

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

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POSTAL RATE AND FEE CHANGES, 2001

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Docket No. R2001-1

RESPONSE OF UNITED STATES POSTAL SERVICE  
WITNESS TAYMAN TO INTERROGATORIES  
OF THE DIRECT MARKETING ASSOCIATION  
(DMA/USPS-T6-35-48, 59, 61-64)

The United States Postal Service hereby provides the responses of witness Tayman to the following interrogatories of the Direct Marketing Association: DMA/USPS-T6-35-48, 59, 61-64, filed on October 24, 2001. Interrogatories DMA/USPS-T6-49-58, and 60 were redirected to witness Patelunas.

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

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Scott L. Reiter

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November 7, 2001

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**DMA/USPS-T6-35.** (a) Please confirm that the USPS-proposed provision for contingencies in this case was initially determined by USPS management and subsequently submitted to and approved by the Board of Governors. If you cannot confirm, please explain in detail.

(b) In preparing its proposals for this case, did USPS management submit to, or discuss with, the Board of Governors a proposed provision for contingencies different from 3%? If so, please explain in detail the size of the proposed provisions for contingencies that were submitted or discussed, and summarize the discussions that took place between the members of the Board of Governors and USPS management on this subject.

(c) Please identify the member or members of USPS management who made the decision (or contributed to the making of the decision) to propose a provision for contingencies of 3%.

(d) Did you personally have a role in management's determination to propose a 3% contingency in this case? If so, please describe this role in as much detail as possible.

(e) At the time that the proposed contingency was submitted by management to the Board of Governors, was it your personal opinion that a contingency of 3% was "reasonable," as required by the Postal Reorganization Act of 1970? If so, what, in your opinion at that time, were the most important factors that caused you to believe that a contingency of 3% was "reasonable"?

**RESPONSE:**

(a) The Board accepted management's recommendation that a 3 percent contingency provision be adopted and that the case be filed early enough to allow implementation of new rates at the beginning of the test year.

(b) The initial judgment that a 3 percent contingency should be used held up well throughout the rate case preparation process. No other contingency provision was presented to the Board for its approval. However, there may have been discussions of contingency provisions as high as 6 percent and as low as 0 percent in the context of developing the mathematics of phasing proposals

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(c) The USPS management team involved in determining the contingency provision was the Rate Case Steering Committee consisting of the Deputy Postmaster General, the Chief Operating Officer, the General Counsel, the Chief Financial Officer, the Vice President of Pricing and Product Design, and the Manager of Budget and Financial Analysis.

(d) Yes, I had a personal role. My role entailed participation in weekly meetings with the group noted above, interactions with the listed individuals and members of their staffs during the meetings and between meetings, and frequent consultations with the Chief Financial Officer and other managers and employees within the Finance function

(e) I agreed that the 3 percent contingency provision was “reasonable” and was “the minimum amount that is necessary” as stated at page 47 of my testimony. The factors underlying this judgment are fully described in the section of my testimony discussing the contingency.

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**DMA/USPS-T6-36.** Please describe in as much detail, and with as much specificity, as possible the reasons why the Postal Service believes that a 3.0% provision for contingencies is reasonable in this case, when it was of the opinion that a 2.5% provision for contingencies was reasonable in Docket No. R2000-1?

**RESPONSE :**

The Postal Service's best judgment is that a 3% contingency provision is warranted when compared with the Postal Service's 2.5% contingency provision in the last case. The Postal Service's financial condition has deteriorated, and its ability to absorb risk has decreased. Clearly the risks the Postal Service is facing have increased. My testimony at pages 3 through 11 and pages 45 through 67 outlines a number of these risks. In my judgment a 3.0 percent contingency provision would have been reasonable in R2000-1. The fact that a 2.5 percent was ultimately used then does not make a 3.0 percent contingency provision unreasonable now. It is also clear that the 2.5 percent contingency provision was inadequate in the last case.

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**DMA/USPS-T6-37.** Please refer to your testimony at page 52, lines 18 - 20, where you state, "There has been a sharp, unexpected slowdown in economic growth that placed the economy on the verge of a recession."

