configurations
16 and are used to sort either Priority packages or flats bundles. Even very large facilities
17 have just a few SPBS. They are typically configured with either four or six keying
18 stations. The cost of adding a fifth or sixth station is probably considerably less than
19 for each of the first four, both in capital outlays and manpower required, since adding
20 them would have relatively little impact on the feeding and sweeping functions of the
21 machines.

22 When flats bundles are sorted, Periodicals and Standard A bundles are **usually** kept
23 separate, requiring separate schemes for each. Additionally, a facility may need to run
24 several sorting schemes for each class. An ADC may, for example, need to sort bundles
25 that come in ADC containers - it typically sorts these to 3-digit **and** some large 5-digit
26 zones in the ADC service area. Then for each of its 3-digit areas to which the bundles
27 have been sorted it may need to set up a new scheme in order to sort the bundles
28 further to the 5-digit level.

1 According to my observations, setting up an SPBS for a given sort scheme is very time
2 consuming. For example. at a visit to the mail processing annex in Charlotte, around
3 midnight. the Joint Industry/USPS Periodicals Review Team was told that the SPBS
4 used for flats bundles (a different machine was dedicated to Priority Mail) would take
5 about 20 minutes to set up for a new sort scheme, since they had just finished a
6 preceding scheme. Even though the SPBS employees seemed to be working at a good
7 pace, the setup actually took well over 30 minutes. Considering the different classes
8 and schemes run on this machine every day. it is clear that a substantial portion of SPBS
9 employees' time is spent setting up for the actual sorting. Once the SPBS operation
10 starts it appears quite efficient. certainly much more efficient than manual bundle
11 sorting and other manual opening unit work that is among the least efficient operations
12 one observes in mail processing plants.

13 With more volume, a facility that already uses one SPBS to sort flats bundles might be
14 able to acquire another machine. In that event it would do fewer schemes on each
15 machine and thereby reduce the per piece setup costs. Perhaps more significantly,
16 facilities that today lack the volume to justify getting their own SPBS might be able to
17 justify acquiring one. thereby eliminating many hours currently spent ~~in~~ manual
18 opening units.

19 FSM's. The Postal Service has more FSM's than SPBS machines. On the other hand,
20 there are many more sorting schemes that need to be run on the FSMs. Most sorting
21 schemes are "incoming secondary" schemes, where mail already sorted to the 5-digit
22 ZIP code level is further broken down to carrier route. Incoming secondary is the
23 largest flats sorting task, because it must be performed on all flats except those already
24 sorted to carrier route. The problem facing postal managers is that the number of five-
25 digit zones for which they must sort the mail far exceeds the number of machines
26 available for sorting, and a machine can sort only one, or at most two, zones at a time.
27 Furthermore, most of this sorting must be done in a relatively short time period before
28 dispatch to delivery units. The result is a series of short runs, in between which
29 substantial setup time is needed to clear a machine of the mail to the zone just sorted
30 and set up for the next zone. As I pointed out in my R97-1 rebuttal testimony, there are

1 about 800 FSM's and over 400 SCF's, so that an SCF is likely to have no more than a few
2 machines while it may have hundreds of zones for which the mail must be sorted.

3 Assume, however, that mail volume doubled and that the Postal Service adjusted by
4 doubling the number of FSM's. Facilities could then not only double the length of
5 sorting runs, cutting average setup costs in half, but would be able to use **FSM** sorting
6 to additional zones where, due to insufficient volumes, manual sorting is today
7 considered more economical.¹³ The result would be lower average costs per piece.

8 **B. EFFECT OF PEAK LOAD CONDITIONS**

9 There can be no doubt that peak load conditions exist in mail processing. ~~In~~ a typical
10 **24** hour cycle at a processing plant there is a strong peak that starts with the arrival of
11 originating collection mail and is caused by the need to perform many operations on
12 *this* mail in just a few hours in order to meet First Class service commitments. There is
13 typically another peak, in the early morning, caused by the need to dispatch processed
14 incoming mail to its stations, branches and associate offices in time for those offices to
15 meet service commitments.

16 Neels criticizes Degen for regarding peak loads as evidence of low volume variability.
17 Tr. 27/12825. In one respect, Neels is correct. If mail volume simply doubles, with
18 mail arriving in the same peak patterns as before, then the peak load conditions **will**
19 not change. Facilities will still have to staff for peak demand, thereby incurring the
20 same proportion of employee idle time in between peaks.

21 However, there are ways in which increased volumes would likely help ameliorate
22 peak load conditions. An increase in collection mail could, for example, make it cost
23 effective for a processing plant to make extra runs to pick up early collections. Such
24 mail would then arrive at the plant literally on "*the* shoulder of the peak," to **use**
25 Neels's terminology.

¹³ Adding to the large number of schemes to be run on the FSM's ~~is~~ the fact that facilities try to keep pre-barcoded and non-barcoded flats, as well as FSM-881 machinable flats and flats that are machinable only on FSM-1000 machines, segregated.

1 Or consider the low volume variability in off-peak hours. To the extent that facilities
 2 do staff for peaks of less than eight hour duration, it is almost true by definition that the
 3 variability of cost with respect to volume is higher during the peak and lower outside
 4 the peak.¹⁴ Assume that a postal facility maintains a small crew at a postal platform
 5 during an off-peak period when one truck arrives with mail every hour. Assume that
 6 the off-loading of a truck and subsequent platform handling of the arrived mail takes
 7 20 minutes, leaving 40 minutes in which this crew has no work assignment. If mail
 8 volume doubles, there will on the average be one truck arriving every half hour. No
 9 increase in crew size will be needed. but the existing crew will be busy two thirds of
 10 the time versus only one third of the time previously.

11 Bozzo's analysis is an econometric estimation of the average variability of cost when
 12 volume varies in certain **mail** processing operations. While peak load conditions by
 13 themselves do not demonstrate low volume variability. neither do they constitute
 14 evidence of high variability or invalidate Bozzo's analysis, which is confirmed by many
 15 other operational realities. Since the minimum unit of time used by Bozzo was postal
 16 quarters, it is in any case unlikely that his study would have picked **up** the effects of
 17 volume and processing variations within individual 24 hour periods. Clearly, Bozzo's
 18 analysis did not address such very short-run phenomena.

19 **C. AUTOMATION AND MECHANIZATION OF MAIL PROCESSING PLANTS**

20 The Postal Service's newest and fastest sorting machines can generate substantial
 21 economies if there is enough mail volume to use them fully. But these economies will
 22 be diminished to the extent that the machines are used for too many different sort
 23 schemes, each having low volume and requiring extensive setup and take-down time.
 24 This would appear to indicate that the Postal Service, in its current automated

¹⁴ This fact is not recognized by the current postal costing method, and cannot possibly be analyzed properly based on IOCS tallies alone. The Postal Service's costing method is flawed in that it estimates the average volume variability only in a given pool, then distributing the costs estimated to be volume variable to subclasses and special services based on IOCS tallies. In fact, this process is likely to assign higher, rather than lower, unit costs to the mail that is processed outside the peak, a period when employees tend to work at a slower tempo, especially at manual operations.

1 processing environment, depends on high mail volumes to minimize its per piece
2 processing costs.

3 Witness Neels appears to recognize this fact. He describes a general scenario,
4 illustrated **in** Figure 1 of his testimony, that depicts the response of a hypothetical
5 service to increases in volume. Tr. 27112783-85. **As** volume increases, processing is
6 gradually shifted to technologies with lower unit costs but higher setup costs. This
7 picture, which appears to correspond well with the automation strategy pursued by
8 Postal Service management for many years, strongly suggests low and declining
9 volume variability.

10 But when it serves his purpose. Neels then describes a very different scenario, one **in**
11 which there appear to be strong diseconomies of scale. In that scenario, illustrated **in**
12 Neels's Figure 2, management uses a fixed and highly productive processing resource
13 to the limit of its capacity, and then handles the remaining volume with a slower
14 technology (e.g., manual sorting). Tr. 27/12785-86. Obviously, such a scenario implies
15 diseconomies of scale: as soon as mail volume has filled up the capacity of the efficient
16 technology, every extra piece raises the overall unit cost.

17 In presenting these two scenarios as if they were equivalent and equally probable,
18 Neels fails to acknowledge that whereas the first corresponds to the long term Postal
19 Service strategy, the second is merely a short term response of facility management
20 when on a given shift it has more mail than it can handle on its automated equipment.
21 Such situations do tend to occur, either because machines break down, or because mail
22 arrives late, or because of unusually high volume. Based on many years study of mail
23 processing operations, I believe that management, in anticipation of such events, tends
24 to maintain a relatively large manual workforce that is fully utilized only in
25 emergencies. This, as I have argued in earlier testimonies, is one reason why the
26 apparent cost of manual processing has become higher in the automated environment,
27 and it is the likely reason why Bozzo's analysis shows lower volume variability in
28 manual than in mechanized and automated sorting operations.

29 Such conditions do not indicate diseconomies of scale. Many of the reasons why mail is
30 diverted to manual processing have nothing to do with volume, but rather with factors

1 such as late arrivals due to weather or traffic conditions combined with service
 2 commitments, unexpected machine breakdown during peak hours and non-
 3 machinability of certain mail pieces. The only economically logical long term response
 4 for Postal Service management to consistent shortfall of capacity in its most advanced
 5 technology is, of course, to expand that capacity. **As** advanced technology capacity is
 6 expanded, processing costs in the given facility will become less volume variable.

7 **D. WHY VOLUME VARIABILITIES CALCULATED BY BOZZO ARE LOWER AT**
 8 **MANUAL OPERATIONS**

9 Neels claims it is counterintuitive that the volume variabilities resulting from Bozzo's
 10 analysis are lower for manual cost pools than for mechanized and automated pools. He
 11 argues that this would mean that, as volume grows, manual processing eventually
 12 would become cheaper than mechanized and automated processing. Tr. 27/12811-12.

13 The fallacy in this argument is that per definition volume variability is the partial
 14 derivative of costs with regard to volume. That is, it indicates the percent change in
 15 cost that would result from a small percent change in volume. One would not expect
 16 this derivative to remain constant under very large volume changes.¹⁵

17 In the larger plants, which today perform most of the mail processing, the manual letter
 18 and flat sorting operations are much smaller than they used to be. Their
 19 interrelationship with their automated/mechanized counterparts is actually quite
 20 simple: on some occasions they are required in short time periods and on short notice to
 21 handle large volumes diverted from the other operations. These manual operations

¹⁵ If C denotes costs and V volume, then the variability of costs with respect to volume is the limit of the expression $(\Delta C/C)/(\Delta V/V)$ for small ΔV . In the simple case where costs are determined by a fixed component plus a fully variable component. i.e., $C=a+b*V$, it can easily be verified that the variability increases as volume increases. If volume becomes very high, the fixed term no longer is significant. It therefore is fallacious to extrapolate a variability that is affected strongly by high fixed costs to much higher volumes where fixed costs are less significant. The high fixed costs at manual sorting operations in today's environment are at least partly related to their role as backup for high-volume automated and mechanized operations. USPS-T-16 at 43-44 (Degen); ~~see also~~ Docket No. R97-1, USPS-T-4 at 21 and Tr. 11/5856 (Möden); and Docket No. MC95-1, USPS-T-11 at 12-13, 21 (Byrne).

1 tend to be overstaffed most of the time: in fact, they must be overstaffed to some extent
2 in order to be prepared for such surges in workload. When an operation is overstaffed,
3 it stands to reason that adding some volume requires little extra personnel time. That is
4 why volume variabilities for these manual operations are so low, as reflected in Bozzo's
5 analysis.

6 **E. THE REAL SIGNIFICANCE OF NEELS' S SHAPE-BASED ANALYSIS**

7 Based on his assertion that Bozzo's finding of lower variability at manual operations is
8 anomalous, and arguing that all operations involving a given shape are interrelated,
9 Neels suggests that a shape aggregated analysis might be preferable to an analysis of
10 individual cost pools. Tr. 27/12793-95. He does in fact carry out such an analysis,
11 using an approach similar to Bozzo's, except that he aggregates the MODS observations
12 of manhours and piece handlings by shape (i.e., letters, flats and parcels). Tr.
13 27/12809-18.

14 While Neels's interpretation of his own results is rendered worthless by his misguided
15 insistence that FHP is an appropriate cost driver, the results themselves are noteworthy
16 in that they reveal, for all three shapes, and with a high degree of statistical confidence,
17 that the variability of costs (manhours) with regard to total piece handlings is
18 substantially less than 100%. Tr. 27/13039-40.

19 Beyond this, and equally important, Neels is correct in arguing that there are strong
20 interrelationships between the different MODS cost pools, certainly among pools that
21 sort mail pieces of the same shape. But if one accepts the premise that there indeed are
22 interactions between these cost pools and that the pools cannot be viewed as entirely
23 separate universes, then this must also have implications for cost distribution.

24 There has been a significant evolution evident in the viewpoints of the parties in this
25 docket. Both the Postal Service and UPS now appear to support the view, presented by
26 MPA witness Cohen and me in Docket No. R97-1, that serving downstream mail
27 processing operations is a major function of allied operations and that it therefore is
28 appropriate to distribute the allied non-direct costs more broadly. Tr. 27/12791-95;
29 USPS-T-15 at 136-37.

1 Unfortunately, there has not yet occurred a similar evolution with regard to the
 2 individual piece distribution operations, which were the object of Bozzo's analysis. The
 3 Postal Service's cost distribution method, which UPS supports (Tr. 27/13124-25),
 4 essentially treats each of these pools as if it were a separate universe. This method
 5 assumes that all mixed mail and not handling costs within each pool are causally
 6 related to subclasses and special service in exactly the same proportion as are the
 7 "direct" IOCS tallies. USPS-T-16 at 58-59.

8 It is highly incongruous to preach about pool interrelationships in **an** academic
 9 discussion aimed at derailing all Postal Service attempts to develop realistic estimates
 10 of volume variability, while at the same time pretending such interrelationships do not
 11 exist when it comes to the issue of pool cost distribution.

12 **As** I have argued in several previous testimonies, a side effect of postal automation has
 13 been increased costs in manual sorting and opening unit operations. This has had the
 14 further effect that while the Postal Service overall has become more efficient, mail that
 15 continues mostly to be processed manually is being held responsible for higher and
 16 higher costs. This fundamental unfairness can be addressed only by a system that
 17 distributes costs based on recognition of the true causal relationships between volumes
 18 of different types of mail and costs incurred by the Postal Service.

19 The Postal Service does not have such a costing system. All it has are the **IOCS**
 20 tallies combined with MODS pool cost data. I believe that since the different piece
 21 distribution pools are treated separately in cost distribution they should also be treated
 22 separately in the estimation of volume variability.¹⁶ By recognizing the lower
 23 variabilities that Bozzo's analysis shows exist at manual sorting operations, the

¹⁶ The shape aggregated analysis presented by Neels gives fairly similar results. Tr. 27/13039-40.

Separate analysis by pool, where pools are defined both by shape and by sorting technology, would also appear to be more accurate, in the sense of being less affected by the migration towards more advanced technologies that has occurred in the time period Bozo analyzed, and by the different degree to which these technologies are used at different facilities. Neels has criticized Bozzo's use of the so-called manual ratio as inadequate for accounting for the interaction between the different pools that handle the same shape. Tr. 27/12791-92. But one hardly improves on the accuracy by pretending that the differences in sorting technology, over time and between facilities, do not exist.

1 Commission would help undo some of the unintended negative effect that automation
2 has had on mail which continues to be handled manually.

3 V. CONCLUSIONS

4 I have focused in this testimony on two main ideas.

5 First, despite the confusion generated by witness Neels and others, piece handlings,
6 measured as TPH in MODS facilities, is indeed the proper workload measure for Postal
7 Service piece sorting operations. TPH is, as explained above, essentially a function of
8 the degree of presort with which mail is entered into the postal system. In an ideal
9 world TPH, along with other relevant workload measures such as required bundle
10 sorts, sack and pallet handlings, etc., should be the elements on which postal rates are
11 based. To some extent **this** is already true within certain subclasses, due to the presort
12 and other worksharing discounts that are in place today.

13 What a supervisor at a mail sorting operation must know, be it manual or fully
14 automated, is how many piece sorts (TPH) are required on his **shift**. Based on an
15 estimate of the TPH he can plan his work and determine whether he has enough
16 workers available to get it done in time. He does not need to know the number of **first**
17 handling pieces (FHP) at his operation, and he normally would not know it.

18 Second, despite numerous facile objections raised by witness Neels, based on my own
19 observations and conversations with Postal Service managers at **all** levels over the
20 years, I am convinced that there are economies of scale in mail processing, and that
21 volume variability therefore must be less than 100%. In fact, the Postal Service has
22 come to depend on volume growth to keep its unit costs in check. The more it
23 automates its operations, the more true it becomes that adding more mail will lower
24 unit costs, while loss of mail volumes, as many fear might happen due to the internet
25 revolution, would leave the Postal Service unable to reduce its costs proportionately.

26 I recommend adoption of the volume variability factors computed by witness Bozzo.
27 The mail processing cost attribution package offered by the Postal Service is not a

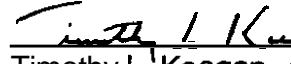
1 perfect approach. In fact, I have been extremely critical of that approach, especially its
2 reliance on numerous unverified assumptions in the application of IOCS data,

3 Nonetheless, Bozzo's results give the best estimates currently available of the average
4 volume variability at certain sorting operations. Ideally, the process of determining
5 volume variability and distributing volume variable costs among subclasses should be
6 accomplished with a unified approach that would yield the partial derivatives of costs
7 in each cost pool with respect to each subclass. **This**, however, would require use of
8 data and modeling approaches not available through IOCS and MODS. It should be a
9 goal for future rate cases.

10 But in order to move towards a correct costing methodology, numerous misconceptions
11 must first be put aside, such as reliance on the archaic and irrelevant FHP data that
12 seem at times to have dominated the debate on mail processing volume variability. I
13 hope that my testimony will have helped set the stage for a more useful debate in
14 future cases. For regardless of what the Commission decides in **this** case, the question
15 of volume variability in mail processing is too important to be neglected. and will
16 continue to be an issue also in future cases.

CERTIFICATE OF SERVICE

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



Timothy L. Keegan

August 14, 2000

1 CHAIRMAN GLEIMAN: As indicated in the previous
2 discussion, one party has requested oral cross examination
3 of this witness, United Parcel Service. I don't believe
4 there is anyone else who wishes to cross examine the
5 witness.

6 That being the case, Mr. McKeever, could you
7 proceed when you're ready?

8 MR. MCKEEVER: Thank you, Mr. Chairman.

9 CROSS EXAMINATION

10 BY MR. MCKEEVER:

11 Q Hello, Mr. Stralberg.

12 A Hi.

13 Q Mr. Stralberg, do you consider yourself an
14 econometrician?

15 A I'm a mathematician and operations research
16 analyst. As such, I do understand the general principles
17 involved in econometrics or in regression analysis, which is
18 a tool of econometrics.

19 I do not consider myself to be an econometrician,
20 and there are many of the finer points that are being
21 debated here that I am not a specialist on.

22 Q Now, on page 4 of your testimony, you indicate --
23 and I'm looking at the heading there at the top of the page
24 -- that TPH is primarily a function of mail volume and
25 degree of presortation; is that correct?

