

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

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POSTAL RATE COMMISSION
OFFICE OF THE COMMISSIONER

POSTAL RATE AND FEE CHANGES, 2001

Docket No. R2001-1

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS SCHERER TO INTERROGATORIES OF
THE OFFICE OF THE CONSUMER ADVOCATE
(OCA/USPS-T30-12-16, 19(d)-(h) and 20(b)-(c))

The United States Postal Service hereby provides the response of witness Scherer to the following interrogatories of the Office of the Consumer Advocate: OCA/USPS-T30-12-16, 19(d)-(h) and 20(b)-(c), filed on December 10, 2001. Interrogatories OCA/USPS-T30-17, 18, 19(a)-(c), 20(a) and 21 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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RESPONSE OF POSTAL SERVICE WITNESS SCHERER
TO OCA INTERROGATORIES

OCA/USPS-T30-12. The following refers to Attachment C page 3, column (c) of your testimony. Please explain the full rationale and derivation for each of the various percentages shown when determining the migration of volumes from 2-pound rates to flat rates for the TYAR. Explicitly state all assumptions made and all sources relied upon. (Give citations to sources used, and copies if these sources are not on file with the Commission).

RESPONSE:

No sources could be relied upon for the percentages in Attachment C, page 3, column (c) because there is no precedent for a Priority Mail migration from 2 pounds to the flat-rate envelope pursuant to detaching the flat rate from the two-pound rate and attaching it to a lower one-pound rate.

Rather, I could only "posit" the migration factors shown in that column (c). This was acknowledged at page 24, line 9 of my testimony. In addition, the footnote to column (c) in Attachment C, page 3 makes clear that the percentages follow from assumptions. Those assumptions were outlined in my testimony from page 23, line 10 to page 24, line 7.

**RESPONSE OF POSTAL SERVICE WITNESS SCHERER
TO OCA INTERROGATORIES**

OCA/USPS-T30-13. The following refers to Attachment B pages 4 and 5, and Attachment C pages 6 and 7 of your testimony. For the following weight increments: flat rate, 1 pound and 2 pounds, you calculate the average weight of a Priority Mail piece. However, you do not treat weight increments greater than 2 pounds similarly. For example, consider the 3-pound Priority Mail weight category. An average weight for Priority Mail Pieces weighing between 2 to 3 pounds is not calculated.

(a) Please explain fully the reasons for determining differently the "average weights" of the flat rate, 1 pound and 2 pound Priority Mail pieces on the one hand, and all other weight increments up to and including the 70 pound maximum on the other.

(b) For weight increments 3 to 5 pounds, which represents approximately 20 percent of the GFY 2000 volumes(244,438,319 /1,222,454,421), please explain why you did not calculate and use an average weight of a Priority Mail piece in the costing of the 3, 4 and 5 pound weight increments.

RESPONSE:

(a) I followed Postal Rate Commission and Postal Service precedent.

(b) I followed Postal Rate Commission and Postal Service precedent.

RESPONSE OF POSTAL SERVICE WITNESS SCHERER
TO OCA INTERROGATORIES

OCA/USPS-T30-14. Please refer to USPS-T-30 at 5, l. 4-9. Please provide Priority Mail's lower market share (Zones 1-4) when ground services such as UPS Ground are considered.

RESPONSE:

This market share calculation is not available. The Colography Group, Inc. has traditionally supplied the Postal Service with share information for separate air and ground transportation markets. See, for example, the "Domestic Quarterly Market Growth and Competitor Share Reports" in USPS-LR-J-201. Recalculating market shares based largely on service standard rather than mode of transportation would require a market research study.

RESPONSE OF POSTAL SERVICE WITNESS SCHERER
TO OCA INTERROGATORIES

OCA/USPS-T30-15. Please refer to USPS-T-30 at 15, I. 18-19. What is the reason for the anomaly described?

RESPONSE:

In Attachment E, page 3, column (j), the total cost per pound is understated for Zone 7 in relation to Zones 6 and 8 because of differences in the distributions of total postage pounds by zone and total pounds flown by zone in the TYBR. Total TYBR postage pounds – shown at the bottom of Attachment B, page 5 – are calculated as TYBR volume (Attachment B, page 3) times average weight per piece (Attachment B, page 4). Total TYBR volume, in turn, was forecast by Witness Musgrave (USPS-LR-J-28. Section C1, page 12), with the distribution by weight increment and zone following from the GFY 2000 Billing Determinants.

