

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

POSTAL RATE AND FEE CHANGES
PURSUANT TO PUBLIC LAW 108-18

Docket No. R2005-1

RESPONSE OF THE UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF THE INSTITUTION FOR RESEARCH ON THE
ECONOMICS OF TAXATION (IRET)
(IRET/USPS-1-4, 5a, 6-11, and 12f)
(June 16, 2005)

The United States Postal Service hereby provides its institutional responses to interrogatories IRET/USPS-1-4, 5a, 6-11, and 12f, filed on June 2, 2005. The Postal Service has filed objections to IRET/USPS-5b-d, IRET/USPS-8, and IRET/USPS 12a-e, f. In the case of IRET/USPS-8, the Postal Service is providing an answer notwithstanding its objections. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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IRET/USPS-1.

- a. On its website, the Postal Service calls R2005-1 the "Escrow Rate Case". (See <http://www.usps.com/ratecase>.) However, the escrow fund created by PL 108-18 does not increase the Service's expenses relative to what they would have been if PL 108-18 had not been enacted. The equivalent of the escrow payments was built into the rate base in R2001-1. Relative to the rate base in R2001-1, the Service's costs have increased because of increases throughout its cost structure (higher costs for wages, health benefits, fuel, etc.). Please explain why the Service attributes this rate case to the escrow fund rather than to increases throughout its cost structure.
- b. It is true that the Service would not be filing for a rate increase now if Congress relieved the Service of the expenses that are to be paid to the escrow fund, but the same would be true if Congress relieved the Service of various other expenses it must pay under current law or if Congress gave the Service a multibillion dollar annual appropriation. Please explain why the Postal Service attributes this rate case solely to one expense from which Congress has not relieved the Service.

RESPONSE:

a. and b. The Postal Service attributes the current rate case to the escrow requirement because without it rates would not have to be increased until after FY 2006. As witness Tayman points out on page 12 of his testimony (USPS-T-6), "the amount of the escrow expense is arbitrarily determined in the sense that it represents the difference between the funding requirement relating to a legitimate estimate of Postal Service's CSRS obligations and an estimate of these obligations that was determined to be substantially in error."

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IRET/USPS-2. As noted above in IRET/USPS-1, the rise in the Service's costs over its current rate base is not due to the escrow fund but to increases throughout its cost structure. Most of those costs are a mixture of attributable and institutional costs. Hence, wouldn't it be factually wrong, as well as inconsistent with previous rate cases, to classify 100% of the added costs in this rate case as institutional costs? Please explain your answer.

RESPONSE:

As stated in response to IRET/USPS-1, the Postal Service would not have filed this case if the escrow requirement did not exist in 2006. As stated on page 12 of witness Tayman's testimony (USPS-T-6), "Congress has provided no legislative direction concerning the use of these funds." Therefore, the cost is not attributed to classes of mail, and the full amount of the escrow expense must be assigned to institutional costs.

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IRET/USPS-3.

- a. Even if USPS did not have to put \$3.1 billion into escrow, wouldn't it still need to raise rates in order responsibly to pre-fund its post-retirement health benefit obligations? Please explain.
- b. In the past, the Postal Service has taken the position that it is not required to record and disclose its health benefit obligations as they accrue because it is a participant in a multi-employer plan. (See U.S. Postal Service, 2004 Annual Report, p. 27.) Is it the Postal Service's position that it would be violating the law if it attempted to pre-fund its post-retirement health benefit obligations? Please explain.

RESPONSE:

- a. Postal Service funding of retiree health benefit costs is in accordance with current law and is consistent with that typical of funding requirements of participants in multi-employer plans. It is worth noting that the Postal Service is the only federal agency, including other self-funding agencies, to directly pay the employer cost of retiree health benefits.
- b. It is not clear if voluntarily pre-funded amounts would be considered expenses of the Postal Service under the Act.

