

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 KIEFER TO INTERROGATORIES OF
UNITED PARCEL SERVICE
(UPS/USPS-T33-21-23, 27-31, 33-35(b), 35(e)-43)

The United States Postal Service hereby files the response of witness Kiefer to the following interrogatories of United Parcel Service: UPS/USPS-T33-21-23, 27-31, filed on December 7, and UPS/USPS-T33-33-35(b), 35(e)-43, filed on December 10, 2001. Interrogatories UPS/USPS-T33-35(c) and (d) were redirected to witness Eggleston and interrogatories UPS/USPS-T33-24, 25, 26, and 32 were 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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UPS/USPS-T33-21. Refer to Witness Eggleston's response to UPS/USPS-T25- 3(d), and workpapers WP-PP-22, WP-PP-24, and WP-PP-26 from library reference USPS-LR-J-106. Confirm that the preliminary rates (exclusive of the weight-related and delivery confirmation components) for intra-BMC parcels and DBMC entry parcels do not take into account the difference in the average cubic feet per piece between intra-BMC and DBMC parcels. If confirmed, explain why not. If not confirmed, explain.

RESPONSE

Not confirmed. The Parcel Post preliminary rates take into account the differences in cubic feet per piece in the transportation component of the rates (in addition to the weight-related mail processing component cited in the question). My preliminary rates for intra-BMC parcels and DBMC parcels do not take differences in the average cubic feet per piece between these two rate categories into account for the per-piece component of the rate since I have no cost information that specifies what, if any, non-weight-related mail processing and delivery cost differences can be attributed to differences in the average cubic feet per piece.

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UPS/USPS-T33-22. Assume the following:

- The parcel subclass is comprised of an equal number of intra-BMC (Bulk Mail Center) parcels and Destination Bulk Mail Center ("DBMC") parcels (these are the only two rate categories).
 - The average intra-BMC parcel has fewer cubic feet per piece than the average parcel subclass parcel.
 - The average DBMC parcel has more cubic feet per piece than the average parcel subclass parcel.
 - Worksharing models, after tying to Test Year Cost and Revenue Analysis (CRA) costs, show that the mail processing costs are \$1.00 for intra-BMC parcels and \$0.50 for DBMC parcels if the parcels have the same cubic feet per piece as the average parcel subclass parcel, yielding a worksharing savings of \$0.50.
 - Worksharing models, after tying to Test Year CRA costs, show that the mail processing costs for intra-BMC parcels are \$0.90 for average intra-BMC pieces (because more of these parcels fit in the average container than do average parcel subclass parcels) and \$0.60 for average DBMC parcels (because fewer of these parcels fit in the average container than do average parcel subclass parcels).
 - Parcel rates are set to exactly recover costs, mail processing costs are the only costs incurred by these parcels, and Test Year CRA mail processing costs are \$0.75 on average for parcels.
 - The rate for intra-BMC is set at \$1.00 and, using the calculated worksharing savings of \$0.50, the rate for DBMC is set at \$0.50, yielding \$0.75 on average in revenue for parcel subclass parcels.
- (a) Confirm that in this example the rate for DBMC parcels will not cover the average cost for DBMC parcels of \$0.60. If not confirmed, explain.
- (b) Confirm that in this example, the rate for intra-BMC parcels will cover more than the average cost for intra-BMC parcels of \$0.90. If not confirmed, explain.
- (c) Do you believe that it is appropriate in this example for DBMC parcels to not cover their average costs? Explain in detail.
- (d) Do you believe it is ever appropriate for DBMC parcels to not recover their average costs? Explain in detail.
- (e) Given this example, where would you set the rates for intra-BMC and DBMC parcels?

RESPONSE

- (a) I can confirm the arithmetic. If, using your example, the average cost of DBMC parcels is \$0.60 and the rate is set at \$0.50, the rate will not cover the average cost of \$0.60.

