

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

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2001

Docket No. R2001-1

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS SCHENK TO JOINT INTERROGATORIES OF THE AMERICAN BANKERS
ASSOCIATION AND NATIONAL ASSOCIATION OF PRESORT MAILERS
(ABA&NAPM/USPS-T43-1-2, 3 a-e, 4-12)

The United States Postal Service hereby provides the responses of witness Schenk to the following joint interrogatories of the American Bankers Association and National Association of Presort Mailers: ABA&NAPM/USPS-T43-1-2, 3 a-e, 4-12, filed on November 21, 2001. The following interrogatory was redirected: Interrogatory 3 f-h was redirected to the Postal Service.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS SCHENK
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ABA&NAPM/USPS-T43-1 In your testimony, you devote less than one page to the discussion and analysis of the largest cost segment of the entire Postal Service, delivery costs. At that, the one page starting at page 10, line 8, simply states that you are sponsoring LR-117, which also contains no analytical discussion of Postal Service delivery costs. *By contrast, for mail processing costs in First Class Mail alone, the direct testimony is 41 pages.*

- a. What is your understanding, if any, of the “single subclass stop” debate between various parties in postal rate cases and how does it affect the topics of your testimony? If you have incorporated any part of the Commission’s methodology on this issue, please state where it LR117 it appears.
- b. What is your position on the “Chown metric” from R97-1 in connection with the allocation of delivery costs?
- c. Why did you avoid the discussion of delivery costs in your testimony?
- d. Who prepared LR-117? If it was not you, who prepared it? Was it prepared under your supervision? If not, under whose supervision was LR117 prepared?

RESPONSE:

- a. My understanding is that ‘single subclass stop’ costs are city carrier access costs treated as incremental in the Postal Service’s cost methodology but included in the Commission’s “attributable” cost estimates. Since my testimony encompasses volume-variable cost analyses using the Postal Service’s volume-variable cost methodology, I do not use single-subclass stop costs.
- b. I assume that by the “Chown metric” you mean witness Chown’s proposed “weighted attributable cost” method (which was not accepted by the Commission in Docket No. R97-1). My opinion is that witness Chown’s

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“weighted attributable cost” involves an economically arbitrary (non-causal) mechanistic method for distributing the Postal Service’s “institutional” costs to products, and that it is therefore irrelevant to the volume-variable cost analyses I present in LR-117.

- c. The cited portion of my testimony does not describe any new methodology for carrier (i.e., “delivery”) costs, but simply sponsors the update of a previous analysis that de-averaged the Postal Service’s volume-variable cost estimates by subclass to finer categories than are reported in the Cost and Revenue Analysis (CRA), which is well documented in the this case. Thus, I do not “avoid” the discussion of delivery costs in any material way, but rather have avoided clogging up the record with repetitious documentation.
- d. USPS-LR-J-117 was prepared under my supervision.

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ABA&NAPM/USPS-T43-2 Why, in your opinion, is there a great deal of testimony, work papers and library references presented on mail processing and so little presented on delivery costs?

RESPONSE:

It is my understanding that both mail processing and city carrier costs have been the subject of extensive testimony and documentation in the last several rate cases.

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ABA&NAPM/USPS-T43-3 You assert in your testimony at line 9, page ii, that you have had experience with "cost models of mail processing".

- a. Can most mail processing costs be attributed by class and subclass?
- b. Have most mail processing costs in the Postal Service request been attributed by class or subclass?
- c. In an automated mail processing system, where several different classes/subclasses of mail are intermingled as they are run on mail processing equipment, do you believe that it is easy to attribute costs as in a manual or mechanized environment for which the IOCS tally method was designed?
- d. At what point in the analysis of costs does work activity including machine time and space time cease to be defined as mail processing costs and begin to be defined as delivery costs. Please give complete and full details in your answer.
- e. Has this demarcation line changed with the advent of automation? For example, were DPS activities now attributed to mail processing once part of the manual activity of carriers and attributed to CRA cost segments 7 and 10?
- f. Is there any part of cost segment 3.1 in the final preparation of mail for delivery that was formerly activity conducted by carriers?
- g. Do carriers spend more time on mail processing docks under automation than they used to before automation?
- h. If your answer to g. is in the affirmative, please explain fully why carriers have to spend more time on the docks and less time on the streets actually delivering mail.

