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

POSTAL RATE AND FEE CHANGES, 1997	Docket No. R97–1

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS MOELLER TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE (OCA/USPS–T36—1–14)

The United States Postal Service hereby provides responses of witness Moeller to the following interrogatories of the Office of the Consumer Advocate: OCA/USPS–T36—1–14, filed on July 31, 1997.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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U.S. POSTAL SERVICE WITNESS MOELLER RESPONSE TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T36-1. Please refer to your testimony at 7, lines 9-11 There you state:

> This last input, the piece rate for pound mail, is theoretically set at the rate which, if it were to take advantage of all applicable discounts, would equal zero.[8]

At footnote 8, you cite "PRC Op., MC95-1. Para 5643." Para. 5643 states:

> Since the Commission is recommending a Regular subclass and an Enhanced Carrier Route subclass, the basis for calculating the piece charge must reflect the presort levels in each subclass. Thus, for the Regular subclass, the basis is the basic presort level compared to the 3/5-digit presort level. For the Enhanced Carrier Route subclass, the basis is the basic level compared to the saturation level. Using the Docket No. R90-1 approach for the Enhanced Carrier Route subclass, the Commission recommends a piece charge equal to the cumulative presort differential between basic flats and saturation flats. However, for the Regular subclass, applying this approach would result in a pound rate exceeding the current rate of 68.7 cents. To mitigate the rate impact on Regular subclass pound rate mailers, consistent with the § 3622(b)(4) pricing criterion, the Commission selects a piece charge greater than the cost differential between a basic flat and a 3/5-digit flat to prevent an increase in the pound rate for the Regular subclass.

Please explain specifically how the para. 5643 language demonstrates the point you make.

a. Do the Commission's Docket No. MC95-1 workpapers illustrate the point you make at page 7 (quoted above)? If so, provide a specific citation to those workpapers.

b. Please cite to any other Commission-generated documents that illustrate the point made at page 7 (quoted above).

RESPONSE:

Regarding para. 5643, if the piece charge is "equal to the cumulative presort differential between basic flats and saturation flats," then the piece rate for pound-rated saturation pieces would be zero.

a.-b. Yes. Page 13 of the Commission's Docket No. MC95-1 workpapers shows "intercept" of 1.8, which is the sum of the discounts, and page 15 has an input called "intercept" of 1.8 cents.

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OCA/USPS-T36-2. Please display, as a mathematical expression, the equation described at 7, lines 7-14, of your testimony.

a. In other words, please display, as a mathematical expression, the equation the Commission preferred and used in Docket No. MC95-1.
b. Also display, as a mathematical expression, the equation you use in the current proceeding, which you describe as containing 2 modifications of the Commission's MC95-1 equation. USPS-T-36 at 8-9.

RESPONSE:

a.-b. Actually, the formula used by the Commission in Docket No. MC95-1 and the formula used in the current proceeding are in essence the same mathematical expression. One modification is simply changing the value for which the formula solves. The rate design proposed in my testimony uses the formula to solve for the piece-rate for pound-rated pieces, whereas in Docket No. MC95-1, the Commission used the formula to solve for the pound rate. The formula can be expressed as follows:

$$RR+D = Vr(i+(BP/16)*P) + Vrp(i) + VpP$$

Where RR is the revenue requirement from postage; D is the value of the discounts claimed by mailers; Vr is the volume of pieces paying minimum per piece rates; i is the basic per piece rate for pound-rated pieces; BP is the breakpoint weight; P is the pound rate; Vrp is the volume of pieces paying the pound rate; and Vp is the total number of pounds paying the pound rate. One modification is that the proposal solves for i with P as an input; whereas the Commission solved for P with i as an input. Both methods solve for the basic piece rate for flats. The other modification is that RR is reduced by the amount of revenue expected to be obtained from the residual-shape surcharge. See WP1, page 16 for a step by step derivation of the formula and the calculation of the rates.

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OCA/USPS-T36-3. Is it correct that, in Docket No. MC95-1, the pound rate you used did not depend on other "decisions" because you selected it? PRC Op. Docket No. MC95-1 at para. 5642. If your answer is negative, please explain.

RESPONSE:

No. Although the proposed methodology in Docket No. MC95-1 included selection of a pound rate, other decisions affected that selection in that the sum of all the decisions needed to result in the required revenue. In other words, if a higher or lower pound rate had been chosen, other selections, or decisions, would have had to change in order to generate the required revenue. The pound rate, however, was not "dependent" upon the other decisions in the sense that it was not the result of an algebraic function.

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OCA/USPS-T36-4. Is it correct that, in Docket No. MC95-1, the pound rate you used was not an algebraic function of decisions such as those cited in n. 69 of page V-255 of PRC Op. Docket No. MC95-1? If your answer is negative, please explain.