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- (b) I can confirm the arithmetic. If the average cost of Intra-BMC parcels is \$0.90 and the rate is set at \$1.00, using your example, the rate will cover more than the average cost of \$0.90.
- (c) The hypothetical model described in this example is so grossly oversimplified and unrealistic that using it to investigate what is and is not "appropriate" practice in postal ratemaking is impossible. This hypothetical model discards so many of the real issues that must be confronted in setting rates in the real world that I am *unable to determine what principles are left to judge whether any particular practice is "appropriate" or not.*
- (d) DBMC parcels differ by, among other things, weight, dimension, destination and entry point, all factors that affect costs. The rates for DBMC parcels are set primarily by zone and weight. Since the rates are not de-averaged by every factor that affects costs, it is likely, and expected, that some DBMC parcels will pay rates that do not recover "average costs," depending on how costs are averaged, and that some will pay rates that recover more than these "average costs." I do not find it inappropriate that some DBMC parcels may pay rates that may not recover some abstractly defined "average costs." The same can be said for other Parcel Post rates and rates for other classifications. I am not aware of a *rationale that DBMC should be singled out for such specialized treatment.*
- (e) See my response to (c).

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UPS/USPS-T33-23. Refer to Witness Eggleston's response to UPS/USPS-T25- 3(e), and workpapers WP-PP-8, WP-PP-14 and WP-PP-15 from library reference USPS-LR-J-106.

- (a) Confirm that in the Parcel Post rate design an average cubic foot per piece for each weight increment from 1 pound to 70 pounds is derived separately for inter-BMC (Bulk Mail Center), intra-BMC, and Parcel Select parcels. If not confirmed, explain.
- (b) Confirm that the separate cubic feet per piece for inter-BMC, intra-BMC, and Parcel Select parcels for each weight increment from 1 to 70 pounds is then multiplied by the transportation cost per cubic foot by rate category to calculate the transportation cost for each rate category by weight and zone. If not confirmed, explain in detail.
- (c) Confirm that this means that in the Parcel Post rate design, the difference in transportation costs between the inter-BMC, intra-BMC, and Parcel Select rate categories takes into account the difference in average cubic feet per piece between the rate categories. If not confirmed, explain.
- (d) Explain why it is appropriate in the Parcel Post rate design to take into account average cubic feet per piece differences between non-Parcel Select and Parcel Select parcels with respect to transportation costs but not for mail processing costs.

RESPONSE

- (a) *Confirmed.*
- (b) Not confirmed. The cubic feet per piece numbers from workpaper WP-PP-8 are multiplied by the transportation costs per cubic foot by rate category and zone to calculate the transportation cost numbers in workpaper WP-PP-15.
- (c) It can be confirmed that in my rate design, the transportation cost estimates between the Parcel Post rate categories take into account the differences between the cubic feet per piece between the rate categories within each weight level.
- (d) Witness Eggleston's responses to UPS/USPS-T25-3(d) and 3(e) describe how she took average cubic feet per piece differences into account in her transportation cost methodology and not in her mail processing cost methodology, and why it was appropriate to use these different approaches in the two cases. Given that her costing approaches were appropriate, it is appropriate for me to use her cost estimates, and to use them in my rate design in a manner that is consistent with the way they were derived.

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UPS/USPS-T33-27. Refer to your response to interrogatory UPS/USPS-T33-16(b), regarding migration of Priority Mail to DDU-entry Parcel Post. Confirm that, assuming a 100% passthrough of worksharing savings, the contribution per piece embodied in the preliminary rates for workshared categories of Parcel Post should be the same as that embodied in the preliminary rates of the non-workshared categories from which the workshared categories' preliminary rates are derived. If not confirmed, explain in detail.

RESPONSE

While this proposition can probably be confirmed for the per-piece components of the rates, I do not believe it can be confirmed for the per-pound components. The per-pound components *incorporate separately derived transportation costs for the so-called workshared and non-workshared components*. These costs were distributed to weight cells based on cube-weight profiles that differ between the workshared rate categories and the non-workshared categories. Accepting, for the sake of argument, that workshared parcel transportation cost "savings" were known and available, I think that the different cube-weight profiles, at least, would be sufficient to lead to different contributions per piece between workshared and non-workshared categories. Given that there are significant differences between the per-pound costs of DDU Parcel Post and retail, or "non-workshared" Parcel Post, I believe that the approach I have adopted—marking up the transportation and weight-related non-transportation costs, when they can be separately identified and estimated—is appropriate in parcel *ratemaking*. This approach is also consistent with the way we treat other "non-workshared" parcels. For example, from a transportation standpoint, there is no logical barrier that distinguishes an Intra-BMC parcel, or even a zone-skipped Inter-BMC parcel from destination entry parcels. In each case, the Postal Service is not required to provide some transportation services. If one argues that DDU parcels are "transportation workshared" parcels, then by the same logic so are Intra-BMC and zone-skipped Inter-BMC parcels. Similarly, if we impose the requirement that both DDU parcels, which have low transportation costs and Intra-BMC parcels which have higher