RESPONSE:

- a. Mail processing costs can be distributed to class and subclass as volume-variable costs to the degree that they are volume-variable. If the degree of volume-variability is greater than 50 percent, then a majority of (i.e., "most") mail processing costs can be distributed as volume-variable costs.

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- b. It is my understanding that a majority of total Cost Segment 3.1 costs are classified as volume-variable in the Postal Service's cost methodology.
- c. It is my understanding that IOCS data collection methods have evolved to provide sufficient, reliable data for the distribution of mail processing volume-variable costs in automated operations.
- d. The Postal Service's costs analysis defines the mail processing cost component (cost segment 3.1) as clerk and mailhandler labor in processing and distribution, allied labor, and support activities. Please see witness Van-Ty-Smith's testimony, USPS-T-13, and USPS-LR-J-55, Section I for details.
- e. It is my understanding that the "demarcation line" has not changed with the advent of automation *per se*, but rather with the subsequent introduction of automated delivery point sequencing (DPS) of letter mail. Note that the manual sorting of mail to delivery point sequence by city carriers would be classified as part of costs segment 6 (city carriers, in-office), not cost segment 7 (city carriers, street activity).
- f. Redirected to the Postal Service.
- g. Redirected to the Postal Service.
- h. Redirected to the Postal Service.

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ABA&NAPM/USPS-T43-4

- a. Explain the distribution keys used for all portions of FCM and Standard A mail delivery costs that are attributed, e.g. per piece for cost segment "x.z" or per weight increment for cost segment "a.c".
- b. What is your expert opinion as to why so few delivery costs are attributed while so many mail processing costs are?
- c. Before the advent of large volumes of advertising and catalogue mail into the Postal Service, did First Class Mail pay for almost all the total costs of the universal delivery system of the Postal Service?
- d. Do you have knowledge of how Standard A mail (old Third Class classification) was first priced when it became a major mailstream within the Postal Service? Specifically, whether it paid any portion of delivery costs at all and if so how much? Can you cite where this data can be found?

RESPONSE:

- a. Please see USPS-LR-J-1, and witness Meehan's B workpapers, provided in LR-J-57.
- b. I have not studied the issue and therefore, I have no expert opinion on the matter.
- c. This question is beyond the scope of my testimony.
- d. No.

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ABA&NAPM/USPS-T43-5. Consider the following hypothetical. An existing product pays for all postal delivery costs, and there is extra capacity available given the universal service statutory requirement wherein even a one letter per week household receives the same services as a fifty letter per week household. A new product becomes available and the Postal Service prices it strictly at short run marginal cost in order to attract the business. Delivery costs, already paid for by the older product, do not figure into the calculation of that short run marginal cost.

- a. Would such pricing for the new product be efficient? Would it be fair?
- b. If the product in a. were an equally mature product that had grown up side by side, year by year with the first product, would it have been efficient to price the second one at SRMC and the first one well above SRMC, *ceteris paribus*, including elasticities?
- c. If the then-new but now-mature product were priced well below its total costs, including all delivery costs, and the original product were as a result priced well above its actual total costs, including delivery costs, could this stimulate the growth of the cost-advantaged product and suppress the growth of the cost-disadvantaged product, *ceteris paribus*, including elasticity considerations?
- d. *Ceteris paribus*, if the pricing situation were reversed, could that stimulate the volume growth of the formerly cost-disadvantaged product and suppress the growth of the formerly cost advantaged product?
- e. Please confirm that efficient pricing of two mature products would not involve volume growth being artificially stimulated or suppressed by under- or over-pricing the two products under consideration, i.e. by having incorrect relative prices in the market.

RESPONSE:

- a. – e. Pricing issues are beyond the scope of my testimony.

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ABA&NAPM/USPS-T43-6 Please confirm that in a purely technical sense, it is possible to allocate all of the Postal Service's delivery costs by piece and by weight, i.e., these numbers are known or could be known by class, subclass and rate category.

RESPONSE:

Not confirmed. It is, of course, possible to allocate all delivery costs to products by whatever method as a purely mechanical exercise without any particular economic significance. However, in the "purely technical sense" of economic (causal) costs, not all delivery costs can be causally associated with classes, subclasses, and/or rate categories of mail.

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ABA&NAPM/USPS-T43-7. In your testimony at page 10, lines 16 and 17, you state that you have adopted the "same" "methodology" for the estimation of delivery costs as used by USPS witness Sharon Daniel in R2000-1.