(a) Is the current level of economic activity reflected in the USPS cost and revenue projections for the Test Year? If your answer is other than an unqualified "yes," please explain in detail.

(b) Is it your opinion that this "sharp, unexpected slowdown in economic growth" supports a larger provision for contingencies than in Docket No. R2000-1? If so, please explain your opinion in detail.

**RESPONSE:**

(a) No. As a result of the events of September 11<sup>th</sup> and following, there have been even more severe economic disruptions to the Postal Service than are reflected in the interim and test year forecasts.

(b) Yes. The reference to a "sharp, unexpected slowdown in economic growth" was intended to support the observation that the Postal Service's finances are subject to significant risk. When faced with significant, increased risk, it is prudent to include a larger provision for contingencies. My reference was meant to be counterpunctual to the statement in the Commission's Docket No. R2000-1 Opinion that there was no significant risk of financial harm to the Postal Service from the economy. In this case, as in Docket No. R2000-1, there are risks of sharp, unexpected slowdowns in economic growth, relative to what had been assumed in the filing. Saying that there is no significant risk of financial harm from the U.S. economy in this case would be as wrong today as it was in Docket No. R2000-1.

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**DMA/USPS-T6-38.** Please refer to your testimony at page 48, lines 1-2, where you state, “. . . adversities may crop up in the context of non-volume workload.”

- (a) Please define “non-volume workload” as you have used the term.
- (b) Please describe in as much detail as possible the types of adversities that may crop up in this context.
- (c) To what extent are the financial consequences of these adversities to the Postal Service unknowable? Please respond in as much detail as possible.

**RESPONSE:**

- (a) Non-volume workload is workload that is unrelated to volume or, in some cases, may be indirectly related to volume. Categories of non-volume workload currently recognized in the revenue requirement and rollforward process include the number of Post Offices, possible city deliveries, rural route box miles, rural boxes, contract stations, CAG L Post Offices, leased facilities square footage, and interior facilities square footage.
- (b) Adversities can crop up with respect to the nature and extent of resources required to service non-volume workload, the introduction of new non-volume workload items, new drivers of non-volume workload, services or processes, the cost levels of such services or processes, and the quantity of items serviced or processed.
- (c) When projecting into the future, all of the particulars of non-volume workload are unknown or unknowable. An example of a new facilities requirement that has introduced significant new requirements and uncertainties into the non-volume workload arena is the need to build and allocate facilities space to house equipment and personnel who will be assigned to sanitize the mail.

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**DMA/USPS-T6-39.** Please refer to your testimony at page 49, lines 18-19, where you state, “The size of a given rate increase has no bearing on the magnitude of possible adversities. The only possible relationship is that a smaller increase may represent a greater risk, . . . .”

(a) In light of this statement, would you agree that the fact that the Postal Service is requesting greater rate increases in this case as compared to Docket No. R2000-1 does not support a provision for contingencies in this case greater than the provision for contingencies in Docket No. R2000-1? If your answer is other than an unqualified “yes,” please explain in detail.

(b) In light of this statement, would you agree that the fact that the Postal Service is requesting greater rate increases in this case as compared to Docket No. R2000-1 may support a provision for contingencies in this case lesser than the provision for contingencies in Docket No. R2000-1? If your answer is other than an unqualified “yes,” please explain in detail.

**RESPONSE:**

(a) & (b) No in both cases. Your questions ask me to link the size of the contingency with the size of the rate increase. As I have testified, the size of a rate increase has no relationship with the magnitude of possible adversities.

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**DMA/USPS-T6-40.** Please refer to your testimony at page 50, line 1 through page 52, line 3, where you discuss the subject, “Institutional Factors Demonstrate the Need for the Postal Service’s Contingency Provision.”

(a) Please confirm that the “institutional factors” that you discuss are: (1) universal service, (2) the USPS deferred retirement cost liability, and (3) the “zero net profit margins that result from the Postal Service’s breakeven objective.” If you cannot confirm, please explain in as much detail as possible.

(b) Please describe in as much detail as possible the ways in which “universal service” increases the risk of unknown adversities in the Test Year.

(c) Please describe in as much detail as possible the ways in which “the USPS deferred retirement cost liability” increases the risk of unknown adversities in the Test Year.

