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

POSTAL RATE AND FEE CHANGES, 2001

Docket No. R2001-1

DIRECT TESTIMONY
OF
JOHN T. PICKETT
ON BEHALF OF THE
UNITED STATES POSTAL SERVICE

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List of Library References

The following library references are associated with my testimony:

1. USPS LR-J-36 SAS Programs Used in the Calculation of the CNET Premium
2. USPS LR-J-37 SAS Program Used in Calculation of the DNET Distribution Key
3. USPS LR-J-38 Calculation of Eagle, WNET, and CNET Premium Factors
4. USPS LR-J-39 Calculation of Daynet and CNET Distribution Keys
5. USPS LR-J-40 Calculation of Alaska Air Adjustment
6. USPS LR-J-41 SAS Program Used in Calculation of Highway Cost per Cubic Foot-Mile for Alaska Air Adjustment (Used in USPS LR-J-40)
7. USPS-LR-J-42 Calculation of Alaska Highway Costs
8. USPS LR-J-43 Calculation of Distance-related Transportation Costs
9. USPS LR-J-44 Calculation of Cost of Eagle and WNET Daytime Operations

1 **Autobiographical Sketch**

2

3 My name is John T. Pickett. I am an economist in the Cost Attribution
4 office in the Finance department at Postal Service Headquarters. I have been
5 employed as an economist, working mostly on rate case and policy matters, by
6 the Postal Service since 1984. From 1984 to 1986 and from 1996 to the
7 present, I have worked on transportation costing issues. In the interim, I worked
8 on service performance measurement, rate levels, rate design, econometric
9 demand analysis and volume forecasting.

10 Prior to joining the Postal Service, I was employed as a consulting
11 economist by Charles River Associates, the firm of Kennan and Rohr, and Brown
12 University Professor George Borts. I also taught economics and statistics to
13 students at Brown University, Salve Regina College, and the Naval War College.

14 Prior to my appearance today, I testified six times before the Postal Rate
15 Commission. In Docket No. C86-3, I testified on parcel post rate levels and
16 transportation costs. In Docket No. R90-1, I testified on rebuttal on econometric
17 demand analysis and forecasting issues. In Docket No. MC95-1, I presented the
18 Postal Service's proposal to reclassify regular rate second-class mail. In Docket
19 No. R97-1, I provided rebuttal testimony on transportation costing issues. In
20 Docket No. R2000-1, I provided direct and rebuttal testimony on transportation
21 costing issues.

22 I received a B.A. in economics from Boston University in 1977 and an
23 M.A. in economics from Brown University in 1980. While at Brown, I completed
24 all the requirements for a Ph.D. except the dissertation.

1 **I. Purpose and Scope of Testimony**
2

3 The purpose of my testimony is to provide certain calculations related to
4 transportation costs. There are five issues discussed in my testimony:

- 5 1. Calculation of network premium costs,
- 6 2. Calculation of Daynet-and-HASP and CNET distribution keys
- 7 3. Calculation of the Alaska air adjustment factors,
- 8 4. Calculation of distance-related transportation costs
- 9 5. Calculation of Eagle and WNET daytime costs.
- 10 6. Calculation of Alaskan Highway costs.

11 The programs and spreadsheets used to make these changes are described in
12 detail in nine Library References, USPS-LR-J-36 through USPS-LR-J-44.

13
14 **II. Calculation of Network Premium Costs**
15

16 My testimony describes the mechanics of calculating network premium
17 percentages for three hub and spoke air networks. The Eagle network is an
18 overnight hub-and-spoke operation that links major markets through a hub facility
19 in Indianapolis. The Western network is a similar, but much smaller, overnight
20 operation that links major cities in the West. Both these networks operate year
21 round. The Christmas network (CNET) is a daytime operation that operates for
22 the two weeks prior to Christmas.

23 As in past cases, costs for these networks have been divided between a
24 network premium cost and volume-variable non-premium costs. The premium is
25 defined as the difference between the cost of the hub-and-spoke operation, and
26 what it would cost to provide this service with passenger air transportation. As
27 was the case in Dockets No. R97-1 and R2000-1, the premiums for the Eagle
28 overnight and WNET overnight networks are treated as costs incremental to
29 Express Mail. In the case of CNET, the premium costs are incremental to Priority
30 Mail. Library Reference USPS-J-38 contains a spreadsheet that calculates the
31 premium factors, which are used as inputs in the Cost Segment 14 B workpapers
32 of Postal Service witness Meehan (USPS-T-11).

1 The Eagle and WNET premiums relate to the cost of the overnight
2 operation. However, costs of certain daytime operations were charged to the
3 Eagle and WNET cost accounts. These daytime costs must be removed from
4 the Eagle and WNET cost pools before calculating the overnight premiums. This
5 modification is described in Section VI below.