1 A Yes.

2 Q I take it, in light of your prior answer, that you
3 did not run any regressions to determine the relationship
4 between TPH and volume; is that correct?

5 A What I am referring to in my testimony here is my
6 knowledge of how mail is actually processed in the system;
7 that it generally is a function of presortation.

8 Q Did you run any regressions to determine the
9 relationship between TPH and volume?

10 A I do not think that would make any sense to do
11 such an analysis.

12 Q So you didn't do it?

13 A No, I did not do that.

14 Q Okay.

15 Mr. Stralberg, does volume affect decisions about
16 what mail processing technology to use?

17 A Mail processing technology is mainly driven, as I
18 see what Postal Service is doing, by the availability of
19 technology.

20 When the Postal Service has a new technology to
21 put on the flat: machine, they put it on all of them.

22 So, it's -- of course, they do then install
23 whatever new equipment there is in all facilities of a
24 reasonable size. But I wouldn't say that the installation
25 of machines is done just because a facility passes a certain

1 threshold.

2 Q Well, you refer to, they would do it in a facility
3 of a -- I think you said reasonable size. What did you mean
4 by that?

5 A Well, generally, all of the major processing
6 plants, of which there are 200 some, have, for example, flat
7 sorting machines that most of them are now bundle sorting
8 machines. Even more have bar code sorters and so on.

9 Q How do you define major plant? That's a term you
10 just used in your answer.

11 A I'm not sure if I can provide you with an exact
12 definition of that, but there are about 470 SCFs, of which
13 some are quite small.

14 About a hundred or so are called -- or even less,
15 I think -- are called ADCs, and they do, in fact, process by
16 far the -- most of the Postal Service's mail processing is
17 done in those facilities.

18 Q Would you define a major plant at least, in part,
19 in terms of the volume handled by that plant?

20 A Yes, of course.

21 Q Let me ask one more time the question we started
22 with.

23 A Yes.

24 Q Does volume affect decisions about what mail
25 processing technology to use?

1 A In the sense that the advanced equipment tends to
2 be installed in larger facilities, yes.

3 Q Okay. Is the relationship between TPH and FHP
4 affected by the sorting technology used by the Postal
5 Service?

6 A Not to a great extent. It may be for the
7 unsorted mail, in other words, single piece mail, there
8 may be some additional piece sorts that are required,
9 depending on whether you use a machine or do it manually.

10 But, for example, for the three types, categories
11 of mail that I list here, the Carrier Route Presorted, the 5
12 Digit Presorted and the 3 Digit Presorted, it is on page 4
13 that we were on, which is, actually, I think more than half
14 of the Postal Service volume. Pretty much that volume
15 receives respectively two, one and zero piece sorts,
16 regardless of the type of machines that are used.

17 Q Well, let me ask you to refer to page 9 of your
18 testimony, please. There on line 5 you indicate that large
19 facilities are likely to have larger TPH FHP ratios, is that
20 correct?

21 A Yes, because they do more rehandlings.

22 Q So the relationship between TPH and FHP is
23 different in larger versus smaller facilities, is that
24 correct?

25 A That is my speculation. I have not really

1 verified that. But it is logical because the Postal Service
2 tends to assign most of the processing responsibility to its
3 large plants, especially the Area Distribution Centers that
4 perform additional functions that are **not** performed by
5 smaller plants.

6 Q Now, you do state on page 6, am I correct, at line
7 3, that sorting costs are affected by the sorting technology
8 used, is that correct?

9 A Yes, of course. I should actually check whether I
10 am really saying that. What line was it?

11 Q Page 6, line 3.

12 A Yes, I do say that.

13 Q Okay. Going back to page 4, on line 8, you
14 indicate that pieces with Carrier Route Presort incur no
15 piece handling, is that correct?

16 A I am referring here to handling by clerks and mail
17 handlers.

18 Q Correct. And that is what I meant. Okay.

19 A Yes. Somewhere I have a footnote that clarifies
20 that, that they do, of course, get handled by the carriers.

21 Q So they do not generate a TPH count?

22 A No.

23 Q No, they don't or --

24 A They don't. The carriers generally work in
25 delivery units, and I don't believe there is any kind of TPH

1 count collected there.

2 Q Do those pieces with Carrier Route Presort
3 nevertheless incur some mail processing costs, as opposed to
4 carrier costs?

5 A They incur handling in the form of bundles and in
6 containers, which generally is done at different types of
7 operations than the piece sorting.

8 Q But they do incur some mail processing costs, is
9 that correct?

10 A They do incur some mail processing costs, yes.

11 Q Could you turn to page 9 of your testimony,
12 please? We talked about this just a little bit a minute
13 ago, but, again, you state there that large facilities are
14 likely to have larger TPH FHP ratios than smaller
15 facilities, correct?

16 A Yes, that is what I am saying.

17 Q And as you discussed in your testimony, and
18 perhaps earlier today, a plant with a larger service
19 territory will have to do further sorting and, therefore,
20 will have a larger TPH FHP ratio?

21 A Yes, because there is more sorting that is done in
22 that one facility, as opposed to being spread over different
23 facilities.

24 Q Okay. Does that mean an analyst should control
25 for the size of the service area in trying to determine the

1 relationship between TPH and FHP?

2 A If he wanted to do that. Well, it depends on what
3 your objective is. If you wanted to simply study what I am
4 describing here, whether large facilities have more
5 rehandlings, then, of course, that is what you would try to
6 tabulate. I assume you are referring to the variability,
7 whether an increase in one would lead to an increase in
8 another. Is that --

9 Q Yes. In trying to determine the relationship
10 between TPH and FHP, what relationship exists there? Should
11 an analyst control for the size of the service area of a
12 plant in trying to determine that relationship?

13 A Well, I assume you are thinking -- or you are
14 talking relative to some kind of regression analysis in
15 order to determine that relationship. The Postal Service
16 uses a different technique, which is much simpler, for that
17 purpose, which is called, for that type of purpose, a mail
18 flow model, where one simply tries to -- one would look at
19 the sorting schemes and the flows of mails, that is really
20 the appropriate way to analyze that.

21 Q Would you not worry about then if you were to do a
22 regression? Not worry about controlling for size of the
23 service area?

24 A Oh, yes, you would have to control for that if you
25 were to do a regression analysis, if that were the technique

1 you chose to use.

2 Q In fact, isn't that the point you are making on
3 page 9, lines 9 to 12, of your testimony when you suggest,
4 and I am quoting here, "a regression" -- "if a regression is
5 properly and fully adjusted for fixed effects such as
6 network related variations in a TPH FHP ratio."

7 A What I am generally saying here is it seems that
8 in Mr. Neels' testimony, he came up with a conclusion that,
9 to me, was obviously counter-intuitive and could not
10 possibly be true. And so I was puzzled by that, as I
11 believe other people were, and I am searching for possible
12 explanations. So I am speculating about something that
13 might have gone wrong.

14 Q Okay.

15 A Okay. I understand Mr. Greene has some more
16 rigorous analyses of what went wrong, but these are some of
17 my suggestions of what might be the problem.

18 Q Do you know if any of Dr. Neels' TPH FHP
19 regressions controlled for size of the service area of a
20 plant?

21 A Well, I understand he did a so-called reverse
22 regression, which had a similar -- apart from being a
23 reverse regression, had a similar format to the regression
24 that Mr. Bozzo did. So in that case, I assume he had all of
25 the fixed effects and so on in there.

1 THE REPORTER: The regression?

2 THE WITNESS: That Mr. Bozzo did.

3 THE REPORTER: Thank you.

4 BY MR. MCKEEVER:

5 Q So it is your testimony that you believe Dr. Neels
6 ran models with facility-specific fixed effects?

7 A My understanding is that was part of his reverse
8 regression, yes.

9 Q In light of your first few answers, I am not sure
10 you can tackle this one, but since you here, let me try.

11 A Yes.

12 Q Does the use of a translog allow the analyst to
13 approximate an unknown functional form?

14 A I would plead ignorance to that question.

15 Q Okay. Let me try it more time in a different way.
16 It is correct that with a translog form, you can let the
17 data tell you what the proper functional form is without
18 having to specify it?

19 A Again, I am going to plead ignorance, this is
20 outside of my testimony.

21 Q I am not sure I agree with that, but we will let
22 it go. One final question, you do agree, I take it, that
23 there are strong interrelationships between the different
24 MODS cost pools, is that correct? That is a primary
25 principle of yours?

1 A Yes. Yes, indeed.

2 MR. MCKEEVER: That is all we have, Mr. Chairman.

3 CHAIRMAN GLEIMAN: Any follow-up questions?

4 [No response.]

5 CHAIRMAN GLEIMAN: Questions from the bench?

6 [No response.]

7 CHAIRMAN GLEIMAN: If not, Mr. Keegan, would you
8 like some time to prepare for redirect?

9 MR. KEEGAN: About two minutes, Mr. Chairman.

10 CHAIRMAN GLEIMAN: Certainly. And just let me say
11 at this point in time that it appears that OCA does have
12 some fairly extensive cross-examination for Witness Degen
13 and, as a consequence, we will probably break for lunch
14 unless in the next two minutes somebody convinces me
15 otherwise. We will break for lunch and take up Witness
16 Degen after lunch.

17 [Recess.]

18 CHAIRMAN GLEIMAN: Mr. Keegan?

19 MR. KEEGAN: We have no redirect, Mr. Chairman.

20 CHAIRMAN GLEIMAN: If there's no redirect, then,
21 Mr. Stralberg, that completes your testimony here today. We
22 appreciate, once again, your contributions to our record,
23 and you're excused.

24 [Witness Stralberg excused.]

25 CHAIRMAN GLEIMAN: What we've decided to do is to

1 begin with our next witness, Postal Service Witness Degen.
2 Mr. Degen is already under oath.

3 We'll proceed with cross examination by several of
4 the parties who have requested oral cross examination, and
5 then we will break for lunch and come back and finish up
6 with the OCA doing its cross examination.

7 As I indicated, Mr. Degen is already under oath,
8 so, counsel, whenever you're ready, you may proceed to
9 introduce his testimony.

10 Mr. Koetting?

11 MR. KOETTING: Thank you, Mr. Chairman. The
12 Postal Service calls as its next witness, Carl G. Degen.
13 Whereupon,

14 CARL G. DEGEN,
15 a witness, having been previously called for examination,
16 and, having been previously duly sworn, was recalled to the
17 stand, continued to be examined and continued to testify as
18 follows:

19 DIRECT EXAMINATION

20 BY MR. KOETTING:

21 Q Mr. Degen, I have handed you a copy of a document
22 entitled Rebuttal Testimony of Carl G. Degen on Behalf of
23 the United States Postal Service, which has been designated
24 as USPS-RT-5.

25 Are you familiar with this document?

1 A Yes, I am.

2 Q Was it prepared by you or under your supervision?

3 A Yes, it was.

4 Q If you were to testify orally today, would this be
5 your testimony?

6 A Yes, it would.

7 MR. KOETTING: Mr. Chairman, the Postal Service
8 moves that the Rebuttal Testimony of Carl G. Degen,
9 USPS-RT-5, be admitted into evidence.

10 CHAIRMAN GLEIMAN: Is there any objection?

11 [No response.]

12 CHAIRMAN GLEIMAN: Hearing none, the testimony of
13 witness Degen will be admitted into evidence and transcribed
14 into the record.

15 [Written Rebuttal Testimony of Carl
16 G. Degen, USPS-RT-5, was received
17 into evidence and transcribed into
18 the record.]

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USPS-RT-5

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

Docket No. R2000-1

POSTAL RATE AND FEE CHANGES, 2000

REBUTTAL TESTIMONY
OF
CARL G. DEGEN
ON BEHALF OF THE
UNITED STATES POSTAL SERVICE

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1 **AUTOBIOGRAPHICAL SKETCH**

2 My name is Carl Degen. I am Senior Vice President of Christensen
3 Associates. Details of my training and experience appear in my direct testimony
4 in this docket (USPS–T–16).

5 **I. PURPOSE AND SCOPE (A GUIDE TO MY TESTIMONY)**

6 The purpose of this rebuttal testimony is to respond to issues raised by
7 various intervenors with respect to my direct testimony in this docket. My
8 discussion follows the logic of the Postal Service's methodology. I discuss the
9 separation of clerk and mail handler costs into mail processing, window service,
10 and administrative components. Next, I address issues related to the volume-
11 variability of clerk and mail handler mail processing costs. Then, I respond to
12 criticisms of the Postal Service's methodology for distributing the volume-variable
13 mail processing costs to subclass. In Section V, I highlight some of the
14 Periodicals Operation Review Team observations that explain increasing
15 Periodicals costs, so that the Commission can see that those costs have been
16 incurred for the benefit of Periodicals and that no reduction in Periodicals costs,
17 beyond the cost savings already presented by the Postal Service, is justified. In
18 the last section of this testimony I address some of AAP witness Siwek's
19 criticisms of the Bound Printed Matter survey performed by Christensen
20 Associates, on which Postal Service witness Crum relied.

21 **II. SEPARATION OF CLERK AND MAIL HANDLER COSTS AT**
22 **MODS OFFICES INTO THE MAIL PROCESSING, WINDOW**
23 **SERVICE, AND ADMINISTRATIVE COMPONENTS SHOULD**
24 **USE MODS OPERATION CODES**

25 In Docket No. R97–1, the Postal Service proposed that clerk and mail
26 handler costs for MODS offices be separated into mail processing, window

1 service, and administration using the MODS codes rather than Question 18, as
2 was done historically. The partition based on MODS codes results in some costs
3 “migrating” from window service and administration to mail processing. The
4 change was made because “the main concern is identifying the activities actually
5 performed by the employees clocked into the operation in a cost pool in order to
6 ensure an accurate distribution of those costs” (Docket No. R97–1, USPS–T–12
7 [Degen], page 7, lines 3–6). In the current docket and in Docket No. R97–1,
8 witness Sellick has opined that the migration “should be reversed to ensure
9 treatment consistent with the Commission’s established practice” (Tr. 27/13126,
10 lines 4-5). In fact, witness Sellick expressly denies that his testimony indicates
11 that the IOCS-based partition results in more accurate cost estimates (Tr.
12 27/13134–5). Furthermore, witness Neels (UPS–T–1), upon whose testimony
13 witness Sellick relies for mail processing variabilities, suggests that the Postal
14 Service’s change in methodology does not appear to be “of a significant nature”
15 (Tr. 27/12940) for clerk and mail handler variabilities. In short, the UPS
16 witnesses provide no operational or economic grounds for the IOCS-based cost
17 partition.

18 In the Commission’s Docket No. R97–1 Opinion and Recommended
19 Decision, it stated that:

20 The variability of Segment 3 costs depends on whether a specific
21 cost element is categorized as administrative, window service, or
22 mail processing, before its variability is evaluated. For this reason,
23 adhering to the established variability assumption for mail
24 processing costs requires adherence to the established
25 apportionment of Cost Segment 3 costs among its components,
26 based on IOCS activity codes. Accepting witness Bradley’s MODS
27 pool variabilities, as the Postal Service and the presort mailers
28 propose, requires accepting the reapportionment of Cost Segment
29 3 costs that is implied by organizing Segment 3 activities by MODS
30 codes (PRC’s Opinion and Recommended Decision, Volume 1,
31 page 129).

1 The Commission is correct that the partition impacts the volume-variability of
2 Segment 3 costs and that, if the Commission accepts the Postal Service's
3 volume-variability analysis in this proceeding, it would be most accurate to adopt
4 the MODS-based partition of clerk and mail handler costs. However, even if the
5 Commission again fails to adopt measured volume-variabilities for clerk and mail
6 handler costs, it should adopt the Postal Service's partition of MODS office costs
7 based on MODS codes. The issue is not adherence to "the established
8 variability assumption." Rather, the issue is: "What is the most accurate method
9 for measuring volume-variable clerk and mail handler costs?"

10 MODS operation codes are the most accurate way to partition clerk and
11 mail handler costs into mail processing, window service, and administrative
12 activities. Most of the "migrated costs" are associated with IOCS tallies that
13 would be classified as representing administrative activities using IOCS question
14 18, part G. We know, from the MODS codes of those tallies, that the observed
15 employees were clocked into MODS Function 1 or Function 4 support
16 operations. The Postal Service's methodology correctly distributes those costs
17 based on the supported Function 1 or Function 4 operations, whereas the IOCS-
18 based method ignores the MODS information and inappropriately treats the
19 tallies as representing general administrative functions.

20 Witness Stralberg's opposition to the MODS-based partition largely stems
21 from the existence of tallies that "migrate" from the window service component to
22 Function 4 operations, mostly Function 4 support. In this docket he says, "Since
23 Van-Ty-Smith's program includes a window-service-based distribution key for
24 Function 4 support pool costs, the potential distortion caused by the presence of
25 window service costs in cost segment 3.1 would appear to be less than in Docket
26 No. R97-1" (Tr. 24/11390, lines 3-6). Witness Stralberg advocates the

1 distribution of not-handling costs in these support cost pools “using a window-
2 service-based distribution key” (Tr. 24/11390, lines 8-9).

3 The basis for witness Stralberg's opinion is anecdotal evidence regarding
4 the sharing of clerks among tasks without re-clocking that he collected on
5 Periodicals Review Team visits. I do not dispute that this occurs, but the extent
6 is unknown. However, we do know that clerks who move between mail
7 processing and window service can perform only very limited functions. In order
8 to sell stamps, window service clerks are given individual responsibility for their
9 stamp stocks, which are typically worth in excess of \$50,000. Accountability is
10 maintained through regular audits that are very time consuming. Mail processing
11 clerks that are shared on an ad hoc basis would not have stamp stock and could
12 not conduct financial transactions. Mail processing clerks observed by IOCS tally
13 takers in the window service unit are most likely retrieving held mail, retrieving
14 collection mail from the window, or assisting with other types of pickups.

15 In arguing that all migrated window-service not-handling costs be
16 distributed using a window-service distribution key, witness Stralberg is arguing
17 for the introduction of bias. We know that the migrated costs would not be
18 associated with postage sales and other financial transactions, which comprise
19 the majority of the costs entering the window-service distribution key.

20 The protestations of witness Stralberg notwithstanding, the Postal
21 Service's proposed partition of clerk and mail handler costs using MODS codes
22 should be adopted without modification. It is a more **accurate** method than the
23 **IOCS-based** method regardless of the Commission's decision on measured
24 volume-variabilities.