(d) Please describe in as much detail as possible the ways in which “the breakeven objective” increases the risk of unknown adversities in the Test Year.

**RESPONSE:**

(a) Not confirmed. The two plus pages referenced from my testimony cite more than the three factors you mention.

(b) The obligation to provide universal service reduces the Postal Service’s ability to absorb risk. Comparisons can be made with the commercial airline industry, which has eliminated somewhere in the neighborhood of 20 percent of its scheduled routes in order to save expenses during this time of extreme financial difficulty. Further, many airlines are substantially reducing the number of their city ticket offices. The Postal Service is not in a realistic position to eliminate 20 percent of its delivery routes or close down a substantial portion of its retail outlets and so cannot use these types of actions as an option for absorbing financial adversity.

(c) This is another factor which is cited primarily to suggest the Postal Service’s limited ability to absorb risk. The deferred retirement liability represents expenditures which must be made in the future regardless of whether or not revenues are generated to



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adequately cover those expenses. These obligations limit the Postal Service's ability to absorb risk.

(d) The breakeven objective, *i.e.*, a zero profit margin, negates the Postal Service's ability to absorb adversities, except to the extent contingency provisions are adequate. Further, the ratemaking process typically requires 18 months for preparation, planning, litigation, and implementation of new rates. The combined impact of these is to sharply limit the Postal Service's ability to absorb adversity.

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**DMA/USPS-T6-41.** Please refer to your testimony at page 53, lines 29 - 30, where you state, "This means the macroeconomic risks are badly skewed against the Postal Service."

(a) Has the Postal Service made any study or estimates of the extent to which the DRI-WEFA economic forecasts used in the USPS volume and revenue projections would need to be wrong in order to create an adverse impact on the USPS net revenue as large as \$2,200,000,000, the approximate size of a 3% provision for contingencies? If so, please provide any such study or estimates and describe them in detail.

(b) Has the Postal Service made any study or estimates of the extent of the impact on USPS net revenues if the "Pessimistic" DRI-WEFA economic scenario occurs? If so, please provide any such study or estimates and describe them in detail.

(c) Has the Postal Service made any study or estimates of the extent of the impact on USPS costs if the "Pessimistic" DRI-WEFA economic scenario occurs? If so, please provide any such study or estimates and describe them in detail.

(d) Has the Postal Service made any study or estimates of the extent of the impact on USPS net revenues if the "Late Recession" DRI-WEFA economic scenario occurs? If so, please provide any such study or estimates and describe them in detail.

(e) Has the Postal Service made any study or estimates of the extent of the impact on USPS costs if the "Late Recession" DRI-WEFA economic scenario occurs? If so, please provide any such study or estimates and describe them in detail.

**RESPONSE:**

(a) The contingency provision is not created to solely reflect risks of errors in DRI-WEFA macroeconomic forecasts, though under current circumstances the risk of such errors is substantial. As noted at page 53 of my testimony, before September 11<sup>th</sup>, the assessment was, "the risk [of forecast error] is especially high now, and the range of possible outcomes is uncomfortably large." And as noted in my response to OCA Interrogatory 21, the "fallout from the attacks now makes U.S. and global recessions inevitable." Net revenues can also be adversely affected by mail mix shifts (such as occurred in the R2000-1 test year) and by risks specific to the Postal Service (such as mailing pattern changes in response to anthrax) or by competitive inroads (such as

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occurred in the R2000-1 test year). It is conceivable that some combination of these and other factors could fully consume the contingency.

(b) – (e) Please see my response to DMA Interrogatory DMA/USPS-T-6-8(a).

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**DMA/USPS-T6-42.** Please refer to Table 51 in your testimony on page 57.

(a) Please provide the complete calculations underlying each of the 10 line items that, when applied against a “Net Income Potential” of \$2.0 billion, produce a “FY 2001 net loss.”

(b) Please provide references to all information used in making such calculations.