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IRET/USPS-4. In its "Cost Segments and Components Analysis for FY 2004", under Administration and Area Operations, the Postal Service lists Administration Personnel costs of \$634.5 million for Headquarters and \$243.65 million for Area Administration (See Library Reference USPS-LR-K-3, p. 56.) Although Headquarters staff and Area Administration staff spend considerable time dealing with the problems and opportunities posed by specific products and services, it appears from the "Summary Description of USPS Development of Costs by Segments and Components, FY 2004" that the Postal Service classifies these Headquarters and Area Administration expenses as entirely institutional, with very limited exceptions for money orders and international mail. (See Library Reference USPS-LR-K-1, cost segments 18.1.1 and 18.1.3.) Is this what the Service is doing? Has the Service undertaken any internal surveys or interviews with Headquarters and Area Administration personnel to ascertain what portion of their time these employees spend dealing with specific products and services? Please elaborate.

RESPONSE:

Included in LR-K-72, (Supporting Materials Relating to Incremental Cost Model), are the product specific costs for money orders and international mail costs found in Segment 18. The Postal Service is continuing to assign money order and international mail costs in Cost Segment 18 as described in USPS-LR-K-1. These costs are included in the incremental costs for BY 2004.

In preparation for Docket No. R97-1, the Postal Service commissioned a consultant to conduct pilot interviews of headquarters personnel to determine the feasibility of a survey to determine what portions of their time were spent dealing exclusively with specific products and services. The analysis revealed that, at headquarters, analysts (1) do not keep track of their hours by product and, what is more important, (2) generally work on more than one product at a time.

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IRET/USPS-5.

- a. In its "Cost Segments and Components Analysis for FY 2004", under Supplies And Services, the Postal Service lists Advertising costs of \$107.6 million. (See Library Reference USPS-LR-K-3, p. 52.) The Service apparently lists here only those Advertising costs that it does not attribute to specific products. (See Library Reference USPS-LR-K-1, cost segment 16.3.5.) Please confirm. For the same period, please provide data on the Service's total advertising costs, both attributable and institutional.
- b. Please provide any studies or analyses the Service has performed or commissioned that have examined whether its advertising expenditures increase mail volume.
- c. For any of its advertising campaigns, such as the (now discontinued), Tour de France sponsorship and the current NASCAR sponsorship, has the Service performed or commissioned any studies examining which classes of mail are benefited?
- d. Please provide any studies or analyses the Service has performed or commissioned following advertising campaigns to assess whether the campaigns achieved their objectives. If no such follow up studies have been performed or commissioned assessing advertising-campaign effectiveness, please confirm.

RESPONSE:

(a) Advertising costs are not volume variable, so therefore they are not included in the volume variable costs of postal products. Instead, advertising costs associated with specific product are considered product specific costs and are included in the incremental costs of products or groups of products. The library reference for advertising costs, both product specific and institutional, broken out for purposes of incremental costs is USPS-LR-K-72 (Supporting Materials Relating to Incremental Cost Model), page 9.

(b)-(d) Objections filed.

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IRET/USPS-6.

- a. In its "Cost Segments and Components Analysis for FY 2004", in the Cost Segment Summary, the Postal Service lists Research and Development costs of \$51.3 million. (See Library Reference USPS-LR-K-3, p. 4.) The Service appears to classify all these costs as institutional costs and none as attributable. (See Library Reference USPS-LR-K-1, cost segment 17) Is this what the Service is doing? Please elaborate.
- b. If the Service attributes some research and development costs to specific products, please indicate the dollar amount of attributed research and development costs in FY 2004.
- c. Does the Service undertake any research and development aimed at improving the quality or lowering the production costs of existing products? Please elaborate.

RESPONSE:

(a) Confirmed. The Postal Service continues to treat the \$51.3 million as institutional and none as attributable. As shown in Library Reference USPS-LR-K-1, page 17-1, these activities are the result of management decisions and do not result from changes in mail volume, so the costs are classified as institutional. Also see the response to c. below.

(b) The Postal Service does not attribute these research and development costs to specific products.

(c) The Postal Service routinely seeks to improve the quality of its products and lower the costs of production of its (existing) products. As evidence, the amount for research and development is routinely in the millions. During FY 2004 the research and development included programs to reduce costs and improve service quality in the areas of piece distribution for letters, flats and parcels; material handling, and in vehicle operations.

