DOCKET SECTION

OFFICIAL TRANSCRIPT OF PROCEEDINGS BEFORE THE POSTAL RATE COMMISSION

In the Matter of:)
)
REQUEST OF THE UNITED STATES) Docket No. R2005-1
POSTAL SERVICE FOR A)
RECOMMENDED DECISION ON)
CHANGES IN RATES OF POSTAGE)
AND FEES FOR POSTAL SERVICES)

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POSTAL RATE COMMISSION

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CHANGES IN RATES OF POSTAGE	)	
AND FEES FOR POSTAL SERVICES	)	

Suite 300
U.S. Postal Rate Commission
1333 H Street, N.W.
Washington, D.C.

Volume 2
Monday, June 27, 2005

The above-entitled matter came on for hearing pursuant to notice, at 9:33 a.m.

BEFORE:

HON. GEORGE A. OMAS, CHAIRMAN
HON. TONY A. HAMMOND, VICE-CHAIRMAN
HON. DANA B. COVINGTON, COMMISSIONER
HON. DAWN A. TISDALE, COMMISSIONER

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C O N T E N T S

WITNESSES APPEARING:
JOHN E. POTTER, USPS-T1
WILLIAM P. TAYMAN, JR., USPS-T6

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P R O C E E D I N G S

(9:33 a.m.)

CHAIRMAN OMAS: Good morning. I would like to take this opportunity to welcome everyone here at the Postal Rate Commission. Today, we begin hearings in Docket R2005-1 to receive testimony of the Postal Service witnesses in support of its request for rate and fee changes.

I have a few brief procedural matters to discuss before we begin to take testimony today. At the prehearing conference in this case, Postal Service counsel indicated that it might be possible for parties to arrive at negotiated settlement in this case. I want to give counsel notice that on July 8th, at the conclusion of the presentation of the Postal Service direct testimony, I will ask Postal Service counsel to provide the Commission with a report on any progress made toward a settlement and whether he still believes that a settlement of some or all of the issues in this case is a reasonable possibility.

During these hearings, the Commission will provide up-to-date information on the progress we are making in hearing scheduled witnesses with a scrolled banner on our home page. Please check the Web site instead of calling our docket section to get accurate information on how the hearings are progressing.

Additionally, to receive a live audio feed of these proceedings, access to the Internet and direct your Web browsers to www.prc.gov. When audio is available, there will be a link and title "Listen Live" at the bottom of the home page. Click once on "Listen Live" to begin to receive live audio.

Finally, as many of you know, the Commission attempts to accommodate counsels' use of laptop computers. If you would like to use a computer during hearings, please contact the Commission's administrative office. They will try to make arrangements to accommodate on a first-come/first-serve basis. I am, however, happy to report that the Commission will be able to allow far more of you to plug in your computers once we move to our new offices in September.

At this point, does anyone have a procedural matter to discuss before we continue?

(No responses.)

CHAIRMAN OMAS: Three witnesses were initially scheduled to appear today. They are Witnesses Potter, Tayman, and Meehan. Ruling 32 excused Witness Meehan. We will enter her testimony by motion at the close of today's session.

Our first scheduled witness today is Postmaster General Potter. Since Jack Potter became postmaster general, the Postal Service has experienced a remarkable revitalization. Productivity has improved, service has improved, and employee morale has improved. I have observed a new, can-do attitude which has resulted in unprecedented progress toward making the Postal Service a model for the rest of the world.

Postmaster General Potter also deserves credit for recognizing that the Postal Rate Commission can reach a better decision in less time when the two organizations are cooperating. The fact that Postmaster General Potter is appearing here today is the best evidence of his commitment to cooperation. For many years, the Commission has asked the Postal Service to provide a policy witness when it filed an omnibus rate case so that the Commission and the public would know what factors led management to authorizing specific requests. For the first time, the chief executive officer of the Postal Service has taken time to clearly describe the Postal Service's views. Obviously, until this case is concluded, the Commission cannot comment on how persuasive it finds this testimony, but I can state that I find this testimony clear, straightforward, and extremely helpful.

Mr. Potter, the Commission appreciates your willingness to provide this testimony.

Mr. Tidwell, would you call your first witness so that I can swear him in, please?

MR. TIDWELL: The Postal Service calls John Potter to the stand.

Whereupon,

JOHN E. POTTER

having been duly sworn, was called as a witness and was examined and testified as follows:

CHAIRMAN OMAS: Please be seated.

(The document referred to was marked for identification as Exhibit No. USPS-T-1.)

DIRECT EXAMINATION

BY MR. TIDWELL:

Q Mr. Potter, on the table before you to the right are two copies of a document entitled the "Direct Testimony of John E. Potter on behalf of the United States Postal Service." It has been designated for purposes of this proceeding as USPS-T-1. Was that document prepared by you or under your supervision?

A Yes, it was.

Q If you were to give the contents of that document as your oral testimony today, would it be the same?

A Yes, it would.

MR. TIDWELL: Mr. Chairman, the Postal Service moves into evidence the direct testimony of John Potter.

CHAIRMAN OMAS: Without objection. Hearing none, I will direct counsel to provide the reporter with two copies of the corrected direct testimony of John E. Potter. That testimony is received into evidence. However, as is our practice, it will not be transcribed.

(The document referred to, previously identified as Exhibit No. USPS-T-1 was received in evidence.)

CHAIRMAN OMAS: Mr. Potter, have you had the opportunity to examine the packet of designated written cross-examination that was made available to you in the hearing room this morning?

THE WITNESS: Yes, I have.

CHAIRMAN OMAS: If the questions contained in that packet were posed to you orally today, would your answers be the same as those previously provided in writing?

THE WITNESS: Yes, they would.

CHAIRMAN OMAS: Are there any corrections or additions you would like to make to those answers?

THE WITNESS: No.

CHAIRMAN OMAS: Thank you. Counsel, would you please provide two copies of the corrected designated written cross-examination of Witness Potter to the reporter? That material is received into evidence and is to be transcribed into the record.

(The document referred to, previously identified as Exhibit No. USPS-T-1 was received in evidence.)

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Request of the United States Postal Service for a Recommended Decision on Changes in Rates of Postage and Fees for Postal Services

Docket No. R2005-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED STATES POSTAL SERVICE
WITNESS JOHN E. POTTER
(USPS-T-1)

Party	Interrogatories
Office of the Consumer Advocate	OCA/USPS-T1-2, 4

Respectfully submitted,

Steven W. Williams
Secretary

(2)

INTERROGATORY RESPONSES OF
UNITED STATES POSTAL SERVICE
WITNESS JOHN E. POTTER (T-1)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory	Designating Parties
OCA/USPS-T1-2	OCA
OCA/USPS-T1-4	OCA

United States Postal Service

John E. Potter
(USPS-T-1)

**RESPONSE OF USPS WITNESS POTTER
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE**

OCA/USPS-T1-2

Please refer to your testimony at pages 6 and 7, line 23, and lines 1-5, respectively, concerning Registered Mail service.

a. Pursuant to your directive, has postal management organized the cross-functional team to thoroughly review Registered Mail service? Please provide a copy of your directive. Also, please identify the individual in postal management who will chair or lead the team.
b. Will the cross-functional team report the results of its review to you? If it is not you, please identify the responsible postal official or officials to whom the team will report the results of its review.
c. Have you established a date when the cross-functional team will report the results of its review to the postal official or officials identified in part b. of this interrogatory? If so, please provide that date. If not, please explain how long you anticipated the review to take when you established the team.
d. Has the cross-functional team begun its review of Registered Mail service? During its review, will the cross functional team meet with customers of Registered Mail service?
e. To date, has the cross-functional team prepared any reports, workpapers, documents, or other materials in preparation for, or as part of, its review? If so, please provide those reports, workpapers, documents, or other materials.
f. Please describe the final work product you expect the cross-functional team to provide to the postal official or officials identified in part b. of this interrogatory at the conclusion of its review? Will this work product be provided to the public?

RESPONSE:

a. Yes. The directive was in the form of an oral communication, so no hard copy record exists. I am informed that the group is being led by Vincent DeAngelis, Manager, Value Added & Special Services. I am further informed that Mr. DeAngelis' group reports to Nicholas Barranca, Vice-President, Product Management.

RESPONSE OF USPS WITNESS POTTER
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

Response to OCA/USPS-T1-2 continued:

b. I do not expect the group to report directly to me. Its findings will be transmitted to senior managers in Operations, Finance and Marketing who will, in turn, inform and advise me and the rest of the headquarters senior management team.

c. No. But, I expect the group to conclude its work in time to permit development and filing of any Registered Mail request with the Commission either before or as part of the omnibus rate case that will likely be filed in calendar year 2006.

d. I am informed that the group has begun its work. I leave it to the discretion of the group to determine whether and, if so, how to solicit customer input.

e. Not to my knowledge.

f. Without a particular form of work product in mind, I want senior management to be provided with an informed basis for considering our next steps. I will leave it to others in the Postal Service to determine the extent to which any final written report from the group should become public, when such a report is produced.

RESPONSE OF USPS WITNESS POTTER
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T1-4. Please confirm that it is still your intention to withdraw the current rate request if Congress relieves the Postal Service of its obligation to make a $3.1 billion escrow payment in FY 2006, before a recommended decision is issued by the Commission in this docket. USPS-T-1 at 7.

a. If you do not confirm, then please explain.

b. In the June 10, 2005, issue of DM News, in an article written by Scott Hovanyetz, Jerry Cerasale, senior vice president of governmental affairs for DMA, is cited for the statement that, if President Bush signs such a bill by early November, the Postal Service might cut the rate increase in half or push it back a few months. Do you contemplate taking the actions described by Mr. Cerasale if the bill is signed prior to the issuance of a recommended decision by the Commission? If so, then please reconcile your answer to part b. of this question with your answer to part a.

c. If such a bill is signed prior to the issuance of a recommended decision in this docket and you plan, not to withdraw the request, but to request cutting the rate increase in half, would the Postal Service amend its request? Re-file it? Please explain.

d. If the Commission recommends a 5.4 percent increase in this docket, and the President signs such a bill *after* the Commission issues its recommended decision, would you consider raising rates less than 5.4 percent, say, to only 2.7 percent? If so, please explain the steps you would take to accomplish this.

RESPONSE:

Confirmed.

a. N/A

b.-d. Trade press reports quoting either Mr. Hovanyetz or Mr. Cerasale do not establish postal policy. As I stated in my testimony, if legislation is enacted that removes the escrow obligation, the Postal Service will withdraw its request in this docket. If the escrow obligation is completely removed, it is not our intention to

RESPONSE OF USPS WITNESS POTTER TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

Response to OCA/USPS-T1-4 continued:

"cut the rate increase in half or push it back a few months." As indicated in the final section of my testimony, we will reassess the need to raise rates if circumstances change. I hesitate to speculate about what the Governors of the Postal Service would do under the circumstances of your question. If legislation reducing (but not eliminating) the escrow requirement were to be enacted, either before or after a recommended decision, it is possible that other provisions of that legislation may restrict the Governors' options. The Postal Service would comply with any legislative requirements. But, with all due respect to you and to the Governors, it would be imprudent for me to hypothesize about how the Governors might exercise such authority before or after a recommended decision under circumstances that can, for now, only be vaguely imagined.

However, if legislation were enacted eliminating the escrow obligation with no other limitations placed upon the Postal Service after the Commission's issuance of a recommended decision approving our across-the board request and before any action by the Governors, then it is my expectation now that I would recommend to the Governors then that they do not implement the recommended rate increases.

CHAIRMAN OMAS: Is there any additional written cross-examination for Witness Potter?

(No response.)

CHAIRMAN OMAS: There being none, this brings us to oral cross-examination. One party has requested oral cross-examination, the Office of Consumer Advocate.

Is there any other party who wishes to cross-examine Witness Potter today?

(No response.)

MR. OLSON: Mr. Chairman, William Olson for Val-Pak. We have no oral cross-examination of Witness Potter, so we would waive that today.

CHAIRMAN OMAS: Without objection.

Ms. Dreifuss, would you please begin?

MS. DREIFUSS: Thank you, Mr. Chairman. Good morning, Commissioners, Mr. Chairman, and an especially warm welcome to you, General Potter, for joining us today.

THE WITNESS: Thank you.