1 **III. THE POSTAL SERVICE'S MEASURED VOLUME-**
2 **VARIABILITIES FOR MAIL PROCESSING COSTS ARE**
3 **SIGNIFICANTLY MORE ACCURATE THAN THE**
4 **COMMISSION'S IOCS-BASED METHOD AND SHOULD BE**
5 **ADOPTED**

6 **IIIA. OPERATIONAL ANALYSIS IS THE FOUNDATION**

7 The Docket No. R97-1 and R2000-1 proceedings have been marked by
8 considerable debate regarding the proper method of measurement of the
9 volume-variability of mail processing costs. UPS and the OCA have been the
10 primary opponents of the Postal Service's estimated volume-variabilities. The
11 arguments of their respective witnesses, Neels and Smith, suffer from the same
12 flaw—they do not address the fundamental question before the Commission. In
13 direct testimony in the current proceeding, witness Smith tries to state the
14 question succinctly, but there are telling omissions in his statement. He says,
15 "Volume-variability for mail processing is defined as the percentage change in
16 cost that results from a percentage change in volume" (Tr. 27/13153, lines 4-6).
17 This is a good start, but a more complete statement of the question at hand is: "If
18 Postal Service volume increases as forecast for the test year, how much will

¹ In the copy of witness Smith's direct testimony originally filed with the Commission, the quoted sentence ended with the phrase "holding delivery points and other non-volume factors constant." Witness Smith removed this phrase in an erratum filed June 28, 2000, referenced in his response to USPS/OCA-T4-33 (Tr. 27/13284). The change to witness Smith's testimony appears to be motivated by his unwillingness to take a stand on the issue of whether or not "growth" in delivery points must be considered part of the growth in volume. This is surprising given that, in his response to an earlier interrogatory, witness Smith clearly states, "There could be a growth in volume with no growth in delivery points. Conversely, conceivably, there could be a growth in delivery points without a change in volume" (Tr. 27/13254). The qualification that witness Smith's "erratum" removed is crucial to separating the costs associated with volumes from those caused by deliveries or other non-volume factors.

1 costs by subclass increase, holding non-volume factors, such as delivery points,
2 constant?"

3 The differences in the *two* statements of the issue are enormous. My
4 statement of the problem makes it clear that we are talking specifically about the
5 Postal Service, we are talking specifically about the volume increase expected
6 for the test year, and, we are talking about holding non-volume factors, such as
7 delivery points, constant. This accurate and straightforward statement of the
8 issue can be used to filter out the irrelevant alternatives that witnesses Neels and
9 Smith used to successfully confuse the Docket No. R97-1 proceeding and
10 continue to advance in this proceeding.

11 Proceeding from a clear statement of the issue, the steps to measuring
12 volume-Variability are as follows.

- 13 • Understand the pattern of expected volume growth for the test year.
14 • Understand what cost-causing factors will vary in response to volume
15 growth in the test year.
16 • Develop and estimate models that reflect the pattern of expected
17 volume growth and hold non-volume cost-causing factors constant.
18 • Review the resulting estimates for robustness and reasonableness
19 vis-a-vis the structure of each operation.

20 By following the above procedure, the Postal Service has developed reliable
21 estimates of mail processing volume-Variability factors. **As** I will discuss below,
22 none of the "alternatives" offered by witnesses Neels and Smith is adequate
23 because it either violates our understanding of the pattern of expected volume
24 growth, fails to hold constant non-volume factors, or does not reflect the extent to
25 which changes to the structure of Postal Service operations can occur over the
26 rate cycle. The "alternatives" of witnesses Neels and Smith are inconsistent with
27 the facts and should be rejected as a basis for volume-variability.

a

1 **III.B. OCA WITNESS SMITH MISINTERPRETS MY GRAPHICAL**
2 **ANALYSIS**

3 My direct testimony (USPS-T-16, pages 24-29) includes a discussion of
4 the graphical analysis that witness Smith claimed to represent “visually
5 compelling” evidence of 100 percent variability in the Docket No. R97-1
6 proceeding. In response to my discussion, OCA witness Smith says, “Mr.
7 Degen’s graphs can be used to justify any of the three techniques under
8 consideration in this case—fixed effects, pooled, or ‘between’” (Tr. 27/13207,
9 lines 2-3). Witness Smith has missed the point of my testimony. I agree that
10 one could draw graphs to justify any of the listed models. Furthermore, the
11 graphs witness Smith reproduces well illustrate the differences among the
12 assumptions underlying each of the models. However, witness Smith’s
13 interpretation of the graphs is wrong on two major points. First, the graphs depict
14 a situation in which the fixed-effects model is by construction the correct model.
15 Thus, witness Smith’s “belief” that the “pooled” line represents the correct cost
16 relationship in the graphs demonstrates the folly of visual analysis, as there is no
17 relationship at all between the pooled line and the data I generated for the
18 illustrations. Second, while it may be possible to draw graphs to depict a
19 situation in which any of the models might be correct, only the fixed effects model
20 is consistent with both the data and the fact that there are cost causing factors,
21 unrelated to mail volume, which will not change over the rate cycle—the relevant
22 horizon for the analysis.

23 Witness Smith says, “The facility by facility plots (labeled “Plant A and
24 “Plant B) are the types of plots that both Dr. Bradley and Dr. Bozzo generate
25 and estimate. These are short term plots of data” (Tr. 27/13212, lines 11-13).

1 Regardless of what they are called? my graphic illustrations are consistent with
2 the fact that there are cost-causing characteristics that will not change in
3 response to test-year volume increases. During oral cross-examination, witness
4 Smith was asked about his plot showing an expansion path along the line
5 corresponding to a pooled or cross-section model.

6 Postal counsel asked:

7 Does your response indicate that point C would not necessarily
8 represent the optimal capacity to [which] point A would expand if
9 the amount of processing it performed increased from TPH sub
10 zero to TPH sub 1?

11 And witness Smith replied:

12 **C is a** different plant, and so I have trouble talking about plant A
13 expanding. In fact, Dr. Bozzo has indicated that due to the fixed
14 effects of various plants, they have different costs, so one could
15 imagine that, for example, a rural plant that expanded would be a
16 bit different *from* an *urban* plant [emphasis added] (Tr. 27/13335,
17 lines 8–17, in reference to the diagram at 13211).

18 Witness Smith is prolonging analysis to which he already knows the conclusion.
19 He acknowledges that fixed effects exist and that “rural” plants will be different
20 from “urban” plants, yet continues to suggest that pooled and cross-section
21 models must be considered. Fixed-effects that will not change with volume do
22 exist, and any model that does not control for them is biased. The “between”
23 estimator, that witness Smith calls the “least bad,” is irrelevant because it is
24 inconsistent with the facts regarding the pattern of expected volume growth and
25 changes in plants that will occur over the rate cycle. If witness Smith wants to
26 argue for consideration of the “between” estimator, he should have to do more

² Short run and long run are relative terms in economics that reflect the extent to which inputs are assumed to be changeable. Continued use of these terms confuses the record. In my mind, the horizon at issue is the period between the base year and the test year, which is also a reasonable and practical approximation of the expected rate cycle. Considerations of other horizons are diversions that are irrelevant to the question before the Commission.

1 than argue it is a conceptual possibility. He should have to show that its
2 assumptions are consistent with the pattern of expected growth and the expected
3 changes in operations over the rate cycle. He cannot do so because it is not
4 true.

5 III.C. MODS DATA ARE USEABLE

6 MODS data are not perfect, but they are more than adequate for
7 estimation of volume-variability factors. The models based on MODS data are
8 clearly better than the alternative, which relies on no data at all. The R^2 statistics
9 obtained in the various models that have been considered are all very high. This
10 means that there is very little noise in the data. There is absolutely no indication
11 that errors in the MODS data are materially distorting the measurement of
12 volume-variability. As a population of data, rather than a sample, the MODS data
13 have an enormous advantage of sheer sample size over survey data. Even after
14 application of sample selection criteria to screen for data errors, the breadth of
15 the sample is far greater than what could be obtained by any feasible sampling
16 effort. Furthermore, Dr. Bozzo (and Dr. Bradley) have applied sample selection
17 criteria and specified models designed to avoid any bias in the estimates of
18 volume-variability.'

19 Whatever imperfections exist in the MODS data set, it more than meets
20 any reasonable threshold in terms of being an improvement over the IOCS-
21 based determination of variabilities, the ad hoc nature of which is thoroughly
22 documented in Dr. Bozzo's testimony (USPS-T-15, pages 4-13). It is
23 somewhat ironic that Dr. Neels, after criticizing MODS data at the beginning of
24 his testimony (Tr. 27/12796-12798), uses FHP as a proxy for volume and
25 calculates the elasticity of TPH with respect to FHP, when FHP is undisputedly
26 the most error-prone of the MODS data. Witness Neels may argue that he is

1 trying to use the best data available, which is precisely what the Postal Service
2 has argued. The MODS hours and TPH are the best data available, and they
3 offer material improvements over the existing method of using no data at all.

4 **IIID. OPERATIONAL ANALYSIS LEADS TO THE CONCLUSION THAT**
5 **MEASURED VOLUME-VARIABILITY WILL BE LESS THAN 100**
6 **PERCENT**

7 **IIID.a Operational Analysis Has Two Roles**

8 Operational analysis plays two roles in developing measures of volume-
9 variability. First, it provides our understanding of the pattern of expected volume
10 growth and the cost-causing factors that will not vary as the result of volume
11 growth by the test year (USPS-T-16, page 6, lines 18-23). Second, it creates
12 our a priori expectation against which we can assess the reasonableness of the
13 results. However, our operational conclusion that volume-variability is less than
14 100 percent is in no way imposed on the econometric models. The models are
15 unconstrained and could yield estimates of 100 percent or more, if the data so
16 dictate.³ In this section I will discuss the operational analysis of UPS witness
17 Neels (Tr. 27/12819-12827). My discussion follows the sub headings in witness
18 Neels's testimony.

19 **IIID.b Setup and Takedown Time**

20 Witness Neels agrees that setup and takedown times cause volume-
21 variability to be less than 100 percent for some range of increase in volume. He
22 states,

³ Witness Neels concurs. In his response to USPS/UPS-T1-38, he says, "In general, I believe that a translog model, such as the one used by Dr. Bozzo, can yield a 100 percent (or greater) variability" (Tr. 27/12981).

1 Mr. Degen argues that **setup** and takedown times for an operation
2 represent a **fixed** cost that does not vary with the volume of mail
3 processed. Over at least some range of volumes, Mr. Degen is
4 almost certainly correct. For small increases in volumes, these
5 costs will remain fixed and with growth they will be amortized over
6 ever larger volumes, giving the result that such operations will
7 exhibit economies of scale (Tr. 27/12820).

8 Witness Neels further indicated that “[r]eplication of setup and takedown times in
9 response to continuing growth in volume could create a situation in which costs
10 increase in a stepwise fashion in direct proportion to volume” (Tr. 27/12822, lines
11 7–9). His reasoning is incorrect for three reasons. First, decisions to deploy
12 automation are not always tied to volume changes. Consider FSMs as an
13 example. This record includes substantial evidence that some test-year
14 deployments are a function of the availability of new technology rather than a
15 specific response to test-year volume growth! Second, for there to be 100
16 percent volume-variability, all plants would need increased machine deployment
17 in proportion to their respective increases in test-year volumes. Witness Neels
18 has not shown that this is true. In fact, all evidence suggests that this will not be
19 the case. Third, witness Neels seems to be under the impression that each
20 machine has only one set-up and take-down each day or even each tour when
21 he argues that “[r]eplication of setup and takedown times in response to
22 continuing growth in volume could create a situation in which costs increase in a
23 stepwise fashion in direct proportion to volume” (Tr. 27/12822, lines 7–9). This is
24 not the case. Scheme changes, not volumes, drive the number of **setups** and
25 takedowns, particularly in secondary scheme operations. The number of

⁴ Witness Neels, in his section on automation and mechanization, cites four examples of additional automation deployment described by witness Kingsley (USPS–T–10). These illustrate the point that machine deployment is not driven by volume. The deployments Quoted there include no mention of volume. In fact, with respect to MLOCRs it says, “[N]o additional deployments are planned” (Tr. 27/12778, lines 4–25).

1 schemes is driven by the network (number of delivery units and the number of
2 delivery points) independent of volume. Dr. Neels step function argument may
3 apply, at most, to the cases where machines run dedicated schemes for entire
4 tours.

5 **IIID.c Volume Growth in the Shoulders of the Peak**

6 Witness Neels says, “What Degen ignores is the possibility that growth in
7 volume could occur during the peak periods that govern staffing levels in these
8 operations, rather than in addition to the shoulders of the peak when extra
9 capacity is available” (Tr. 27/12825, lines 3–5). Witness Neels’s statements flatly
10 misrepresent the clear meaning of my testimony. I do not ignore the possibility
11 that increases might occur “at the peak.” As I said explicitly in my direct
12 testimony, “Increases in total collection volume that exhibit the current time
13 distribution will not increase cancellation hours proportionately because the
14 staffing early and late in the operation will not need to change—some of the
15 waiting time will simply be converted to processing time” [emphasis added]
16 (UPS–T16, page 37, lines 20–24).

17 Witness Neels goes on to say that “[i]f all volumes grow proportionately—
18 including the peak period volume that sets staffing levels—one would expect
19 staffing levels to grow proportionately in response” (Tr. 27/12825, lines 7–8).
20 This statement reveals a fundamental misunderstanding of Postal Service
21 staffing—peaks and shoulders are not staffed the same. Additional peak
22 volumes may increase peak staffing, but it need not increase shoulder staffing.
23 In an operation like cancellation there is nearly always excess capacity at start-
24 up and finish. Increases in overall volume may increase peak staffing, but
25 staffing in the shoulders will not change. Similarly, staffing of container sortation
26 (opening) both inbound and outbound has excess capacity at startup and finish.

1 The unfounded assumption on which Dr. Neels's arguments fail is his
2 presumption that it is impossible to adjust staffing at the peak without directly and
3 proportionately adjusting staffing for the shoulder periods. If peak and shoulder
4 staffing automatically moved in lockstep, his claims might have some validity.
5 Peak and shoulder staffing do not move in lockstep, and to the extent that
6 staffing adjustments at the peak are not matched by staffing adjustments in the
7 shoulders, the necessary result will be volume-variability less than 100 percent.

8 **IIID.d Gateway Operations**

9 Witness Neels says, "The need to make full use of downstream
10 processing capacity implies that gateway staffing levels are in fact volume driven"
11 (Tr. 27/12825, lines 19–20). Dr. Neels misunderstands the role of the gateway.
12 Gateways are generally capable of much more throughput than the downstream
13 operations they feed. The issue is not that gateways, such as collection, must be
14 staffed to get all mail downstream as soon as possible. Rather, as I stated in my
15 direct testimony, "Early in the operation, as collection mail arrives, inventories *of*
16 mail must accumulate quickly at downstream operations to insure no interruption
17 due to inadequate mail supply. Late in the operation, cancellation must be
18 staffed to quickly clear any late arriving volumes" [emphasis added] (USPS–T–
19 16, page 37, lines 17–20). Increased mail volume in the shoulders simply means
20 more of the gateway (shoulder) time is spent processing rather than waiting, as I
21 explained in my direct testimony (see USPS–T–16, page 37, lines 23–34).

22 **IIID.e Worker Pacing**

23 Witness Neels argues, for a number of reasons, that my analysis of
24 worker pacing assumes "an extremely short run view of volume-variability" (Tr.
25 27/12827, lines 9–10). Some of his confusion may be my fault. Witness Neels

1 interprets my statement that “manual sortation relies heavily on the discretionary
2 effort of employees” (USPS–T–16, page 41, lines 25–26) to apply only to random
3 fluctuations in daily mail volume. This is not the case. In my direct testimony I
4 should have made it clear that, by not adding additional manual clerks as
5 average daily volume grows, the Postal Service is able to capture this
6 discretionary effort. Furthermore, spreading the costs associated with “fixed”
7 activities, such as final pull-downs of cases, over larger volumes of mail, would
8 increase operation productivity, and allow volume growth to be accommodated
9 without a proportional increase in work hours, and without requiring an increase
10 in the effort exerted by manual clerks. Volume growth without a proportional
11 increase in work hours means volume-variability is less than 100 percent.

12 **IV. THE COMMISSION SHOULD ACCEPT THE POSTAL**
13 **SERVICE’S DISTRIBUTION OF VOLUME-VARIABLE COSTS**
14 **TO SUBCLASS**

15 **IVA. THE COMMISSION NEEDS THE MOST ACCURATE ESTIMATES**
16 **OF MARGINAL COSTS**

17 The need for marginal cost estimates in the rate setting process derives
18 from the Postal Reorganization Act’s mandate that prices be set to cover costs
19 causally attributable to the subclass of mail. Witness Neels’s assertion that mail
20 processing costs caused by deliveries should be included in volume-Variabilities
21 (Tr. 27/12845, line 15–16) is at odds with basic economics and the plain meaning
22 of volume-variability.

23 In his direct testimony, witness Neels pays lip service to the fact, which is
24 described at length in my direct testimony (USPS–T–16) and witness Kingsley’s
25 testimony (USPS–T–10), that it is costly to the Postal Service to provide service
26 to its ever-growing network. The Commission acknowledges the distinction

1 between volume and network in its use of volume-variable transportation and city
2 carrier street costs. However, Dr. Neels presses his argument by incorrectly
3 trying to tie the network-related costs to volumes anyway (Response to
4 USPS/UPS-T1-5, Tr. 27/12905-6). When pressed, witness Neels admitted that
5 the costs of the network that are independent of volumes would not be
6 attributable to subclasses as marginal (volume-variable) cost or incremental cost,
7 but claimed that he could not think of any such costs (Response to USPS/UPS-
8 T1-37, Tr. 27/12977-8). However, the testimonies of witness Kingsley and
9 myself, which witness Neels cites, include descriptions of operation set-up costs
10 that are determined by the number of delivery units, not volumes (See for
11 example USPS-T-IO, page 21, lines 11-15 and USPS-T-16, page 45, lines 17
12 -20).

13 Once variabilities have been determined, calculating volume-variable
14 costs by subclass is a zero-sum exercise. All volume-variable costs must be
15 distributed to the subclasses of mail that cause them. The Postal Service
16 method partitions cost into segments and components with the intent of more
17 accurately identifying the costs incurred for each subclass. In Docket No. R97-1,
18 the Postal Service refined its methodology for clerk and mail handler cost
19 estimation. A major part of the Postal Service's new methodology was the
20 measurement of volume-variability for mail processing costs. However, an
21 equally important part of the new methodology was the introduction of a new
22 partitioning of mail processing costs designed to more accurately identify use of
23 resources by class of mail.

24 In Docket No. R97-1, the Commission adopted the Postal Service's
25 MODS-based partition of mail processing costs into cost pools, but issues of cost
26 distribution within those cost pools still remain. In deciding among the
27 distribution alternatives proposed by the Postal Service and the intervenors, it is

1 important to understand that broader is not always better. Unsupported
2 allegations of bias do not justify broader distribution, for the same reasons that
3 we do not simply divide total costs by total volumes. A broad distribution of
4 costs, when it is not justified, can be more wrong than a narrow distribution of
5 costs. There is no easy way out. Every decision the Commission makes in this
6 regard has winners and losers. The Commission must evaluate all the evidence
7 when making its decisions and choose the alternative best supported by the
8 facts.

9 **IVB. THE POSTAL SERVICE'S MIXED-MAIL DISTRIBUTION IS THE**
10 **MOST ACCURATE**

11 **IVB.a Item and Container Information Must Not Be Ignored,**
12 **Even If Broader Distribution of Mixed-Mail Costs is**
13 **Adopted**

14 The item and container type of mail being handled is information from
15 which we can more accurately infer the subclass of mail being handled. Ignoring
16 this information biases the distribution of costs. In Docket No. R97-1 there was
17 discussion of the strong correlation between container type and class of mail.
18 Witness Cohen compiled a table showing that direct tallies of green sacks are
19 observed to contain First-class Mail 73 percent of the time and brown sacks
20 contain Periodicals mail 72 percent of the time (Docket R97-1, Tr. 26/14048).
21 The purpose of witness Cohen's table was to show that the correlations are not
22 100 percent. However, as I said in my rebuttal testimony in that docket,

23
24 The existence of any correlation between item [and container] type and
25 subclass means that bias will likely result if item [and container] type is not
26 used to partition mixed mail costs (Docket No. R97-1, Tr. 36/19331).