RESPONSE:

Yes, it is true that in Docket No. MC95-1, the proposed pound rate was not an algebraic solution; but as described in OCA/USPS-T36-3, other decisions played a role in selection of the pound rate in that the total revenue needed to meet the revenue requirement.

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OCA/USPS-T36-5. Is it correct that the Commission rejected your approach to determining the pound rate, and instead, determined the pound rate as an output of the formula described at para. 5642 of PRC Op. Docket No. MC95-1? If your answer is negative, please explain.

RESPONSE:

In Docket No. MC95-1, the Commission used the Docket No. R90-1 methodology for determining the pound rate, which was different from the methodology I proposed in Docket No. MC95-1. In this proceeding, the proposed rate design acknowledges the utility of the PRC-adopted formula and enhances its use by allowing for the pound rate to be an input, rather than an output. As described at page 26, line 17 of my testimony, this modification provides more latitude to consider other factors when determining the appropriate pound rate.

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OCA/USPS-T36-6. Is it correct that you are essentially proposing again in your current testimony that the pound rate should be "chosen"? USPS-T-36 at 9, lines 4-5. If your answer is negative, please explain.

RESPONSE:

Although the pound rate is selected, unlike the proposed rate design in Docket No. MC95-1, the rate design in this docket uses the PRC-adopted formula to determine other rates. Some choices have to be made as inputs to the formula. As described in my testimony at page 9, line 9, the proposed modification substitutes the variable for which the formula solves, i.e., the pound rate as opposed to the piece rate for pound rated mail. This modification of how the per-piece rate element for pound-rated mail is determined gives the Postal Service and the Commission more latitude to consider other factors in a comprehensive fashion when determining the appropriate pound rate. It should be noted that the PRC-recommended pound rate for Regular was essentially chosen as well. As stated in PRC Op., MC95-1, para. 5643, the Commission selected a particular piece rate for pound-rated mail in order to prevent an increase in the pound rate. In other words, the pound rate, although not an input to the formula, was monitored during the selection of the piece rate, and the piece rate was chosen to result in a pound rate which was deemed appropriate. The modified formula would allow for the direct input of an appropriate pound rate, and the output of the piece rate for pound rated mail. See my testimony at pages 8-9 regarding the advantages of the modification to the formula.

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OCA/USPS-T36-7. Please confirm that the 65-cent pound rate (for the regular subclass), that you recommend, would be higher if the Commission's Docket No. MC95-1 methodology for calculating the pound rate were employed. If you do not confirm, please explain your reasoning.

RESPONSE:

I cannot confirm. As stated in the passage in OCA/USPS-T36-1 from the Recommended Decision in Docket No. MC95-1, the Commission selected a piece rate greater than the cost differential between a basic flat and a 3/5-digit flat in order to prevent an increase in the pound rate for the Regular subclass. I do not know if the Commission would again choose a piece rate in this proceeding to avoid an increase in the pound rate, nor do I know what that piece rate would be if it were chosen by the Commission; consequently, it is uncertain whether the pound rate would be higher if the PRC's Docket No. MC95-1 methodology were employed. If, however, the term "methodology" in this question is intended to mean selecting a piece rate which equals the differential between a basic flat and a 3/5-digit flat (as described in the final sentence of PRC Op., MC95-1, para. 5643 and reproduced in OCA/USPS-T-36-1), then, yes, the pound rate produced by the formula would be considerably higher. The Commission could, however, select a piece rate to avoid this substantially higher pound rate, but I cannot speculate as to whether such a selection would result in a pound rate above 65 cents.

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OCA/USPS-T36-8. In preparing your testimony for Docket No. R97-1, did you ever calculate rates for Standard Mail A, bulk regular rate mail using the Commission's approach of solving for the pound rate, rather than selecting it?

a. If so, please provide the rates that resulted from such a calculation.
b. If not, please generate a set of Standard Mail A, bulk regular rates which result from using the Commission's approach concerning the pound rate (in place of your approach).

RESPONSE:

Initial question and a I did not calculate rates for Standard Mail (A) using the Commission's approach in preparing my testimony.

b. As stated in my response to OCA/USPS-T36-7, I cannot speculate what piece rate the Commission would select for the Regular subclass. One can use the formula in my workpapers (WP1, page 16) to calculate what rates might result if a strict adherence to the Commission methodology were followed regarding the calculation of the per-piece rate for pound-rated mail. In other words, pound rates can be input into the formula (at line 13) in an iterative fashion in order to produce a piece rate (at line 19) which equals the proposed rate differential between Basic and 3/5-digit flats. As stated in my response to OCA/USPS-T36-7, the result would be a higher pound rate, and lower piece rates. It is unclear whether the rates produced by such an exercise would result in the target cost coverage since they would have to be applied to a different set of after-rates volumes.