MS. DREIFUSS: I have to echo the chairman's accolades. You've made impressive, unprecedented strides in service improvements and cost containment, and I'm one of your fans, along with, I think, millions of others, and thanks for your appearance this morning.

THE WITNESS: Thank you.

//

CROSS-EXAMINATION

BY MS. DREIFUSS:

Q I thought I would start out by -- well, let me first state, I think you said in your testimony you've been postmaster general and CEO of the Postal Service since June 2001. Is that correct?

A Correct.

Q You allude to your role as a member of the board of governors. You say in your testimony, you consult with the governors about postal, operational, personnel, financial, and other policy matters. I wonder if you could elaborate on that a bit, on the kind of role you play as a member of the board of governors.

A Well, first of all, I represent management to the governors, and, just as any other company in America, I report to the board of governors. They have the ultimate authority over the Postal Service when it comes to all matters but, in particular, matters when it comes to rates, and we have an ongoing dialogue about all matters pertaining to the Postal Service. They have been a great counsel to me in terms of day-to-day management of the Postal Service, and they are very, very helpful when it comes to dealing with a lot of the challenges that the Postal Service has. They are a very innovative group. I would say the relationship between postal management and our board of governors is comparable to any corporate board of directors or board of governor management relationship.

Q In addition to your being a member of the board of governors, you note that you direct postal management. That's another one of your general spheres of responsibility. Is that correct?

A Correct.

Q How many vice presidents report to you, General Potter?

A Report directly to me, or how many do we have? We have 39 vice presidents. I have an executive committee of seven that report to me.

Q Who are the members of the executive committee?

A The chief marketing officer, the chief financial officer, general counsel, deputy postmaster general, chief operating officer, VP of strategic planning, chief human resources officer, and myself, and -- excuse me -- senior vice president for government relations. I said six; that was seven.

Q Is it safe to say that, in your position as CEO, that you have the final word, with respect to management decisions, you have the final word on important policy issues?

A In terms of the day-to-day conduct of the Postal Service, I would say yes. There are, by statute, certain things that are reserved for the board of governors, such as rates issues and selection of people, where obviously we consult.

Q Would you have given the benefit of your advice and experience to governors in matters of the timing of a rate case, the size of a rate increase? Would you tend to give your advice to the governors on the timing of a rate case, a filing here with the Commission, and the size of the postal rate increase that would be necessary?

A Certainly, we would have a discussion about it, yes.

Q I would like you to turn to your answer to an interrogatory that OCA posed to you. It's our number 4. I'm going to go to the last paragraph of that answer. In that answer, you say, "If the legislation were enacted eliminating the escrow obligation, with no other limitations placed upon the Postal Service after the Commission's issuance of a recommended decision approving our across-the-board request and before any action by the governors, then it is my expectation now that I would recommend to the governors, then, that they do not implement the recommended rate increases."

One of the things that occurred to me as I read that answer is, what advice would you give to the governors if Congress did promulgate a new law relieving the Postal

Service of its current Public Law 108-18 obligation in Fiscal Year 2006 and thereafter and, instead, imposed an obligation on the Postal Service perhaps to make a payment into a prefunded health benefits plan, and the annual payment that would be due in Fiscal Year 2006 would not be as large as the one that is currently required by Public Law 108-18?

Let's say this hypothetical new law would require the Postal Service to make a payment half the size of the one that is required currently under P.L. 108-18. What would you recommend to the governors in a case like that?

A I would recommend that we discuss the financial condition of the Postal Service at that time, and we look at, again, what our projections would be going forward for the Postal Service's finances, and I would assume that the governors would consider that and then make whatever they think the appropriate decision is.

Q If all of the numbers in this case are pretty close to being correct, and the 5.4 percent increase is scaled to a $3.1 billion escrow payment of 2006, then if the Postal Service went forward with a 5.4 percent increase, it would appear that, at least in Fiscal Year 2006, the test year, there would be a substantial surplus at the end of the fiscal year, wouldn't there be?

A Based on what, the hypothetical?

Q Based on the hypothetical, yes. I'm sorry.

A I don't know if it would be a significant surplus, but there would be a surplus because, as currently filed, and if we were to implement in January, and if the escrow were to hold true, we would lose somewhere between $800 million and a billion dollars. So if there was a swing of $1.5 billion, which, I think, is what you're suggesting, --

Q Yes.

A -- we might make $500 million. Again, there are many, many factors that have to be considered going forward. In particular, right now, we're very concerned about the price of fuel. It's much higher than was anticipated in this rate case. It's having a significant impact on CPI, and CPI drives COLA. So at this point in time, we're anticipating probably the highest COLA payment ever in the history of the Postal Service next year unless fuel prices are mitigated somewhat over the next month.

So, as I said, there are many, many variables when it comes to postal finances that would be factored in, if and when legislation were to occur, if and when the rate commission makes a decision, and those would all be presented to the board, and, again, they would consider them and make the appropriate decision going forward.

Q Let me change my hypothetical just a little bit. I posed one where the Commission had already issued a recommended decision, --

A Uh-huh.

Q -- and you had to advise the governors on what steps to take at that point. In my hypothetical, the actual payment required of the U.S. Treasury was half of what Public Law 108-18 would require.

Let's say that this hypothetical law were to be passed while the case is still before the Commission, and the Commission has not yet issued its recommended decision. So the payment that would be required in Fiscal Year 2006 would be approximately half of what the Postal Service anticipated when the case was filed. What kind of actions do you think you would recommend to the governors in such a case?

A I think the action would be -- the Commission's action -- we would have to wait and hear what the recommendation of the Commission was, and certainly they are governed by the laws, and we would hope that we would get what's requested here, and we're hoping for a settlement here.

Q You would hope to get what you requested even if the payment that was required in 2006 were half of what you anticipated coming into the case. Is that your position?

A That's my position, yes.

Q All of the previous rate cases that have been filed at the Postal Rate Commission were designated a number, typically -- I'll use the last rate case as an example -- Docket No. R2001-1 was the way the Commission identified the last rate case, and generally the Postal Service has also followed that convention.

This case is a little different, though, than I've seen before. The Postal Service called this case "a request pursuant to Public Law 108-18." Is that correct?

A I'll assume so.

Q I even see that appearing on the face --

A -- semantics of the rate commission.

Q Okay. Were you aware that normally rate cases were identified simply by a number and not by a characterization of this type?

A But this is a very unusual circumstance, so it doesn't surprise me that we did that.

Q Can you tell me why the Postal Service chose to give the case that label as opposed to the ordinary conventional number?

A There is only one reason we're filing this case. It's because of Public Law 108-18 and because it requires an escrow payment in 2006. Were it not for that, we would not have filed this case.

Q Do you have a position on the wisdom of having the Postal Service now response for $27 billion of military service retirement obligations, as provided by Public Law 108-18?

A I believe that the original law was correct in that it had the military obligation borne by the Treasury. In testimony before the House and the Senate, I've consistently stated that the military obligation should be borne by the federal government and not by the U.S. Postal Service.

Q Witness Tayman characterized this -- I'll just quote him, and if you would like to see more or anybody else, I'll make copies available. Witness Tayman said, in his Appendix A to his testimony -- he has a lengthy discussion there about the military service obligation. He views the military service retirement obligation as a direct cost transfer of $27 billion from U.S. taxpayers to postal rate payers. Is that consistent with your own views?

A Yes.

Q You disfavor having postal rate payers make transfers to taxpayers.

A Simply stated, the original law provided a military benefit for postal employees, and that military benefit was to be borne by the Treasury. In 1984, when they changed the retirement system and went with FIRS, they left the Civil Service obligation for military time for postal employees with the Treasury. I believe that to be the correct policy.

Q As a general proposition, if Congress enacts future laws that attempt to impose obligations on the Postal Service that are not directly related to the provision of postal services, transfer them from taxpayers to rate payers, would you tend to oppose such changes in the law?

A That's such a hypothetical that it's hard to imagine what else is out there besides the military, but theoretically, I don't believe that the Postal Service should bear costs beyond the provision of postal services.

Q In Docket No. R76-1, the Commission expressed a similar view, I think, to the one you just articulated and that Mr. Tayman did. Let me see if you would agree with this view of the Commission's.

I'm reading from Volume 1 of Postal Rate Commission Opinion R76-1, at page 45, and on that page, the Commission said, "The only owner of the service is the United States, which is not invested in it in the hope of receiving dividends out of profits. Indeed, the act is so structured as to make it clear that the Service was not to seek a profit."

Does that sound pretty much consistent with your view of the Postal Service?

A Sure. The law says that we break even over time, and I believe in doing that.

Q I'm going to ask you to compare a couple of different things right now because I want to go over the history of what happened after Public Law 108-18 was passed. What I'm going to ask you to compare will be Table 6 from Witness Tayman's testimony. Table 6 is a listing of the Postal Service's escrow obligations on an annual basis, starting with Fiscal Year 2003 and ending with Fiscal Year 2015, so that's one of the things I'm going to hand you. And the other thing I'm going to hand you is Exhibit 6I of Witness Tayman's. The exhibit is titled "U.S. Postal Service Summary of Net Income (Loss) and Equity, Fiscal Year 1971 through FY 2005."

These are copies that I do want to give to you and your counsel, Commissioners, and members of the audience.

(Pause.)

(The document referred to was marked for identification as Exhibit No. 6I.)

BY MS. DREIFUSS:

Q You won't need to concern yourself with all of the years that are listed in both of these tables. I'm going to focus on the years 2003, 2004, and 2005, since those were the years, at least prior to filing of this case, that impacted the Postal Service's financial position.

In 2003, the Postal Service was spared a payment of $3.48 billion that would otherwise have been paid into the U.S. Treasury. Is that correct?

A Correct, according to this paper.

Q And the net income for the Postal Service in Fiscal Year 2003 was $3.9 billion. Is that correct?

A Correct.

Q Nevertheless, there was a cumulative net income of negative $2.2 billion in Fiscal Year 2003. Is that correct?

A Say that again.

Q I've looked at it a lot myself, so I'm familiar with it, but let me explain what we're looking at in Exhibit 6I. Witness Tayman has presented a column on the left-hand side for fiscal years, and to the right of that is a net income column. When I ask you about net income, you will see that for all of those fiscal years, it's in the net income column. To the right of that is a net loss column, and then to the right of that is a cumulative net income loss column.

In general, what I'm going to be asking you to do is I'm going to be asking you to look at the net income column and the cumulative net income loss column, so those are the columns 2 and 4 for Fiscal Years 2003, 2004, and 2005.

A Right.

Q For Fiscal Year 2003, there was a negative

cumulative net income of $2.2 billion. Is that correct?
A Correct.
Q The following year, in Fiscal Year 2004, the Postal Service was spared a CSRS payment of $2.77 billion. Correct?
A Correct.
Q And it showed a net income of $3 billion at the end of 2004, --
A Right.
Q -- and it showed a cumulative net income of $.9 billion in Fiscal Year 2004. Is that true?
A True.
Q Okay. Now, we're on to the last year, which is Fiscal Year 2005. The Postal Service was spared a Civil Service retirement payment of $2.98 billion. Is that correct?
A Correct.
Q The Postal Service estimates a net income in the current fiscal year of $1.6 billion. Actually, it's a little more than that. It's $1.64 billion. Is that correct?
A Correct.
Q And that will produce cumulative net income at the end of Fiscal Year 2005 of $2.54 billion. Is that correct?
A Correct.

Q And the way we get to the $2.54 billion is we add the cumulative net income of Fiscal Year 2004 to the estimated net income of 2005. Is that right?

A Right.

MS. DREIFUSS: In Witness Tayman's answer to an OSA interrogatory, OSA Interrogatory T6-1, and I have copies of that if anybody cares to see it, but I'm not going to do much more than quote one statement.

(Pause.)

BY MS. DREIFUSS:

Q I'll give you a chance to look over the whole question and set of answer, if you like, or we can go directly to the part that I'm interested in, if you're comfortable with that.

A C.

Q Okay, Part C. What we did was we asked Witness Tayman, "Please confirm that the cumulative net income at the end of any fiscal year for the Postal Service has never been positive, from the inception of the present Postal Service in Fiscal Year 1971 until the end of Fiscal Year 2004. If you cannot confirm, please explain." And you'll see that he did confirm.