Total pounds flown by zone are from an entirely different source: USPS-LR-J-96, page 13. That distribution is for GFY 2000 and is scaled up to the TYBR – using volume – in my testimony's Attachment E, page 1, column (e). The relationship in that column of total pounds flown in Zone 7 (177,510,000) to total pounds flown in Zones 6 and 8 (241,651,000 and 413,015,000, respectively) is less than the relationship in Attachment B, page 5 of total Zone 7 postage pounds (196,627,299) to total Zone 6 and Zone 8 postage pounds (248,520,696 and 371,786,972, respectively). These different distributions result in relatively lower Zone 7 air transportation costs per postage pound as a constituent of total cost per postage pound in Attachment E, page 3, column (j). In fact, this effect

RESPONSE OF POSTAL SERVICE WITNESS SCHERER
TO OCA INTERROGATORIES

Response to OCA/USPS-T30-15 (Cont.)

more than offsets the effect of greater average distance flown in Zone 7 than in Zone 6 on total distance-related air costs in Attachment E, page 1, column (h) (carried over to Attachment E, page 3, column (b)), producing the anomaly of a lower total cost per postage pound (Attachment E, page 3, column (j)) in Zone 7 than in Zone 6.

RESPONSE OF POSTAL SERVICE WITNESS SCHERER
TO OCA INTERROGATORIES

OCA/USPS-T30-16. Please refer to USPS-T30 at 16, l. 20-21 - p. 17, l. 1-3 and l. 17 - 21. Please explain fully why you mitigate the over-five-pound rates by constraining an increase in these weights to 18.5 percent, but you do not mitigate the re-zoned below-five-pound rates. These are not constrained and, under your proposal, are permitted to increase as much as 64.4 percent. There are numerous examples of dramatic increases in the re-zoned Priority Mail rates, e.g.:

- 2 pounds, zone 7 increases by 36.7 percent
 - 2 pounds, zone 8 increases by 45.6 percent
 - 3 pounds, zone 7 increases by 51 percent
 - 3 pounds, zone 7 increases by 64.4 percent
 - 4 pounds, zone 7 increases by 46.5 percent
 - 4 pounds, zone 8 increases by 60.5 percent
 - 5 pounds, zone 7 increases by 42.8 percent
 - 5 pounds, zone 8 increases by 57.8 percent
- (a) Give all reasons for deciding not to mitigate the rate shock associated with such dramatic increases.
- (b) Refer to page 17, l. 7-10. Why did you constrain over-five-pound rates to such a degree that \$72.3 million must be recovered from pounds 1-5? Explain fully.

RESPONSE:

My proposed rate design had two entirely different objectives for pounds 2-5 and pounds 6-70. The objective for pounds 2-5 was to rezone/de-average, as discussed in my response to OCA/USPS-T30-6d. While this led to some large individual rate increases as cited above, the average rate increase at pounds 2-5 – shown in the last column of my testimony's Attachment F, page 16 – exceeded the 18.5% cap for pounds 6-70 in only one case: 3 pounds (21.0%).

The objective for pounds 6-70, which are already zoned, was to pass along pro-rated cost increases while considering the impact, including potential rate shock, on mailers. As discussed in my response to OCA/USPS-T30-6c, some rate cells over 5 pounds had already experienced relatively large rate increases in Docket No. R2000-1. Some mitigation of the back-to-back impacts

RESPONSE OF POSTAL SERVICE WITNESS SCHERER
TO OCA INTERROGATORIES

Response to OCA/USPS-16 (Cont.)

of Docket Nos. R2000-1 and R2001-1 seemed appropriate to me. In addition, as discussed in my testimony at page 16, lines 2-20, the rate pressure on heavyweight pieces is resulting from the shift to a significantly more transportation-intensive cost structure. Such a significant change in cost structure merits, I believe, the smoothing of rate impacts over more than one rate case – not only to avoid rate shock, but also to avoid dislocating rate effects between rate cases if the change turns out not to be permanent.

(a) Please see my response to OCA/USPS-T30-6d.

(b) The reasons for mitigating rate impacts on pounds 6-70 are explained above. That the resulting \$72.3 million revenue shortfall was recoverable from pounds 1-5 (and the flat-rate envelope) is evidenced by the average rate increases for pounds 1-5 (and the flat-rate envelope) shown in the last column of my testimony's Attachment F, page 16: they are not excessive in comparison to the 18.5% cap for pounds 6-70.