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transportation costs, bear the same absolute (rather than percentage) markup, there is no logical barrier that can keep this requirement from extending also to weight differences. This could then lead to the unacceptable situation where a 70-pound Intra-BMC parcel would have the same absolute contribution as a 3-pound Intra-BMC parcel, when the heavier parcel requires significantly more transportation services from the Postal Service. The approach I used in my workpapers uses a consistent *percentage*, rather than *absolute*, markup on separately derived transportation costs. This approach will, naturally, lead to higher contributions per piece on heavier parcels within rate categories. It will also lead to higher contributions per piece on the per-pound components of parcels for which the Postal Service provides more transportation services, and lower contributions per piece for parcels, such as DDU parcels, where the Postal Service provides little, if any, transportation services. See also my response to UPS/USPS-T33-42.

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UPS/USPS-T33-28. Refer to your response to interrogatories UPS/USPS-T33- 17(d) and (h). Identify any instances in which the Commission has applied the same markup to separately derived transportation costs for non-destination entry rate categories and destination-entry rate categories other than "the procedure adopted by the Commission in its own Parcel Post workpapers in Docket No. R2000-1."

RESPONSE

I am not aware of any other instances.

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UPS/USPS-T33-29. Refer to your response to interrogatory UPS/USPS-T33- 17(d), (g) and (h). Confirm that the Postal Service's proposed Parcel Post rate design in Docket No. R97-1, in Docket No. R2000-1, and in Docket No. R2001-1 applies the same markup to separately derived transportation costs for non-destination entry rate categories and destination-entry rate categories.

RESPONSE

The Parcel Post rate design applies the same markup factor to separately derived transportation costs for destination entry and non-destination entry transportation costs in Docket No. R2001-1, Docket No. R2000-1 and for Inter-BMC, Intra-BMC and DBMC rate categories in Docket No. R97-1. Rate categories for DSCF and DDU were introduced for the first time in Docket No. R97-1.

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UPS/USPS-T33-30. Refer to your response to interrogatory UPS/USPS-T33- 17(d), (g) and (h). Provide citations to any discussion in the Commission's recommended decision in Docket No. R2000-1 regarding whether to apply the same markup or different markups to separately derived transportation costs for non-destination entry rate categories and destination-entry rate categories for Parcel Post.

RESPONSE

To my knowledge, this subject was not explicitly addressed in the Commission's Opinion and Recommended Decision in Docket No. R2000-1.

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UPS/USPS-T33-31. Refer to your response to interrogatory UPS/USPS-T33- 17(e)(ii), where you state that "Applying a 20% markup in my approach produces combined revenue of \$1.44 (\$1.20 plus \$0.24), falling short of the revenue target. A higher markup than 20% would be needed to achieve the same revenue, producing higher rate elements for both the Intra-BMC and DSCF hypothetical pieces than the rate elements cited in [the previous subpart]." Confirm that the higher markup necessary under your approach to achieve the same \$1.60 revenue target achieved in subpart (i) would be 33.33%, and that applying this 33.33% markup would yield an intra-BMC rate of \$1.333 and a DSCF rate of \$0.2667.

(a) If confirmed, explain why a rate differential of \$1.0663 is an appropriate means to reflect 80 cents of worksharing savings.

(b) If not confirmed, explain.

RESPONSE

It can be confirmed that, within the context of the hypothetical example given in question UPS/USPS-T33-17, applying the same markup of 33.33% to the costs assumed for the hypothetical Intra-BMC piece and to the costs assumed for the hypothetical DSCF piece would yield a total revenue of \$1.60 for the two pieces and rates of \$1.333 for the hypothetical Intra-BMC piece and \$0.2667 for the hypothetical DSCF piece.