He says: "The positive cumulative net income at the end of Fiscal Year 2004 is due in large part from the reduction in Civil Service Retirement System (CSRS) expense resulting from Public Law 108-18." Do you agree with that?

A Particularly, the large part, yes.

Q Okay, in large part.

A There were a lot of efforts on the part of a lot of postal employees to reduce our costs, increase productivity that contributed mightily to our ability to have a positive net income.

Q I'm aware that you did contain costs very well, and you're properly praising all of those who work for the Postal Service who brought that about.

A Who did it, yes.

Q Yes. I do agree with that.

Now, he didn't offer a similar remark or observation for Fiscal Year 2005, but would you say that's generally true of Fiscal Year 2005 as well, the fact that there is a $1.64 billion net income at the end of Fiscal Year 2005 is in large part due to the Civil Service retirement savings?

A Without that, we would have a negative net income.

Q Are you familiar at all with Section 3621 of Title 39?

A I've probably read it, but not off the top of my head.

Q I imagine you've read it from time to time. I'm just going to quote you one sentence from there. It certainly is relevant to this proceeding, and I think it may have reflected something about this problem on your part, on the part of management as a general proposition.

About halfway into that statute, Congress says: "Postal rates and fees shall provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs to the Postal Service."

I want to focus on the three words "total estimated income" because I see in your testimony and generally this filing that there has been no mention of the cumulative net income that the Postal Service goes into the test year with, that is, $2.54 billion. It would appear to me that total estimated income would include cumulative net income and operating income for Fiscal Year 2006. Do you have any reason to disagree with that?

A Yes, I do. I don't think you just take the cumulative net income and put it as an add. I would disagree with that.

Q Are you aware that in the case of prior year losses -- let's turn back to Exhibit 6I for a moment.

A I'm aware of prior year loss recovery.

Q Right. So anything that showed up in that column 4 of Witness Tayman's Exhibit 6I, a prior year loss, the Postal Service did wish to recover in future years, and, in fact, it wanted those losses to be placed on the total estimated cost side of the ledger, didn't it?

A Yes, it did, but from a policy standpoint, let me just state that we're dealing with this escrow, and we're trying to get the escrow built into the base -- assume no legislative change occurred. You would want that built into your base going forward, okay, the $3.1 billion, and you can see from Witness Tayman's testimony that that rises going forward.

So therein lies the dilemma. Now, in theory, if you looked at 2006, in theory, yes, you could say it's break even or slightly better than break even, but in reality we can't raise the rates until January, so there is a loss of $800 million to a billion dollars, and, again, depending on the finances and what goes on with the economy and what goes on with the Postal Service, in all likelihood, that cumulative net income is going to go backwards, is not going to be raised. In theory, you could claim it would be, but if we go beyond the theory of the case and get into what's the reality of when you would fine, it's going to go backwards.

Q I understand from your testimony that when you asked the Commission to approve recommended rates of 5.4 percent, yielding $3.06 billion revenues in the test year, you had not taken into account the fact that there was a

$2.54 billion cumulative net income coming into the year. Is that correct?

A It was taken into account in the sense of the timing of when the rates would be increased. It was well known that it would be into the fiscal year and that there would be a net income loss and that the cumulative net income of the Postal Service would decline if there was no change to Public Law 108-18.

Q In fact, in some of Witness Tayman's exhibits -- I believe it's Exhibit A, although I don't have it in front of me -- he shows that if there is a 5.4 percent increase in the test year without taking into account the cumulative income going into the test year, there would be a surplus of $280 million. Does that number sound familiar to you?

A Theoretically, we could raise rates Day One of Fiscal Year October 1, 2005. That rings true. It's also been stated publicly that we wouldn't raise rates no sooner than January 1, 2006.

Q Let's say we make the subtraction that you're suggesting. I think you would say, to be fair, we ought to subtract the $800 million that will not be obtained at the beginning of Fiscal Year 2006 because, at the earliest, rates can be implemented in January of 2006. Is that your position?

A What I'm basically saying is that should be accounted for. As you've stated, we've never been in a position where we've had cumulative net income. We've never established a policy of what do you do when you get into that position.

Theoretically, I guess if you look at what we do when we had a negative cumulative net income, you divide by nine, you might want to play that scenario out. Okay? Let's divide by nine going forward. If you wanted to play that game where you divided by nine, it took $2.5 billion, it's well short of the $800 million to a billion dollars we think we would lose if the case were to transpire, and there would be no legislative change.

Q Dividing by nine is certainly one possibility, but wouldn't you suggest that we need to go about this in a very thoughtful way and decide what is the correct way to view and apply a $2.54 billion cumulative net income, not make a snap judgment about it, but think about it very carefully.

A We will when we file a true omnibus rate case. In this case, we're filing, very specifically. We made a policy decision to file very specifically for the escrow. So if you look at this case, it's extremely narrow. I think if we have a cumulative net income, and we file the omnibus rate case, you will see us proffer a policy on how we deal with that situation.

Q Do you think there is any limit on the cumulative net income that the Postal Service should be able to build over the years?

A (Laughter.) If you look at what happened recently, we've been able to build that without raising rates. I can't foresee a hypothetical where, given the challenges facing the Postal Service, that that would be replicated in the years ahead. I would defer, I guess, to the board of governors when it comes to whether or not there should be a cap on retained earnings or cumulative net income.

Q Have you ever been advised by counsel at the Postal Service that Section 3621 might not allow for cumulative net income?

MR. TISDALE: I'm going to object to this question. It's going to get into discussions of privileged attorney-client consultations, to which we're going to object.

BY MS. DREIFUSS:

Q Well, let me just ask you your opinion, then, and not a legal opinion, but what do you think this means when Congress says that postal rates and fees shall provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable the total estimated costs of the Postal Service? You did say a moment ago that you thought that total estimated costs included the notion of prior year losses. Does total estimated income include the notion of cumulative net income?

A Let me say this. If you read the Postal Service's transformation plan, we dealt with this notion of retained earnings on cumulative net income, and what we said was that would provide an opportunity for us to use those funds to invest in capital to make us more productive. It would also provide an opportunity for us, over the course of time, to smooth our rate increases.

So it's not that we have not thought about it. We have two objectives that we would seek to reach if and when we're in a situation where we have cumulative net income. And so in this case, what we're basically doing -- I think you can look at it as a direct opportunity to file this case strictly as a policy matter to get the escrow fund funded, and we've told folks that on the heels of this there is going to be an omnibus rate case in which we would take care of classification issues, and I view this matter of cumulative net income to be an issue that will be dealt with in a policy way when we file that next case.

Q You would agree, though, that the Commission is faced, in this case, with a problem of being asked to approve a 5.4 percent increase that will end Fiscal Year 2006 with a very sizable cumulative net income. You are aware of that, aren't you?

A I am. I also know that it's a reduced cumulative net income from Fiscal Year 2005.

Q And you're asking the Commission to do this without proffering any guidance or testimony in this case on what it should do when faced with that situation. Isn't that true?

A Again, we're filing for a very narrow need. The narrow need is the escrow account and the notion that we build that funding into our base because, going forward, we have no idea whether or not there is going to be legislation that will resolve that matter, and until then, this is a unique circumstance that none of us have ever dealt with, and so we're all going to have to try to figure out how to best do it. Again, the policy decision that was made by the board of governors was to pursue an across-the-board increase with a very narrow purpose: to build funding into our rates such that it covered the escrow account.

Q Well, all of that funding may have a purpose, but I agree that it does. It's clear from your testimony that it does.

A Right.

Q Nevertheless, the Commission would have to approve a sizable cumulative net income for the test year if it went along with the Postal Service proposal, wouldn't it?

A Yes. But if I was on the Commission, I would also note that that cumulative net income will be diminished by, as I said earlier, $800 million to a billion dollars, maybe more because of the fact that we're not raising that rate until sometime in January 2006. So I think there has to be some recognition of the fact that what's been proposed, in my opinion, is fair and will result in not an increase in that cumulative net income but a decrease in that cumulative net income, a sizable decrease in that cumulative net income, and I think with the notion that there is a rate case that's coming on the heels of this one, to deal with, again, all matters because, again, we're very narrow here, all matters that are germane to a normal rate case, including whether in the past there had been prior year loss recovery. In this case, it would be cumulative net income. If I was on the Commission, I would take comfort in that. I'm not growing a cumulative net income, and I am going to have an opportunity to make a policy decision and make a ruling in very short order on this matter.

Q Let's go over the numbers that I've given to you and you've given to me. Going into Fiscal Year 2005, the Postal Service estimates a cumulative net income of $2.54 billion. Correct?

A Correct.

Q You want the Commission to take account of the fact that if rates are put into place in January of 2006 and not at the beginning of 2006, that you won't receive the full revenue impact that Witness Tayman presents in his testimony.

So we should subtract $800 million from the $2.54 billion, and we would get something in the neighborhood of $1.7 billion cumulative net income as of January 2006. Correct?

A No. That would be as of September 30, 2006. That would be at the end of the fiscal year.

Q Okay.

A Right?

Q 2.54 going in, using his numbers. Well, you're right. I don't know what will happen as of January 2006. You're right. At the end of 2006, there will be a $1.75 billion cumulative net income.

A In theory, if nothing else happens.

Q As a matter of fact, it will probably be higher than that because if rates do go into effect in January 2006, the Postal Service will likely start to accrue surpluses in every accounting period until the end of the year, would it not?

A I would have to defer to our financial witnesses to tell you that. I don't know if they would because at low-volume periods, we tend to have a net loss, not a net gain, by month.

Q Well, let's do an end-of-the-year calculation. Witness Tayman says in his exhibits we'll put the 5.4 increase in effect in the beginning of Fiscal Year 2006, which appears not to be possible.

A It's definitely not possible.

Q And at the end of 2006, --

A We publicly stated, and I've publicly stated over and over again, we would not raise rates until calendar year 2006. When Public Law 108-18 was passed, that was a commitment that the Postal Service made to its customers, to Capitol Hill, and we've lived up to that commitment.

Q Let's do an end-of-year calculation. We'll assume, as we would from Witness Tayman's exhibits, that the Postal Service puts a 5.4 percent increase in place at the beginning of Fiscal Year 2006, and I grant you, it doesn't seem likely. I will grant you that. In fact, I'll even grant you that rates don't go up any earlier than January of 2006, as you've just described. So if we put rates into place at the beginning of 2006, the rate increase of 5.4 percent in place at the beginning of 2006, you end 2006 with a net of $280 million. Does that ring a bell for you? We haven't discussed cumulative net income yet; we're just talking about --

Q Wait a second. Have you made the concession that we wouldn't raise rates until January 1, 2006?

A I'm going to get to that in just a moment. Let's just start out with his exhibit as he presents it. He assumes a 5.4 percent increase at the beginning of 2006. It's in there for a full year, and at the end of that year, there is a $280 million net. Does that sound right?

A That sounds right, to my knowledge of his testimony.

Q Okay. I'm going to add the $280 million, the net income from 2006, to the cumulative net income that we had going into Fiscal Year 2005, and I'm going to end up with something in the neighborhood of $2.8 billion. I'll work with some simple round numbers here.

A Okay.

Q Somewhere in the neighborhood of $2.8 billion of cumulative net income at the end of Fiscal Year 2006. You're with me so far.

A I'm with you.

Q Okay.

A I could throw a whole bunch of arguments why that's not going to happen, but that's fine.

Q Okay. And then I'm going to make that concession that you don't want rates to go up in earlier than calendar year 2006, so they won't go up any earlier than January of 2006.

A That you can count on.

Q Okay. And you just explained to me that that would set the Postal Service back. It would push it in the negative direction by $800 million.

A Correct.

Q Okay.

A Eight hundred million to a billion dollars.

Q Okay. So if we subtract the $800 million from the $2.8 believe, we see that the Postal Service will end test year 2006 with a cumulative net income of $2 billion. Correct?

A Theoretically, correct.

Q And that's what the Postal Service is asking the Commission to approve in this case, those numbers.

Q The Postal Service is asking for a 5.4 percent across-the-board case to deal with the escrow, period.

Q But from what we know about the cumulative net income going into 2006, it will result, as best we can estimate, in a $2 billion cumulative net income.

A There will be a cumulative net income of somewhere on the order of -- you'll have to round it out -- potentially around $2 billion, yes.

Q Okay. Let me ask you, the Postal Service had a cumulative net income of $900 million at the end of Fiscal Year 2004. Is that correct?