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OCA/USPS-T36-9. Please provide citations that support your statement at page 13, lines 17-19, that:

> [I]n Classification Reform I and in other forums, mailers have argued that there are different types of parcels, some of which are claimed to be similar in cost to flats, and some of which are claimed to be more costly than flats.

RESPONSE:

For example, see Docket No. MC95-1 Tr. 39/17378-89, Tr. 39/17402-03, and Tr. 19/8275; and Reply Brief of Recording Industry Association of America. (Nov. 16, 1995) at 3-5. It is also my understanding that this issue has been raised during informal discussions between representatives of the Standard A and B parcel shipping communities and the Postal Service.

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OCA/USPS-T36-10. You observe, at page 13 of your testimony, that the Postal Service proposes to pass through "less than one-third of the measured cost difference" between flats and non-flats. What is the timetable of the Postal Service for increasing the passthrough to 100 percent of the cost difference?

RESPONSE:

There is no "timetable." As described in my testimony at page 13, there are a number of factors contributing to the selection of the passthrough. These factors will always need to be considered, and reevaluated, as necessary, when choosing a passthrough in future proceedings.

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OCA/USPS-T36-11. At page 16 of your testimony, you explain that:

> Due to significant changes in costing methodology, the cost differentials supporting many of the discounts have changed significantly.

Please summarize the "significant changes" and provide citations to the testimonies of other Postal Service witnesses who espouse (or generate) the "significant changes."

RESPONSE:

Many of the inputs to the cost models (see testimony of witness Daniel, USPS-T-29) have been updated with more recent information In addition, one of the more significant changes is the volume variability study described by witness Bradley (USPS-T-14).

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OCA/USPS-T36-12. Please confirm that the 80 percent passthrough described at page 17, line 14, of your testimony may be illustrated as follows
the current 3/5-digit presort letter discount of 4.7 cents (25.6 cents — 20 9 cents) x 0.8, yields a proposed 3/5-digit presort letter discount of 3.8 cents (rounded up from 3.76 cents). If you do not confirm, please provide the correct calculations, accompanied by an explanation and citations to the sources for the numbers used.

RESPONSE:

Not confirmed. The 80 percent figure is not a "passthrough," but rather a percentage of the current discount. The calculation, however, is correct and represents the derivation of the 80 percent figure.

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OCA/USPS-T36-13. Please refer to your WP 1, page 11, Worktable C, "Passthrough Percentages." The passthrough percentage for presort letters is given as "1.65." The note beneath Worktable C states "Assumed."

a. Does this mean that the 1.65 (or 165 percent) passthrough has been assumed? If not, please explain.
b. Does the 165-percent passthrough result solely from your decision not to allow discounts to fall below 80 percent of their current level (USPS-T-36, p. 17, lines 9-11)? If not, please explain how you arrived at a passthrough of 165 percent.
c. Do you agree that the 165-percent passthrough is far out of line with the uniform 100-percent passthroughs recommended by the Commission in Docket No. MC95-1 for Standard A letters (see Table V-4, at page V-264, of the opinion and recommended decision)? If not, please explain.
d. Please confirm that a 100-percent passthrough of the presort savings for 3/5-digit mail would result in a discount of approximately 2.3 cents (your WP 1, page 12). If you do not confirm, please explain.
e. Please confirm that a 2.3-cent discount (based upon a 100-percent passthrough) would result in a 3/5-digit piece rate for Standard A letters of 22.4 cents (24.7 — 2.3 cents). If you do not confirm, please explain.

RESPONSE:

a. The term "assumed" is from the Docket No. MC95-1 PRC Standard Mail Workpapers, page 7. It is "assumed" in that it is selected.

b. The passthrough was selected as described in my testimony at page 17, lines 13-14, and followed the guidelines discussed at page 16, line 17 - page 17, line 12.

c. As stated on page 16, line 20 of my testimony, the proposed rates reflect unconventional passthroughs. Such passthroughs are used in order to meet the guidelines described on pages 16-17.

d. Confirmed.

e. I cannot confirm. A reduction in the discount would result in lower "leakage" due to discounts and this in turn could result in lower basic rates. In other words, the 24.7 cent rate would probably be lower. The differential would be 2.3 cents, however.