6 USPS Library References J-29 and J-31 contain the SAS code used to
7 calculate the pounds and pound-miles for the Eagle and WNET premium
8 calculations. The premium percentage calculations themselves are contained in
9 an Excel spreadsheet in USPS Library Reference J-38. Source data and the
10 necessary calculations of CNET pounds and pound-miles used in the premium
11 calculations for the CNET can be found in USPS Library Reference J-36.

12 13 **III. Calculation of Daynet-and-HASP and CNET Distribution Keys**

14

15 The calculation of the CNET and Daynet-and-HASP distribution keys is
16 essentially the same as in prior years. TRACS data by airclass and mailcode are
17 extracted from TRACS expansion programs contained in USPS Library
18 References J-29 and J-31. These data allow the development of pound-miles
19 proportions by airclass and mailcode. The planned versus actual (PVA) file
20 provides pound-miles by airclass for the CNET (see USPS-LR-J-36) and Daynet
21 (see USPS-LR-J-37) operations. These weights are applied to the TRACS data
22 to produce pound-mile based distribution keys for each network. See USPS-LR-
23 J-39. These keys are used in the Cost Segment 14 B workpapers of witness
24 Meehan (USPS-T-11) to distribute CNET and Daynet-and-HASP air costs.

25 26 **IV. Alaska Air Adjustment Factor**

27

28 The Postal Service attributes only a portion of non-preferential Alaska air
29 costs using what has come to be known as the Alaska air adjustment factor.
30 The factor is the ratio of the hypothetical costs of transporting mail in Alaska by
31 highway divided by the actual cost incurred for non-preferential air service. The
32 remaining Alaska non-preferential air costs are treated as institutional. The

1 Alaska adjustment factor uses the same basic methodology as in the last
2 omnibus case. In calculating the adjustment, the cost per cubic foot-mile by
3 highway contract type is used. The calculation of this input can be found in
4 USPS LR-J-41. The Alaska Adjustment factor is calculated in an Excel
5 spreadsheet in USPS LR-J-40. The factor is applied to test year non-preferential
6 Alaska air costs in workpapers of witness Patelunas (USPS-T-12).

7
8 **V. Distance-related Transportation Costs**
9

10 The rate designs for certain zone-rated products rely on drawing a
11 distinction between distance- and non-distance-related transportation costs. The
12 calculation of these costs follows the Commission's methodology used in prior
13 cases. The base year and test year calculations appear in an Excel spreadsheet
14 in USPS Library Reference J-43. Test Year FedEx network costs are treated as
15 non-distance related in light of the fact that there is no mileage component to the
16 rates FedEx charges for transportation service.

17
18 **VI. Calculation of Eagle and WNET Daytime Costs**
19

20 Prior to 1998, the three Eagle and WNET contracts were used to provide
21 an overnight hub-and-spoke network designed to meet Express Mail service
22 commitments. Since that time, these contracts have been amended to provide
23 daytime dedicated airlift, as part of Daynet and HASP operations.

24 In FY 1999, a substantial amount of Daynet and HASP expenses were
25 attributed to accounts 53541, 53543, 53545, 53546, and 53547, which were
26 traditionally used for overnight operations. Appropriate adjustments were made
27 in the development of Cost Segment 14 costs for FY 1999. (See Docket No.
28 R2000-1, Tr. 46C/21059-61.) In FY 2000, changes were made to accounting
29 procedures to address this issue. Nevertheless, some additional adjustments
30 are still needed. Therefore, I reviewed purchasing documents and developed an
31 estimate of the Daynet and HASP expenses charged to the overnight accounts.
32 These daytime costs were removed from the Eagle and WNET overnight

1 accounts and placed in the Daynet-and-HASP cost pool. In the process, I also
2 corrected a similar error that added to the CNET cost pool.

3 The estimates of re-allocated Daynet-and-Hasp (and CNET) costs are
4 documented in USPS Library Reference J-44, and carried forward to sheet 14.2
5 in the B workpapers of witness Meehan (USPS-T-11). These adjustments were
6 also made in the calculation of Eagle, WNET, and CNET premium factors in
7 Library Reference J-38.

8

9 **VII. Calculation of Alaskan Highway Costs**

10

11 Costs of certain Alaskan highway contracts are removed from the Intra-
12 BMC cost pool and placed in a separate cost pool. These costs are distributed
13 based on the combined cost distribution of inter-BMC and freight rail. USPS
14 Library Reference J-42 contains the source documents and the quarterly
15 aggregation of costs that constitute the Alaskan highway cost pool used in the B
16 workpapers of witness Meehan (USPS-T-11).

17