A Correct.

Q Did the Postal Service use any of that $900 million for the benefit of rate payers in Fiscal Year 2005?

A Yes, we did.

Q What did you do with it to benefit rate payers?

A We had money in the Treasury, it earned interest, and it generated revenue for us.

Q But you didn't spend that money on any capital projects that might increase productivity in a future period of time.

A We've continued our capital investment where we could offset labor. We've never deviated from those investments. We did have a capital freeze, and when we froze capital, it was strictly on facilities, so we've never deviated from that. One could make a case that some of those monies may have been used for capital investment.

Q And since you didn't deviate from your plans, your long-established plans, that left, that $900 million, as a net income, that was not used for those purposes --

A That was a cumulative net income.

Q The cumulative net income. If they had been used for those purposes, then they wouldn't have shown up -- we wouldn't have been able to add them to the Fiscal Year 2005 net income of $1.64 billion to get a final cumulative net income of $2.54 billion. Isn't that true?

A I'll defer to the finance people. It seems like a very circuitous route you've gotten. The bottom line is there was a cumulative net income.

Q Right. And, in fact, in this filing, even though the Postal Service estimates an additional net income of $1.64 billion in Fiscal Year 2005, there has been no evidence presented in this filing that the $900 million plus the $1.64 billion would be used to benefit mailers in a specific way in the test year. Is that correct?

A I'm not familiar with the total filing, but I'll assume what you say is correct.

MS. DREIFUSS: I'm going to ask you to look at Public Law 108-18 for a moment, please, and I do have copies of that for you, for counsel, and for the commissioners, and anybody else who is interested.

(Pause.)

BY MS. DREIFUSS:

Q Public Law 108-18 was enacted -- it was signed by the president on April 23, 2003. Does that sound about right to you?

A Yes.

Q And, in particular, I want to look at -- this is a lengthy law, so I don't want to look at all of it -- what I want to look at, in particular, is Section 3(a) of this law, and the pages that I've handed to you.

MR. TISDALE: Counsel, could you pause for a second? I don't know if I got that particular handout?

MS. DREIFUSS: I'm sorry. We did hand out the wrong thing. I apologize for giving you the wrong thing. We're going to be looking at a copy of Public Law 108-18, and I'm going to specifically look at Section 3(a). I want to give you a chance to look it over, and let me know when you're ready to talk about it.

(Pause.)

THE WITNESS: I've read it.

BY MS. DREIFUSS:

Q Thank you. In Section 3(a)(1), it says that "the Postal Service shall, to the extent that such savings are attributable to Fiscal Year 2003 or 2004, be used to reduce the postal debt and not incur additional debt." Is that what the Postal Service did in 2003 and 2004?

A Right. We paid down debt. It would have been approximately $6 billion. According to the law, we paid down by over $8 billion.

Q So this would be 3(a)(2): "The Postal Service shall, to the extent that such savings are attributable to Fiscal Year 2005, be used to continue holding postage rates unchanged and to reduce the postal debt." Did the Postal Service take those actions in 2005?

A We didn't raise rates, and we'll know at the end of the year what happens with debt. I can't tell you until the year end, but we're on track to do that.

Q Earlier, I think you agreed that, in large part, the $1.64 billion of net income for Fiscal Year 2005 resulted from being spared a CSRS payment in 2005. Correct?

A Yes.

Q So, in some sense, at least part of that $1.64 billion net is the result of savings, that is, being spared a payment in Fiscal Year 2005, and we know that one of its purposes is to continue holding postage rates unchanged. Now, I know this may be a legal matter, and you may want to defer to counsel, but as I read this, I don't see any limitation here on the year in which savings would be used to hold down postage rates and keep then unchanged. In other words, the savings that are attributable to Fiscal Year 2005 are to be used to continue holding postage rates unchanged and to reduce the postal debt. From what you said a moment ago, it looks like you're very much on track to reduce the postal debt, but it would appear that you have not used the $1.64 billion, which, in large part, are due to savings, CSR savings, to hold down postal rates in a time period after Fiscal Year 2005. Is that correct?

A When this law was constructed, and we looked forward and sat with the people who wrote the law, basically we felt that we would be able to pay down debt in the first two years commensurate with the savings.

In 2004, and the reason this paragraph was written was because we said, at that point in time, even with the savings, we thought we would be in a break-even mode, and going into this fiscal year, that's what we anticipated. What's happened is we've gotten revenue beyond expectations, our cost savings, in terms of the amount of money we've expended for the additional volume, we haven't used the work hours commensurate with that additional volume, and our productivity has risen.

So instead of being at break even, which is what this law was addressing, we actually have made some money. And, in fact, were it not for this law and the requirement of an escrow account, in 2006, we believe we would be just about in a break-even mode, and we would not be here talking about rates.

But the fact of the matter is this law required an escrow account of approximately $3.1 billion, and if you're entering a new fiscal year, and the notion is you're going to break even, how do you generate $3.1 billion? It was a policy decision that was made by the governors to file this case, to do it in an across-the-board manner so we could expedite it so that we would not harm the finances of the Postal Service going forward. It's as simple as that.

This law never addressed what would happen in

2006. Had it addressed what was going to happen in 2006, at the time, we would have told the Congress that, in all likelihood, we would lose about $2 billion. Now, we've worked very hard to change those finances, but if this law were written today, with what we know today, we might have said something different, but at that time, we told them we were going to be filing for a rate increase in 2006, regardless, because our operating costs would have been up that high. So there is no way that this law can be interpreted to refer to anything in 2006, and I don't need counsel to help me because I helped with the construction of it. I know what commitments were made.

MS. DREIFUSS: Well, it looks like I got not only an interpretation of those words but even a little bit of legislative history, and with that, I have no further questions.

I do thank you so much, and I thank you again on those accomplishments you alluded to in your last statement.

THE WITNESS: Thank you.

CHAIRMAN OMAS: Mr. Olson, For the record, would you introduce yourself, please?

MR. OLSON: Yes, Mr. Chairman. William Olson representing Val-Pak Direct Marketing Systems and Val-Pak Dealers Association. I just have a few questions. Thank you for allowing me to ask them.

CROSS-EXAMINATION

BY MR. OLSON:

Q General Potter, I'm going to ask you about a different public law, not 108-18 but just a couple of questions about Public Law 106.384, and that's the law that provides that nonprofit rates are to be as nearly as practicable set at 60 percent of the corresponding commercial rates. Are you generally familiar with that law?

A I'm familiar with that percentage. I would not say I've ever read the law. So if there is a particular reference, I would need to see it.

Q I know your testimony said you weren't coming forward as a costing expert or rate-setting expert, but what I have to do -- I'm not going to quiz you about the statute but just ask you as to where your testimony ends and where the testimony of Witness Taufique begins because he is going to come on the stand after you, and we'll ask him some questions.

Let me tell you what I'm getting at. His testimony said, at page 12, and I'll just ask you to accept this representation, he said that, honoring the 60 percent portion stipulated in the law would require a rate increase for nonprofit ECR on the order of 13 percent, but under the unique circumstances of this request, it was capped to 5.9 percent. We asked him to explain why it was capped, and he refers to you. He said, "The policy reasons stated in Witness Potter's testimony were the basis for the Postal Service's judgment that a higher rate increase for standard mail and ECR was not practicable in this case."

So that reference leads me to this question: Did you direct Witness Taufique as to how to implement Public Law 106.384?

A Not specifically, no. That matter was never brought to my attention. I will tell you this, though. The board of governors directed us to go with an across-the-board rate increase in order to expedite this case, and I think that based on what you've just described to me, the staff are working hard to stay within the direction that we were given.

Q But so far as you know, there was no direction from you or the board of governors to specifically apply the requirements of that law in any particular way.

A Again, it was strictly to expedite this case and to get the monies required for the escrow account to apply an across-the-board rate increase, again the notion of get it done quickly; that was the rationale.

Q And just to clarify, that was the rationale rather than any specific direction that you provided him that I would have to ask you questions about as opposed to asking him.

A It sounds like there is only one answer to that question.

Q Ask Witness Taufique?

A You've got it.

Q Okay. Let me just ask one final question. As the Postal Service's policy witness in this case, if I were to ask you to create a hierarchy of authoritative sources in this case, and I were to say there are public laws written by Congress, and then there are policies of the Postal Service, which would you say is more authoritative?

MR. TISDALE: I'm going to object. You're asking him for a legal opinion. He has testified in very strong fashion on legislative history and his hand at putting together 108-18, but I think I'm going to object to this question as it is well beyond the scope of his testimony and is something that Witness Taufique is chomping at the bit to respond to --

(Laughter.)

MR. TISDALE: -- when he appears tomorrow.

MR. OLSON: In deference to your counsel, I'll withdraw the question.

THE WITNESS: Thank you.

MR. OLSON: Thank you, General.

CHAIRMAN OMAS: Thank you, Mr. Olson.

Is there any follow-up cross-examination?

(No response.)

CHAIRMAN OMAS: Are there any questions from the bench? Commissioner Covington?

COMMISSIONER COVINGTON: Good morning, General Potter. I was quite pleased at the information you shared with us as to what the policy foundation is, you know, in this case, and I was wondering, as a matter of policy, since you are basically seeking the 5.4 rate increase, did the board or did anyone at postal headquarters look at what could be done through borrowing capabilities as opposed to -- knowing that you've got another rate case on the horizon -- as opposed to looking towards the taxpayers and the customers at this point in time?

THE WITNESS: I think the best way, it would be fair to say that we looked at all possibilities. Again, the policy decision in terms of how we would deal with the revenue requirement for 2006 was made by the board, and the path that was chosen was their decision and the direction that they gave us.

COMMISSIONER COVINGTON: So, in other words, when we look at the uncertainty that's still around the proposed postal reform, this was probably the best avenue that you felt you all should pursue at this time.

THE WITNESS: The board, again, gave us that direction. They are the only ones that can make decisions when it comes to filing a rate case. I don't want you to think it was solely my decision. It wasn't. It was the board of governors' decision, and it was their decision that this was the best public policy route to take, given the unique circumstances that we're dealing with.

COMMISSIONER COVINGTON: Okay. Thank you, Mr. PMG.

That's all I have, Mr. Chairman. Thank you,

CHAIRMAN OMAS: Any other questions from the bench?

(No response.)

CHAIRMAN OMAS: There being none, Mr. Tidwell, would you like some time with your witness to review the need for redirect.

MR. TISDALE: Give us five minutes, Mr. Chairman.

CHAIRMAN OMAS: All right. Why don't we take a break, and we'll come back at 10 minutes of the hour?

(Whereupon, at 10:43 a.m., a brief recess was taken.)

CHAIRMAN OMAS: Mr. Tidwell?

MR. TISDALE: Mr. Chairman, the Postal Service has not redirect, but the postmaster general has a brief statement for the record.

CHAIRMAN OMAS: Well, Mr. Potter, why don't you let me dismiss you first? We thank you for your testimony.

We appreciate your appearance today. We appreciate your being a part of this rate case, and as I stated earlier, we appreciate all that you're doing for the United States Postal Service. Thank you very much, and you are now excused.

(The witness was excused.)

CHAIRMAN OMAS: So if you would like to make a statement, we would welcome it.

MR. POTTER: Thank you, Mr. Chairman, and before I leave the stand, I would like to make that statement on behalf of everyone on the Postal Service.

First, I want to express our appreciation to you and your fellow commissioners for establishing procedures and creating an environment that gives the parties pursuing settlement of this case a fair opportunity to explore that feasibility and that possibility.

I also must express appreciation to the many parties who have constructively sat down with the Postal Service to search for common ground and to candidly express their concerns.

And finally, I would like to take this opportunity to confess my admiration for someone who, even with you and me in the room, George, is still the most powerful person here today. Mr. Chairman, at best, you and I can only hope to keep a room full of postal rate attorneys in line most of the time. But I'm told that there is someone here today who is able to keep them all in line all of the time and that she works for you in the docket section, Ms. Joyce Taylor.

(Applause.)

MR. POTTER: Mr. Chairman, again, thank you very much, and that concludes my remarks.

CHAIRMAN OMAS: And thank you, Jack.

Now, I think we're switching gears here. Mr. Koetting?

Mr. Tidwell, it was nice to see you again. It's been a while. I'm sure.

(Pause.)