(a),(b) In judging appropriateness in rate design one must take into consideration many factors. The hypothetical model of question UPS/USPS-T33-17, by apparently focusing solely on a narrow mathematical consideration, strips away all context and all other criteria that are key factors in determining what is appropriate in ratemaking. What may be an appropriate action when the full range of ratemaking factors and the full context of the action are considered, may be an inappropriate action in an unrealistic, narrow mathematical model that is shorn of the contextual factors that tie it to the real world in which the Postal Service and the Commission must make their ratemaking decisions. The reverse is also true. The hypothetical model of question UPS/USPS-T33-17 is an example of such an unrealistic model. While all models simplify to a degree, some, like the example of question 17, are inappropriately simplistic because they simplify in a way that gives a distorted view of the object they attempt to model. For example, the

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example assumes rates and the transportation cost component of rates are made in isolation, rather than as part of an integrated process. This ignores the countervailing tendencies that mitigate the impacts of any expansion of cost worksharing differences that might result from applying a markup factor to separately derived transportation cost figures. The example also assumes that the volumes of drop-shipped and non-drop-shipped Parcel Post are equal, when the reality is that approximately 85% of all Parcel Post is drop-shipped. By assuming equal volumes, this model again inappropriately distorts the impacts of marking up separately derived transportation costs. This model is based on further unrealistic and unrepresentative assumptions that magnify the impacts of any expansion of worksharing cost differences that might occur when separate transportation cost components are marked up. Such unrealistic assumptions include picking an unrealistically high markup (33.33% in the example, compared to less than 16% in my workpapers), and assuming a 5 to 1 ratio of Intra-BMC transportation costs to DSCF transportation costs, when the transportation cost ratios are much less than this. While the approach I adopted in my workpapers is appropriate within the overall context of crafting Parcel Post rates, if one is forced to abandon this context and deal solely within the mathematical context of the caricature model of UPS/USPS-T33-17, the rate differential may well be inappropriate.

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UPS/USPS-T33-33. Refer to library reference USPS-LR-J-106, WP-PP-1, line 18(a), 18(b) and 18(c), workpaper WP-PP-20, and USPS-T-25, Table X-1: Final Adjustments (\$000).

(a) Confirm that the TYBR Total Adjusted Volume Variable Cost of \$1,124,669,905 shown in workpaper WP-PP-1 is net of \$163,429 thousand of TYBR Parcel Post final adjustments. If not confirmed, explain.

(b) Confirm that the TYBR Total Purchased Transportation Costs of \$387,206,000 is not net of the \$78,379 thousand TYBR Parcel Post transportation cost final adjustment. If not confirmed, explain.

(c) Confirm that the TYBR Total Purchased Transportation Costs used in WP-PP- 1 should be net of final adjustments in order to properly derive piece-related costs in workpaper WP-PP-20. If confirmed, explain why the figure is not net of final adjustment. If not confirmed, explain in detail.

(d) Confirm that the TYBR Total Vehicle Service Driver Costs in workpaper WP-PP-1 of \$106,051,780 are not net of TYBR Parcel Post Vehicle Service Driver final adjustments of \$11,787 thousand.

(e) Confirm that the TYBR Total Vehicle Service Driver Costs in workpaper WP-PP-1 should be net of final adjustments in order to properly derive piece related costs in workpaper WP-PP-20. If confirmed, explain why the figures are not net of final adjustments. If not confirmed, explain in detail.

RESPONSE

(a) Confirmed.

(b) The TYBR Total Purchased Transportation Costs figure in WP-PP-1 is not net of any final adjustment figure.

(c),(e) Not confirmed. The Total Purchased Transportation Costs and Total Vehicle Service Driver Costs numbers I used were consistent with the values used by witness Eggleston to develop the transportation cost estimates for each of the Parcel Post rate categories. I used witness Eggleston's transportation cost estimates together with the total purchased transportation and vehicle service driver values they were developed from in my rate design model. Witness Eggleston informs me that the Parcel Post final adjustment was derived after the transportation cost figures were estimated and was based, in part, on those cost estimates, so the Parcel Post final adjustment was not known when the transportation costs were derived. I have also been informed by witness

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Patelunas that final adjustments are not distributed to cost segments in the Postal Service's rollforward costing methodology, which is the source of my Parcel Post aggregate cost data. I am not familiar with the full details of how witness Eggleston arrived at the apportionment of the Parcel Post final adjustment among the cost components shown in USPS-T-25, Table X-1, so I cannot say whether it would be appropriate to adjust Total Purchased Transportation Costs or Total Vehicle Service Driver Costs by the figures shown in her Table X-1 for use in developing rates, particularly since such "adjusted" data would be used together with witness Eggleston's transportation costs by rate category which are only consistent with the "unadjusted" Total Purchased Transportation Costs and Total Vehicle Service Driver Costs. Ideally, all necessary costing information would be known before the transportation costs were derived and both the per cubic foot transportation costs and the total purchased transportation and vehicle service driver costs used in the rate design model could reflect this costing information, obviating the need for final adjustments.