27 In response to MPA/USPS-T16-17 (Tr. 15/6515-32), I provide the results
28 of a broad distribution of allied mixed mail costs within item and container type.

1 The broad distribution can be viewed as increasing the sample of direct tallies
2 from which the distribution key is developed for each item and container type.

3 While I believe that the Postal Service's method is more accurate, broad
4 distribution within item and container type is an acceptable alternative.

5 Witness Stralberg was absolutely right when he said that "[m]aintaining
6 this broad distribution [the PRC's Docket No. R97-1 method] effectively means
7 ignoring the container and item type information in the allied cost pools"
8 [emphasis added] (Trt 24/11353). Witness Stralberg can justify this because he
9 "believes" there is the "possibility" of bias. The Commission must act on the
10 facts. Absent proof and quantification of the bias, the Commission should accept
11 the Postal Service's proposed method or, at least, only apply broad distribution of
12 allied mixed costs within item and container type.

13 **IVB.b** There is **No Evidence of Bias** in Direct Pallet Tallies

14 There is no evidence of bias in sampling pallets as alleged by witness
15 Stralberg. In my direct testimony, I present quantitative analysis of the potential
16 bias in the Postal Service's mail processing cost distribution methodology
17 (USPS-T-16, pages 58-68). None of this analysis is rebutted or even discussed
18 by witness Stralberg. Instead he simply reiterates his concern that there are
19 "severe possibilities of bias" (Tr. 24/11353, line 21, with details at Tr. 24/11387-
20 8, lines 7-19 and 1-2). The Commission accepted the Postal Service's use of
21 items and containers in Docket No. R97-1 with the exception of the
22 Commission's broad distribution of allied. The only new analysis is quantitative
23 and it supports the Postal Service's methodology. The Commission should
24 continue its use of the Postal Service's method for non-allied and extend it to
25 allied, as well.

1 **IVB.c** Use ~~of~~ Question 19 Data, in Lieu ~~of~~ Item and Container
2 Information, **to** Distribute Allied Mixed Mail Costs
3 Discards Useful Information and Tells Us Nothing About
4 What an **Employee** Was **Doing—Only** Where the Tally
5 Taker Observed Her

6 Witness Stralberg argues that Question 19 data can improve the accuracy
7 of the cost distribution for Function 4, non-MODS, allied, and "support" cost pools
8 (Tr. 24/11379, lines 16–20). However, substituting Question 19 data for item and
9 container information discards shape information for 75 percent of the MODS
10 Allied mixed-mail costs. Earlier in witness Stralberg's testimony he states, "The
11 objective of postal costing is to identify causal links between accrued costs and
12 mail subclasses" (Tr. 24/11373, lines 12–13). Yet, Question 19 data tell us
13 nothing about the causal relationship between subclasses of mail and a worker's
14 time, especially when the worker is clocked into Function 4, non-MODS, allied, or
15 support cost pools.

16 In Table 1, I show the identification of mixed-mail costs by shape from
17 Question 19 data compared to the shape information obtained from item and
18 container type. For the shape-specific mixed cost pools, the correlation is very
19 high, but not perfect. This indicates that, for a small amount of costs, the
20 Question 19 method would distribute costs contrary to the shape indicated by the
21 container being handled. However, the most important point from Table 1 is that
22 the Question 19 method provides shape information for only **14** percent of mixed-
23 mail costs. Item and container information provides the shapes for another 75
24 percent of mixed mail costs, but witness Stralberg's method discards it.⁵

25 **The** Postal Service's methodology distributes empty container costs
26 associated with each of these cost pools using the distribution of costs by

⁵ Calculated as the sum of letter, flat, parcel, and class costs (based on item/container for cost pool 5750) divided by total mixed-mail costs.

1 container type. When a platform worker, creating a flat-bundle or parcel sorting
 2 corral, is tallied retrieving an empty hamper from a **BCS** operation, Question **19**
 3 will report the **BCS** location. If, as witness Stralberg proposes, those costs were
 4 distributed only *to* letters, then flat and parcel costs would be biased downward.
 5 In Function 1, non-allied cost pools, the consistency between Question **19** and
 6 MODS operation is extremely high. However, the activities of Function 4, non-
 7 MODS, allied, and support are much less location specific. In these cost pools,
 8 some workers are required to move among activities, transporting full and empty
 9 containers.⁶

10 The Postal Service's method ignores the location of the tallied worker and
 11 distributes the associated costs using the cost distribution by container type
 12 within the Function **4**, non-MODS, and allied pools? Movement of containers,
 13 container retrieval, and corral set up are non-trivial portions of Function 4, non-
 14 MODS, and allied activities.

15 **IVC. BROAD DISTRIBUTION OF ALLIED NOT-HANDLING COSTS IS**
 16 **NOT SUPPORTED BY THE FACTS AND WILL BIAS**
 17 **PERIODICALS COSTS DOWNWARD.**

18 Witness Stralberg argues that not-handling costs are increasing. There
 19 was a time when not-handling costs increased **as** a percentage of the **total** costs,
 20 but that proportion has been very stable in recent years as shown by the
 21 following table.

⁶ Workers clocked into support may be collecting or relaying data. In Section IVD below, I discuss the fact that mail handling is incidental *to*, rather than the cause of, support activities. My discussion here will be confined to the non-support activities.

⁷ Platform costs are distributed using direct tallies from all allied pools. Opening and pouching use direct tallies within their respective pools.

Comparison of Not-Handling Costs
Relative to Total Clerk and Mail Handler Mail Processing Costs
(dollar-weighted tally costs)

<u>Fiscal Year</u>	<u>Not-Handlinga(%)</u>
1993	45
1994	46
1995	45
1996	45
1997	47
1998 ^c	46

- Uses the Postal Service Docket No. R2000-1 partition of clerk and mail handler costs. For FY93-FY97, the Postal Service's Docket No. R97-1 methodology is used.

1 Witness Stralberg stated very clearly during oral cross-examination that he
2 believes IOCS is accurately measuring the level of not-handling costs.

3 Postal counsel asked,
4 Are you saying that the observed not-handling time is wrong or just
5 that it could or should be lower?

6 Mr. Stralberg answered,
7 I am not saying it is wrong. I believe that the IOCS actually --
8 accurately reflects the fact that there is a lot of not-handling time
9 (Tr. 24/11484, lines 12-16).

10 Mr. Stralberg's only issue with not-handling time, from a costing perspective, is
11 that he believes there should be broad distribution of allied not-handling costs
12 because they are not caused in proportion to the direct and mixed tallies
13 observed within allied operations. He says, "Costs at allied operations,
14 particularly their large 'not-handling' component, are mainly driven by piece
15 distribution requirements" (Tr. 2411 1353, lines 9-10). Based on this conclusion,
16 witness Stralberg recommends that allied not-handling cost be broadly
17 distributed irrespective of the cost pool in which they were incurred. I disagree
18 for several reasons.

1 First, his argument applies, at most, only to platform operations, which
 2 represent 42 percent' of MODS office allied not-handling costs. The other two
 3 large components of allied are opening and pouching. Opening units sort
 4 containers of mail, which will be sorted as pieces, but also containers with mail
 5 that will be sorted as bundles, and containers that will not be opened. Pouching
 6 operations are essentially bundle sort operations. Witness Stralberg's arguments
 7 simply do not apply to the large, non-platform portion of allied operations.

8 Second, witness Stralberg's assertion that all platform not-handling time
 9 is caused by mail that requires exigent processing is not true. As I explained in
 10 my direct testimony, workers clocked into platform operations also have
 11 responsibility for movement of mail to operations within the plant (see USPS-T-
 12 16, p. 50). The movement of mail inherently involves not-handling time. This
 13 was acknowledged by witness Stralberg during written and oral cross-
 14 examination (see Tr. 24/11435 and 11482, lines 4-14). In particular, the mail
 15 that witness Stralberg argues should not bear any not-handling costs, cross-
 16 docked pallets, involves not-handling costs by his own admission.

17 With respect to time spent waiting for trucks, witness Stralberg
 18 simplistically characterizes not-handling costs as being "incurred in order to serve
 19 other operations effectively, e.g. getting the mail prepped and to piece
 20 distributions as quickly as possible" (Tr. 24/11376, lines 16-18). As I explained
 21 in my direct testimony, "the waiting time is necessary so the vehicles can be
 22 quickly loaded or unloaded" (USPS-T-16, page 50, lines 17-18). Witness
 23 Stralberg acknowledged that, at least some waiting time is caused by the need to
 24 unload trucks quickly (Tr. 24/11480, lines 6-8).

⁸ See USPS-LR-I-184 in response to interrogatory DMA/USPA-T17-1 (Van-Ty-Smith). Calculated from worksheet 'MODS' located in workbook 'T1701.xls' by dividing cell S50, by the sum of cells O50 through V50.

1 Third, not all preferential mail is sorted as pieces. In fact, Periodicals, the
2 class which most concerns witness Stralberg, undergoes significant bundle
3 sortation. More than 47 percent of Periodicals mail is in firm or carrier-route
4 bundles, and another 34 percent is in 5-digit bundles⁹ Many 5-digit bundles are
5 not opened for piece sortation in plants—the piece sortation is done in the
6 delivery unit. Witness Stralberg's recommendation that allied not-handling costs
7 should be broadly distributed would bias Periodicals costs downward.
8 Periodicals require exigent processing, but have less than proportional piece
9 handlings in the plant.

10 The Commission should not accept witness Stralberg's recommendation
11 for broad distribution of allied not-handling costs. His argument applies, at best,
12 to only platform costs. Within the platform cost pool, witness Stralberg
13 acknowledges causes of not-handling costs besides exigent mail. Finally, piece
14 distribution costs understate the importance of Periodicals within exigent mail,
15 because more than 80 percent of Periodicals is in bundles that do not receive
16 piece distribution within the plant.

⁹ See LR-I-87. The numbers reported are for Regular Rate and Nonprofit combined. From Table 8, page 27; 79.4 million Regular Rate pieces are presented in firm bundles; 3.007 billion Regular Rate pieces are presented in carrier route bundles; 2.257 billion Regular Rate pieces are presented in 5-Digit automation bundles; and 337.8 million Regular Rate pieces are presented in 5-Digit non-automation bundles. From Table 11, page 30; 2.4 million Nonprofit pieces are presented in firm bundles; 1.279 billion Nonprofit pieces are presented in carrier route bundles; 381.5 million Nonprofit pieces are presented in 5-Digit automation bundles; and 181.0 million Nonprofit pieces are presented in 5-Digit non-automation bundles. The 47 percent of Nonprofit and Regular Periodicals in firm and carrier route bundles is calculated as the ratio of the sum of Regular Rate and Nonprofit pieces in firm and carrier route bundles to the sum of FY98 Regular and Nonprofit RPW volume. The 37 percent in 5-Digit bundles is calculated as the ratio of the sum of Regular Rate and Nonprofit pieces in 5-Digit automation and 5-Digit non-automation bundles to total RPW Regular Rate and Nonprofit RPW volume.

1 IVD. SUPPORT COSTS SHOULD BE BROADLY DISTRIBUTED
2 BECAUSE THEY ARE CAUSED BROADLY

3 In Section C of witness Stralberg's direct testimony, he states that "[t]he
4 objective of postal costing is to identify causal links between accrued costs and
5 mail subclasses" (Tr. 24/11373, lines 12–13). This objective appears to be
6 forgotten in section 6 when witness Stralberg recommends that direct tally costs
7 within the support cost pools be assigned to the classes of mail with which they
8 were observed. For clerks and mail handlers in processing operations, I agree
9 with witness Stralberg's reasoning—the mail being handled can reasonably be
10 inferred to be the cause of the associated cost. However, when we know that an
11 observed clerk or mail handler is functioning in a support role, actual piece
12 handlings are incidental to, rather than the cause of, those support activities.

13 The Commission should follow the logic of witness Stralberg's section C
14 recommendation instead of his recommendation in Section 6. All support costs
15 should be broadly allocated because support costs are caused by the broad
16 operations being supported rather than the incidental piece handlings that tally
17 takers may observe.

18 **V. INCREASING COSTS DO NOT JUSTIFY ADJUSTMENTS TO**
19 **PERIODICALS COSTS BEYOND THOSE ALREADY**
20 **SPECIFIED**

21 Complaints put forth by the Periodicals mailers involving increased costs
22 based on allegations of inefficient processes or the existence of annexes provide
23 no basis for any adjustment of Periodicals costs. It is my understanding,
24 however, that a number of cost savings opportunities and costing methodology
25 changes, which provide a basis for a \$203 million adjustment to Periodicals
26 costs, have been identified on the record.

1 The cost savings opportunities, beyond what was contained in the Postal
2 Service's Request, are:

- 3 1. Requiring preparation of basic rate carrier route Periodicals mail in
4 line of travel sequence, which would result in savings of
5 approximately \$23 million in the test year (see Response of United
6 States Postal Service to MPA/USPS-47, April 18, 2000, and
7 USPS-LR-I-307, April 18, 2000).
- 8 2. Changes in other Periodicals mail preparation requirements
9 involving (a) mandatory compliance with the L001 option; (b)
10 elimination of carrier route skin sacks; and (c) allowing barcoded
11 and non-barcoded bundles in the same sack, which would result in
12 total test year savings of about \$15 million (see Responses of
13 United States Postal Service Witness O'Tormey to MPA/USPS--
14 ST42-4 and 5, May 9,2000, and USPS-LR-I-332, May 15,2000).
- 15 3. Efforts to reduce bundle breakage, which would result in savings of
16 around \$15 million in the test year (see Response of United States
17 Postal Service Witness O'Tormey to MPA/USPS-ST42-10, May 9,
18 2000).
- 19 4. Various mail processing enhancements involving (a) increased
20 manual distribution productivity; (b) better AFSM 100 performance;
21 and (c) addition of OCRs and automatic feeders to the FSM 1000,
22 which could result in total test year cost savings of approximately
23 \$6 million (see Response of United States Postal Service Witness
24 O'Tormey to MPA/USPS-ST42-8 and 9, May 9,2000, and
25 Response of United States Postal Service to TW/USPS-9, May 9,
26 2000).

1 5. A work methods change embodied in a Memorandum of
2 Understanding with the National Association of Letter Carriers,
3 which could result in savings of approximately \$7 million in the test
4 year (see Response of United States Postal Service to TW/USPS-
5 7, May 9,2000).

6 The costing methodology changes, which have been identified as superior
7 to or acceptable alternatives for what was contained in the Postal Service's
8 Request, are:

9 1. A broader distribution of mixed mail costs, maintaining item and
10 container information, which would result in a reduction of Periodicals
11 costs in the base year of approximately \$17 million (see Tr. 21/8449-50
12 and USPS-LR-I-313, May 9,2000).

13 2. A change in the rural carrier mail shape adjustment using annual
14 data, which would result in a reduction of base year Periodicals costs of
15 about \$17 million (see Response of United States Postal Service to
16 MPA/USPS-49 and USPS-LR-1-335, May 12,2000).

17 3. New city carrier load time variability regressions, which would result
18 in a reduction of base year Periodicals costs of around \$50 million (see
19 Response of United States Postal Service Witness Baron to
20 ADVO/USPS-T12-11 and USPS-LR-1310, May 12,2000; Response of
21 United States Postal Service Witness Baron to UPS/USPS-T12-13 and
22 USPS-LR-I-398, June 6,2000).

23 4. New city carrier ~~dismount~~/drive time variability assumptions, which
24 would result in a reduction of base year Periodicals costs of approximately
25 \$46 million (see Rebuttal Testimony of United States Postal Service
26 Witness Baron, USPS-RT-12).

1 5. A new distribution key for AMTRAK Roadrailer costs, which would
2 result in a reduction in Periodicals base year costs of about \$ 2 million¹⁰
3 (see Rebuttal Testimony of United States Postal Service Witness Pickett,
4 USPS-RT-9).

5 There is no basis in the record for any adjustments to or reallocations of
6 Periodicals costs beyond those listed above, which have been specifically
7 identified and supported on the record.

8 Several witnesses in this proceeding, Cohen, O'Brien, and Stralberg have
9 called the Commission's attention to the issue of rapidly increasing Periodicals
10 costs. At the Commission's request, the Postal Service provided testimony from
11 witnesses Unger and O'Tonney. I was a member of the Periodicals Operations
12 Review Team (the Team) and participated in all the site visits. I agree with the
13 recommendations in the Team's report," but I feel that some important findings
14 of the Team have not been sufficiently stressed in the testimony thus far. These
15 findings indicate that no adjustment to actual Periodicals costs, beyond those
16 already specified by the Postal Service, is necessary or justified.

17 VA. SERVICE

18 The Periodicals Operations Review Team identified fifteen issues and
19 made recommendations. I believe that five of the fifteen issues have, in whole or
20 in part, arisen from service pressure.

¹⁰ It is my understanding that MPA witness Nelson also identified a potential base year savings of approximately \$ 5 million for Periodicals based on use of a different distribution key for rail empty equipment costs. See MPA-T-3, at 10. It is my understanding that the Postal Service does not challenge this redistribution.

¹¹ "Report of the Periodicals Operations Review Team," filed as LR-I-193.

- 1 ▪ Enforcement and Enhancements of Entry/Acceptance Requirements
- 2 (Issue 4)
- 3 ▪ Flats Operation Plan (Issue 5)
- 4 ▪ Combination and Separation of Mail Classes (Issue 6)
- 5 ▪ Interclass Cost Impacts (Issue 12)
- 6 ▪ Low Cost and Good Service Are Not Mutually Exclusive (Issue 13)

7 Understanding the unique nature of Periodicals service expectations is
8 key to understanding the pressure on the Postal Service. There is general
9 pressure from First-class and Standard mailers to meet published or reasonable
10 delivery standards. But, for Periodicals, there are mailer and recipient pressures
11 for particular-day delivery. The Team's report says, "Periodicals, more than any
12 other type of mail, are often expected on a specific day by recipients" (p. 37).

13 Many factors affect the Postal Service's ability to provide particular-day
14 delivery, only some of which are controlled by the Postal Service. However,
15 many recipients assume that delivery delays are always due to the Postal
16 Service. Mailers' failures to meet critical entry times, poor address quality, and
17 poor mail preparation increase the cost of achieving particular-day delivery.
18 Recipients and publishers can and have generated enormous service pressure
19 on the Postal Service in recent years. In my opinion, that pressure has played a
20 substantial role in the increase in Periodicals costs. I do not mean to say that the
21 Postal Service's operating decisions have always been the best way to address
22 service concerns, but I think it is important for the Commission to understand that
23 service has played an important role in operating decisions. Below I will discuss
24 each of the five issues that I believe arise, at least in part, from service pressure.

1 **VA.a** Enforcement and Enhancement **of** Acceptance/Entry
2 Requirements (Issue 4)

3 When mail is presented after the critical entry time, the Postal Service has
4 two choices. It can deviate from its standard operating plan or fail to provide
5 particular-day service. During the site visits, I observed sortation operations on
6 platforms that were specifically in place to handle late arriving mail. The
7 Periodicals Review Team Report said:

8 We also recommend that local postal managers recognize that
9 mailers who miss critical entry times should not expect the Postal
10 Service to undertake measures to deliver such mail as if it were not
11 delayed in entry (p. 4).