CHAIRMAN OMAS: Mr. Koetting, would you introduce your witness, please?

MR. KOETTING: It's Mr. Reiter, Mr. Chairman, representing the next witness.

CHAIRMAN OMAS: I'm sorry.

MR. KOETTING: That's okay. Our next witness is William Tayman.

CHAIRMAN OMAS: Mr. Tayman, would you stand, please?

Whereupon,

WILLIAM P. TAYMAN, JR.

having been duly sworn, was called as a witness and was examined and testified as follows:

CHAIRMAN OMAS: Please be seated.

(The document referred to was marked for identification as Exhibit No. USPS-T-6.)

DIRECT EXAMINATION

BY MR. REITER:

Q Mr. Tayman, you have before you two copies of a document entitled "Direct Testimony of William P. Tayman, Jr." on behalf of the United States Postal Service designated USPS-T-6. Was this testimony prepared by you or under your direction?

A Yes, it was.

Q And if you were to give the contents of that document as your oral testimony today, would your testimony be the same?

A Yes, it would.

MR. TIDWELL: Mr. Chairman, I will hand those copies of Mr. Tayman's testimony to the reporter and ask that they be entered into the record.

CHAIRMAN OMAS: Is there any objection?

(No response.)

CHAIRMAN OMAS: Hearing none, I will direct counsel to provide the reporter with two copies of the corrected direct testimony of William P. Tayman, Jr. That testimony is received into evidence. However, as is our practice, it will not be transcribed.

(The document referred to, previously identified as Exhibit No. USPS-T-6 was received in evidence.)

CHAIRMAN OMAS: Mr. Tayman, have you had an opportunity to examine the packet of designated written cross-examination that was made available to you in the hearing room this morning?

THE WITNESS: Yes, I did.

CHAIRMAN OMAS: If the questions contained in that packet were posed to you orally today, would your answers be the same as those previously provided in writing?

THE WITNESS: Yes, they would.

CHAIRMAN OMAS: Are there any corrections or additions you would like to make to those answers?

THE WITNESS: Yes. I have one correction. On OCA USPS T-6-29, I reference October 2005 in the response, and that should be October 2004.

CHAIRMAN OMAS: Counsel, would you please provide two copies of the corrected designated written cross-examination of Witness Tayman to the reporter? That material is received into evidence and is to be transcribed into the record.

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(The document referred to, previously identified as Exhibit No. USPS-T-6 was received in evidence.)

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Request of the United States Postal Service for a Recommended Decision on Changes in Rates of Postage and Fees for Postal Services

Docket No. R2005-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED STATES POSTAL SERVICE
WITNESS WILLIAM P. TAYMAN, JR.
(USPS-T-6)

Party	Interrogatories
Office of the Consumer Advocate	OCA/USPS-T6-1-5, 9, 11-13, 15-47 OCA/USPS-T1-5 redirected to T6
Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association Inc.	VP/USPS-T6-1-3, 3b, 4, 4c, 5-14 VP/USPS-T27-16 redirected to T6

Respectfully submitted,

Steven W. Williams
Secretary

INTERROGATORY RESPONSES OF
UNITED STATES POSTAL SERVICE
WITNESS WILLIAM P. TAYMAN, JR. (T-6)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory	Designating Parties
OCA/USPS-T6-1	OCA
OCA/USPS-T6-2	OCA
OCA/USPS-T6-3	OCA
OCA/USPS-T6-4	OCA
OCA/USPS-T6-5	OCA
OCA/USPS-T6-9	OCA
OCA/USPS-T6-11	OCA
OCA/USPS-T6-12	OCA
OCA/USPS-T6-13	OCA
OCA/USPS-T6-15	OCA
OCA/USPS-T6-16	OCA
OCA/USPS-T6-17	OCA
OCA/USPS-T6-18	OCA
OCA/USPS-T6-19	OCA
OCA/USPS-T6-20	OCA
OCA/USPS-T6-21	OCA
OCA/USPS-T6-22	OCA
OCA/USPS-T6-23	OCA
OCA/USPS-T6-24	OCA
OCA/USPS-T6-25	OCA
OCA/USPS-T6-26	OCA
OCA/USPS-T6-27	OCA
OCA/USPS-T6-28	OCA
OCA/USPS-T6-29	OCA
OCA/USPS-T6-30	OCA
OCA/USPS-T6-31	OCA
OCA/USPS-T6-32	OCA
OCA/USPS-T6-33	OCA
OCA/USPS-T6-34	OCA
OCA/USPS-T6-35	OCA
OCA/USPS-T6-36	OCA
OCA/USPS-T6-37	OCA
OCA/USPS-T6-38	OCA

OCA/USPS-T6-39	OCA
OCA/USPS-T6-40	OCA
OCA/USPS-T6-41	OCA
OCA/USPS-T6-42	OCA
OCA/USPS-T6-43	OCA
OCA/USPS-T6-44	OCA
OCA/USPS-T6-45	OCA
OCA/USPS-T6-46	OCA
OCA/USPS-T6-47	OCA
OCA/USPS-T1-5 redirected to T6	OCA
VP/USPS-T6-1	Valpak
VP/USPS-T6-2	Valpak
VP/USPS-T6-3	Valpak
VP/USPS-T6-3b	Valpak
VP/USPS-T6-4	Valpak
VP/USPS-T6-4c	Valpak
VP/USPS-T6-5	Valpak
VP/USPS-T6-6	Valpak
VP/USPS-T6-7	Valpak
VP/USPS-T6-8	Valpak
VP/USPS-T6-9	Valpak
VP/USPS-T6-10	Valpak
VP/USPS-T6-11	Valpak
VP/USPS-T6-12	Valpak
VP/USPS-T6-13	Valpak
VP/USPS-T6-14	Valpak
VP/USPS-T27-16 redirected to T6	Valpak

United States Postal Service

William P. Tayman, Jr.
(USPS-T-6)

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T6-1. Please refer to your Exhibit USPS 6I.

a. Please confirm that the Postal Service's total net income for the last two complete fiscal years, FY2003 and FY2004, was, in millions, $6,933.388. If you cannot confirm, please explain.

b. Please confirm that when net income for FY2003 and FY2004 are combined with the Postal Service's estimated net income for FY2005, the total net income for the three years, FY2003, FY2004 and FY2005 will be, in millions, $8,576.841. If you cannot confirm, please explain.

c. Please confirm that the cumulative net income at the end of any fiscal year for the Postal Service has never been positive from the inception of the present Postal Service in FY1971 until the end of FY2004. If you cannot confirm, please explain.

d. Please confirm that the Postal Service has never filed a rate case before the Postal Rate Commission at a time when its cumulative net income was a positive amount. If you cannot confirm, please explain.

e. Please confirm that the cumulative net income figure in the "Cumulative NI(Loss)" column for FY2005, in millions, is $2,540.712. If you cannot confirm, please explain.

f. Please confirm that based upon the filing in this proceeding, the total estimated retained earnings of the Postal Service at the end of FY2005, will be the same amount as in subpart e, above, in millions, $2,540.712. If you cannot confirm, please explain.

g. Please confirm that the total estimated FY2006 cumulative net income figure in the "Cumulative NI(Loss)" column if it were extended to FY2006, would be comprised of, in millions, $2,540.712, for the estimated FY2005 Cumulative net income plus, in millions, $112 (Net surplus test year after rates from Exhibit 6A, line 30.) for a total, in millions, of $2,652.712.

h. Please confirm that the "Equity" column in exhibit 6I is the "Cumulative NI (Loss)" plus cash infusions into the Postal Service authorized by Congress at various times. If you cannot confirm, please explain.

i. Please confirm that since 1970, Congress has authorized cash infusions into the Postal service amounting to the difference between the totals in the Equity and Cumulative NI(Loss) columns in your Exhibit USPS 6I, or approximately $3.034 billion. If you cannot confirm, please explain.

j. Please confirm, as shown on your testimony in Table 63 at page 54, (Analysis of Changes in Equity, Ending Balance, Test Year Before Rates) that even if the Postal Service does not raise its rates during FY2006, based upon the estimates filed in this proceeding, the Postal Service equity at the end of FY2006 would be, in millions, a positive $2,532.776 (i.e. $5,574.636 less the Public Law 108-18 escrow payment, in millions, of $3,041.860). If you cannot confirm, please explain.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
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k. Please confirm, as shown on your testimony in Table 63 at page 54, (Analysis of Changes in Equity, Ending Balance, Test Year After Rates) that if the Postal Service raises its rates for FY2006, based upon the estimates filed in this proceeding, the Postal Service equity at the end of FY2006 would be, in millions, a positive $5,686.659 (i.e. rounded $5.7 billion). If you cannot confirm, please explain.

l. In view of the Postal Service's situation regarding retained earnings at the end of FY2005, please confirm that that if rates are not increased in FY2006, then the retained earnings of the Postal Service at the end of FY2006 would be a negative $501 million. If you cannot confirm, please explain.

m. Please confirm that if rates are not increased during FY2006, based upon the Postal Service's filing and your Table 63 at page 54 of your testimony, the Postal Service's equity position at the end of FY2006 would be a positive, in millions, $2,532.776. If you cannot confirm, please explain.

RESPONSE:

a. Confirmed.

b. Confirmed.

c. Confirmed. The positive cumulative net income at the end of FY 2004 is due in large part from the reduction in Civil Service Retirement System (CSRS) expense resulting from Public Law 108-18.

d. This case to fund the escrow expense requirements of Public Law 108-18 is the first case filed before the Postal Rate Commission at a time when its cumulative net income was positive. While the escrow expense is defined by Public Law 108-18 as an operating expense of the Postal Service, the escrow expense is unrelated to postal operations. As I stated on page 18 of my testimony, "In this unique instance, the escrow requirement stands alone as the reason for the proposed increases. Without an escrow requirement, a general rate increase would not be needed." As stated in witness Potter's testimony (USPS-T-1) at page 2 "The Postal Service's decision to seek

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changes in postal rates and fees at this time represents a policy judgment about the most reasonable, practical and effective way to meet a currently unavoidable financial obligation in Fiscal Year 2006. Otherwise, the Postal Service would not have filed this request now. Instead, in all likelihood, we would now be preparing to file in the future a more traditional omnibus filing."

e. Confirmed. Also see my response to parts c. and d. above.

f. Confirmed. See response to part d. above.

g. Confirmed assuming the rate increases proposed in this filing were to be approved as requested and the revised rates were implemented on October 1, 2005. However, it should be noted that because implementation of rates resulting from this filing will not occur October 1, 2005 as assumed in the numbers cited above, the cumulative net income at the end of FY 2006 will be substantially less than $2,652.712 billion. As stated in my testimony at page 54, I project that actual 2006 income will be at least $800 million less than the After Rates projection if rates are implemented in January 2006.

h. Not Confirmed. The "Equity" column includes the equity at Postal Reorganization of $1.686 billion, which represents the difference between the assets and the liabilities transferred at Reorganization, plus the "Cumulative Net Income," plus any capital contributions such as the capital contribution made pursuant to the Postal Reorganization Act Amendments of 1976 (PL 94-421) of $500 million in the Transition Quarter of 1976 and the $500 million contribution in FY 1977. The appropriations language required that these funds be used to reduce operating indebtedness.

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i. Not confirmed. See response to part h. above.

j. Not confirmed. As shown in Table 63 at page 54 of my testimony, estimated total equity at the end of FY 2006 before implementation of new rates is $2,532.776 million. This number represents the beginning equity of $5,574,636 million less the estimated before rates net loss for 2006 of $3,041.860 million. On a before rates basis, the estimated cumulative net loss would be $501 million. However, as shown in Table 10 (Outstanding Debt as a Percentage of Statutory Ceiling) on page 15 of my testimony, this scenario would require increasing outstanding debt to $1,999 million. Doing so would be inconsistent with the requirements of Public Law 108-18 to reduce outstanding debt. Additionally, note that the escrow payment required by Public Law 108-18 is $3.081 billion not $3,041.860 million.

k. See my response to part g. above.

l. Confirmed. See my response to parts d. and j. above.

m. See my response to parts d. and j. above.

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OCA/USPS-T6-2. Please refer to your Exhibit USPS 6A, line 27, "Recovery of Prior Year Losses." Please confirm that the amount shown on that line is a zero amount for the Test Year before rates and Test Year after rates. If you cannot confirm, please explain.