- (d) The TYBR Total Vehicle Service Driver Costs figure in WP-PP-1 is not net of any final adjustment figure.

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UPS/USPS-T33-34. Refer to library reference USPS-LR-J-106, workpaper WP-PP- 1, line 18(c).

(a) Confirm that a piggyback factor of 1.516 has been applied to the TYBR Vehicle Service Driver costs.

(b) Explain why a piggyback factor was applied to the TYBR Vehicle Service Driver costs.

(c) Explain in detail why the final adjustment piggyback factor for Vehicle Service Drivers of 1.141 (see USPS-T-15, Attachment 11) was not applied instead of 1.516.

RESPONSE

(a) Confirmed.

(b) Using piggybacked Vehicle Service Driver costs is consistent with the way witness Eggleston informs me the transportation cost estimates I used in my rate design were derived.

(c) Witness Eggleston informs me that the 1.516 value is the correct one to use, since it is the same piggyback factor she used with Vehicle Service Driver costs when she developed her transportation cost estimates for Parcel Post rate categories.

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UPS/USPS-T33-35. Refer to your response to interrogatory UPS/USPS-T33- 1(c), (f), and (i) where costs for the 3-pound Destination Delivery Unit ("DDU") destination entry parcel are referred to as "unadjusted."

(a) Are you referring only to the mail processing costs, including piggyback, for DDU destination entry pieces of 34.6 cents per piece obtained from Witness Eggleston's Parcel Post analysis contained in library reference USPS-LR-J-64, Attachment A, or are there other costs that need to be "adjusted"? If there are other costs, identify each cost that should be "adjusted".

(b) Confirm that you are referring to the final adjustment process, which in the case of Parcel Post, has been performed by Witness Eggleston, in library reference USPS LR-J-64, Attachment I. If not confirmed, explain in detail the adjustment(s) to which you are referring.

(c) Confirm that the final adjustments for Parcel Post adjust Test Year Parcel Post costs for the differing volume mix by rate category from the Base Year to the Test Year. If not confirmed, explain.

(d) Confirm that, in adjusting Parcel Post costs, the final adjustments use Witness Eggleston's Parcel Post mail processing and transportation cost estimates by rate category derived in library reference USPS-LR-J-64, Attachment A and B. If not confirmed, explain.

(e) Why will the application of final adjustments to Parcel Post overall costs impact the underlying cost by rate category of Parcel Post derived by Witness Eggleston?

RESPONSE

(a) In my response to question UPS/USPS-T33-1, my reference to unadjusted costs was designed to reflect my concern that building up a rate using unit costs that tie to individual cost pools before final adjustments would produce incorrect results. There are two reasons for this concern: first, if these unit costs were aggregated across all rate cells, they would significantly exceed total adjusted Parcel Post costs. And second, the markup used in the bottom-up process was developed with post-final adjustment costs, and would therefore be incorrect to use with unit costs that did not reflect these adjustments. It was not my intent in my response to either limit or specify which individual cost items should receive final adjustments (see my response to subpart (b), below, and to question UPS/USPS-T33-33). Rather, my response was intended to point out that final adjustments must be incorporated somewhere within the bottom-up ratemaking

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process, and must be applied in an appropriate fashion. Since I did not use the bottom-up approach in preparing my testimony and workpapers, I did not have to solve the problem of how the final adjustments should appropriately feed into unit costs for the purposes of developing Parcel Post rates using a bottom-up approach. I cannot say in detail which cost components should bear which portion, if any, of the total adjustment.