12 While this recommendation may be appropriate, it is difficult to universally
13 implement when field managers know they may be rightly or wrongly held
14 accountable for delays. My discussions with Postal Service personnel revealed
15 that failing to meet critical entry times is an inherent problem for some
16 publications. The task **of** collecting timely information, getting it printed, and
17 getting it to the Postal Service by the critical entry time frequently cannot be
18 done. For other publications the process is generally successful, but there are
19 regular failures. The Postal Service is in the very difficult position **of** having to
20 incur additional costs or lose goodwill with publishers and readers.

21 Based on team experiences in the sites visited, there appears to be
22 a **mindset** that service levels must be met regardless of the cost
23 implications (p. 37).

24 The connection between mail preparation and service is not as direct, but
25 it still exists. Refusal of poorly prepared mail causes delayed mail and unhappy
26 mailers and recipients. I spoke with acceptance personnel who clearly
27 expressed a real hesitancy to employ the extreme measure of rejecting late or
28 poorly prepared mailings.

1 **VA.b** Flats Operation Plan (Issue 5)

2 The Team recommended that the Postal Service develop and implement a
3 systemwide operations plan for processing Periodicals. I agree with the
4 recommendation as a cost saving measure, but adherence to it would mean no
5 deviations for late arriving mail, with the inherent issues I previously mentioned.

6 **VA.c** Combination and Separation of Mail Classes (Issue 6)

7 The Team report stated:

8 Opportunities exist for reducing costs without compromising service
9 by combining flats of different mail classes in incoming sorting
10 operations, as is already being done successfully in some locations
11 (p. 5).

12 I agree with this statement, but the "opportunities" must be carefully reviewed.

13 **As** the Team report later says:

14 [T]his separation is performed because the USPS believes that
15 by having pure streams of mail, it has more flexibility to meet its
16 service standards (p. 21).

17 It is not just belief, but rather fact, that the Postal Service has more
18 flexibility to meet service standards when it maintains separate mail streams.

19 The real issue is how often that flexibility is used and whether the avoided
20 service failures are worth the additional costs. Field managers that we observed
21 were clearly sometimes insuring better service by incurring additional cost.
22 However, it would be equally wrong to ignore the increased opportunities for
23 service failures inherent in commingling classes.

24 **VA.d** Interclass Cost Impacts (Issue 12)

25 It is important to understand that the existence of a separate Periodicals
26 class is due, at least in part, to service considerations. The need to separate

1 Periodicals flats from Standard flats is the direct result of a separate service
2 standard for Periodicals. Any discussion of interclass cost impacts must begin
3 with this understanding.

4 Just as with letter automation, the Postal Service attempts to identify the
5 most compatible mail to tun on its deployed flat automation. There is mailer
6 pressure to process Periodicals on automation, so many offices perform "triage"
7 operation on Periodicals to identify volumes that will be machine-compatible. In
8 some cases, the machine-compatible Periodicals mail is not processed on the
9 **FSM**. In some cases, machine-compatible Periodicals are processed manually
10 because the remaining processing window (after First-class has been sorted) is
11 too short. We do not know how frequently this occurs, but we do know that
12 service is at least sometimes a factor.

13 **VA.e Low Cost and Good Service Are Not Mutually Exclusive**
14 **(Issue 13)**

15 I agree that low cost and good service are not mutually exclusive.
16 However, I do not believe that there is no trade-off between cost and service. In
17 general, my experience is that efficiently run operations can also run consistently
18 and provide reliable service. But, very high levels of consistency and reliability
19 can cause substantial additional costs.

20 Consider the example of separate mail streams by class. I don't think
21 anyone doubts that Periodicals mail processing costs would be lower if they were
22 simply part of the Standard Mail stream. Periodicals are handled as a separate
23 stream in nearly all cases because of the need for better service.

24 The point that I would like the Commission to understand is that, while not
25 all service comes at a cost, much of it does. The problem is to identify where
26 and to what extent the trade-offs occur. I am sure that all Periodicals mailers

1 would like lower costs holding service constant. I am also sure that all
2 Periodicals mailers would like better service holding costs constant. What no
3 one knows is the extent to which Periodicals mailers are willing to trade off cost
4 for service. In fact, different types of Periodicals mailers have very different cost-
5 service trade-offs. What we do know is that service is very important to
6 Periodicals mailers in general and that Periodicals mailers are very vocal about it,
7 which influences operating decisions and causes costs.

a **VA.f Summary**

9 The point of this discussion has been to demonstrate to the Commission
10 that service plays an integral role in the Postal Service's operating decisions and
11 has, therefore, been an important factor in increasing costs. I fully support efforts
12 to improve Postal Service efficiency and to find the proper balance between
13 service and cost. However, I do not agree that the observed cost increases are
14 simply inefficiencies that are caused by other classes of mail and, therefore,
15 should not be considered Periodicals costs.

16 **VB. FLAT AUTOMATION**

17 Flat automation includes FSMs for piece sortation and **SPBS** for bundle
18 sortation. The evolution of Postal Service flat automation is well documented in
19 the current proceeding. I believe it would be fair to **characterize** the Postal
20 Service as moving along the learning curve.

21 The Commission made no adjustment for the costs of moving along the
22 learning curve for letter automation. Similarly, no adjustment other than those
23 proposed by the Postal Service should be made for the current costs of
24 automating flat processing. **A** review of some of the Periodicals Operation
25 Review Team observations will demonstrate that costs are being incurred as the

1 Postal Service learns to automate flat mail processing that will benefit
2 Periodicals.

3 The FSM 881 jams when certain types of mail are run on it. Flimsy
4 pieces, open-sided pieces, sticky polywrapped pieces, and pieces with oversized
5 polywrap all cause jams. Saying that mail is or is not compatible with the FSM
6 881 is an arbitrary distinction. In reality, almost any flat mail can be processed
7 on an FSM 881, but some types of pieces generate such frequent jams that the
8 processing becomes impractical and too costly.

9 Many factors have contributed to the need for “triage” operations to
10 determine how flat mail should be processed. These operations are necessary
11 so that the new equipment can be efficiently utilized. Mail piece characteristics,
12 bar-coding, and available machine types all determine the need for and
13 complexity of the triage operations. These triage operations are caused by the
14 lack of homogeneity of the mail pieces.

15 The small parcel and bundle sorters appear to be an improvement over
16 manual bundle sortation in terms of productivity and depth of sort. To increase
17 the overall efficiency of the SPBSs, the Postal Service has installed auto-feed
18 systems that reduce the required staffing. However, the auto-feed system has
19 caused increased bundle breakage. The Periodicals Operations Review Team
20 identified Postal Service and mailer actions to reduce bundle breakage and
21 capture the savings from the auto-feed systems. It also recommended
22 consideration of alternative technologies going forward (See pages 24–26 of the
23 report). This is another example of moving along the automation learning curve.

24 By arguing that Periodicals mail is not responsible for the learning curve
25 costs, the Periodicals mailers would seem to be arguing that Postal Service
26 efforts to automate flat mail have proceeded too quickly—before significantly
27 better technology was available. This is ironic because Periodicals mailers have

1 continually pushed for more automation and more processing of Periodicals flats
2 on existing automation. Costs may have been avoided by waiting for better
3 technologies with a wider range of tolerance for piece characteristics, or it could
4 simply have postponed the inevitable learning curve. The important points are
5 that the Postal Service is moving forward with cooperation from the mailers and
6 that the effort will benefit all flat mail, including Periodicals. The Commission
7 should not make any adjustments beyond those already proposed to reallocate
8 the cost of the flat-automation learning curve.

9 **VC. ANNEXES**

10 In direct testimony, witness O'Brien says,

11 The movement of Periodicals into annexes was not requested by
12 Periodicals mailers, nor was it caused by a growth of Periodicals
13 mail volume. So why should Periodicals be paying for it?
14 (Tr. 24/11184).

15 But, the Team's report says,

16 In many cases Annexes appear to be created to accommodate
17 deployments of automation equipment, such as Small Parcel &
18 Bundle Sorters (p. 31).

19 and also,

20 Flats bundles are at risk of breaking during bundle sorting,
21 especially when dumped on the automated feed systems of SPBS
22 machines (p. 24).

23 Clearly, annexes are being employed not to handle increases in flat
24 volumes, but rather to house the increased deployment of equipment to process
25 existing flat volumes, among other reasons.¹² It is wrong to argue that annex

¹² Witness Kingsley reported that a February 2000 survey revealed that 34 of the 67 mail processing annexes processed some Periodicals mail (See MH/USPS-T10-7, filed 4/5/00 and MH/USPS-T10-17, filed 4/28/00). However, my

1 costs are not for the benefit of the mail being processed therein. IOCS provides
2 an estimate of the portion of clerk and mail handler time that is spent handling
3 Periodicals, which includes clerks and mail handlers working in annexes and on
4 the platforms that move mail to and from those annexes. There **is** no justification
5 for any adjustment to Periodicals costs, because Periodicals are processed in
6 annexes that were required to deploy the machines on which they are processed.

7 **VI. THE BPM MAIL CHARACTERISTICS SURVEY PROVIDES**
8 **a RELIABLE DATA FOR COST MEASUREMENT**

9 Witness Siwek states in his testimony that "the BPM Mail Characteristics
10 Survey is fraught with a set of statistical oddities and infirmities" (Tr. 30/14578,
11 lines 2–3). Witness Siwek's oddities and infirmities appear to boil down to the
12 estimation of volumes by office for one stratum, the use of FY98 volumes to
13 inflate sample data from FY99, and the collapsing of strata 2 and 3 to estimate
14 standard errors. While witness Siwek's criticisms may **very** well be technically
15 correct, as I demonstrate below, they are absurd from a practical standpoint. In
16 the real world, the perfect data seldom exist and small compromises must be
17 made.

18 Instead of using estimated volumes for the smallest **offices** (stratum **4**),
19 witness Siwek's criticisms imply abandoning the efficiency advantages of
20 stratified sampling. Given the available resources, the result would not be
21 **useable** due to the enormous standard errors from any practical sample size.
22 With respect to the **use** of FY98 annual data, I can only say that **complete** FY99

understanding **is** that only one annex processes **only** Periodicals mail. Most of
the annexes that process Periodicals mail are flat annexes that also process
Standard Mail.

1 data were not yet available. They have since become available and I will
2 demonstrate that their use makes little difference, as we expected.

3 Finally, the collapsing of strata 3 and 4 is a necessary and frequently used
4 step in application of the bootstrapping technique. The alternative is no standard
5 errors, which cannot be preferred.

6 The choice of the stratified sampling method was driven primarily by the
7 simple fact that very few offices actually report acceptance of Bound Printed
8 Matter. With this fact in mind, I will proceed to discuss witness Siweks criticisms.

9 **VIA. THE INCREASED EFFICIENCY OF A STRATIFIED SAMPLE**
10 **MORE THAN OFFSETS THE SMALL POTENTIAL BIAS FROM**
11 **HAVING TO ESTIMATE VOLUMES FOR THE SMALL OFFICES**

12 In general, stratification will produce large gains in precision under the
13 following conditions:¹³

- 14 1. The population is composed of institutions varying widely in size.
- 15 2. The principal variables to be measured are closely related to the
16 sizes of the institutions.
- 17 3. A good measure of size is available for setting up the strata.

18 All of these conditions are satisfied with respect to presorted Bound'
19 Printed Matter mailings.

20 Bias does exist when strata populations are measured with error.¹⁴ But,
21 almost any information available on a population of interest is subject to some
22 form of measurement error. Every study employing stratification based on real-
23 world data is subject to this criticism. Absent a sterile sampling environment,

¹³ See William G. Cochran, *Sampling Techniques*, 3rd Edition, Wiley 1977, at page 101.

¹⁴ See Cochran, at page 117.

1 such sources of bias can only be avoided by abandoning stratification in favor of
2 a simple random sample.

3 However, bias **is** not the only criterion that should be considered when
4 making methodological decisions. Due to the fact that BPM volumes are
5 concentrated in a small proportion of all offices, simple random sampling would
6 require enormous resources to yield useful estimates with acceptable standard
7 errors. Given the distribution of BPM across offices, the gains in precision that
8 result from stratification are large and the population measurement bias is small.

9 **VIA.a** Offices Accepting **BPM** Vary Widely by Size

10 There are over 27,500¹⁵ Postal Service facilities authorized to accept
11 Bound Printed Matter. ~~Of~~ these 27,500, the 150 largest finance numbers
12 accepted over 89 percent of the 1998 presorted BPM volume, while the 20
13 largest finance numbers accepted over 58 percent of the total.¹⁶ The largest
14 finance number accepted 41.5 million pieces, compared to the 20th largest office
15 which accepted 4.8 million pieces. In contrast, 23,200 of the 27,500 acceptance
16 locations accepted little or no presorted BPM in 1998.

17 **VIA.b** The Size of the Office ~~is~~ Closely Related to the Variables
18 of Interest

19 LR-1-109 measures the current drop-shipping practices of **BPM** mailers.
20 The size of the mailing is the principal determinant in the decision to transport the
21 mail to a facility other than the facility where it is verified. A mailer is likely to

¹⁵ In the National Consolidated Trial Balance, 27,883 unique finance numbers reported revenue of some kind in FY99.

¹⁶ See Table 4, below.

1 incur the additional transportation cost if the reduction in postage is larger than
2 the cost of the transportation needed to get the pieces to a facility closer to their
3 destination. Mailers of similar size will have similar dropshipping incentives, with
4 larger mailers generally dropshipping more.

5 **VIA.c** A Good Measure of Size is Available for Establishing the
6 Strata

7 The PERMIT system and the National Consolidated Trial Balance (NCTB)
8 revenues provide excellent measures of the size of each finance number's
9 presorted BPM volumes. For instance, in 1998 over 96 percent of BPM revenue
10 was collected at automated PERMIT system sites. In the NCTB reports, four
11 percent of the presorted BPM revenues are at offices not reported in the PERMIT
12 database. The correlation of volume and revenue across finance numbers is
13 nearly perfect (.99).¹⁷

14 **VIA.d** The Case for Choosing Stratification Over Simple
15 Random Sampling

16 Since BPM is concentrated in so few offices, simple random sampling,
17 while unbiased, is likely to provide unreliable estimates. Even if we restrict
18 sampling to the 4,278 offices reporting BPM revenue in 1998, a random sample
19 of 44 offices would result in an 81 percent probability that none of the largest 20
20 offices would be selected. Similarly there would be an 80 percent probability the
21 sample would contain 2 or fewer of the largest 150 offices. Witness Siweks
22 recommendation of unstratified random sampling would have the Postal Service
23 making inferences about dropshipping based on a sample that contained few, if
24 any, dropshippers.

¹⁷ 1998 PERMIT System.

1 Another illustration of the shortcomings of an unstratified random sample
2 is presented in Table 2, which presents a comparison of the offices actually
3 sampled in LR-I-109 with the expected distribution of offices by stratum from a
4 simple random draw from the 4278 offices reporting BPM in 1998. As illustrated
5 in this table, one would expect that only a single office out of a sample of 214
6 would be from the largest 20 offices. Only seven or eight offices from this
7 sample would be from the largest 150 offices.

8 Both of these examples illustrate that a simple random sample approach
9 wastes resources, and yields samples from which inferences about dropshipping
10 should not be made. Even though random sampling provides unbiased
11 estimates, it would not likely provide reliable estimates given the distribution of
12 BPM volumes in the population. In contrast, Table 2 also illustrates that by
13 stratifying offices, the Bound Printed Matter Mail Characteristics Survey
14 employed resources such that the characteristics of over 56 percent of BPM mail
15 volume would be sampled with certainty. Moreover, 96 percent of the population
16 would not be subject to witness Siwek's accusation of error estimating stratum
17 volumes. Lacking unlimited budget, stratified random sampling is the preferred
18 approach.

19 **VIA.e Bias Resulting from Measurement Error in Stratum 4 is**
20 **Insignificant**

21 As defined in LR-I-109 (page 4), stratum 4 consists of offices not
22 reporting in the PERMIT system. For these offices, the only information available
23 about Bound Printed Matter is office-specific permit imprint BPM revenue from
24 the NCTB. The survey imputes piece counts for stratum 4 offices from their
25 reported revenue and the mean revenue per piece for stratum 3 offices. Since

1 actual revenue per piece for each office in stratum 4 is unknown, the resulting
2 inflation factors will be measured with error.

3 Two factors suggest that the bias from estimating volumes will not be
4 appreciable. First, the bias will be insignificant since there are no systematic
5 differences between stratum 3 offices and stratum 4 offices., The BPM
6 customers at both stratum 3 and 4 offices generally do not have the volume
7 necessary to make dropshipping profitable, nor do they typically have sufficient
8 route density to prepare national carrier route mailings. Furthermore, there is no
9 evidence to indicate that there are systematic differences between stratum 3 and
10 4 offices in the mailing characteristics determining postage: weight, sortation, and
11 drop shipment behavior. On the contrary, strata 3 and 4 are comprised of over
12 27,000 relatively homogeneous offices. Second, the measurement error affects
13 a small fraction of presorted Bound Printed Matter. Strata 3 and 4 offices
14 accepted less than 11 percent of presorted Bound Printed Matter in 1998, with
15 less than half of that attributable to stratum 4.

16 Table 3 illustrates the effect that bias in the revenue per piece measure
17 has on the estimates presented in the Bound Printed Matter survey. Column 1 of
18 Panel A provides the baseline measure for the entry profile, measured assuming
19 that revenue per piece in stratum 3 is the same as in stratum 4. Columns 2 and
20 3 give the distributions if we assume that the stratum 4 revenue per piece is
21 actually plus or minus ten percent from the stratum 3 average. Similarly,
22 columns 4 and 5 show the distributions assuming plus or minus 25 percent. No
23 appreciable difference in the distributions is observed even with the extreme
24 assumption that the stratum 4 average could be 25 percent different from stratum
25 3.

1 **VIA.f** The Bias ~~from~~ Using the **FY98 Data** *for* Weights is **Small**

2 **As** with population measurement errors, issues arise in most applied
3 statistical research because of changes in populations over time. Ideally,
4 observations from a stratified random sample would be sampled and weighted in
5 proportion to their contemporaneous population proportions. Since one cannot
6 simultaneously establish the sample design, collect the data, and construct the
7 sample weights, temporal fluctuations in population characteristics make it
8 impossible to create strictly unbiased and efficient estimates. However this is not
9 to say the information gained in such research is unreliable and unsuitable for
10 policy decisions. The relevant question pertains to whether the gains from
11 efficiency outweigh the bias inherent in using a stratified approach.

12 Since a full year of information on offices was necessary in order to assign
13 each office with the appropriate sampling probability, and rates were to be based
14 on FY1998 volumes, the sample design for the Bound Printed Matter Mail
15 Characteristics Study utilized 1998 data, the most recent **full** year for which data
16 were available. However, data were collected from June 21 through July 17 of
17 1999. The final results presented to witness Crum in August of 1999 use the
18 survey data **collected** in 1999 to represent national totals from base year 1998.