RESPONSE:

Confirmed.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T6-3. Please confirm that in recent past rate cases, in calculating the revenue requirement, the Postal Service and the Commission have included one-ninth of the prior years' losses on this line in order to recover the prior years' losses. If you cannot confirm, please explain.

RESPONSE:

Confirmed as to all past rate cases since Docket No. R77-1.

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OCA/USPS-T6-4. Please refer to your Exhibit USPS 6A, line 27, "Recovery of Prior Year Losses."

a. Please confirm that, theoretically, if prior year gains were to be accounted for in the revenue requirement, the heading of this line could appropriately be styled "Recovery of Prior Year Losses **(Gains).**" If you cannot confirm, please explain.

b. Please explain where the prior year gains (retained earnings) are accounted for currently in the revenue requirement, particularly in your Exhibit USPS6A?

RESPONSE:

a. The theory supporting a provision for recovery of prior years' losses presupposes the existence of a cumulative net loss. As stated in the Commission's Recommended Decision in Docket No. R94-1, at paragraph 2092, "As a matter of fact, revenue must exceed costs if the RPYL is to be accomplished. It is this excess of revenue over costs that, for the Postal Service, would become RPYL. When the total RPYL reaches the goal targeted by the Postal Service, it would no longer be necessary to include such a provision in the revenue requirement." Since there are no prior years' losses to recover, by definition there is no basis for including a recovery provision.

b. There is no provision in the revenue requirement for accounting for cumulative net income.

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OCA/USPS-T6-5. Please refer to your Exhibit USPS 6A, line 27, "Recovery of Prior Year Losses." Please confirm that if the amount shown on line 27 for Test Year Before Rates were the amount of the estimated cumulative net income of the Postal Service at the end of FY 2005, (in millions, $2,540.712), the amount on line 30, "Net Surplus (Deficiency)," would be reduced by a like amount and, therefore, rather than showing a deficiency, in millions, of $3,041.9, the deficiency would be $501.2 million. If you cannot confirm, please explain.

RESPONSE:

Not confirmed. See my response to OCA/USPS-T6-4.

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OCA/USPS-T6-9. Please refer to your testimony at page 16, lines 27-29 where you state, "If borrowing were used to fund the escrow, we would likely exceed the annual borrowing limit of $3 billion in FY2007." Please also refer to Table 10, page 15, of your testimony showing the FY2006 before rates total debt increasing by 0.999 billion over the FY2005 total debt of 1.0 billion. Please confirm that if the proposed rates did not become effective during FY2006, the Postal Service would not exceed the annual borrowing limit of $3 billion in FY2006.

RESPONSE:

Confirmed.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T6-11. The following interrogatory refers to Appendix A and Exhibit USPS-6O of your testimony as well as USPS-LR-K-50, page 315.

a. Please confirm that a portion of the $3.1 billion ($3,081.016 million) escrow payment scheduled for FY 2006 and required by Public Law 108-18 relates to the requirement to fund postal employees and retirees CSRS benefits earned through military service.

b. If you are unable to confirm part a of this interrogatory, please explain fully.

c. If you confirm part a of this interrogatory, please explain how much of the $3.1 billion escrow payment relates to:
   (i) CSRS benefits earned through military service, and
   (ii) CSRS benefits not earned through military service.

d. For parts c(i) and c(ii) of this interrogatory, please show the derivation of all calculated values, cite all source documents and provide copies of source documents not previously provided in this docket. Please state any assumptions made in preparing page 315 of LR-K-50 or responding to part c of this interrogatory.

Response:

a. Not confirmed.

b. As explained on page 11, line 2 of my testimony the escrow, ""savings" are determined as the annual difference between what the Postal Service would have paid annually into the CSRDF prior to Public Law 108-18 less the amount paid after application of the new funding provisions of the law." I further explain on page 12, line 4 that "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." Also explained on page 9 of my testimony is the basis for correcting the $105 billion over funding that would have resulted had the

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then current funding mechanism remained in place. The new funding mechanism consists of dynamic normal cost contributions of totaling 24.4% (17.4% employer and 7.0% employee contribution) and a supplemental liability to cover any excess of the actuarial present value of the postal Service CSRS obligations over the fund balance and future normal cost payments, including earnings on those payments. Thus, the combination of payments made in prior years, actual interest earnings and the new funding mechanism, not the escrow payment, covers the $27 billion in CSRS obligations related to current and former employees' military service transferred to the Postal Service under Public Law 108-18.

c. See my responses to a and b.

d. See my responses to a and b. As noted in the LR K-50 Table of Contents (page 3), the work paper included at pages 314 and 315 was prepared by the Office of Personnel Management, as required by Public Law 108-18.

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OCA/USPS-T6-12. In a manner similar to the response provided in response to OCA/USPS-T6-1 (a) in Docket No. R2001-1, please provide the USPS FY 2005 Operating Plan by accounting periods for operating revenues, appropriations, investment income, expenses and volumes, with operating revenues broken out my mail class and subclass cost categories.

Response:

Attachments A and B provide the requested information.

The Operating Budget of the Postal Service is approved at the beginning of each fiscal year by the Board of Governors. Once approved, the total annual budget does not change. However, the Postal Service employs a flexible budget process.

When using flexible budgeting, monthly expense line item adjustments reflecting changes in workload and other management decisions can be made. When workload is greater than plan, workload sensitive expenses are increased. In order to maintain the total annual expense budget, offsetting adjustments are applied to the miscellaneous expense budget line item.

($ Millions)	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	FY 2005
Operating Revenue	$5,842	$5,697	$ 6,623	$5,719	$5,255	$ 5,975	$5,670	$5,409	$ 5,678	$5,244	$5,589	$ 5,589	$68,290
***Appropriations* ***	*5*	*5*	*5*	*5*	*5*	*5*	*5*	*5*	*5*	*5*	*5*	*5*	*62*
Investment Income	2	3	3	4	4	4	5	6	6	6	5	3	50
Total Revenue	5,845	5,700	6,626	5,723	5,259	5,979	5,675	5,414	5,684	5,249	5,594	5,592	68,340
Total All Expenses	5,535	5,520	6,192	5,795	5,372	6,001	5,691	5,629	5,652	5,492	5,841	5,813	68,532
Net Income/(Loss)	$ 310	$ 180	$ 434	$ (72)	$ (113)	$ (22)	$ (16)	$ (215)	$ 32	$ (242)	$ (247)	$ (222)	$ (192)
Volume *(Millions)*	17,970	17,795	18,971	17,211	15,924	18,011	16,888	16,255	17,181	15,664	17,049	17,558	206,476
Quarterly Operating Revenue			$18,162			$16,950			$16,756			$16,421	$68,290

** Non-Add, Included in Operating Revenue*

Note: Totals May Not Add Due to Rounding

($ Millions)	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	FY 2005
FIRST-CLASS MAIL													
First-Class Letters & Flats	2,776.1	2,767.6	3,422.5	2,990.2	2,609.6	2,953.8	2,812.5	2,727.9	2,868.0	2,717.2	2,710.8	2,676.2	34,032.3
-- Single-Piece	1,610.4	1,598.8	2,178.3	1,656.4	1,499.8	1,766.5	1,658.9	1,599.5	1,694.5	1,584.9	1,563.9	1,587.6	19,999.6
-- Workshared	1,165.7	1,168.9	1,244.2	1,333.8	1,109.7	1,187.3	1,153.6	1,128.5	1,173.5	1,132.3	1,146.8	1,088.5	14,032.8
(Nonautomated Presort)	61.5	62.8	64.9	71.8	61.3	64.6	62.2	60.2	66.2	59.8	61.4	60.4	757.2
(Automated)	1,104.1	1,106.0	1,179.2	1,262.0	1,048.4	1,122.7	1,091.4	1,068.3	1,107.3	1,072.5	1,085.5	1,028.1	13,275.6
First-Class Cards	98.6	103.6	93.5	97.0	83.1	100.7	94.3	87.9	101.4	89.5	91.2	97.0	1,137.9
-- Single-Piece Cards	55.2	56.9	46.4	50.4	43.7	56.9	51.8	47.6	53.1	46.5	48.1	54.9	611.5
-- Workshared Cards	43.4	46.7	47.1	46.6	39.5	43.8	42.5	40.3	48.3	42.9	43.0	42.1	526.4
(Nonautomated Presort Cards)	7.0	7.0	7.3	6.3	5.8	7.9	6.1	5.9	8.3	6.4	6.9	6.6	81.4
(Automated Cards)	36.4	39.7	39.8	40.3	33.7	35.9	36.4	34.5	40.0	36.5	36.2	35.6	445.0
(First-Class Mailing Fees)	21.0	25.4	27.2	24.4	19.0	23.3	23.2	20.4	22.7	20.8	21.6	21.9	270.8
TOTAL FIRST-CLASS MAIL	**2,895.8**	**2,896.6**	**3,543.2**	**3,111.5**	**2,711.7**	**3,077.8**	**2,930.0**	**2,836.3**	**2,992.1**	**2,827.4**	**2,823.5**	**2,795.1**	**35,441.0**
Priority Mail	331.7	354.8	557.4	331.9	335.8	378.7	348.1	315.4	341.8	290.9	332.2	314.0	4,232.5
(Priority Mail Fees)	0.2	0.2	0.3	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	2.8
Total Priority Mail	**331.9**	**355.0**	**557.7**	**332.1**	**336.1**	**378.9**	**348.3**	**315.6**	**342.1**	**291.1**	**332.4**	**314.2**	**4,235.3**
Express Mail	65.6	63.9	87.5	66.8	68.2	77.4	71.1	69.9	75.8	66.1	72.4	67.6	852.3
Mailgrams	0.0	0.1	0.0	0.1	0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.6
PERIODICAL MAIL													
In County	5.5	5.8	5.8	4.8	5.4	5.3	5.3	5.3	5.9	5.3	5.6	5.2	65.1
Regular	150.3	146.7	146.9	123.9	140.6	151.7	144.2	128.8	151.9	125.3	130.9	141.4	1,682.5
Special Nonprofit	30.0	26.3	28.5	27.0	30.6	31.2	29.4	25.7	27.9	22.3	30.8	25.4	335.1
Classroom	2.1	1.1	1.3	1.1	1.2	1.5	2.1	0.8	0.7	0.7	1.6	1.0	15.4
(Periodical Mailing Fees)	1.7	1.6	1.6	1.7	1.4	1.8	1.6	1.7	1.5	1.5	1.6	1.5	19.1
Total Periodical Mail	**189.6**	**181.5**	**184.0**	**158.5**	**179.2**	**191.5**	**182.6**	**162.3**	**188.0**	**155.0**	**170.4**	**174.5**	**2,117.1**
STANDARD MAIL													
Regular Rate Bulk	1,616.5	1,467.1	1,328.6	1,318.5	1,273.7	1,502.9	1,437.7	1,363.6	1,366.7	1,244.4	1,443.4	1,486.3	16,849.2
Regular	1,072.6	973.4	892.6	940.1	872.0	1,050.3	999.9	964.0	965.3	864.7	999.2	1,022.7	11,616.9
-- Nonautomated Rglr	117.9	110.9	105.9	102.4	95.2	115.5	116.3	109.6	105.5	98.4	110.2	110.0	1,297.8
-- Automated Rglr	954.7	862.5	786.7	837.7	776.8	934.8	883.6	854.4	859.9	766.3	889.0	912.7	10,319.0
Enhanced Carrier-Route	543.9	493.7	436.0	378.4	401.7	452.5	437.8	399.6	401.4	379.7	444.2	463.5	5,232.3
-- Nonautomated ECR	515.9	467.2	409.2	354.7	380.8	426.8	415.2	375.8	378.0	357.7	420.3	436.9	4,938.4
-- Automated ECR	28.0	26.5	26.8	23.6	20.9	25.7	22.6	23.8	23.4	22.1	23.8	26.7	294.0
Nonprofit Rate Bulk	**184.3**	**180.5**	**168.2**	**144.2**	**138.0**	**157.6**	**137.3**	**133.2**	**129.9**	**120.8**	**155.9**	**175.1**	**1,824.9**
Nonprofit	157.7	159.2	143.8	123.7	120.7	136.3	117.7	116.1	112.7	104.0	133.2	153.3	1,578.5
-- Nonautomated (NP)	31.4	31.4	30.6	23.6	24.7	27.8	25.0	22.3	20.9	19.4	25.0	28.9	311.0
-- Automated (NP)	126.3	127.8	113.3	100.1	96.0	108.5	92.8	93.8	91.7	84.6	108.2	124.4	1,267.4
Nonprofit ECR	26.6	21.3	24.3	20.5	17.3	21.4	19.6	17.1	17.2	16.7	22.7	21.7	246.4
-- Nonautomated (NP ECR)	24.5	19.6	22.9	18.9	16.0	19.9	18.4	15.6	15.8	15.6	20.9	20.1	228.3
-- Automated (NP ECR)	2.1	1.7	1.4	1.6	1.3	1.5	1.1	1.5	1.4	1.1	1.8	1.6	18.1
(Standard Mailing Fees)	7.6	9.8	13.3	10.7	7.7	8.0	8.8	8.0	8.0	8.0	9.1	9.7	108.6
Total Standard Mail	**1,808.3**	**1,657.4**	**1,510.0**	**1,473.3**	**1,419.3**	**1,668.5**	**1,583.8**	**1,504.8**	**1,504.6**	**1,373.2**	**1,608.4**	**1,671.0**	**18,782.6**