- a. Please explain fully for each column in USPS LR-J-117, e.g. "6.1", "6.2" etc., BY and TY cost sheets for FCM letters, exactly what that methodology is?
- b. Did you accept the methodology after independently evaluating it, or did you evaluate it at all?
- c. Were you asked to evaluate the Postal Service's methodology for examining delivery costs?
- d. Did you ask the Postal Service whether you could independently evaluate the pre-packaged delivery cost methodology that was handed to you?

RESPONSE:

Actually, I state in my testimony, page 10, lines 17 and 18 (USPS-T-43 revised) that "The methodology used in this library reference is the same as that described in witness Daniel's testimony." Nowhere in my testimony do I state that I "adopt" the methodology.

- a. The methodology used to deaverage volume variable carrier costs as shown in USPS-LR-J-117.xls is fully described in the formulae in the workbook. For BY cost segment 6.1, costs for First-Class single piece, First-Class Presort and Standard flats and letters, and Standard ECR are deaveraged using the LIOCATT method, while for First-Class Presort letters deaveraged costs are developed by taking the weighted average of DPS and non-DPS costs, with weights equal to the estimated percentage of DPS and non-DPS letters in each modeled category. Cost segment 6.2 costs are distributed to modeled category

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by using the relevant ratio for cost segment 6.1 costs. Cost segment 7.1 and 7.2 costs are each distributed to modeled category by using the relevant volume ratio. Cost segment 7.3 costs are distributed to modeled category by using the relevant load key. Cost segment 7.4 costs are distributed to modeled category by using the relevant ratio of total 6.1 – 7.4 costs. Cost segment 10 costs are distributed to modeled category by using the relevant rural key. TY costs are estimated using the same methodology for all categories except cost segment 6.1 First-Class single piece costs, which are distributed to modeled category by using the relevant ratio of BY segment 6.1 costs.

b. – d. My assignment was to update a methodology that had been presented in Docket R2000-1. In doing so I reviewed witness Daniel's methodology. It appears to be a reasonable methodology for de-averaging carrier costs below the CRA subclass level.

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ABA&NAPM/USPS-T43-8. With reference to your base year or test year spread sheets by CRA delivery cost segment, please explain:

- a. The methodology for each piggyback in the "total piggybacked" column, including exactly what costs are piggybacked by rate category.
- b. What "adjusted" means in the column labeled "Adj TY Volume", by rate category unless the adjustment is identical in content across all rate categories.

RESPONSE:

- a. The calculations in the "total piggybacked" column multiply the estimated Test Year city carrier labor costs (cost segments 6 and 7) and the estimated Test Year rural carrier costs (cost segment 10) by the corresponding (subclass-specific) piggyback factor, developed by witness Smith. Generically, "piggybacked" costs include "overhead" costs causally related to carrier labor, including supervision, administrative expenses, carrier facilities, carrier vehicles, supplies, etc. See also witness Smith's testimony, USPS-T-15, at 16-19, and USPS-LR-J-1.
- b. The referenced column does not involve an adjustment as such, but rather a distribution of Test Year volumes by subclass to the detailed mail categories.

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ABA&NAPM/USPS-T43-9. In your BY spreadsheets, you show that cost segment 7.1 (city carrier route costs) is distributed by volume.

- a. Please confirm using the audited 2000 CRA that only \$110 million of C. S. 7.1 are distributed across classes by volume, while \$2.7 billion of those costs are not distributed across classes and subclasses at all.
- b. Please provide the calculations distributing all 7.1 costs by volume across classes and subclasses.
- c. Please do the same for cost segment 7.2.

RESPONSE:

- a. Partially confirmed. According to witness Meehan's exhibit USPS-11A, cost segment 7.1 volume-variable costs are \$110.366 million, and other (non-volume-variable) cost segment 7.1 costs are \$2,695.645 million. Since these "other" costs are non-volume variable costs, they are not distributed to classes and subclasses as volume-variable costs.
- b. The calculation you describe would, presumably, assign the \$2,806.011 million in total cost segment 7.1 costs to classes and subclasses in proportion to the volume shares by class and subclass—i.e., the calculations would have the form $(C/S\ 7.1\ Total\ Cost) \times (Volume\ of\ Subclass\ j) \div (Total\ Volume)$. Since the "other" costs in the C/S 7.1 total are non-volume-variable, this mechanical cost distribution exercise is meaningless from the standpoint of economic (causal) costing principles. See also the response to ABA&NAPM/USPS-T43-1(b) and ABA&NAPM/USPS-T43-6.
- c. See the response to part b.