19 **As** witness Siwek asserts, the LR-I-109 estimates cannot be unbiased
20 estimates of either year because the sample design and data collection are
21 based on different periods. Bias results from the error introduced because BPM
22 volume in each office changes from year to year or because mailer behavior is
23 not identical from one year to the next. The magnitude of the bias depends on
24 the size of the difference in the two years. Since we have some indirect evidence
25 about changes in Bound Printed Matter, we can infer that the bias alluded to by
26 witness Siwek is likely to be small.

1 Specifically, there is not evidence that relative office sizes changed
2 significantly between 1998 and 1999, nor evidence that mailer behavior changed
3 markedly. In 1998 the largest 20 offices accounted for 56.08 percent of
4 presorted BPM volumes, in 1999 these same 20 offices accounted for 56.33
5 percent of the presorted BPM—a difference of only one-quarter of a percentage
6 point. Table 4 shows the distribution of presorted BPM by strata for 1998 and
7 1999.

8 While BPM population proportions did fluctuate from 1998 to 1999,
9 fluctuations in easily observed characteristics are minor. For example, Table 5
10 shows that the zone distributions of pieces in the PERMIT system are nearly
11 identical between FY1998 and FY1999. This is especially significant since any
12 material changes in mailer drop-shipping behavior will be reflected in the zone
13 distribution of pieces. Furthermore, as demonstrated in Table 6, recasting the
14 statistics presented in LR-I-109 Bound Printed Matter using 1999 volumes does
15 not materially affect the estimated distributions. The meager differences in strata
16 sizes between the two years indicate that any bias is small.

17 **VIB. SMALL BIAS IN THE STANDARD ERRORS IS PREFERRED TO**
18 **NO STANDARD ERRORS**

19 Mr. Siwek also claims that the standard errors reported in LR-I-109 are
20 unsound (Tr. 30/14578, line 27 to Tr. 30/14579, line 8). This observation follows
21 from the fact that data were collected on only one BPM mailing for stratum 3
22 offices. Because there is only one observation, the bootstrap estimate of stratum
23 3's variance is zero. Therefore, standard bootstrap estimates of the variance will
24 understate the true variance. This problem is generally addressed by collapsing
25 strata when estimating the population variance, as was done in the Bound

- 1 Printed Matter Mail Characteristics Survey.” This procedure will result in
- 2 variance estimates that are larger than the true variance, thereby providing
- 3 conservative estimates for the confidence intervals.

¹⁸ See Cochran, at page 138.

Table 1
BY98 IOCS Mail Processing Mixed-Mail Tallies (Dollar Weighted)—Clarks/Mailhandlers
Crosswalk of Question 19 Activity Code to Item/Container Information
MODS 1 & 2 Allied Cost Pools Only
(excludes empty items and containers)

Shape	Mixed Actv (Q19)	Mixed Item/Container Tally Dollar Weights (00)			Total	% of Total	
		Letters	Flats	Parcels			
Letters	5610	23,102	1,682	196	1,172	26,173	8%
Flats	5620	198	12,914	36	119	14,543	4%
Parcels	5700	299	278	4,281	1,559	7,117	2%
None	5750	96,150	58,688	52,207	51,941	297,118	86%
Total		119,750	73,563	56,719	41,180	345,551	100%
% of Total		35%	21%	16%	16%	10%	
% 5750 of Total		32%	20%	18%	17%	10%	
% 5750 w/ shape or class from item/container of total mixed-mail						75%	

Note: This table was created using the 1998 IOC data set as presented in USPS LR 1-12. Cost pool assignments are based on the proposed MODS based cost distribution methodology described by witness Van-Ty-Smith in USPS-T-17 and USPS LR-1-106. This methodology is also used to classify individual tallies as mixed-mail items, counted mixed-mail containers, and uncounted mixed-mail containers. All mixed-mail tallies are then summed by mixed-mail activity code (IOCS field F262) and item/container categories based on item and container type. Item type is assigned based on IOCS field F9214, container type based on IOCS field F9219, and counted container contents based on IOCS fields F9901 through F9919. Individual item and container types are then assigned to the above categories as follows: Letters—loose cards and letters in containers and letter trays, Flats—loose flats in containers and flat trays, Parcels—loose IPP's and parcels in containers and small parcel trays, Class—all sacks (individual items and in counted containers), None—all remaining items and container types.

Table 2
Expected Samples Using Stratified Random Sampling v. Simple Random Sampling

	Number of offices	Distribution of FY98 BPM Pieces	Offices Selected in LR-I-109	Expected distribution of simple random draw of size N			
				N=44	N=100	N=150	N=214
Stratum 1	20	56.1%	20	0.2	0.5	0.7	1.0
Stratum 2	130	33.2%	16	1.3	3.0	4.6	6.5
Stratum 3	971	6.9%	4	10.0	22.7	34.0	48.6
Stratum 4	3,157	3.8%	4	32.5	73.8	110.7	157.9
Total	4,278	100.0%	44	44	100	150	214

NOTE The expected value is calculated as the product of the sample size and the ratio of the number of offices in each Stratum to the total number of offices in the population. See LR-I-109 for programs and documentation for summarizing strata volumes.

Table 3
Distribution of Bound Printed Matter by Entry Profile and Zone
Mail Processing Version
All Containers

1 Base Line	2 10 % Adjustments		3 25 % Adjustments		5 Revenue Per Piece 25% >
	Revenue Per Piece 10% <	Revenue Per Piece 10% >	Revenue Per Piece 25% <	Revenue Per Piece 25% >	
Stratum 3 Average	Stratum 3 Average	Stratum 3 Average	Stratum 3 Average	Stratum 3 Average	Stratum 3 Average
All Zones	All Zones	All Zones	All Zones	All Zones	All Zones
7.1%	7.2%	7.0%	7.5%	6.8%	
1.2%	1.2%	1.2%	1.2%	1.2%	
1.1%	1.1%	1.1%	1.1%	1.2%	
3.9%	3.9%	3.9%	3.9%	3.9%	
17.3%	17.2%	17.4%	17.1%	17.4%	
3.4%	3.4%	3.4%	3.4%	3.4%	
4.9%	4.9%	4.9%	4.9%	4.9%	
39.1%	39.1%	39.2%	39.0%	39.2%	
21.5%	21.5%	21.5%	21.5%	21.5%	
0.4%	0.4%	0.4%	0.4%	0.4%	
0.0%	0.0%	0.0%	0.0%	0.0%	
467,297,415	467,297,415	467,297,415	467,297,415	467,297,415	467,297,415
A. Entry Profile:					
DDU					
DDU - Destinating 3-Digit ZIP Area					
DDU - Destinating BMC Service Area					
Origin AO					
Destinating SCF					
SCF - Destinating BMC Service Area					
Origin SCF					
Destinating BMC					
Origin BMC					
Destinating ASF					
Origin ASF					
Total Pieces					
B. Zone Distribution:					
Local					
Zone 1	15.0%	15.1%	14.9%	15.2%	14.8%
Zone 2	31.7%	31.6%	31.7%	31.5%	31.8%
Zone 3	16.8%	16.8%	16.8%	16.7%	16.8%
Zone 4	10.9%	10.9%	10.9%	10.9%	11.0%
Zone 5	12.4%	12.4%	12.4%	12.3%	12.4%
Zone 6	8.1%	8.1%	8.1%	8.1%	8.1%
Zone 7	2.4%	2.4%	2.4%	2.4%	2.4%
Zone 8	1.6%	1.6%	1.5%	1.6%	1.5%
1.2%	1.2%	1.2%	1.2%	1.2%	1.2%
Total Pieces	467,297,415	467,297,415	467,297,415	467,297,415	467,297,415

NOTE: Proportions are for total FY1999 volumes. Volumes are inflated using the sources and procedures described in LR-1-109. Average revenue per piece for Stratum 3 (in column 1) is .89.

Table 4
Presorted BPM
Distribution of Pieces by Strata

	FY1990		FY1999	
	Pieces	Percent of Total	Pieces	Percent of Total
Strata:				
Stratum 1	257,850,605	56.1 %	263,199,979	56.3%
Stratum 2	152,853,389	33.2%	147,780,079	31.6%
Stratum 3	31,624,815	6.9%	44,614,183	9.5%
Stratum 4	17,468,091	3.8%	11,685,173	2.5%
	459,796,900		467,279,415	

NOTE: FY1998 & FY1999 PERMIT **System** Data. See LR-1-109 (pages 206-223) for programs and documentation used to summarize PERMIT system data.

Table 5
Presorted BPM
Distribution of Pieces by Zone

	FY1998	FY1999
Local	13.1%	13.8%
Zone 1&2	50.9%	50.6%
Zone 3	13.5%	13.2%
Zone 4	9.0%	8.9%
Zone 5	6.5%	6.6%
Zone 6	2.6%	2.5%
Zone 7	1.9%	1.9%
Zone 8	2.4%	2.6%

NOTE: FY1998 & FY1999 PERMIT System Data. See LR-1-109 (pages 206223) for programs and documentation used to summarize PERMIT system data.

Table 6

Distribution of Bound Printed Matter by Entry Profile and Zone: 1998 and 1999 Volumes
 Mail Processing Version
 All Containers

	Inflated Using 1998 Volumes	Inflated Using 1999 Volumes
	All Zones	All Zones
A. Entry Profile Distribution:		
DDU	7.2%	7.1%
DDU - Destinating 3-Digit ZIP Area	1.2%	1.2%
DDU - Destinating BMC Service Area	1.0%	1.1%
Origin AO	2.7%	3.9%
Destinating SCF	16.0%	17.3%
SCF - Destinating BMC Service Area	3.6%	3.4%
Origin SCF	5.6%	4.9%
Destinating BMC	41.4%	39.1%
Origin BMC	20.9%	21.5%
Destinating ASF	0.3%	0.4%
Origin ASF	0.0%	0.0%
Total Pieces	459,792,628	467,297,415
B. Zone Distribution:		
	All Entry Profiles	All Entry Profiles
Local	14.6%	15.0%
Zone 1	32.0%	31.7%
Zone 2	17.7%	16.8%
Zone 3	10.9%	10.9%
Zone 4	11.9%	12.4%
Zone 5	7.7%	8.1%
Zone 6	2.4%	2.4%
Zone 7	1.6%	1.6%
Zone 8	1.3%	1.2%
Total Pieces	459,792,628	467,297,415

Proportions are for total FY1998 and FY1999 volumes. Volumes are inflated using the sources and procedures described in LR-I-109.

1 CHAIRMAN GLEIMAN: Three parties requested oral
2 cross examination of this witness, American Business Media,
3 the Office of the Consumer Advocate, and United Parcel
4 Service.

5 Is there anyone else who wishes to cross examine?

6 [No response.]

7 CHAIRMAN GLEIMAN: If there is not, then Mr.
8 Straus on behalf of American Business Media -- I can't keep
9 up with the name changes sometimes.

10 MR. STRAUS: We've changed a lot less frequently
11 that the Association for Postal Commerce. I've been around
12 for four of their names.

13 [Laughter]

14 CHAIRMAN GLEIMAN: No comment. They keep moving
15 up alphabetically, I think, so it works to their advantage.

16 If you are prepared to begin, proceed.

17 MR. STRAUS: Yes.

18 CROSS EXAMINATION

19 BY MR. STRAUS:

20 Q Mr. Degen, in your original testimony in this
21 case, beginning at page 69, you testified that the
22 non-handling portions of the allied labor cost pools should
23 be broadly distributed.

24 Are you still proposing the same distribution of
25 those costs as you proposed in your initial testimony?

1 A Yes, I am.

2 Q You have been -- well, let me hand you a copy of a
3 proposed cross examination exhibit.

4 [Pause.]

5 COMMISSIONER LeBLANC: Mr. Straus, you've got it
6 already marked, and that's how you want it to stay?

7 MR. STRAW: Yes, I hope I did it right.

8 COMMISSIONER LeBLANC: That's why I'm checking
9 with you. It's ABM-XE-USPS-RT-5; is that correct?

10 MR. STRAW: That's right.

11 COMMISSIONER LeBLANC: Thank you, that clarifies
12 the record.

13 [Exhibit Number ABM-XE-USPS-RT-5
14 was marked for identification.]

15 BY MR. STRAW:

16 Q Mr. Degen, first let me ask if you've seen this
17 document before?

18 A Yes, I did; I saw it yesterday.

19 Q And have you confirmed that the numbers shown
20 there are accurate?

21 A Essentially. I wasn't able to replicate them
22 exactly, but back-of-the-envelope got us very close.

23 Q Okay, so these numbers are the IOCS tally costs
24 for allied not handling costs by shape; is that right?

25 A I'm pretty sure that's true. It may also include

1 some support cost, which I think is why maybe we didn't hit
2 them right on the head, but essentially that's what they
3 are, yes.

4 Q Okay, and on line 1 for the not-shape-specific,
5 that shows that \$1.66 billion of not-shape-specific,
6 amounting to 91 percent of the total -- now, you and Mr.
7 Stralberg agree, don't you, on the manner in which these
8 costs should be distributed?

9 A Yes, and in terms of methodology in both cases, I
10 think each of us says that they should be distributed
11 broadly over all cost pools.

12 Q And with respect to the remaining nine percent, is
13 it true that you and he disagree with respect to a portion
14 of these distributions?

15 A Yes.

16 Q And on some you do agree?

17 A Well, in that remaining nine percent, he's
18 proposing to use Question 19 shape information, which I did
19 not propose to use and did not agree with.

20 Q But the end result of his approach versus your
21 approach would not allocate these costs totally separately?
22 I mean, there would be some overlap in the way you would
23 distribute the costs?

24 A It would be pretty close, yes.

25 Q On page 24 of your rebuttal testimony, you state

1 that you support a \$203 million downward adjustment in
2 periodical costs that had been identified on the record.

3 To put this into context, is it true that this
4 \$203 million is based upon the 1998 base year?

5 A That's my understanding as to how it was actually
6 calculated.

7 Q And if the Postal Rate Commission were to go
8 against the Postal Service's wishes and use 1999 as the base
9 year, would this \$203 million reduction or something very
10 close to it still be as appropriate for that test year as --
11 excuse me, for that base year -- as a 1998 base year?

12 A My understanding is that that is correct. I
13 didn't do the actual calculations, but I did ask that
14 question, and my understanding is that the answer is yes.

15 MR. STRAUS: Thank you. That's the end of my
16 questioning.

17 [Exhibit Number ABM-XE-USPS-RT-5
18 was received into evidence and
19 transcribed into the record.]

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Cross Examination Exhibit No. ABM-XE-USPS-RT-5

**FY 1998 Allied Not-Handling Costs by Shape
(Dollars in Millions)**

Shape	Tally Cost	Percent by Shape
Not Shape-Specific	\$1,666	91%
Letter	\$106	6%
Flat	\$41	2%
Parcel	\$25	1%
Total	\$1,838	100%

Source: USPS-LR-I-12. Allied not-handling costs summed by shape using Question 19 data.

1 CHAIRMAN GLEIMAN: United Parcel Service?

2 MR. McKEEVER: Thank you.

3 CROSS EXAMINATION

4 BY MR. McKEEVER:

5 Q Mr. Degen, how are you?

6 A Good.

7 Q Good.

8 Is it your view that volume growth at a given
9 location has no effect on whether to move to automation at
10 that location?

11 A It is certainly my opinion that those do not move
12 in lock-step; that equipment deployments are driven by
13 things like the availability of new technology, and
14 significant changes in volume probably beyond what would
15 happen in the test year might cause additional deployments.

16 Q Switching a little bit to another subject -- we're
17 already done that one -- is it your view that the Postal
18 Service can add staff during peak hours if volume increases
19 without having to add staff during the shoulders of the
20 peak?

21 A With respect to a particular operation, yes,
22 that's my opinion.

23 Q Now, you qualified it with respect to a particular
24 operation. Can you expand on that a little bit?

25 Are there situations, for example, where you're

1 not talking about a particular operation, but just overall,
2 generally, if volume increases during the peak?

3 A My understanding is that part-time flexibles and
4 casuals do not have eight-hour work requirements, and can be
5 scheduled to work peaks and sent home early if necessary.

6 Q It is your testimony that there is excess capacity
7 in the shoulders of the peak; is that correct?

8 A Intentional excess capacity designed to generated
9 inventories of mail for downstream operations.

10 MR. McKEEVER: That's all we have, Mr. Chairman.

11 MR. STRAUS: If I might, I neglected to move into
12 evidence, cross examination exhibit ABM-XE-USPS-RT-5. I
13 have given two copies to the Reporter, and will now ask that
14 it be copied into the record and admitted into evidence.

15 CHAIRMAN GLEIMAN: Without objection.

16 MR. STRAUS: And if I could burden the Reporter by
17 having it put in the record between my cross examination and
18 that of Mr. McKeeever, that would probably be helpful to
19 anyone reading the transcript.

20 CHAIRMAN GLEIMAN: If it's possible, I'm sure that
21 the Reporter will accommodate us.

22 We're going to take a break now for lunch. We'll
23 come back at 2:00, and pick up with OCA's cross examination.

24 [Whereupon, at 1:04 p.m., the hearing was recessed
25 for luncheon, to be reconvened this same day at 2:00 p.m.]

AFTERNOON SESSION

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[2:00 p.m.]

CHAIRMAN GLEIMAN: Mr. Richardson, whenever you're ready.

MR. RICHARDSON: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. RICHARDSON:

Q Good afternoon, Dr. -- Mr. Degen.

A Good afternoon.

Q I've been thinking of Dr. Bozzo too often, or more than I would like to admit.

I want to ask you some questions about part 3 of your prepared testimony. If you would turn to page 6 to start with on your testimony. Do you have that in front of you?

A Yes, I do.

Q And you're discussing a definition that Dr. Smith was using in his testimony and an erratum which he filed to change his testimony. You discuss that in the footnote. Do you see that?

A Yes.

Q And the mere fact that he corrected his testimony didn't cause you any problems, did it? It's not unusual for witnesses to correct their testimony once it's filed. Corrections per se were not a problem.

1 A No.

2 Q Now, as corrected, is it your position that the
3 testimony as modified, the definition of Dr. Smith is
4 suspect? Do you disagree with his definition as he has
5 modified it for his purposes?

6 A I think his modification makes it less useful.
7 While it may not be technically correct, his original
8 definition was explicit that delivery points were among
9 factors that were not volume variable, and his revised
10 definition has basically taken that off the table. So it's
11 not incorrect, but it's less useful because he has made it
12 more general, and in that sense less specifically accurate.

13 Q Does Dr. Bozzo define volume variability in his
14 testimony?

15 A I think he does, but I --

16 Q Would you agree --

17 A -- I would have to look.

18 Q Would you agree subject to check that he does not?

19 A No.

20 Q And if he did not, would you consider that to be a
21 problem in his testimony?

22 A Well, I don't know that it would be a problem per
23 se. I mean, he calculates volume variabilities and is
24 therefore very specific -- specifically defining them in
25 terms of how he calculates them. I don't -- you know, I

1 don't know whether additional discussion is necessary. The
2 term has been around for two rate cases now, so to say
3 whether he took time to explicitly discuss it in this case
4 or not, I just don't remember, but I don't know that that
5 would be a big problem.

6 Q In your view, is his definition -- does it include
7 holding non-volume factors such as delivery points constant?

8 A Yes.

9 Q Now, on page 6, at the bottom of page 6, lines 17
10 to 18, your testimony states: If the Postal Service volume
11 increases as forecast for the test year, how much will costs
12 by subclass increase, holding non-volume factors such as
13 delivery points constant?

