Postal Rate Commission
Submitted 11/2/01

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

POSTAL RATE AND FEE CHANGES, 2001 | Docket No. R2001–1

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS TAYMAN TO INTERROGATORIES
OF THE OFFICE OF THE CONSUMER ADVOCATE
(OCA/USPS–T6–22–32)

The United States Postal Service hereby provides the responses of witness Tayman to the following interrogatories of the Office of the Consumer Advocate: OCA/USPS–T6–22–32, filed on October 19, 2001.

Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking

Scott L. Reiter

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260–1137
(202) 268–2999; Fax –5402
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RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
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OCA/USPS-T6-22. Please turn to your testimony at page 46, lines 23-24, wherein you state that the annual capital need for network growth associated with the provision of additional service to approximately 1.7 million new delivery points per year is approximately $400 million.

(a) Please provide the additions to annual revenues based on current and proposed rates from the additional provision of mail service to the approximately 1.7 million new delivery points each year, assuming that the capital investment of approximately $400 million is invested (which was apparently not the case in FY 2001 due to the budget freeze).

(b) Please provide the addition to annual operating costs for FY 2001 through FY 2003 that would be associated with the $400 million of capital investment needed to serve the approximately 1.7 million new delivery points every year.

(c) For the additional annual costs referenced in (b), please provide a breakout between annual costs resulting from the investment of capital (e.g., typically amortization, depreciation, and possibly other costs flowing through to the income statement) and direct costs (e.g., typically wages, supplies, etc., again flowing through to the income statement).

RESPONSE:

(a) There is no additional revenue. As I say at page 14 of my testimony, the "Postal Service does not charge for existing or new delivery points."

(b) I have not estimated the impact on annual operating costs.

(c) Not applicable.

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OCA/USPS-T6-23. Please turn to your testimony at page 46, lines 24-25, wherein you state that the investment projects associated with the addition of the 1.7 million new delivery points have not been funded due to the capital freeze.

(a) How has the Postal Service been able to deliver mail (assuming that such is the case) to the additional 1.7 million new delivery points, assuming that the investment projects were in fact needed but not made?

(b) Assuming that the mail to the 1.7 million new delivery points was delivered in FY 2001 without incurring the $400 million of needed investment, how much additional annual cost was incurred to make those deliveries that would not have been incurred had the additional investment been made?

(c) Please explain how the annual cost incurred in providing the additional service to the 1.7 million new delivery points (but absent the addition of the desired capital investment) is different from what would have been incurred had the capital projects been implemented. Please provide quantification in your answer in addition to explanations.

(d) Assuming that mail to the 1.7 million new delivery points is being delivered without the addition of capital projects, can it be assumed that this is the result of increased efficiency by the Postal Service? In the management literature this is sometimes referenced as “Doing more with less.”

(e) If you agree that the Postal Service delivery of mail to 1.7 new delivery points without the addition of needed capital investment is the result of increased Postal Service efficiency, is such increased Postal Service efficiency probably likely to occur in future years?

RESPONSE:

(a) Space needs unmet by the capital program can be satisfied by shoehorning personnel and operations into existing space, by executing temporary leases, or other even shorter-term solutions such as placing trailers or erecting tents in parking lots.

(b) No comprehensive study has been conducted, but it is believed that the short-term solutions noted in part (a) above are ultimately more costly to the Postal Service than building proper facilities.

(c) Annual operating costs are higher without facility investment but the short-term cash outflow is less.

(d) No. It is hard to imagine that employees or production processes are more efficient in temporary quarters and substandard environments.

(e) Not applicable.

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OCA/USPS-T6-24. You have delineated $400 million of capital projects associated with the addition of 1.7 million new delivery points.

(a) Are there any other additional capital costs that would be associated with the addition of the new delivery points exclusive of the already mentioned $400 million? Such costs might, for example, be associated with the need for additional mail processing equipment. If you agree, please quantify the additional capital costs. If you disagree, please explain.