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ABA/NAPM-USPS-T43-10

- a. Please list and explain the entire “rural key” that is referenced in your spreadsheets.
- b. Why shouldn't the rural allocation of delivery costs be based, e.g., on the same method used for 7.1 and 7.2, namely volume?
- c. Why are a higher percentage of rural carrier costs declared as volume variable than city carrier costs?

RESPONSE:

- a. See workbook LR-J-117.xls, sheet 'Rural Crosswalk,' range A42:F52. The “rural key” is a distribution key used to distribute rural carrier costs from CRA subclass categories to shape. In the CRA, rural carrier costs are developed by rural carrier compensation categories (that do not necessarily correspond to a single shape as defined in DMM C050) and subclass. The “rural key” is developed by cross-walking the rural carrier costs by subclass and compensation category to subclass and shape.
- b. Rural carriers and city carriers are compensated according to different systems that are differentially affected by mail volumes and other cost-causing factors. See USPS-LR-J-1, pages 10-1 to 10-4.
- c. According to witness Meehan's Exhibit USPS-11A, city carrier (cost segments 6 and 7) volume-variable costs are 47.4 percent of total city carrier costs (6,229,387/13,139,989), whereas rural carrier (cost segment 10) volume-variable costs are 43.9 percent of total rural carrier costs. Thus, it is actually the case that

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the percentage of volume-variable costs is higher for city carriers than for rural carriers, contrary to the statement of the interrogatory.

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NAPM/USPS-T43-11 In the allocation of rural volume variable cost as between FCM and Standard Mail for C.S. 10.1, Standard mail delivery costs are 55% greater, whereas under city carrier costs, C.S. 7, Standard mail volume variable delivery costs are slightly under corresponding FCM mail costs.

- a. Why is the percentage of the volume variable costs as between rural and city carrier activities so different?
- b. Since most C.S. 7 costs are "declared" to be institutional rather than volume variable, please confirm that the allocation of these supposed non-volume variable, non-allocable costs is based on relative cost coverages as between Standard and FCM especially, and among classes general.
- c. Why is the percentage of allocable delivery costs as between rural and city carrier activities so different?

RESPONSE:

I note that the comparison in the preamble to the interrogatory appears not to be between "corresponding" categories of First-Class Mail and Standard Mail, but rather between total First-Class Mail and total Standard Mail costs for the given cost segments (i.e., total Standard Mail volume-variable costs are 90.6 percent of total First-Class Mail volume-variable costs in Cost Segment 7, whereas total Standard Mail volume-variable costs are 153.4 percent of total First-Class Mail volume-variable costs in cost segment 10.1, according to USPS-T-11, Exhibit USPS-11A).

- a. Please see the response to ABA&NAPM/USPS-10(c). For a description of the Postal Service's costing methodologies for cost segments 7 and 10, please see also USPS-LR-J-1, at, respectively, pages 7-1 to 7-10, and pages 10-1 to 10-4.

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b. USPS-LR-J-117 provides the analysis used to de-average volume-variable carrier costs by subclass to finer categories than are reported in the CRA.

Therefore this part is beyond the scope of my testimony.

c. Please see the response to part a, above.

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ABA&NAPM/USPS-T43-12

- a. Please state where in your TY spreadsheets you used the "Mix TY Piggys" referenced on page 2.
- b. Please explain what you mean by "discount" in the set of TY rural and city Piggys labeled "Discount TY Piggys".

RESPONSE:

- a. The "Mix TY Piggys" are not used in the LR-J-117 calculations.
- b. The term "discount" has no significance other than to distinguish the piggyback factors used in the LR-J-117 calculations from the "Mix TY Piggys." The referenced set of piggyback factors is described in witness Smith's testimony, USPS-T-15, at 18-19.

DECLARATION

I, Leslie M. Schenk, declare under penalty of perjury that the foregoing answers are true and correct, to the best of my knowledge, information, and belief.

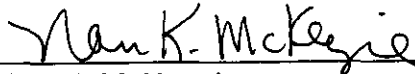


Leslie M. Schenk

Dated: 12/6/01

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.


Nan K. McKenzie

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December 6, 2001