**RESPONSE:**

(a) – (b) Please see my testimony at pages 59 through 64. The calculations are presented separately for each line item in this portion of my testimony. For example, at page 61, a base year health benefits costs of \$3,835 million is given at line 14. Additional health benefits expense acceleration of one to five percent is noted lines 12 and 13. Over a two year period (see page 59, lines 3 through 8), the potential variation using these parameters is then from \$77 million ( $1.01^{**2} \times 3,835 - 3,835 = 77.0835$ ) to \$393 million ( $1.05^{**2} \times 3,835 - 3,835 = 393.0875$ ). These are the amounts shown for health care benefits in Table 51.

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**DMA/USPS-T6-43.** Please refer to your testimony at page 58, lines 8 - 12, where you state, “The dominant considerations in selecting a contingency provision remain management judgment and policy with respect to the degree of risk that the Postal Service is willing and able to absorb. This judgment should be upset if and only if it can be shown that the proposed contingency provision, as I have described it, is unreasonable.”

(a) Has the Postal Service modified, in any respect whatsoever, the legal positions it asserted during the course of Docket No. R2000-1 concerning its authority over the size of a “reasonable provision for contingencies” and the authority of the Postal Rate Commission over this issue? If so, please describe any such modification in as much detail as possible.

(b) Is it a reasonable summary of the Postal Service’s position in this respect to say that, while the Commission has the authority to recommend rates based on a provision for contingencies different from that underlying the USPS request, the Commission has the burden of demonstrating that the USPS-proposed provision for contingencies is “unreasonable”?

(c) Given your assertion that the “dominant considerations” in choosing a provision for contingencies “remain management judgment and policy,” does the Postal Service have a position on the type and extent of the evidence or other information that would be legally necessary or sufficient to support a Commission determination on this subject different from that of management? If so, please describe such evidence or other information in as much detail as possible.

(d) Given your assertion that the “dominant considerations” in choosing a provision for contingencies “remain management judgment and policy,” does the Postal Service have a position on whether the Postal Service has a legal obligation to support its “judgment and policy” with objective evidence of any kind? If so, please describe such obligation in as much detail as possible.

**RESPONSE:**

(a) Not to my knowledge.

(b) I am not a lawyer, but it is my layman’s opinion based on my understanding of the law that the Commission should not change any reasonable contingency provision used by the Postal Service in its revenue requirement.

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(c) My layman's opinion is that postal management is in a better position to judge the extent of operating and economic risk on postal operations than anyone outside the Postal Service. I think it is dangerous for the Commission to substitute its judgment for postal management's, as it did in the last case, based on what the Commission thought was sufficient evidence on the record provided by parties outside the Postal Service. It turned out that the Postal Service's assessment of the risks it faced was correct and the view the Commission adopted was not.

(d) Again, I am not a lawyer, and cannot tell you the legal bounds of your implied hypothetical. From a reasonable layman's perspective, I do not see the hypothetical as applicable, since I believe that the Postal Service has supported its position with substantial objective evidence, both in this case and in past cases. Indeed, in this case, I have endeavored to provide greater detail in my discussion of the contingency so that there can be no doubt or mystery about the reasonableness of or the bases for management's judgment underlying the Postal Service's contingency provision.

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**DMA/USPS-T6-44.** Please consider a hypothetical situation where the Postal Service had projected Test Year After Rates volumes in this case one percent smaller on a class by class, subclass by subclass, rate cell by rate cell basis.

(a) Please confirm that the revenues associated with this forecast would be less than those associated with the Postal Service's actual forecast.

(b) Please confirm that the Test Year After Rates costs would be less than those associated with the Postal Service's actual forecast.

**RESPONSE:**

(a) Not confirmed.

(b) Not confirmed.

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**DMA/USPS-T6-45.** Page 46 of your testimony refers to the freeze and deferral of capital programs and projects.

(a) If the freeze and deferral had not been in effect, how much more cash would the Postal Service have expended in FY 2000?

(b) In FY 2001?

(c) If the freeze and deferral had not been in effect, how much bigger would the revenue requirement have been?

**RESPONSE:**

(a) The Postal Service was scheduled to spend \$3.564 billion in FY 2000, which was reduced by the freeze and deferrals to \$3.169 billion, or a \$395 million reduction.

(b) For FY 2001, the Postal Service had scheduled cash outlays of \$3.531 billion, which were reduced to \$2.804 billion, or a \$727 million reduction.