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OCA/USPS-T36-14. Please confirm that the 5.3 cents set forth in Worktable D of WP 1, page 11, was calculated as follows:
26.1585 cents (from WP1, page 10) — 12.8452 cents (id.) =
13 3133 cents (from Worktable B, WP 1, page 11) x 40% = 5.3

a. If you do not confirm, please provide the derivation of the 5.3-cent basic letter/flat differential unit cost passthrough.
b. Is the non-letter basic presort rate of 30 cents, that you propose, the result of adding 5.3 cents to the proposed basic presort letter rate of 24.7 cents, i.e., 24.7 + 5.3 cents = 30 cents? If this is not correct, please show how the 30-cent basic presort non-letter rate was developed.
c. Is it correct that the proposed rate for 3/5 digit presort non-letter Standard Mail, Regular was derived as follows:
   30.6 cents (current rate for basic presort non-letter) — 22.5 cents (current rate for 3/5 digit non-letter presort) = 8.1 cents x 75.6% (from USPS-T-36-17, line 15) = 6.12 cents; and 6.12 cents was rounded to 6 cents as set forth in Worktable E of WP 1, page 11; and the 6-cent presort flat discount was subtracted from the proposed basic presort non-letter rate of 30 cents to arrive at the 3/5 digit presort non-letter rate of 24 cents?
   If the calculations set forth in this subpart are not correct, then please provide all necessary corrections and citations to sources relied upon.
d. Please confirm that the 75 6-percent passthrough of the basic/3-5 digit presort differential was assumed, as noted in Worktable C, WP1, page 11. If you do not confirm, please explain.
e. You note at page 17, lines 17-19, that the proposed presort passthrough for non-letters is only 74 percent of the current discount. Was that percentage calculated in the following manner:
   30.6 cents (current basic presort non-letter rate) — 22.5 cents (current 3/5 digit presort non-letter rate) = 8.1 cents; and
   30 cents (proposed basic presort non-letter rate) — 24 cents (proposed 3/5 digit presort non-letter rate) = 6 cents; and
   6– 8 = 74 percent? If this is not correct, please explain.
f. Was the 75.6 percent passthrough assumed in order to maintain a non-letter 3/5 digit discount of 74 percent of the current discount? If not, please explain how you chose the 75.6-percent passthrough.
g. Please confirm that a 100-percent passthrough of the letter/flat differential of 13.3133 cents would result in a basic presort non-letter rate of approximately 38 cents, i.e., 24.7 cents (basic presort letter rate) + 13.3 cents = 38 cents. If you do not confirm, please explain.
h. Also confirm that a 38-cent rate for basic presort non-letters is approximately a 24-percent increase from the current rate of 30.6 cents. If you do not confirm, please explain

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OCA/USPS-T36-14. Continued

RESPONSE.

a. Confirmed.

b. The 30 cent rate is an output from the formula on page 16 of WP1. The letter rate is 30 cents - 5.3 cents.

c. The calculations are correct, but this was not the method followed. The question implies that 75.6 percent was selected as the passthrough between Basic and 3/5-digit nonletters. In fact, that passthrough is characterized in my testimony as a "resulting passthrough" since it is determined by the other three passthroughs in the "presort tree." As stated in PRC Op., MC95-1, para. 5638: "Setting the letter presort passthrough and the letter-flat passthrough automatically produces the presort passthrough for flats." See response to parts d and f.

d. Not confirmed. The note in Worktable C says the passthroughs were assumed "*except* for the flat passthrough" (emphasis added). It is the result of the shape passthroughs and the letter presort passthrough.

e. The calculation is correct; however, the passage cited does not state that the "passthrough" is 74 percent. Rather, the proposed discount is 74 percent of the current discount.

f. The passthrough was not selected explicitly; it is the result of the selection of the shape passthroughs and the letter presort passthroughs. In other words, the rates for Basic nonletters and 3/5-digit nonletters can be determined without selecting a nonletter presort passthrough; the two shape passthroughs (basic

and 3/5-digit) and the letter presort passthroughs determine the discount for 3/5-digit nonletters. Once these three passthroughs are selected, the rate differential between basic and 3/5-digit nonletters "falls out." This differential is divided by the cost differential between Basic and 3/5-digit flats in order to see what the effective passthrough is for this discount. Although the rate difference and the effective passthrough are determined by the other passthrough choices, they are reviewed for appropriateness. See my testimony at page 17, line 15 through page 18, line 2.

g. I cannot confirm. An increase in the passthrough would change the "value of discounts" element of the rate design formula. This could lead to a change in the output of the formula. In other words, the basic nonletter rate might not be 38 cents; however, the differential between basic letters and basic nonletters would indeed be 13.3 cents. One can use the spreadsheet underlying WP1 to get an idea of what rates might result from 100 percent passthrough by entering 1 in place of the 0.4 in Worktable C, p 11.

h. Confirmed.

DECLARATION

I, Joseph D. Moeller, declare under penalty of perjury that the foregoing answers are true and correct, to the best of my knowledge, information, and belief.

JOSEPH D. MOELLER

Dated: August 14, 1997

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.

Anthony F. Alverno

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August 14, 1997