(b) If there are any additional costs, please break out the additional annual direct costs similar to the request in OCA/USPS-T6-22(c).

(c) How many of the 1.7 million new delivery points, if any, represent a transfer of existing mail service to a new location concurrent with the elimination of the old location?

(d) How much are annual capital investment and direct costs, as delineated in OCA/USPS-T6-22(c), decreased when the delivery point of mail is transferred to a new delivery point and the previous delivery point eliminated? The number may be aggregated in terms of a specific quantity of sites rather than site specific.

RESPONSE:

(a) No.

(b) Not applicable.

(c) None. That figure is a net number.

(d) See (c).

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OCA/USPS-T6-25. Please turn to your testimony at 49, lines 21-26, wherein you state that the Postal Service's overall revenue and expense projections must be at least 99.5 percent accurate in order for the three percent contingency not to be fully consumed by adverse variances. Please provide the underlying mathematical reasoning and computations including references to specific exhibit pages and lines, if appropriate, that lead to this conclusion.

RESPONSE:

Please refer to the parenthetical at lines 24 and 25 of the cited passage of my testimony where the requirement for 99.5 percent accuracy is stated in terms of being accurate within 0.5 percent, per year for each revenue and expense.

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OCA/USPS-T6-26. Please turn to your testimony at page 51, lines 13-19, wherein you state that the break-even requirement allows no margin of safety other than through the contingency provision. Based on information in the financial press, it is common knowledge that companies frequently announce major and substantial budget cuts in order to achieve lower costs during times of financial difficulty.

(a) Is it your testimony that such an approach is inapplicable to the Postal Service?

(b) If your answer is "yes", please explain the unique characteristics that produce such a situation for the Postal Service.

(c) If your answer is "no", please explain how much of the currently projected costs could be cut in the interim years and test year during economic adversities.

RESPONSE:

(a) – (c) The Postal Service has made significant budget cuts and cost reductions. When the Postal Service announces and commits to budgetary cuts, those cuts are used to reduce the Postal Service's revenue requirement and thus limit the revenues that otherwise would be available to support bottom line financial performance. It seems unlikely that many, if any, of the companies that you are referring to are required to balance revenue and expense in this way. The $2.6 billion in cost savings I identify at page 17, line 8 of my testimony is passed along to customers in the form of lower rates. None of those savings are available to cushion against financial adversity. In the other situations that you reference, a large portion, or perhaps all, of these savings would go to the bottom line of the income statement.

OCA/USPS-T6-27. Please turn in your testimony at 53, lines 20-21, wherein you state that inflation can accelerate beyond projections and negatively affect the Postal Service's costs. It is understood that over 76 percent of the Postal Service's costs are labor. It is further understood that these costs are set by contract or by management policy and are not subject to inflation except to the degree that economic conditions such as inflation impact the terms of the contract or management policy.

(a) Assuming that accelerated inflation is an important issue to consider, would the aforementioned 76 percent of costs be subject to inflation once the contracts or management policies had been determined? If your answer is other than no, please explain.

(b) Assuming that accelerated inflation is an important issue to consider, have the interim year and test year revenue and cost projections taken this possibility into account?

(c) Have you quantified the potential levels of accelerated inflation and their potential impacts? Is so, please furnish the studies.

RESPONSE:

(a) Yes. Inflation can be a factor that either directly, such as through a cost of living allowance, or indirectly, such as through medical costs underlying health benefit expenses, affects wage and benefit expenses.

(b) Neither the interim year nor test year revenue and cost projections have been adjusted to assume accelerated inflation.

(c) Table 52 on page 65 of my testimony shows potential variations for a number of expense items. Some or all of these variations could relate to accelerated inflation depending on specific circumstances.

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OCA/USPS-T6-28. You state at page 53, lines 27-29, that two alternate DRI-WEFA scenarios have less economic growth through the test year.