- (b) I can confirm that when I referred to Parcel Post final adjustments, I was referring to the final adjustments reported to me by witness Patelunas in the "D report" of the rollforward model. I understand that witness Eggleston developed most of the final adjustments for Parcel Post that were included in the D report.
- (c) This question has been redirected to witness Eggleston (USPS-T-25) for response.
- (d) This question has been redirected to witness Eggleston (USPS-T-25) for response.
- (e) If the "underlying cost by rate category of Parcel Post derived by Witness Eggleston" refers to the transportation costs for each Parcel Post rate category estimated by witness Eggleston and supplied to me, then application of final adjustments will not affect those cost estimates, since they tie to the cost pool numbers before final adjustments. Witness Eggleston also supplied me with a number of estimated cost differences between workshared and non-workshared Parcel Post, which I used in my rate design. The final adjustments would not affect these cost differences.

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UPS/USPS-T33-36. Refer to your response to interrogatory UPS/USPS-T33- 1(g) and to workpapers WP-PP-20 and WP-PP-1 from library reference USPS-LR-J-106. Confirm that the mark-up included in the per piece component of your preliminary Parcel Post rates, including that applicable to Destination Delivery Unit ("DDU") destination-entry parcels, is $\$564,137,378 \times (1.03) \times (15.26\%) / 405,633,782$ pieces, or 21.9 cents per piece. If not confirmed, explain in detail.

RESPONSE

The markup factor applied to the per-piece costs plus contingency produces an average "preliminary per piece markup" of 21.9 cents per piece.

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UPS/USPS-T33-37. Refer to your response to interrogatory UPS/USPS-T33- 1(e) and to workpaper WP-PP-20 from library reference USPS-LR-J-106. Confirm that the delivery confirmation cost assessed to each Parcel Select piece, including Destination Delivery Unit ("DDU") destination-entry parcels, in deriving preliminary rates is 3.8 cents per piece (including contingency and the markup used to derive preliminary rates). If not confirmed, explain in detail.

RESPONSE

Confirmed.

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UPS/USPS-T33-38. Refer to your response to interrogatory UPS/USPS-T33-1(f) regarding the per piece costs used in the calculation of the cost of a 3-pound Destination Delivery Unit (“DDU”) destination entry piece not being adjusted to “remove weight-related non-transportation costs.”

(a) Confirm that, in your Parcel Post rate design, weight-related non-transportation costs are removed from the per piece charges and replaced by weight-related non-transportation costs included in the per pound charges. If not confirmed, explain.

(b) Refer to workpaper WP-PP-20 from library reference USPS-LR-J-106. Confirm that the weight-related non-transportation costs removed from the per piece charges in your Parcel Post rate design is 12.1 cents (obtained by dividing \$49,060,830 of weight-related non-transportation costs by the number of TYBR pieces of 405,633,782), excluding contingency. If not confirmed, explain.

(c) Refer to workpaper WP-PP-16, from library reference USPS-LR-J-106. Confirm that the weight-related non-transportation cost for a 3-pound DDU destination entry parcel applied in your Parcel Post rate design is 6.9 cents per piece, excluding contingency. If not confirmed, explain.

(d) Confirm that in your Parcel Post rate design the costs applied to a 3- pound DDU parcel in deriving preliminary rates is reduced by 5.2 cents (12.1 cents minus 6.9 cents), excluding contingency, by application of the weight-related non-transportation cost calculation. If not confirmed, explain.

RESPONSE

(a) Confirmed.

(b) The amount of weight-related non-transportation costs, excluding contingency, subtracted from the total costs allocated to the per-piece element when divided by the total number of pieces is 12.1 cents.

(c) Confirmed.

(d) Not confirmed. There is no cost reduction. Weight-related non-transportation costs, as well as transportation costs are removed from total costs. The remaining costs are then recovered in the per-piece rate elements and the weight-related non-transportation costs and transportation costs are recovered in the per-pound rate elements. Weight-related non-transportation costs are apportioned to all Parcel Post rate categories based on their cube-weight relationships as recommended by the Commission in Docket No. R2000-1. Referring to this apportionment as a “cost reduction” is erroneous and is

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analogous to referring to a tax refund that I might receive because too much money was withheld from my paycheck as a "tax reduction."