(c) The impact of the freeze on the revenue requirement depends on what type of capital commitments would have been made, when such commitments would have resulted in acquisitions, and the exact date they would have been put in service, without the freeze. Additionally, in relation to facilities, certain lease costs may have been incurred as a result of the capital freeze. The net impact of these actions on the revenue requirement is unknown.



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**DMA/USPS-T6-46.** Page 46 of your testimony says, “The resulting annual capital need for network growth is approximately \$400 million.” How much depreciation is associated with the capital expenditure of \$400 million?

**RESPONSE:**

Postal facilities are depreciated over a 40-year period. The \$400 million capital expenditure equates to an additional \$10 million yearly to the depreciation cost.

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**DMA/USPS-T6-47.** On page 53 of your testimony you say, “Second, the economy can slow down or contract and reduce the Postal Service’s revenue stream.” Please confirm that in the US, slowing or contracting economies have typically not been accompanied by high rates of inflation. If you can not confirm, please explain why you believe this generalization to be untrue and provide as much data or other information as possible to support your view.

**RESPONSE:**

It is my understanding that the benefits of slowing inflation, if any, typically lag economic contractions. I am informed that this is the mainstream view among economists. This situation is exacerbated with respect to the Postal Service where costs for important items are driven by inflation from a previous time period. For example, COLA’s are based on actual, not projected values. ECI is handled consistent with this lagged process in developing test year projections for this case, as in previous cases. The Postal Service’s current situation is one where it is suffering sharply and immediately from a revenue slowdown, and has experienced little, if any, net palpable benefit from reduced inflation.

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**DMA/USPS-T6-48.** On page 53 of your testimony you say, “First, inflation can accelerate beyond projections and negatively affect the Postal Service’s costs.”

(a) Please confirm that in the US high rates of inflation have been accompanied by high rates of income growth. If you can not confirm, please explain why you believe this to be untrue and provide data to support your view.

(b) Please also confirm that high rates of income growth have been accompanied by high levels of growth in Postal volumes. If you can not confirm, please explain why you believe this to be untrue and refer to witness Tolley’s model for volume forecasting.

**RESPONSE:**

(a) Not confirmed. I have not studied this, but, I understand that there is not any necessary correlation between income growth and inflation. For example, a period of substantial economic and income growth peaked in calendar year 2000. This growth was accompanied by fairly low inflation rates, particularly when compared to the very high rates of inflation that persisted during some lower growth periods in the late 1970s and early 1980s.

(b) Not confirmed. Again, I have not studied this, but I understand that there is not any necessary correlation between income growth and volume growth. For example, it is my understanding that, using historical norms, Postal Service volume growth was relatively weak during the last 5 years, relative to total economic growth. I understand that witnesses Musgrave, Thress, and Tolley rely on many variables to project volumes, not merely one that represents income growth.

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**DMA/USPS-T6-59.** You briefly discuss Final Adjustments on pages 20 and 21 of your testimony. On page 20 you state, "FY 2000 costs reflect the mail volume mix that existed prior to the Docket No. R2000-1 rate changes that went into effect on January 7, 2001 and July 1, 2001. In order to reflect the cost changes due to those rate changes and certain other volume trends at a finer level of aggregation than represented in the Cost and Revenue Analysis (CRA) report, adjustments were made."

(a) Please confirm that if the mail becomes more presorted (and everything else stays the same) between base year and test year, the final adjustment will reduce costs. If you cannot confirm, please explain why this is not so.

(b) Please confirm that if the mail becomes more barcoded (and everything else stays the same) between base year and test year, the final adjustment will reduce costs. If you cannot confirm, please explain why this is not so.

(c) Please confirm that if the mail becomes more dropshipped (and everything else stays the same) between base year and test year, the final adjustment will reduce costs. If you cannot confirm, please explain why this is not so.

(d) Please confirm that the final adjustments reduce clerk and mailhandler costs. If you cannot confirm, please explain why this is not so.

(e) Please confirm that clerk and mailhandlers costs decrease because the work content of the mail decreases. If you cannot confirm, please explain why this is not so.