Note: Totals May Not Add Due to Rounding

($ Millions)	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	FY 2005
Parcel Post	97.3	113.6	181.4	97.4	88.0	97.1	89.9	86.5	92.9	85.6	101.4	93.7	1,224.7
Bound Printed Matter	48.9	45.0	56.2	53.1	48.6	52.9	41.9	38.9	48.6	51.2	56.5	56.5	598.3
Media Mail	28.0	30.9	33.2	29.0	26.9	31.2	28.2	28.3	30.7	27.5	30.3	32.8	357.1
Library Rate	2.7	3.0	2.5	2.5	2.3	3.1	2.9	2.4	2.4	2.5	2.4	2.6	31.3
(Package Services Mailing Fees)	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	2.7
Total Package Services Mail	**177.1**	**192.7**	**273.5**	**182.3**	**166.0**	**184.5**	**163.1**	**156.3**	**174.8**	**167.0**	**190.7**	**185.9**	**2,214.0**
Total Domestic Mail	**5,468.4**	**5,347.3**	**6,155.9**	**5,324.7**	**4,880.6**	**5,578.7**	**5,279.0**	**5,045.2**	**5,277.3**	**4,875.9**	**5,201.9**	**5,208.3**	**63,643.0**
International Mail	102.6	118.5	176.4	114.8	122.1	124.2	109.2	115.8	112.3	109.1	125.1	112.4	1,442.4
(International Fees)	2.5	2.6	2.1	2.4	3.0	1.8	2.9	2.4	2.2	1.3	1.4	4.9	29.7
(Terminal Dues)	29.4	23.1	18.5	27.3	25.2	17.9	29.1	9.2	35.5	29.5	28.9	4.7	278.4
Total International Mail	**134.5**	**144.2**	**197.0**	**144.6**	**150.4**	**144.0**	**141.2**	**127.4**	**150.0**	**139.9**	**155.4**	**122.0**	**1,750.5**
TOTAL MAIL	**5,602.9**	**5,491.5**	**6,352.8**	**5,469.2**	**5,030.9**	**5,722.6**	**5,420.2**	**5,172.5**	**5,427.4**	**5,019.7**	**5,353.3**	**5,330.4**	**65,393.5**
Serv, & Fees	**186.3**	**185.6**	**213.2**	**195.7**	**188.2**	**214.1**	**204.4**	**191.9**	**219.7**	**194.1**	**197.7**	**221.8**	**2,412.7**
Miscellaneous & Other Revenue	**48.0**	**13.6**	**52.2**	**49.4**	**32.7**	**32.0**	**39.9**	**40.0**	**25.0**	**24.3**	**32.3**	**32.3**	**421.7**
Appropriations	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	61.7
Total Operating Revenue *	**5,842.3**	**5,695.9**	**6,623.4**	**5,719.5**	**5,256.9**	**5,973.8**	**5,669.6**	**5,409.6**	**5,677.2**	**5,243.3**	**5,588.5**	**5,589.6**	**68,289.6**
Quarterly Totals			**18,162**			**16,950**			**16,756**			**16,421**	**68,289.6**

* Monthly totals may vary from Attachment A. However, quarterly totals remain constant.

Note: Totals May Not Add Due to Rounding

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T6-13. Please provide the USPS FY 2005 budget broken down by accounting period as used in the following schedules and pages of the Financial and Operating Statements filed each accounting period with the Commission.

a. Highlights (page 1)
b. Statement of Income & Expense (page 2)
c. Revenue by Category (page 6)
d. Expense Analysis (page 7)
e. Analysis of Operating Expenses (page 8)
f. Analysis of Non-Personnel Expenses (page 9)
g. Work hours & Overtime/Sick Leave Ratios (page 14)

Response:

Attachments A through G provide the FY 2005 budget by months (accounting periods) based on the schedules and pages of the Financial and Operating Statements outlined above. One exception is noted. In part g, a sick leave ratio plan is requested. Although actual and prior year sick leave ratios are provided in the Financial and Operating Statements, planned sick leave ratios are not included and are not available. Also see my response to OCA/USPS-T6-12 for a description of the flexible budget process.

Highlights (FOS Page 1)

(Millions)	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	FY 2005
Total Revenue	$ 5,845	$ 5,700	$ 6,626	$ 5,723	$ 5,259	$ 5,979	$ 5,675	$ 5,414	$ 5,684	$ 5,249	$ 5,594	$ 5,592	$ 68,340
Total Expenses	5,535	5,520	6,192	5,795	5,372	6,001	5,691	5,629	5,652	5,492	5,841	5,813	68,532
Net Income/(Loss)	$ 310	$ 180	$ 434	$ (72)	$ (113)	$ (22)	$ (16)	$ (215)	$ 32	$ (242)	$ (247)	$ (222)	$ (192)
Capital Commitments	$ 63	$ 44	$ 418	$ 125	$ 144	$ 79	$ 63	$ 155	$ 315	$ 94	$ 1,449	$ 327	$ 3,276
Total Workhours	121.0	117.4	133.7	117.9	110.8	126.9	120.8	118.0	119.2	115.6	124.1	119.9	1,445.4

Note: Totals May Not Add Due to Rounding

Statement of Income and Expenses (FOS Page 2)

($ Millions)	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	FY 2005
Operating Revenue	$ 5,842.3	$ 5,697.4	$ 6,622.6	$ 5,719.4	$ 5,255.5	$ 5,975.2	$ 5,669.5	$ 5,408.7	$ 5,678.1	$ 5,243.8	$ 5,588.5	$ 5,588.6	$ 68,289.6
Operating Expenses	5,514.9	5,501.2	6,173.7	5,776.6	5,353.7	5,982.9	5,672.3	5,610.8	5,633.3	5,473.1	5,822.7	5,793.7	68,308.9
Income/(Loss) from Operations	327.4	196.2	448.9	(57.2)	(98.2)	(7.7)	(2.8)	(202.1)	44.8	(229.3)	(234.1)	(205.0)	(19.2)
Investment Income	2.3	2.7	3.2	3.6	3.9	4.3	5.4	5.7	5.5	5.7	5.2	3.1	50.4
Interest Expense	1.7	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	1.5	6.4
Interest on Deferred Retirement Obligations	18.1	18.1	18.1	18.1	18.1	18.1	18.1	18.1	18.1	18.1	18.1	18.1	217.2
Net Income/(Loss)	$ 309.9	$ 180.5	$ 433.7	$ (72.0)	$ (112.7)	$ (21.8)	$ (15.9)	$ (214.9)	$ 31.9	$ (242.0)	$ (247.3)	$ (221.6)	$ (192.3)

Note: Totals May Not Add Due to Rounding

Revenue by Category (FOS Page 6)

($ Millions)	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	FY 2005
Permit Imprint	$ 2,615.1	$ 2,496.1	$ 2,493.5	$ 2,428.5	$ 2,251.6	$ 2,566.0	$ 2,444.4	$ 2,342.7	$ 2,405.1	$ 2,269.6	$ 2,470.5	$ 2,487.7	$29,270.9
Other Commercial Revenue	1,863.2	1,763.5	1,915.3	1,911.6	1,674.1	1,924.7	1,841.7	1,747.3	1,868.0	1,699.8	1,769.5	1,756.0	21,734.8
Total Commercial Revenue	4,478.3	4,259.7	4,408.8	4,340.1	3,925.8	4,490.7	4,286.1	4,090.0	4,273.1	3,969.4	4,239.9	4,243.7	51,005.7
Retail Postage	1,052.9	1,128.3	1,764.4	1,055.9	1,023.3	1,148.4	1,084.0	1,016.0	1,091.8	976.0	1,021.4	1,029.4	13,391.8
Retail Services	89.4	88.1	127.5	93.8	88.0	99.9	92.5	87.0	104.6	89.2	89.3	89.1	1,138.4
Retail Products	10.8	11.4	30.2	14.3	12.0	12.3	12.2	12.1	13.3	12.9	13.8	10.4	165.7
Other Retail Channels	160.1	164.1	244.0	168.8	163.6	188.2	169.9	156.0	171.0	157.6	159.5	180.0	2,082.9
Total Retail Revenue	1,313.2	1,391.9	2,166.0	1,332.9	1,286.9	1,448.8	1,358.7	1,271.0	1,380.7	1,235.7	1,284.0	1,309.0	16,778.8
Total Commercial and Retail Revenue	5,791.5	5,651.6	6,574.8	5,672.9	5,212.6	5,939.5	5,644.8	5,361.1	5,653.8	5,205.1	5,523.9	5,552.7	67,784.5
Other Income	45.6	40.7	42.7	41.3	37.7	30.5	19.6	42.5	19.1	33.5	59.5	30.8	443.5
Appropriations	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	61.7
Total Operating Revenue	5,842.3	5,697.4	6,622.6	5,719.4	5,255.5	5,975.2	5,669.5	5,408.7	5,678.1	5,243.8	5,588.5	5,588.6	68,289.6
Investment Income	2.3	2.7	3.2	3.6	3.9	4.3	5.4	5.7	5.5	5.7	5.2	3.1	50.4
Total Revenue	$ 5,845	$ 5,700	$ 6,626	$ 5,723	$ 5,259	$ 5,979	$ 5,675	$ 5,414	$ 5,684	$ 5,249	$ 5,594	$ 5,592	$ 68,340

Note: Totals May Not Add Due to Rounding

Expense Analysis (FOS Page 7)

($ Millions)	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	FY 2005
Personnel Compensation	$ 4,447.0	$ 4,330.9	$ 4,848.5	$ 4,457.4	$ 4,137.7	$ 4,715.7	$ 4,482.3	$ 4,442.7	$ 4,530.5	$ 4,379.1	$ 4,697.5	$ 4,593.1	$ 54,062.3
Non-Personnel Expense													
Transportation	403.2	390.9	536.7	478.3	409.3	427.6	406.1	427.7	392.8	407.3	424.4	411.8	5,116.1
Supplies and Services	174.0	203.6	227.4	256.8	225.5	222.4	210.9	233.2	203.0	176.0	215.7	314.7	2,663.3
Other	490.7	575.8	561.1	584.1	581.2	617.2	573.1	507.2	507.0	510.7	485.1	474.0	6,467.2
Subtotal	1,067.9	1,170.3	1,325.2	1,319.2	1,216.0	1,267.2	1,190.0	1,168.1	1,102.8	1,094.1	1,125.2	1,200.6	14,246.6
Total Operating Expense	5,514.9	5,501.2	6,173.7	5,776.6	5,353.7	5,982.9	5,672.3	5,610.8	5,633.3	5,473.1	5,822.7	5,793.7	68,308.9
Interest Expense	1.7	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	1.5	6.4
Interest on Deferred Retirement Obligations	18.1	18.1	18.1	18.1	18.1	18.1	18.1	18.1	18.1	18.1	18.1	18.1	217.2
Total Expense	$ 5,534.7	$ 5,519.7	$ 6,192.1	$ 5,795.0	$ 5,372.1	$ 6,001.3	$ 5,690.8	$ 5,629.2	$ 5,651.7	$ 5,491.5	$ 5,841.1	$ 5,813.3	$ 68,532.4