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UPS/USPS-T33-39. Refer to your response to interrogatory UPS/USPS-T33- 1(f). Confirm that, prior to any potential "adjustment" to the 34.6 cent mail processing cost for Destination Delivery Unit ("DDU") destination-entry parcels:

- (a) The total of city and rural carrier, mail processing, and transportation costs for a 3-pound DDU destination entry piece is 78.5 cents ($37.7 + 34.6 + 6.2$) per piece (excluding contingency). If not confirmed, explain.
- (b) Accepting the need to adjust non-transportation costs for weight would reduce the cost of 78.5 cents per piece cost by 5.2 cents per piece (excluding contingency) for a 3-pound DDU parcel. If not confirmed, explain.
- (c) This yields a cost for a 3-pound DDU destination entry piece of 73.3 cents per piece ($78.5 - 5.2$) excluding contingency, and 75.5 cents per piece with a 3.0% contingency applied. If not confirmed, explain in detail.
- (d) Adding to this total the delivery confirmation charges (including markup and contingency) of 3.8 cents per piece, the per piece markup used in deriving preliminary rates of 21.9 cents per piece, and the per pound markup used in deriving preliminary rates of 2.2 cents per piece, yields a total cost, including the markup used in deriving preliminary rates, for a 3-pound DDU destination entry piece of \$1.03.4. If not confirmed, explain.

RESPONSE

- (a) The reservations expressed in my responses to UPS/USPS-T33-1 still apply. If the cost components are understood as unadjusted costs, the proposition can be mathematically confirmed.
- (b) The reservations expressed in my responses to UPS/USPS-T33-1 still apply. If the cost components are understood as unadjusted costs, the proposition can be mathematically confirmed.
- (c) The reservations expressed in my responses to UPS/USPS-T33-1 still apply. If the cost components are understood as unadjusted costs, the proposition can be mathematically confirmed.
- (d) The reservations expressed in my responses to UPS/USPS-T33-1 still apply. If the cost components are understood as unadjusted costs, the proposition can be mathematically confirmed.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIEFER TO
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UPS/USPS-T33-40. Refer to your response to interrogatory UPS/USPS-T33-1(i) regarding taking "into account the impacts of revenue offsets, such as from surcharges," in deriving the cost plus markup of a 3-pound Destination Delivery Unit ("DDU") destination entry piece.

(a) Confirm that preliminary rate markups per piece are used both in the bottom-up calculation in interrogatory UPS/USPS-T33-1 of the cost, plus markup, of a 3-pound DDU destination entry piece and the preliminary rate you derive for a 3-pound DDU destination entry piece. If not confirmed, explain.

(b) Explain why a bottom-up cost analysis that applies the same markup as used in preliminary rates needs to take into account the impact of revenue offsets when the results of the bottom-up cost analysis is being compared to the preliminary rate.

RESPONSE

- (a) It can be confirmed that both procedures use markup factors. The term "preliminary rate markups" is not one that I have used in my testimony. If it refers to the Cost Coverage Markup Factor that I used in my Parcel Post workpapers, I can confirm that both my preliminary rate calculation and the bottom-up calculation referred to in this question use this factor.
- (b) To the extent that the same markup factor is applied to the same set of costs, the same revenue apparently should be generated. With this understanding in mind, the revenue offsets, such as from surcharges, only serve to reduce the overall revenue target, and so they should not need to be taken into account when my approach is being compared to a bottom-up approach. My response to UPS/USPS-T33-1(i) should be revised to reflect this understanding.

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UPS/USPS-T33-41. Refer to your response to interrogatory UPS/USPS-T33- 1(i). Confirm that, in your Parcel Post rate design, in the absence of rate change constraints, preliminary Parcel Post rates will equal final Parcel Post rates. If not confirmed, explain in detail.

RESPONSE

Not confirmed. In developing the rates the Postal Service proposes to the Postal Rate Commission, my preliminary rates serve as only a starting point. How the rates change from their current values is certainly an important consideration, but it is by no means the only issue considered when developing the proposed rates. My testimony and workpapers show that other factors such as the relationship of Intra-BMC rates to DBMC rates, and the relationship of Intra-BMC and Inter-BMC rates to Priority Mail rates also impose constraints on the final rates proposed. If it were the case, which it is not, that the preliminary rates were in complete accord with all Postal Service ratemaking goals, it is then likely that the preliminary Parcel Post rates would be those recommended to the Commission.

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UPS/USPS-T33-42. Refer to your response to interrogatory UPS/USPS-T33- 1(h)(iii) and workpaper WP-PP-21, from library reference USPS-LR-J-106.