(f) Please confirm that cost changes due to changes in mail mix reflect changes in work content, not changes in USPS productivity. If you cannot confirm, please explain fully.

**RESPONSE:**

(a) Not confirmed. It is my general understanding that in certain situations in an automated environment, presortation may have no value to the Postal Service. As I am not an operations expert, I cannot detail the full range of such situations.

(b) Not confirmed. It is my general understanding in certain situations, bar-coding has no value to the Postal Service, such as if mail is not machinable. As I am not an operations expert, I cannot detail the full range of such situations.

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(c) Not confirmed. It is my general understanding in certain situations drop shipping has no value to the Postal Service, such as where mail must be moved upstream in order to receive automated processing. As I am not an operating expert I cannot detail the full range of such situations.

(d) Confirmed that final adjustments reduced projected clerk and mailhandler costs.

(e) I agree that reduced work content presents an opportunity to reduce costs. The ability to actually capture these cost savings can vary from time to time and place to place.

(f) It is my understanding that the work content of mail is reflected in the output measure used in Postal Service productivity calculations. Accordingly, the Postal Service would not get any productivity credit for cost savings that it captures as a result of mail mix changes.

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**DMA/USPS-T6-61.** The 18 series you show in your exhibit USPS 6T encompass data from 1985 to 2003. Please provide an Excel spreadsheet containing these data for each of the 18 series from 1940 through 1984.

**RESPONSE:**

The fiscal year data that you request can be calculated from published sources. This calculation of data, which would be derived almost entirely from calendar year data published by the United States Government, was not needed to prepare my testimony and has not been produced.

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**DMA/USPS-T6-62.** Exhibit USPS 6T provides a forecast for the 1-Year Treasury Bill.

- (a) Please confirm that the exhibit shows a forecast for the 1-Year bill in 2001 of 3.9 percent.
- (b) What is the current yield on 2 Year notes?
- (c) Please confirm that the yield curve is not currently inverted.

**RESPONSE:**

- (a) Confirmed.
- (b) The yield on 2 Year Treasury notes as of November 2, 2001 was 2.47%.
- (c) Not confirmed. As of November 2<sup>nd</sup> the yield for 6 month bills was less than the yield for 3 month bills.

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**DMA/USPS-T6-63.** Please refer to your Library Reference J-49, Spreadsheet Prg\_01-\$\_27094, Exhibit A, Summary of FY 2001 Other Program Changes from Prior Years.

(a) Please confirm that there are no “Other Program” breakthrough productivity savings for supervisors even though there are \$172.5 million of savings for clerks and \$77.5 million of savings for city carriers in 2001.

(b) Please describe the process by which you decided there would be no “Other Program” savings for supervisors in FY 2001.

(c) Please describe the process by which you decided there would be “Other Program” savings for supervisors in FY 2001.

**RESPONSE:**

(a) Confirmed. Please refer to my testimony at page 16, lines 12-24, where I explain why it is incorrect to assume that targeted savings in clerk and city carrier costs automatically result in supervisor savings.

(b) The process for determining achievable program savings is discussed in Section 1 of LR J-49.

(c) The breakthrough productivity “Other Program” savings for Fiscal Years 2002 and 2003 shown in the Segment 2 (supervisors) column of LR J-49, Exhibits B and C, are district professional staff. Please refer to Chapter V, Section d. of LR J-50, and page 26, lines 26 and 27 where these savings are identified as district professional staff.



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**DMA/USPS-T6-64.** Please refer to your spreadsheet Sptdoc\_01s, tab Non-Pers Other Programs, cell F18.

- (a) Please confirm that the value entered in this cell is \$22,000.
- (b) Please confirm that the heading on this page of the spreadsheets indicates that entries are in thousands of dollars.
- (c) Please confirm that row 18 is labeled "Rate Case/Legal Services" and that column 18 is labeled "Incremental FT 2002".
- (d) What is the distribution key for this cost?

**RESPONSE:**

- (a) Confirmed.
- (b) Confirmed.
- (c) Confirmed, except that the label is "Incremental FY 2002".
- (d) It my understanding that this cost is a portion of Component 210 and that it is entirely "Other" – there are no volume variable costs.

## 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.

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November 7, 2001