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IRET/USPS-7. Does the Postal Service attribute any of the costs of its call centers to specific products or services? If so, please show total all center costs broken down into attributable costs and institutional costs. Has the Service undertaken any surveys or interviews with call center personnel to ascertain what portion of their time these employees spend dealing with specific products and services? Please elaborate.

RESPONSE:

The data systems for cost attribution do not provide separate costs for the call centers nor a method for extracting the information. However, the Postal Service has been able to obtain the following information. The total for all center costs was approximately \$95 million in FY 2004.

The best estimate of the amount that was attributable (i.e. volume variable) was approximately \$28.4 million which was distributed to all classes of mail based on an all labor distribution key and included in their volume variable costs as reported in the CRA. The remaining \$66.3 million was treated as non-volume variable (i.e. institutional).

A nascent effort is currently underway to determine the most correct treatment for call center costs. However, the only product of this effort so far has been the location and identification of call center-related costs (which have been provided above), so that further work can proceed. The management of the Postal Service will determine if time and resources are sufficient for further study of the call center costs.

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IRET/USPS-8. As the owner of over 212,000 vehicles in 2004 (2004 Annual Report, p. 21), the Postal Service is a heavy user of motor vehicle fuel.

- a. Please provide a library reference in the current rate case to the Service's costs for motor vehicle fuel in the test year.
- b. Does the Postal Service pay federal and state excise taxes on its fuel purchases? If so, please break the excise tax payments into federal and state portions.
- c. If the Postal Service is able in some cases to buy motor vehicle fuel on a tax-exempt basis (or eligible to have taxes it pays rebated), please provide details. Also, if the answer is affirmative, please include estimates of the number of gallons of fuel on which federal and/or state motor vehicle taxes were not paid or paid at reduced rates, in each year since the last rate case (R2001-1).
- d. Are Postal Service contractors ever eligible to obtain motor vehicle fuel on a tax-exempt basis on work they do for the Service or eligible to taxes it pays rebated? Please explain.

RESPONSE:

(a) Objection filed. Notwithstanding this objection, the Postal Service states that its highway fuel costs were approximately \$628 million in FY2003 and approximately \$704 million in FY2004.

(b)-(c) Objections filed. Notwithstanding this objection, the Postal Service states that it pays the Federal excise tax except, in Puerto Rico. The exceptions are stated at PM/IIPG 7.3.2., provided below for your convenience.

7.3.2 Federal Excise Taxes

7.3.2.a Applicability. Federal excise taxes are levied on the sale or use of particular supplies and services. Subtitle D of the Internal Revenue Code of 1954, Miscellaneous Excise Taxes, 26 U.S.C. 4041 et seq., and its implementing regulations, 26 CFR 40 through 299, cover miscellaneous federal excise tax requirements. Questions on federal excise taxes should be directed to assigned counsel. The most common excise taxes are:

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1. Manufacturers' excise taxes imposed on certain motor vehicle articles, tires and inner tubes, gasoline, lubricating oils, coal, firearms, shells, and cartridges sold by manufacturers, producers, or importers; and
2. Special fuels excise taxes imposed at the retail level on diesel fuel and special motor fuels.

7.3.2.b *General Exemptions from Federal Excise Taxes.* No federal manufacturers' or special fuels excise taxes are imposed when the supplies are for any of the following:

1. *Shipment to a U.S. possession or Puerto Rico, or for export.* Shipment or export must occur within 6 months of the time when title passes to the Postal Service. When the exemption is claimed, the words "for export or shipment to a possession" must appear on the contract or purchase document, and the contracting officer must furnish the seller proof of export or shipment to a possession (see 26 CFR 48.4041-12).
2. Further manufacture, or resale for further manufacture (this exemption does not include tires and inner tubes, however) (see U.S.C. 4221).
3. Emergency vehicles (see 26 U.S.C. 4064(a) and 4064(b)(1)(c)).

7.3.2.c *Solicitations.* Contracting officers must solicit price proposals on a tax-exclusive basis when it is known that the Postal Service is exempt from federal excise taxes and the exemption is at least \$100. Proposals must be solicited on a tax-inclusive basis when no exemption exists or the exemption is less than \$100.

Turning to state taxes, the answer depends on the nature of the tax and whether the "incidence" of the tax is on the Postal Service or the seller, and thus the answer would vary from state to state.