14 Do you see that?

15 A Yes, I do.

16 Q You refer to volume increases for the test year.
17 Why do you use test year rather than some other period?

18 A Well, I think test year or rate cycle are the
19 relevant horizons here. You know, the question before the
20 Commission is what are costs going to be in the test year so
21 they can set rates that cover those costs.

22 Q Is it your testimony that the Commission should
23 just look at volume changes during the test year for
24 measuring volume variability?

25 A The test year or the rate cycle, but, you know, a

1 fairly short-term view corresponding to the period for which
2 they are considering setting rates.

3 Q That would be a short-term view, you said a fairly
4 short-term view.

5 A Yes.

6 Q Well, the test year is normally a period shorter
7 than the rate effective period. Of those two periods, which
8 length ~~of~~ time would you focus on?

9 A Well, my understanding is that the Commission is
10 focusing specifically on what test year costs are going to
11 be. That's my understanding of the exercise. So I think
12 the test year is a relevant consideration.

13 Q So moving over to page 7 of your testimony, along
14 those same lines, on lines 14 to 15, you indicate one of the
15 steps towards measuring volume variability is, quote, "to
16 understand what cost-causing factors will vary in response
17 to volume growth in the test year." Again you use the word
18 test year. Do you see that?

19 A Yes.

20 Q And what struck me as I was reading these, it
21 occurred to me that they sounded like the steps that one
22 takes in establishing test year costs, which is something
23 quite apart from establishing a regression for volume
24 variability. Could you see any distinction between those
25 two points?

1 A Well, I think that's part of the problem in this
2 case, is that the -- we have to focus on the use to which
3 volume variability factors are going to be put, and their
4 use is to calculate test year costs with the aid of the
5 roll-forward, and my discussion is to focus attention on
6 that use and use it to understand whether we should be
7 looking at longer-run, shorter-run, what kind of factors we
8 should be controlling for. Otherwise, you know, it's simply
9 an academic exercise and, you know, you can consider all
10 kinds of options. But the use to which volume variability
11 factors are put is to calculate test year cost.

12 Q I would like to focus again on that same sentence
13 on lines 14 to 15 of your testimony, and you discuss
14 cost-causing factors. You refer to cost-causing factors.

15 Now, volume can grow in several ways. It could
16 increase at a given delivery point or it could also increase
17 through an increase in the number of delivery points. Do
18 you agree with that?

19 A You're saying that some volumes could go to new
20 delivery points.

21 Q Correct

22 A Yes, I agree with that.

23 Q New volumes at new delivery points.

24 A Yes.

25 Q And would you agree that that would cause an

1 increase in cost-causing factors?

2 A Not caused by volume, you know. I will accept
3 that new points cause volume; I do not accept that new
4 volume causes points.

5 Q Well, which comes first -- the delivery point or
6 the volume? Wouldn't it be the volume that would give rise
7 to the need for a delivery point?

8 A No, I don't see that. I mean, giving rise to a
9 delivery point would be a new business formation or a new
10 household formation.

11 Q And there would be a delivery point formed with
12 zero volume? **Is** that what you're saying? Doesn't there
13 have to be a volume before there is justification for a
14 delivery point?

15 A No.

16 Q Or at least the understanding that there will be a
17 volume?

18 A No. My understanding is that the Postal Service
19 only deliveries addressed mail, and so until an address
20 exists, I don't see how there can be volume for it.

21 Q Since your testimony indicates that holding
22 non-volume factors such as delivery points constant seems to
23 indicate that the growth of delivery points, even though
24 associated with increased volume, does not increase cost,
25 can we assume that -- can we assume that you believe the

1 Commission's opinion in R97 was wrong and --

2 A That was an awful lot of question.

3 Q Okay.

4 A I think I need to hear that again.

5 Q Okay. Let me break it up.

6 In R97, the Commission stated in its Appendix F,
7 and I'll quote to you, "If the number of facilities varies
8 with volume, then Witness Bradley's elasticities are flawed
9 because they do not correctly represent the variability of
10 mail processing labor costs for the entire postal system."
11 And that appears in Appendix F at page 21. Did you --

12 A I think I read that before, yes.

13 Q Do you agree with that statement?

14 A Could you read it again?

15 Q Yes. "If the number of facilities varies with
16 volume, then Witness Bradley's elasticities are flawed
17 because they do not correctly represent the variability of
18 mail processing labor costs for the entire postal system."

19 A I think I'm in general agreement with the idea
20 that if volume causes additional facilities, then the cost
21 associated with those additional facilities are, in fact,
22 volume variable.

23 That's not really the gist of that sentence,
24 though. That seems to say that volumes will cause
25 additional facilities. You can't just say that they happen

1 to vary with them, but again, it's a causality issue -- do
2 volumes cause additional plants? And my understanding is
3 that that's just not true in any general sense, and the
4 relationship is fairly tenuous, that given substantial
5 volume increases over a time period probably a lot longer
6 than a rate cycle, than the test year or a rate cycle, there
7 may be a need to build additional facilities, but I go to
8 great length in my direct testimony to explain the -- sort
9 of the way the Postal Service Zip structure dictates the
10 location of facilities, and it really is not as simple as
11 building a new facility to handle the additional volumes.
12 It's much more complicated than that.

13 While in the extreme a facility may be built to
14 add additional capacity, test year increases in volume are
15 going to be spread across the entire system and a very, very
16 small number of facilities are going to be replaced or even
17 modified over a horizon as short as the test year or the
18 rate cycle.

19 Q Okay. On page 7 of your testimony, I would like
20 to refer to line 24 through 26. You criticize Witnesses
21 Neels and Smith because their alternative does not reflect
22 the extent to which changes to the structure of Postal
23 Service operations can occur over the rate cycle.

24 Now, here your -- do you see that?

25 A Yes, I do.

1 Q And in this case, you're speaking of the rate
2 cycle rather than the test year.

3 A Yes. I think they could be used interchangeably
4 here, that the difference between the test year and the rate
5 cycle is of little consequences when we're talking about the
6 Postal Service changing facilities.

7 Q And why do you think Witness Smith does not favor
8 the approach of looking at the rate cycle?

9 A Well, I've seen a lot of his discussion about
10 longer-run volume variabilities. My understanding is that
11 he's anticipating more fundamental changes to the Postal
12 Service mail processing facilities than could ever take
13 place by the test year or within a rate cycle.

14 Q The rate effective time period is another phrase
15 that has been used. Would you compare that to the rate
16 cycle? In your mind, would that be the same length of time?

17 A That's usually what I think of when I hear that
18 phrase.

19 Q In your testimony, you have not discussed capacity
20 utilization. Can we assume that you do not view capacity
21 utilization as a cost-causing factor?

22 A I haven't really explicitly considered that one as
23 a cost-causing factor. I'm sure that the sample analyzed by
24 Dr. Bozzo includes a variety of levels of capacity
25 utilization, so in that sense, it's part of the econometric

1 analysis. I have not really studied that per se in my
2 analysis.

3 Q Are you aware that many economists do use capacity
4 utilization as an important variable or view it as an
5 important variable?

6 A In what context?

7 Q In the context of regression analysis on volume
8 variability or production function.

9 A That would be kind of a general statement to make.
10 I'm not comfortable agreeing with that.

11 Q Could you move to page 8 of your testimony
12 discussing graphical analysis of your testimony -- in your
13 testimony.

14 A Yes.

15 Q On lines 9 and 10, you refer to your direct
16 testimony and you say, "I agree that one could draw graphs
17 to justify any of the listed models."

18 Do you see that?

19 A Yes, I do.

20 Q And you're criticizing comments on your graphs.
21 Could you explain your comment that "I agree that one could
22 draw graphs to justify any of the listed models."

23 A I'm simply saying that pictures can help
24 demonstrate sort of the underlying assumptions you're making
25 with particular models.

1 In this instance, I constructed a set of graphs
2 based on hypothetical data with the particular intent of
3 demonstrating how wrong one can be by doing visual
4 inspection of points. I constructed an example where I
5 generated the data in a format such that the expansion paths
6 of the individual plants were much flatter than 100 percent
7 volume variability. From that, Dr. Smith, you know, drew
8 the line that would be the result **of** a pooled regression
9 where he had an expansion path, or at least that's how I
10 read his initial testimony, that he was saying the expansion
11 path would skip from one plant's path to the next plant's
12 path.

13 As we touched on earlier, I infer that to be a
14 longer-run view, that these plants could somehow change some
15 of their fundamental cost-causing characteristics and skip
16 to different levels.

17 During cross examination, I think Mr. Smith said
18 that -- and I hate to rely on the graph without everybody
19 having a copy of it, but, you know, I was saying plants
20 would grow from A to B along their plant-specific expansion
21 paths. I thought Mr. Smith was saying they would go from **A**
22 to C along a pooled kind of line, but then during his
23 direct, he seemed to recant that and say, no, rural plants
24 won't become city plants and vice versa, which was the point
25 I was trying to make all along.

1 Q Well, I will get to some of those points you've
2 just raised and we can refer again to that graph that you
3 referred to, but from your graphs, you do seem to agree that
4 you could support any of the models by looking at the graphs
5 that you presented, which is what Dr. Smith has done. Isn't
6 that essentially what Dr. Smith has done?

7 A No, no, he has not really -- he is explaining how
8 you could get a situation where a plant could grow along a
9 pooled expansion line. The problem is that he never
10 connects that to the reality of the Postal Service operating
11 structure.

12 The point I'm trying to make here is that these --
13 you can draw any picture you want; it's the picture that
14 matches the reality of the Postal Service's operation that's
15 the relevant one.

16 Q Your concern is -- or at least that's your
17 concern, your view, that his expansion path line is of a
18 longer-term nature rather than a shorter-term that you are
19 looking at in this case.

20 A Well, I thought that was the case, but then during
21 his cross examination, he said Plant A wouldn't look like
22 Plant C because rural plants never turn into urban plants.
23 So at that point, I was very confused. I thought that's the
24 point he was trying to make; yet, in cross examination, he
25 seemed to say, no, A was never going to grow to look like C,

1 it was always going to -- it was going to stay on its line
2 and look like B.

3 Q Well, we'll get to that in a minute.

4 Also on page 8, on line 13 of your testimony, you
5 indicate Witness Smith's interpretation of your graph -- of
6 the graphs is wrong on two points, and one of the points:
7 Because the graphs depict a situation in which the fixed
8 effects model is by construction the correct model.

9 Would you explain what you mean "by construction
10 the correct model"?

11 A Yes. If you go back to my direct testimony that
12 begins that series of graphs, I start with a situation where
13 I'm assuming that we know the underlying technology is
14 represented by the flatter expansion paths, --

15 Q And that's part of the fixed effects. Is that
16 what's --

17 A That has nothing to do with fixed effects; that
18 says let's suppose we have an underlying technology where
19 you have a number of plants, each of whom has a relatively
20 flat expansion path. That was the supposition behind my
21 whole example. That's what I mean by "by construction."
22 Those data were generated with the assumption that we had a
23 set of plants, each of which had a
24 flatter-than-45-degree-line expansion path.

25 Q And so that assumes the expansion is less than

1 what we referred to as, well, a one-to-one ratio?

2 A Right, less than 100 percent volume variability.
3 That's how I constructed it.

4 Q You did not have to construct it that way; that
5 was the way you established it or set it up.

6 A No, but just for the record, I constructed it that
7 way because that is the reality of Postal Service
8 operations, that we have a set of plants, many of whose
9 cost-causing characteristics will not change in response to
10 volume changes by the test year or the rate cycle, and to
11 use Mr. Smith's words, urban plants won't become rural
12 plants or vice versa.

13 So it is how I constructed it, but I also
14 constructed it to mimic the reality of Postal Service
15 operations.

16 Q Yes, but during the test year or whatever
17 rate-effective period is under consideration, there are
18 changes in plants all the time, aren't there? There is an
19 ongoing program to expand an existing plant or build new
20 plants in response to increased volumes, new delivery
21 points.

22 A In fairly trivial numbers with substantial time
23 lags. The planning horizon to build a new plant is probably
24 more like ten years, and even then -- I think there's some
25 discussion in my direct testimony that I don't recall off

1 the top of my head that cites how many new plants are built
2 each year or substantially remodelled, and it's a trivial
3 number compared to the entirety of the Postal Service
4 operating structure.

5 Q Again I'd like to refer to page 8 of your
6 testimony, lines 16 to 18, and you have a statement there
7 where you're criticizing Dr. Smith's supporting of the
8 pooled model and you say there is no relationship between
9 the pooled line and the data generated for the
10 illustrations.

11 Now, Dr. Smith acknowledges that there is no
12 relationship, doesn't he, in his testimony?

13 A Well, I remember him sitting here in R97 saying
14 that he could look at those plots, and based on that, that
15 volume variabilities were 100 percent. That's just flat-out
16 wrong.

17 Q But that was from a visual analysis as opposed to
18 doing the technical analysis which -- the numerical analysis
19 which you're doing or Dr. Bozzo is doing; isn't that
20 correct?

21 A Well, but in the current procedure, if I
22 understood Dr. Smith's direct testimony properly, he was
23 imposing a pooled line, if you will, on my example which
24 illustrated the folly that happened in R97.

25 I generated data based on an assumption which I

1 believe reflects the reality of the Postal Service that the
2 expansion paths of these plants are less than 100 percent
3 volume variable, and even after I made it clear that that's
4 exactly how I constructed the data, he came along and drew a
5 pooled line over the top of it, and that absolutely
6 demonstrated my point. If all you do is look at a
7 two-dimensional plot of the points and don't understand the
8 operational reality underneath, it's folly.

9 Q But -- okay. I'll move on to another point.

10 Further on that page, you say, "Only the fixed
11 effects model is consistent with both the data and the fact
12 that there are cost-causing factors unrelated to mail
13 volume."

14 Do you see that?

15 A Yes, I do.

16 Q And you focus on cost-causing factors unrelated to
17 mail volume. What about cost-causing factors related to
18 mail volume?

19 A The point I'm trying to make here is that there
20 are some cost-causing factors that are unrelated to mail
21 volume, site-specific factors that will not vary -- if you
22 will, the urban versus rural plant that Dr. Smith talked
23 about in his cross examination.

24 There are fundamental characteristics of local
25 work forces, local network structures that are not going to

1 change by the test year or over the rate cycle that must be
2 controlled for. The point of using a fixed-effects model is
3 that it controls for those factors so you don't erroneously
4 attribute them to volume as was done when a pooled line was
5 superimposed on a two-dimensional plot of the data.

6 You think you're seeing that costs go up as volume
7 goes up. What you're really seeing is an underlying pattern
8 that bigger plants have other cost-causing factors that make
9 their costs higher -- lower relative wages -- you know, I've
10 been through all that stuff in my testimony.

11 But you're confusing that effect with volume, and
12 that's why you would think a fixed-effects model would at
13 least have to be tested and, lo and behold, our
14 understanding of postal operations is confirmed by the
15 econometric results of Dr. Bozzo. There are cost-causing
16 factors that do not change with volume and are related to
17 other factors.

18 Q Now, you have referred to -- let's turn to page 9
19 of your testimony where you discuss the cross-examination of
20 Witness Smith, and there is a discussion that you have
21 mentioned about the urban -- you have referred to his
22 response about the difference between rural and urban
23 plants. Now, in Dr. Smith's response, he indicated that
24 rural and urban plants were just one example as to why the C
25 was a different plant on the Figure 5 that you were

1 referring to.

2 Now, there could be differences that are volume in
3 character that could affect the sizing of the plant,
4 couldn't there, besides things that are non-volume?

5 A Could you ask that again? I was a little unclear
6 exactly what you were asking.

7 Q Okay. Do you have a copy of the Figure 5 that was
8 referred to in that question that is discussed in your
9 testimony on page 9?

10 A I don't have one in front of me.

11 MR. RICHARDSON: May I approach the witness?

12 CHAIRMAN GLEIMAN: Sure.

13 BY MR. RICHARDSON:

14 Q You have a copy, I think it is a blown-up copy
15 that was presented to Dr. Smith during cross-examination,
16 that was the source of the question that appears on page 9
17 of your testimony.

18 A Yes, it is a blowup of the figure that was on his
19 -- in his testimony at 13211.

20 Q That's correct. That's correct.

21 A Okay.

22 Q And if you could just explain again your point --
23 well, let me ask it another way. Let me get at it another
24 way.

25 MR. RICHARDSON: Mr. Chairman. could I have a few

1 minutes? Could we take a brief recess, so I could clarify
2 this? Just a minute.

3 CHAIRMAN GLEIMAN: Certainly.

4 MR. RICHARDSON: Thank you.

5 [Recess]

6 CHAIRMAN GLEIMAN: How are doing, Mr. Richardson?

7 MR. RICHARDSON: Mr. Chairman, I will move on to
8 another question, another subject. Thank you for the
9 indulgence.

10 BY MR. RICHARDSON:

11 Q Mr. Degen, in your opinion, has Dr. Bozzo modeled
12 all of the potentially relevant variables in his model?

13 A Yes, and let me explain why. My understanding of
14 Postal Service operations is that there are site-specific
15 effects, you know, relative local wage rates, local
16 workforce characteristics, et cetera, which must be
17 controlled for. The fixed effects model, though it does not
18 specify individual effects, controls for site-specific
19 effects in a general way.

20 He has also included explicit measures of capital
21 and delivery points, but by including, by using a fixed
22 effects estimator, he has done the most complete job of
23 controlling for site-specific effects. Even if we thought
24 we had a complete list and excellent data for all the
25 site-specific effects, you would still want to run a fixed

1 effects estimator. And when you got to the point where the
2 fixed effects were no longer statistically significant, then
3 you would know you had measured everything else.

4 But that is really not necessary. It is necessary
5 if you want to understand what all the fixed effects are.
6 It is not necessary to get accurate estimates of volume
7 variability, it is only important that you control, even in
8 a general way, for the non-volume effects.

9 Q Well, if a labor hour causing factor is not in the
10 fixed effects, and is not explicitly modeled as an exogenous
11 variable, then may we assume that the variable is not
12 modeled in the equation?

13 A But how would you know it is not captured by the
14 fixed effects estimator? I mean that is a completely
15 characterization that basically looks at the data and
16 separates anything unique to that facility that is not
17 picked up by the -- that is unique to that facility,
18 independent of the volume trend.

19 So I don't understand your question in that I
20 don't understand how you could ever know that it was in
21 there in the first place.

22 Q Well, I am not sure that answered the question.
23 My question was, if a labor hour causing factor is not in
24 the fixed effects, and is not explicitly modeled as an
25 exogenous variable, can we assume that the variable is not

1 modeled?

2 A And my answer was, you can never know that it is
3 not in there. So the point is moot.

4 Q Does he explicitly model for the age of the
5 facility?

6 A I don't believe so.

7 Q Or the degree of the support costs, does he model
8 for degree of support costs?

9 A Let me back up, I said I don't think so to the
10 last one. You said explicitly model.

11 Q Yes.

12 A He explicitly models to the extent he uses a fixed
13 effects estimator. He does not include a separate data
14 measure that is the age of the facility.

15 Q And would the same be -- would you agree that the
16 same is also true, that he does not use a separate estimator
17 for space utilization or the degree of flex labor or for a
18 delivery network, and for the number of locations?