**RESPONSE OF POSTAL SERVICE WITNESS SCHERER
TO OCA INTERROGATORIES**

OCA/USPS-T30-19. Please refer to witness Spatola's response to POIR No. 5, Question 8. For each of the city pairs listed, give the:

- (a) number of air miles traveled
- (b) the Priority Mail zone
- (c) the number of miles between the originating facility and the destinating facility
- (d) Confirm that, under your proposal, the Priority Mail rate paid by each of the pairs listed in response to Question 5 will be based on the zone for the pairs, not the air miles traveled. If you do not confirm, explain fully.
- (e) Confirm that the zone basis for the rate generally reflects the distance between the originating facility and the destinating facility. If you do not confirm, explain fully.
- (f) Confirm that, in general, the distance between the originating and destinating facilities (as represented by zones) will, in many instances, be a poor approximation of the air miles traveled (for pieces transported by Fedex). If you do not confirm, explain fully.
- (g) Given the statements posited above in this interrogatory, explain why you did not choose to eliminate any rate differentials based upon zones, for those zones whose pieces are carried entirely (or almost entirely) by Fedex air.
- (h) Alternatively, given the statements posited above in this interrogatory, explain why you did not choose to keep rate differentials based upon zones, for those zones whose pieces are carried entirely (or almost entirely) by Fedex air, much narrower than the differentials you propose.

RESPONSE:

- (a) Redirected to the Postal Service.
- (b) Redirected to the Postal Service.
- (c) Redirected to the Postal Service.
- (d) Confirmed.
- (e) Confirmed, "generally." Zones are based on the distance between units of area thirty minutes square containing the Sectional Center Facilities (SCFs) of origin and destination. See 39 CFR Chapter III, Part 3001, Subpart C, Appendix A, Sections 4010 and 4020.

RESPONSE OF POSTAL SERVICE WITNESS SCHERER
TO OCA INTERROGATORIES

Response to OCA/USPS-T30-19 (Cont.)

(f) Confirmed that the distance between the originating and destinating facilities will in some instances not be a good approximation of the air miles traveled (for pieces transported by FedEx).

(g) I was informed that the extent to which, in the Test Year, the FedEx network will be used to transport Priority Mail in each zone is not known. Therefore, there was no way of knowing if the FedEx network will be used to transport Priority Mail “entirely (or almost entirely)” in any zone.

(h) Again, I had no way of knowing if the FedEx network will be used to transport Priority Mail “entirely (or almost entirely)” in any zone. In any case, my proposed rate differentials between zones already take into account that “air miles traveled” are not relevant in the FedEx transportation contract. These differentials result from distance-related air transportation costs and distance-related surface transportation costs (see Attachment E to my testimony). The factor used to calculate distance-related air transportation costs, 16.9% (of total air transportation costs), derives, I am informed, only from the line-haul costs of commercial (passenger) air transportation, not in any way from the FedEx transportation contract. See USPS-LR-J-43 at 12. Therefore, no narrowing of the proposed rate differentials between zones is warranted.

RESPONSE OF POSTAL SERVICE WITNESS SCHERER
TO OCA INTERROGATORIES

OCA/USPS-T30-20. Please refer to the testimony of another Postal Service witness in this proceeding - witness Kiefer. At page 22 of USPS-T-33 he describes intra-BMC transportation as having a "hub-and-spoke nature."

- (a) Is this an apt description of the nature of the Fedex air transportation of Priority Mail? If not, explain fully.
- (b) Are you aware that witness Kiefer uses a very narrow range of Zoning Factors (described at POIR No. 2, Question 1); i.e., 0.99 for zones 1 & 2, 1.00 for zone 3, 1.02 for zone 4, and 1.05 for zone 5, to establish rate differentials for Zones 1 - 5?
- (c) By contrast, you propose much larger rate differentials by zone. For example, you propose a rate differential for 2-pound Priority Mail, between zones 6 and 7, of 6.9 percent; you propose a rate differential for 5-pound Priority Mail, between zones 6 and 7, of 11.7 percent; and a rate differential for 5-pound Priority Mail, between zones 7 and 8, of 10.5 percent. Why didn't you attempt to keep the differences narrow, as witness Kiefer did? Explain fully.

RESPONSE:

(a) Redirected to the Postal Service.

(b) Witness Kiefer confirms that this is the case.

(c) Unlike intra-BMC Parcel Post transportation costs, which Witness Kiefer says "bear no readily identifiable relationship to the distances between the origin and destination ZIP codes" (see USPS-T-33 at 22), the costs that drive my proposed Priority Mail rate differentials between zones – distance-related air and surface transportation costs (as explained in my response to OCA/USPS-T30-19h) – do bear identifiable relationships to the distances between origin and destination. In the case of distance-related air transportation costs, that is because they are attributable solely to commercial (passenger) air transportation, which is not of a "hub-and-spoke nature," in contrast to the FedEx transportation network as confirmed in the Postal Service's response to OCA/USPS-T30-20a. Therefore, no narrowing of my proposed rate differentials between zones, which reflect actual differences in transportation costs, is warranted.

DECLARATION


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

Thomas M. Scherer
THOMAS M. SCHERER

Dated: 12/26/01

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.



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