(d) Objection filed. Notwithstanding this objection, the Postal Service states that it is unaware of any circumstances where Postal Service contractors are eligible to obtain motor vehicle fuel on a tax-exempt basis on work they do for the Service or eligible to have taxes it pays rebated. However, this is a situation which would depend on the laws of the jurisdiction under which the contractor might be attempting to exempt its tax payments, and the contractor should be

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referred to both the taxing jurisdiction and to the contractor's legal staff before proceeding.

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IRET/USPS-9. In its Cost Segments and Components Analysis for FY 2004, under Miscellaneous Operating Costs, the Postal Service lists Tolls and Ferriage costs of \$361,000. (See Library Reference USPS-LR-K-3, p. 40, cost segment 13.2.) Do Postal Service vehicles pay highway and bridge tolls at the same rates as private-sector commercial vehicles? If the answer is not a categorical "yes" or "no", please provide details.

RESPONSE:

The Postal Service pays tolls the same as private-sector commercial vehicles.

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IRET/USPS-10. In its "Cost Segments and Components Analysis for FY 2004", under Administration and Area Operations, the Postal Service lists Unemployment Compensation costs of \$46.1 million. (See Library Reference USPS-LR-K-3, p. 61, cost segment 18.3.5.) Does the Postal Service pay the Federal Unemployment Tax, or, due to its Federal status, does it in effect self-insure and pay reimbursement for claims filed. Please provide details. Also, please list how much the Service has paid in unemployment benefits (in numbers of claims and dollars) in each year since the last rate case (R2001-1).

RESPONSE:

The Department of Labor (DOL) invoices the Postal Service quarterly for unemployment benefits paid to former postal employees by states and U.S. territories.

Since Docket No. R2001-1, the Postal Service's unemployment expense and the annual number of wage verifications resulting from initial claims are as follows:

	Expense	Wage Verifications
FY 2001	\$ 60,820,218	75,506
FY 2002	\$133,552,544	78,928
FY 2003	\$ 60,449,756	59,961
FY 2004	\$ 45,927,359	39,029

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IRET/USPS-11.

As a government entity, is the Postal Service assigned a portion of the electromagnetic spectrum that it may use without charge? If so, please provide details on which portion this is and how the Postal Service is currently using it.

RESPONSE:

No.

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IRET/USPS-12.

- a. Please list the total revenue and costs of USPS eBillPay and USPS Send Money in each year since the last rate case (R2001-1).
- b. Please list the total revenue and costs of USPS Electronic Postmark (EPM) in each year since the last rate case (R2001-1).
- c. Please list the total revenue and costs of DineroSeguro, and any other its international money wire services you have offered, in each year since the last rate case (R2001-1).
- d. Please list the total revenue and costs of NetPost CardStore in each year since the last rate case (R2001-1).
- e. Please list the total revenue and costs of the Online Magazine Subscription service offered through the USPS website in each year since the last rate case (R2001-1).
- f. Please list the total revenue and costs of Pickup On Demand in each year since the last rate case (R2001-1) or, if a shorter period, in each year since development of this service began.
- g. The Postal Service sells various packing and shipping supplies to the public, such as the BoxPak, TubePak, and SpecialtyPak Lines of products offered on the USPS website (see <http://www.onepak.com/products/index.php>) and an assortment of envelopes, boxes, bubble wrap, packaging tape, carton markers, and miscellaneous other packaging supplies that may be purchased at many post offices. For each year since the last rate case, please list the types of packaging products that the Service offered for sale to the public, the quantities sold, total revenue, and costs.

RESPONSE:

(a)-(e) Objections filed.

(f) Pickup on Demand is a service feature available for Express Mail, Priority Mail, and Parcel Post, pursuant to DMCS §§ 123.2, 223.6, and 322.18, for which an additional fee is charged. Total revenue associated with Pickup on Demand was \$ 6,018,502.00 in FY02, \$ 6,579,397.25 in FY03, and \$ 6,199,762.50 in FY04. Any costs associated with this service feature, however, are reported within the costs for the relevant subclasses.

(g) Objection filed

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice and Procedure.

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