(a) Confirm that intra-BMC (Bulk Mail Center) Zone 1 through 5 pieces 3- pound pieces have a per pound charge of \$1.5825 per piece applied in deriving preliminary rates. If not confirmed, explain.

(b) Confirm that the preliminary rate markup (using the markup factor of 15.26%) embodied in this per pound charge for a 3-pound intra-BMC Zone 1 through 5 piece is 21.0 cents. If not confirmed, explain.

(c) Explain why the preliminary rate markup in the per pound charge for a 3- pound piece should be 21.0 cents for an intra-BMC piece, but only 2.2 cents for a Destination Delivery Unit ("DDU") destination entry piece when DDU destination entry is a workshared rate category.

RESPONSE

(a) Confirmed.

(b) Confirmed.

(c) When the markup factor is applied to separately derived transportation costs those rate categories with higher per pound costs (such as Intra-BMC and Inter-BMC) experience a greater "preliminary rate markup" than those categories (such as DDU) that impose less per-pound costs on the Postal Service. It should be remembered that this so-called "preliminary rate markup" on the per-pound component of the preliminary rates represents only one portion of the total "preliminary markup" associated with any particular rate cell. It should also be noted that the preliminary rates are just the starting point for developing the final rates (see my response to UPS/USPS-T33-41), and that these rates undergo significant adjustments before they become the final rates that the Postal Service proposes to the Postal Rate Commission. These adjustments have significant impact on the real "markup," or contribution, associated with individual rate cells. Furthermore, for the reasons discussed in my response to UPS/USPS-T33-27, calling DDU mail a workshared category for transportation cost purposes can be misleading and lead to artificial distinctions and ratemaking practices that are

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIEFER TO
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inappropriate, since there are no logical distinctions between the "transportation worksharing" involved in destination entry and in, for example, zone skipping. Moreover, as explained in my response to question 27, once one accepts the argument that transportation costs should bear the same absolute markup, there is no logical barrier to extending this requirement to all zones and weights, a wholly undesirable result. Finally, if a 3-pound DDU parcel were to have the same 21.0 cent markup on its per-pound component as a 3-pound Intra-BMC parcel, the transportation component of the DDU piece would bear a markup that far exceeds 300%. I fail to see why it is reasonable to impose this kind of markup on DDU parcels' transportation costs.

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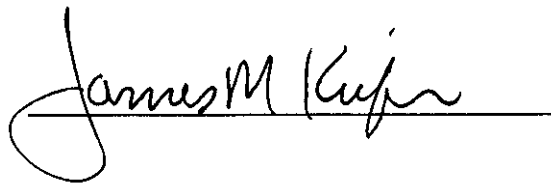
UPS/USPS-T33-43. Refer to Witness Eggleston's response to UPS/USPS-T25- 26 regarding the uncertainty associated with the cube and the corresponding costs for 1-pound Parcel Post parcels (e.g., extremely light parcels cannot be sorted using a parcels sorting machine). Given this uncertainty, why is it appropriate for there to be a different rate for 1 and 2 pound Parcel Post pieces?

RESPONSE

The way I read witness Eggleston's response, it is an attempt to reply accurately to an overly broad inquiry. While she does discuss how it is possible that smaller parcels might cost more to sort than slightly heavier parcels (since the smallest parcels might not be machinable), I do not read her discussion as a statement that she believes that, on average, Parcel Post parcels paying the one-pound rate will incur either significantly higher or significantly lower mail processing costs than parcels that weigh up to two pounds. Any lack of universal certainty that may exist regarding the exact cost of processing parcels weighing under one pound appear to be within the range of uncertainty that the Postal Service faces all the time when making rates. This lack of total certainty does not raise sufficient concern to argue against offering our customers the benefits of a separate rate for parcels weighing less than one pound. Such lack of universal certainty could exist for various weight increments for various classes. Given the Commission's obvious interest in seeing a separate rate, if possible, for these parcels, and the fact that two-pound parcels cost more to transport than one-pound parcels, I believe a much more compelling reason than the aforementioned "uncertainties" would have to emerge to deny our customers the benefits of a one-pound rate.

DECLARATION

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

A handwritten signature in cursive script that reads "James M. Kiefer". The signature is written over a solid horizontal line.

Dated: 12-21-01

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.



Scott L. Reiter

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
December 21, 2001