(a) Does this mean that you have used a forecast that is optimistic but has only a 55% chance of occurring as a probability?

(b) Does correct budgeting and planning suggest that you should take into account all reasonably prudent possibilities?

(c) Was there any consideration of using more realistic numbers, allowing for downside implications in preparing the revenue and cost projections?

(d) What part of the requested three percent contingency is expected to cover inflation and adverse economic conditions, and what percent is for other contingencies?

RESPONSE:

(a) We used the forecast scenario that was most likely at the time the forecast scenarios were produced. This macroeconomic scenario was more optimistic than the other available scenarios, but was not optimistic when compared with actual economic growth in the years leading into the rate case forecast.

(b) I concur that planning and budgeting should consider various possibilities. In particular, these should be performed to the extent possible with an understanding of the applicable risks. I would also say that when it comes to assessing those risks, those risks should not be dismissed and unduly minimized.

(c) There was limited discussion concerning the possible use of a weighted version of the DRI-WEFA forecasts. At the time of that discussion it was not clear that a weighted forecast would be more realistic.

(d) The contingency provision is not allocated or allocable among different sources of risk. As is suggested by the non-exhaustive list of risks in Table 52 on page 65 of my testimony, the total risks to breakeven performance far outstrip the funds that would be made available by a 3 percent contingency provision. A 3 percent contingency cannot be allocated among these various components.

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OCA/USPS-T6-29. Please turn to your testimony on page 54, lines 1-2, discussing the economic outlook. Is it your testimony that a more pessimistic economic possibility is appropriate, suggesting that the use of the June estimate of the economy was incorrect?

RESPONSE:

The world has changed dramatically since June and a more pessimistic economic outlook is appropriate at this time. Please see my response to OCA/USPS-T6-21.

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OCA/USPS-T6-30. Please turn to your testimony at page 58, line 1 through page 61, line 15. Are there any potential situations under which costs could be lower than expected?

RESPONSE:

Yes. These situations do not create financial risk for the Postal Service and do not give rise to a need for a contingency provision. To the extent any such situation would come to pass and lead to unexpected net incomes, the benefit would accrue to the ratepayers in the form of deferred future rate increases and/or increased investment toward improved service.

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OCA/USPS-T6-31. Please turn to your testimony at page 61 line 18 through page 62, line 2. You have discussed potential revenue variances of one percent and three percent.

(a) Please indicate the types of changes in each of the variables in the DRI-WEFA forecasts that would result in a one percent revenue variation, upwards or downwards.

(b) Please indicate the types of changes in each of the variables in the DRI-WEFA forecasts that would result in a three percent revenue variation, upwards or downwards.

RESPONSE:

(a) - (b) There are virtually an infinite number of combinations of economic conditions and projected values for economic variables which can result in a reduction in revenues in the ranges noted in the question. There is also a wide range of factors other than changes in macroeconomic assumptions that can have an adverse affect on revenue.

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OCA/USPS-T6-32. Please turn to your testimony on page 62, lines 7-26.

(a) You testify past and expected increases in Postal Service Total Factor Productivity (TFP) of 2.5 percent in FY 2000, 2.0 percent in FY 2001 through accounting period 12, 1.1 percent in FY 2002, and at least 0.5 to 1.0 percent lower than assumed in the test year after rates. Please state the TFP assumption for the test year.

(b) In many cases, programs to lower costs are stated in terms of cutting specific dollars or percentages of costs. Please indicate how a percentage cut in costs relates to the TFP projections you present. For example, assuming that the overall level of cost is cut by one percent, how much does TFP increase? Please state all assumptions.

RESPONSE:

(a) There have been no TFP calculations made beyond FY 2002.

(b) It would depend on what type of costs are cut as to their impact on TFP. As a rule of thumb, generally a $600 million reduction in costs equates to an approximate one percent improvement in TFP.

CERTIFICATE OF SERVICE

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

Scott L. Reiter

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260–1137
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