19 A That was a lot there.

20 Q Could we take one at a time? Space utilization.

21 A Not that I am aware of.

22 Q Or degree of flex labor.

23 A Not that I am aware of.

24 Q Delivery network.

25 A My understanding is that he does have delivery

1 points as a measure. What do you mean by delivery network?

2 Q The entire network as a whole, as opposed to
3 delivery points.

4 A If you mean something other than delivery points,
5 I don't think he does.

6 Q And the number of locations, delivery locations.

7 A What do you mean by delivery locations, something
8 other than delivery points? Addresses?

9 Q So he does include delivery points.

10 A I think so, or at least he has, in some versions,
11 he has tried.

12 Q NOW, also on page 9 of your testimony, on line 25,
13 you state that if Witness Smith wants to argue for
14 consideration of the between estimator, he should have to do
15 more than argue it as a conceptual possibility, he should
16 have to show that its assumptions are consistent with the
17 pattern of expected growth and the expected changes in
18 operations over the rate cycle. He cannot do so because it
19 is not true. Do you see that?

20 A Yes, I do.

21 Q Now, is the between estimator a type of
22 cross-sectional estimator?

23 A Yes, that is my understanding.

24 Q And in light of that, I would again read to you a
25 portion of the Commission Opinion in R97-1, Appendix F at

1 14, and I would like your comment on that in light of your
2 comment that the between estimator is a type of
3 cross-sectional estimator. And I have the pertinent
4 appendix here if you would like to see it, but it is a short
5 sentence, "Consequently, an estimating procedure which
6 primarily relies on the cross-sectional dimension of the
7 panel data set is preferred to one that relies on
8 differences over time within the same facility such as the
9 fixed effects estimator." Could you comment on that?

10 A I think it is wrong.

11 Q And could you say why you believe it is wrong?

12 A Well, everything I have said so far today is a
13 good start at explaining why I think it is wrong.

14 Q Okay.

15 A I think it is wrong fundamentally because it
16 assumes that existing plants will morph into their larger
17 counterparts as volume grows, and that is just not true.
18 And so any model that tries to infer what is going to happen
19 when volume increases, by comparing one plant to the other
20 plant, is going to be wrong. You really need to look at
21 what is going to happen in each individual plant because
22 there are cost causing characteristics associated with each
23 of them that will be unique to them.

24 And so not only do I think that one is wrong, I
25 think it is exactly the opposite of the truth, which is you

1 must look at the time pattern over individual plants, which
2 the fixed effects model does, in order to get a realistic
3 estimate of what is going to happen by the test year or over
4 the rate cycle.

5 CHAIRMAN GLEIMAN: Excuse me a moment. Would you
6 define what you mean by over time? **You** used the phrase just
7 now that you should look at it over a time period. Are you
8 talking about an accounting period, a week, two accounting
9 periods, a year, two years, three years? An accounting
10 period?

11 THE WITNESS: Over the course of a year or two by
12 the rate cycle, or, well, by the test year over the rate
13 cycle.

14 CHAIRMAN GLEIMAN: So for at least a year, and
15 preferably over a two year period?

16 THE WITNESS: Well, the sample of data that you
17 analyze should cover several years worth of data. You
18 wouldn't necessarily have to have annual observations to do
19 it, but you would want a sample that included at least the
20 amount of volume variation that you were going to expect
21 over the rate cycle.

22 CHAIRMAN GLEIMAN: Thank you.

23 BY MR. RICHARDSON:

24 Q I will refer you to page 10 of your testimony,
25 lines 6 and 7, where you are discussing "MODS Data Are

1 Usable" is your heading. And you state that "MODS data are
2 not perfect, but they are more than adequate for estimation
3 of volume variability factors." Am I correct that the
4 Postal Service has not presented any information through a
5 witness on the collection of the MODS data in which
6 field-based verification, correction, feedback and analysis
7 for validity takes place as part of the data entry process?

8 A You are correct, although that statement **is**
9 completely unrelated to the sentence of mine that you
10 quoted.

11 Q Well, you indicate that the data is more than
12 adequate for estimation of volume variability factors. Now,
13 is the data subject to quality checks, that is used, that
14 you are referring to?

15 A Yes, I think I went through this at some length
16 during R97 and talked about the various uses to which these
17 data were put, and, you know, the audit, if you will, that
18 represents on the data. These data are used to evaluate
19 performance and so, you know, clinkers are corrected from
20 time to time.

21 I am not saying that there are no errors in the
22 MODS data. My point is that the models that have been
23 estimated are so robust and exhibit such high r squareds
24 that the amount of noise in the data is clearly negligible.
25 I think **Dr.** Greene points out in his rebuttal testimony that

1 one impact of noisy data is to bias the estimated r squareds
2 downward. You know, we have got r squareds of 99 percent on
3 some of these models. How much noise can there be?

4 You know, we can point all day to individual
5 observations and create tables of how many are suspicious
6 for this reason or how many are suspicious for that reason.
7 The bottom line is these models work. Every specification
8 that is tested comes up with very high r squareds. So,
9 independent of the modeling question, we don't seem to have
10 an underlying data problem here, other than picking away at
11 individual observations.

12 Q There is testimony by another witness in this case
13 that does take issue with the amount of errors in the data.
14 Isn't there a Witness Neels for UPS who does have extensive
15 testimony on that subject?

16 A He does.

17 Q Disagreeing with your view.

18 A He nitpicks at the data, but if you look at his r
19 squareds, they are nearly perfect. So, yeah, we can tell
20 stories all day, but the ultimate test is his r squareds are
21 biased downwards, **so** instead of 99, they should be perfect?
22 How much noise can there be?

23 Q Moving on to your testimony, page 10, line 25,
24 where you indicate that First Handled Piece, FHP, is
25 indisputably the most error prone of the MODS data. Do you

1 have an opinion as to what would be the second most error
2 prone or third most error prone of the MODS data?

3 A My opinion would be that the hours are the best of
4 the MODS data, other than some minor potential for
5 misclocking across individual operations. Those data drive
6 paychecks, and so you have got an entire workforce, if you
7 will, auditing those data.

8 The TPH and the TPF are both based primarily on
9 end of run reports, machine generated. I would think they
10 would of essentially equal quality, both substantially
11 greater than the quality of FHP, which relies on weight
12 conversion for a number -- well, substantially relies on
13 weight conversion.

14 MR. RICHARDSON: Those are all the questions I
15 have, Mr. Presiding Officer.

16 CHAIRMAN GLEIMAN: Followup?

17 [No response.]

18 CHAIRMAN GLEIMAN: Questions from the Bench?

19 [No response.]

20 CHAIRMAN GLEIMAN: Why should I believe you and
21 Dr. Bozzo, instead of Mr. Patelunas?

22 THE WITNESS: With respect to what particular
23 issue?

24 CHAIRMAN GLEIMAN: You were here this morning.
25 You heard what Mr. Patelunas said in response to a question

1 on redirect.

2 THE WITNESS: Could you refresh my memory? I may
3 have been studying instead of listening.

4 CHAIRMAN GLEIMAN: Well, counsel may correct me if
5 I'm wrong, but I thought that after I beat up on Mr.
6 Patelunas a little bit for suggesting that rate case
7 proceedings and the works that go into them weren't the real
8 world, but the developing of the operating budget was, that
9 in redirect, it was clarified that he didn't mean to say
10 that rate proceedings and the numbers associated with it
11 that we bandy about here, and the theories, aren't
12 real-world; it was just the models that were a problem; that
13 they weren't real-world.

14 So, why should I believe you and Dr. Bozzo and not
15 Mr. Patelunas?

16 MR. KOETTING: Mr. Chairman, you did say that I
17 could step in if your recollection differed from my. My
18 recollection was that Mr. Patelunas was talking about the
19 mail flow models, specifically.

20 CHAIRMAN GLEIMAN: Well, models are models. I
21 mean, you know --

22 Well, my recollection is that Mr. Patelunas said
23 that it's those folks sitting out there, the line
24 supervisors who know what goes on. *So*, you know, if I'm
25 wrong in that he wasn't casting aspersions on models, then

1 let me ask you it this way:

2 How come you know more than all the line
3 supervisors out there?

4 THE WITNESS: I wouldn't say I know more, but I go
5 out and talk to them a lot, and my testimony in R-97 and in
6 this case, has not been econometric testimony. It's been
7 primarily based on the understanding I've gotten from line
8 supervisors over the last 17 years.

9 CHAIRMAN GLEIMAN: What were those R-thing'ies you
10 were talking about a moment ago with the 99 percent and
11 bumping them up?

12 THE WITNESS: That's the R^2 coefficient.

13 CHAIRMAN GLEIMAN: Oh, yes. I can't ever remember
14 those fancy terms for things.

15 Isn't it true that if you scrub data at the front
16 end and add variables in your analyses, your regressions,
17 that you can make those R^2 thing'ies bump right **up** to the
18 top, as far as you want them to go?

19 THE WITNESS: I don't think that's true. I think
20 what you said is generally true; that you can do things to
21 improve your R^2 , and R^2 **is** a measure of how much of the
22 variation in the data your model actually explains.

23 So by adding additional variables, you can
24 increase them.

25 Most of the criticisms here seem to be that we've

1 got a bunch of variables missing, and yet the R^2 s are
2 already quite high.

3 CHAIRMAN GLEIMAN: No, I'm not being critical of
4 what's in or out; I'm just kind of curious as a matter of
5 theory and working with the R^2 s, whether, indeed, you can't
6 manipulate them. And I don't mean that necessarily in a
7 derogatory sense, but you can tilt them, let's say, one way
8 or another by virtue of scrubbing data, by virtue of the
9 number of variables you choose to add in.

10 THE WITNESS: You can.

11 CHAIRMAN GLEIMAN: Your choice of variables.

12 THE WITNESS: You can increase your R^2 s by doing
13 the things you have described. What you can't do is make
14 something out of nothing.

15 If you have data that are so noisy as to be
16 unusable, adding additional variables is not going to
17 increase the statistical significance of their coefficients.

18 It may raise the R^2 s to a certain extent, but if
19 you have, you know, underlying -- if the primary data in
20 your regressions are so noisy as to be unusable, there's not
21 much you can do to rig the R^2 s after that.

22 CHAIRMAN GLEIMAN: **All** right, let me understand
23 correctly, because this is really important, not only to
24 this case, I think, but I just need to have a good
25 understanding of this, and certainly the Postal Service and

1 everybody who is interested in the Postal Service ought to
2 have a good understanding.

3 You talked about the relationship of cost to
4 volume, and essentially said that as -- that costs don't
5 necessarily vary directly with volume, that volume could
6 increase without costs going up.

7 THE WITNESS: Yes.

8 CHAIRMAN GLEIMAN: Well, tell me about volume
9 decreasing and costs not changing. I mean, is variability,
10 in your presentation, a two-edge sword in terms of it
11 doesn't vary -- costs don't vary on the upside, and costs
12 don't vary on the downside? I mean, that's the conclusion
13 one would draw.

14 THE WITNESS: Well, my understanding is that the
15 volume variability factors we're applying do apply in both
16 directions; that if volume declines one percent, you will
17 see less than a one percent reduction in costs.

18 And, you're right, that's a huge issue for the
19 Postal Service.

20 CHAIRMAN GLEIMAN: That's a scary issue for the
21 Postal Service. I think that all the post-ECS messages and
22 electronic postmarks and whatever the fee is that CheckFree
23 is going to pay back to the Postal Service for the messages
24 that go electronically all the way, aren't going to be worth
25 a hill of beans if you guys are right.

1 I'm not suggesting that I know whether you're
2 right or wrong at this point, or whether I agree or
3 disagree. I mean, we'll look at the evidence in the record,
4 but it's a frightening concept, far beyond the hearing room
5 and R2000-1.

6 THE WITNESS: And I think it's a concept not lost
7 on the Postal Service.

8 CHAIRMAN GLEIMAN: I wonder about that at times.
9 I don't know whether you heard my pitch about how, you know,
10 it's -- the nutrition you get out of being a cannibal is
11 better than starving to death straight off the bat, but
12 sooner **or** later, *you* know, reduced calories aren't going to
13 help you very much in terms of your survivability.

14 And in any event, I'm getting far afield from the
15 case at this point, and I shouldn't do that.

16 I don't have any other questions. I don't know
17 whether any of my colleagues do.

18 [No response.]

19 CHAIRMAN GLEIMAN: Followup to any of my
20 ramblings?

21 [No response.]

22 CHAIRMAN GLEIMAN: If not, that brings us to
23 redirect. Would you like some time?

24 MR. KOETTING: Yes, Mr. Chairman, we'd like about
25 --

1 CHAIRMAN GLEIMAN: Hour, two? Ten minutes?

2 MR. KOETTING: Five minutes.

3 CHAIRMAN GLEIMAN: Five minutes, you've got it.

4 [Recess.]

5 CHAIRMAN GLEIMAN: Mr. Koetting.

6 MR. KOETTING: Thank you, Mr. Chairman.

7 REDIRECT EXAMINATION

8 BY MR. KOETTING:

9 Q Mr. Degen, in your last discussion with the
10 Chairman, you were discussing the prospects of a
11 double-edged sword of volume variabilities for mail
12 processing that are less than one. Do you recall that
13 discussion?

14 A Yes, I do.

15 Q Without going into the intricate technical
16 permutations and possibilities, in a certain non-technical
17 sense, are volume variabilities less than one, can we equate
18 those with economies of scale, or economies of something --
19 economies, let's just say economies?

20 A Yes.

21 Q **Has** the Postal Rate Commission in the past
22 accepted that there are economies or volume variabilities of
23 less than one in delivery operations?

24 A That is my understanding.

25 Q Have they accepted that there are economies or

1 volume variabilities of less than one in transportation?

2 A Yes, that is my understanding.

3 Q Would the same double-edged sword apply to those
4 types of costs and those types of operations with a volume
5 variability estimated less than one?

6 A Yes.

7 Q Is there any particular reason why the Postal
8 Service should be more concerned about a double-edged sword
9 associated with variabilities less than one in mail
10 processing than it would be with respect to carrier
11 operations and transportation, or any other Postal functions
12 for which economies or volume variabilities less than one
13 have been measured?

14 A No.

15 MR. KOETTING: That is all I have, Mr. Chairman.

16 CHAIRMAN GLEIMAN: You mean to tell me that the
17 Postal Service shouldn't be more concerned if a whole other
18 chunk of money is determined and is truthfully determined to
19 be, and is truthfully not 100 percent volume variable, you
20 mean to tell me that somebody sitting up there shouldn't be
21 concerned if \$19 billion can't be shed when the volume
22 disappears?

23 That is \$19 billion more than we are talking about
24 with delivery and transportation. That is a whole other pot
25 of money, you know, separate and apart from the implications

1 for this case. Do you mean to sit there and tell me that
2 somebody shouldn't be concerned that \$19 billion in cost
3 can't be shed as quickly as some might feel it should be
4 shed?

5 THE WITNESS: They should be concerned to the
6 extent that if that is the reality of it, they should be
7 aware of it. Whether or not the Commission blesses it, I
8 don't think changes their problem any.

9 CHAIRMAN GLEIMAN: **You** were asked whether they
10 should be more concerned if everyone agreed that the volume
11 variability for processing was less than one than they
12 should be right now with an accepted volume variability of
13 less than one in certain other areas. So the operative word
14 here is "more." And I didn't put that word in there, **Mr.**
15 Koetting did. So you don't think they should be more
16 concerned?

17 THE WITNESS: Well, in a sense, as you point out,
18 since it represents a bigger chunk of costs, they should be
19 more concerned. Given the amount of drop shipping and
20 things that have gone on, the less than 100 percent volume
21 variabilities in transportation have probably made more of a
22 difference in recent years than volume variability, because
23 volume variability -- volumes haven't really turned down.

24 But your point is well taken, and I would agree
25 completely that the magnitude of costs involved makes it

1 important to get it right. But even if the Commission keeps
2 volume variability at 100 percent, that doesn't change the
3 reality that the Postal Service needs to be concerned about
4 with respect to their business.

5 CHAIRMAN GLEIMAN: Thank you, sir. I appreciate
6 that.

7 Anything further?

8 [No response.]

9 CHAIRMAN GLEIMAN: Well, if there is nothing
10 further, I want to mention that it is my understanding that
11 Witness Prescott's testimony will be filed within the day,
12 will be relatively short.

13 MR. KOETTING: Relatively short, filed today if
14 possible. Certainly no later than tomorrow, which is what
15 the notice said when it was filed yesterday.

16 CHAIRMAN GLEIMAN: And it appears that absent some
17 fly in the ointment, that he will indeed be scheduled to
18 appear on Monday, the 28th. And we will learn whether there
19 is a fly in the ointment probably by close of business
20 tomorrow. I just wanted to close the loop on that one to
21 the extent we can close it.

22 Mr. Degen, that completes your testimony here
23 today. We appreciate your appearance, your contributions.
24 I personally appreciate them. You are one of the people I
25 try to learn from when you are here. I don't always agree

1 with you, I don't always understand you, but always try and
2 learn. And you are excused.

3 THE WITNESS: Thank you, sir.

4 [Witness excused.]

5 CHAIRMAN GLEIMAN: That concludes today's hearing.

6 MR. KOETTING: Mr. Chairman.

7 CHAIRMAN GLEIMAN: Yes, sir.

8 MR. KOETTING: We do have one more scheduling
9 matter that we would like to discuss. Counsel for UPS, Mr.
10 McKeever, and the Postal Service have been discussing, and
11 thought it would be appropriate to raise now, yet another
12 potential scheduling change. I don't know whether I should
13 explain or Mr. McKeever. I will take a shot and see if he
14 wants to.

15 It would appear that the Postal Service believes
16 that Dr. Neels' testimony on the Notice of Inquiry Number 4
17 and his response to Presiding Officer's Information Request
18 Number 19, which is currently scheduled to happen on Monday,
19 the 28th. The Postal Service would prefer that be postponed
20 until later in the week, presumably on the same day that Dr.
21 Bozzo and Professor Greene, and I believe Dr. Smith as well,
22 would be scheduled for their NOI 4 responses, as well.

23 And I believe that Mr. McKeever has indicated that
24 UPS finds that suggestion agreeable, subject to the Postal
25 Service trying to get the cross-examination exhibits to Dr.

1 Neels on Monday. And I believe that those are the parties
2 that would be likely to be most involved, would be the
3 Postal Service and UPS, although the OCA and MPA also have
4 witnesses on this matter.

5 CHAIRMAN GLEIMAN: Your side of the story?

6 MR. McKEEVER: No, that is -- Mr. Koetting has
7 stated it accurately. They have asked for Dr. Neels to be
8 pushed back and we are perfectly agreeable to that under the
9 condition expressed.

10 CHAIRMAN GLEIMAN: I will take it under advisement
11 and issue a ruling one way or the other within the day.

12 MR. KOETTING: Thank you, Mr. Chairman.

13 CHAIRMAN GLEIMAN: Is that it? Thank you.

14 That concludes the hearing today. We will
15 reconvene tomorrow, the 24th, at 9:30 and we will hear for
16 the first time around from Witnesses Prescott, Campbell,
17 Davis, Mayo, Stevens, Kay, Kent and Raymond.

18 Have a great afternoon.

19 [Whereupon, at 3:12 p.m., the hearing was
20 recessed, to reconvene at 9:30 a.m., Thursday, August 24,
21 2000.]

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