Note: Totals May Not Add Due to Rounding

Analysis of Operating Expenses (FOS Page 8)

($ Millions)	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	FY 2005
Operations													
-Support	$ 31.6	$ 31.6	$ 32.8	$ 33.1	$ 31.0	$ 37.4	$ 33.8	$ 34.8	$ 36.7	$ 33.0	$ 37.9	$ 35.0	$ 408.7
-Mail Processing	963.5	937.2	1,096.6	970.1	884.5	987.9	934.6	934.6	913.2	904.5	950.5	944.5	11,421.6
-Rural Delivery	405.3	395.1	454.2	407.7	382.7	454.2	435.3	425.3	445.6	428.9	462.9	436.8	5,134.0
-City Delivery	1,354.8	1,335.5	1,477.2	1,352.8	1,251.1	1,450.1	1,382.5	1,350.8	1,398.6	1,346.7	1,460.2	1,388.4	16,548.6
-Vehicle Services	97.6	95.9	108.5	98.3	91.4	106.2	99.0	98.2	100.2	95.5	102.7	97.5	1,191.1
-Plant & Equip Maint	254.4	246.3	268.3	254.3	235.9	273.6	255.8	254.0	256.8	245.8	265.5	254.3	3,065.0
-Customer Services	653.4	642.1	742.6	654.8	609.2	702.8	660.8	654.3	682.5	651.6	708.4	676.3	8,038.7
Finance	19.0	18.8	19.6	19.7	18.5	22.2	19.6	19.6	20.6	19.2	21.8	20.2	238.8
Human Resources	29.8	29.6	30.4	30.7	28.7	34.4	31.3	33.1	34.4	31.9	36.2	33.8	384.2
Customer Service & Sales	43.1	42.7	44.0	43.2	40.2	47.8	44.3	44.3	46.6	42.8	48.6	46.2	533.7
Administration Field	199.5	196.3	215.4	202.1	190.6	226.0	214.1	213.8	223.8	208.1	229.8	213.6	2,533.3
Other Salaries & Benefits	151.8	115.9	117.7	117.7	117.3	119.3	117.2	117.8	118.5	117.1	118.5	206.5	1,535.2
Total Salaries and Benefits	4,203.9	4,087.0	4,607.3	4,184.5	3,881.0	4,461.8	4,228.4	4,180.6	4,277.4	4,124.9	4,443.0	4,353.1	51,032.9
Workers Compensation	107.9	107.9	107.9	104.9	104.9	104.9	104.9	104.9	104.9	104.9	104.9	87.6	1,250.4
Unemployment Compensation	4.5	4.5	4.5	5.4	5.4	5.5	4.8	4.8	4.7	6.0	6.0	6.1	62.2
Deferred Retirement	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	22.8
Annuitant Health Benefits	115.7	115.7	115.7	129.7	129.7	129.7	129.7	129.7	129.7	129.7	129.7	129.7	1,514.0
Other Compensation	13.1	13.9	11.2	31.0	14.8	12.0	12.7	20.9	11.9	11.7	12.0	14.8	180.1
Total Personnel Compensation	$ 4,447.0	$ 4,330.9	$ 4,848.5	$ 4,457.4	$ 4,137.7	$ 4,715.7	$ 4,482.3	$ 4,442.7	$ 4,530.5	$ 4,379.1	$ 4,697.5	$ 4,593.2	$ 54,062.4

Note: Totals May Not Add Due to Rounding

Anlysis of Non Personnel Expenses (FOS Page 9)

($ Millions)	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	FY 2005
Transportation	$ 403.2	$ 390.9	$ 536.7	$ 478.3	$ 409.3	$ 427.6	$ 406.1	$ 427.7	$ 392.8	$ 407.3	$ 424.4	$ 411.8	$ 5,116.1
Supplies and Services	174.0	203.6	227.4	256.8	225.5	222.4	210.9	233.2	203.0	176.0	215.7	314.7	2,663.3
Depreciation	164.5	171.7	178.9	183.1	182.1	181.4	183.3	186.8	177.1	178.2	179.5	174.4	2,140.9
Rent	82.6	88.3	92.5	88.0	89.2	86.6	86.8	83.9	84.8	86.9	84.8	87.9	1,042.3
Utilities and Heating Fuel	39.4	43.9	45.0	48.0	51.7	59.1	42.5	42.5	44.8	43.4	49.5	55.1	564.9
Rural Carrier Equip Maint	49.2	34.5	37.1	34.5	36.2	35.9	54.1	38.5	37.1	37.4	38.0	53.4	485.8
Vehicle Maintenance	37.7	42.6	53.0	42.1	43.3	54.0	39.3	41.1	44.6	36.2	39.1	41.6	514.6
Information Technology	42.1	69.3	42.9	25.4	27.1	30.0	34.1	34.2	34.5	48.2	61.6	81.8	531.2
Building Projects Expensed	12.5	16.7	21.7	17.3	18.7	17.0	18.4	16.6	18.9	19.4	19.6	23.4	220.2
Contract Job Cleaners	7.1	7.3	7.5	7.6	6.7	7.3	7.2	7.1	7.3	6.9	7.3	7.5	86.8
Travel & Relocation	13.9	15.9	16.5	14.3	21.1	18.4	18.3	22.3	15.4	14.7	18.6	19.8	209.2
Communications	16.2	19.1	18.7	18.4	18.6	19.9	18.9	19.0	19.0	18.6	19.6	24.0	230.1
Contract Stations	6.2	5.8	7.0	6.9	6.0	7.1	6.5	6.7	6.6	6.8	6.7	7.3	79.7
Printing	2.0	2.7	2.8	2.3	2.4	3.1	2.5	2.5	2.4	2.8	2.4	3.6	31.3
Training	4.8	5.1	6.0	5.3	5.7	7.1	6.1	5.8	6.0	5.5	6.1	7.3	70.9
Carfare and tolls	2.7	2.8	3.0	3.1	2.9	3.8	2.9	2.9	2.8	2.8	3.0	3.7	36.4
Vehicle hire	1.4	1.5	1.5	1.7	1.9	1.8	1.5	1.3	1.3	1.2	1.3	1.7	18.1
Accident Costs	3.5	3.6	4.3	4.7	3.7	4.3	3.2	4.0	5.5	5.4	5.2	6.0	53.6
Miscellaneous Exp	24.8	45.0	22.4	61.6	63.9	80.4	47.4	(8.0)	(1.1)	(3.8)	(57.1)	(124.4)	151.2
Total Non-Personnel Expenses	$ 1,087.9	$ 1,170.3	$ 1,325.2	$ 1,299.2	$ 1,216.0	$ 1,267.2	$ 1,190.0	$ 1,168.1	$ 1,102.8	$ 1,094.1	$ 1,125.2	$ 1,200.6	$ 14,246.6

Note: Totals May Not Add Due to Rounding

Total Workhours (FOS Page 14)

(Thousands)	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	FY 2005
-Support	751	731	765	744	712	854	778	792	818	742	847	792	9,324
-Mail Processing	28,235	27,497	32,912	27,626	25,494	28,275	26,811	26,655	25,684	25,541	26,775	26,970	328,476
-Rural Delivery	14,346	13,877	15,918	14,035	13,279	15,628	15,126	14,611	15,130	14,632	15,787	14,814	177,183
-City Delivery	38,799	37,643	41,754	37,521	35,274	40,783	39,027	37,638	38,506	37,336	40,223	38,372	462,875
-Vehicle Services	2,660	2,574	2,926	2,607	2,456	2,852	2,664	2,610	2,616	2,512	2,681	2,578	31,738
-Plant & Equip Maint	7,020	6,691	7,286	6,795	6,413	7,387	6,950	6,864	6,834	6,600	7,113	6,885	82,837
-Customer Services	19,149	18,624	21,726	18,741	17,717	20,307	19,126	18,645	19,113	18,373	19,880	19,243	230,643
Finance	464	452	474	461	443	530	483	486	501	469	528	498	5,790
Human Resources	724	703	729	709	675	806	734	760	775	724	816	769	8,924
Customer Service & Sales	1,164	1,126	1,172	1,136	1,075	1,270	1,176	1,155	1,189	1,105	1,245	1,192	14,007
Administration Field	5,442	5,316	5,868	5,291	5,084	6,008	5,729	5,582	5,757	5,399	5,958	5,547	66,981
Other	2,232	2,180	2,214	2,197	2,178	2,239	2,210	2,224	2,239	2,208	2,245	2,229	26,596
All Workhours	120,986	117,414	133,744	117,864	110,802	126,940	120,813	118,022	119,162	115,640	124,098	119,889	1,445,372
OT Percentage	8.1%	8.6%	9.2%	8.4%	8.4%	7.8%	8.1%	7.7%	7.7%	8.3%	8.0%	8.0%	8.2%

Note: Totals May Not Add Due to Rounding

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T6-15. Please refer to the "Equity" column in your Exhibit 6I and your response to OCA/USPS-T6-1h.

a. Please confirm that the difference between the total Equity of $5,574.636 million and the sum of the initial equity of $1,685.717 million and "Cumulative Net Income" of $2,540.712 million of the Postal Service is made up solely of appropriations.
b. Please confirm the total appropriations included in the Equity column of that exhibit are a total of $1,348.207 million.
c. Please list separately all of the appropriations included in the Equity column and the dates those appropriations were received by the Postal Service.
d. Please confirm that the Postal Reorganization Act Amendments of 1976 (PL94-421) authorized to be appropriated $500 million for each of two years to be applied against the accumulated operating indebtedness of the Postal Service as of September 30,1976 and 1977.
e. Please indicate whether any of the appropriations other than those referred to in d, above, were authorized by Congress with the requirement that the funds must be used to reduce operating indebtedness.
f. Does the Postal Service currently have "operating indebtedness?" If so, what is it now and what will it be by the end of FY 2005?
g. Please identify where the appropriations included in the Equity column, cited above, were taken into account in determining the Postal Service's revenue requirement.

Response:

a. Not confirmed. Property transfers to and from the Postal Service are also included in total equity.

b. Not confirmed. Net property transfers would also be reflected in this total.

c. Appropriations received by the Postal Service are documented in the footnotes to Postal Service Annual Reports

d. Confirmed. PL 94-421 also placed restrictions on raising rates, reducing service, and closing post offices.

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e. I am not aware that any other capital contributions had such a requirement.

f. The Postal Service currently has no operating debt and does not anticipate any at the end of FY 2005.

g. Equity is not a component of the revenue requirement.

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OCA/USPS-T6-16. Please refer to your response to OCA/USPS-T6-1j where you state that if Postal Service rates are not increased in FY 2006 the outstanding debt would increase to $1.999 billion. You also state that increasing the debt would be inconsistent with the Public Law 108-18 requirement to reduce outstanding debt.

a. If the Postal Service makes the required escrow payment in FY 2006 of $3.1 billion as required by the Public Law 108-18, what are the foregone escrow payment savings in FY 2006?
b. Please explain why the Postal Service is bound in FY 2006 by the terms of Public Law 108-18 providing that foregone escrow payment savings are to reduce outstanding debt in FY 2006.
c. Once the Postal Service recommences paying the escrow amount in FY 2006, why is it still bound by the requirement in Public Law 108-18 to reduce outstanding debt?
d. Is the Postal Service prohibited from increasing outstanding debt in FY 2006 by the terms of Public Law 108-18? If so, please cite to the language or the legislative history to support your conclusion.

Response:

a. I do not know what is meant by "foregone escrow payment savings."

b. Public Law 108-18 does not require the reduction of outstanding debt beyond FY 2005.

c. See my response to b.

d. See my response to b.

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OCA/USPS-T6-17. Please refer to your response to OCA/USPS-T6-4a. Your response discusses the fact that there are currently no prior year's losses. The question is intended to focus rather on the current situation where there are prior years gains, "cumulative net income." Please confirm that in calculating the Postal Service's revenue requirement, if the Commission wishes to reduce accumulated past years gains smoothly and to conform the timing of the recovery of those gains more nearly in time with mailers who were responsible for the gains, the Commission could reverse the methodology used for handling past year's losses and insert in USPS 6A, line 27, a negative number (rather than a positive number) to reduce the revenue requirement so as to reduce accumulated past year gains at a measured pace over a particular period of time.

Response:

Not confirmed. The type of mechanism that was applied to recover prior years' losses in the context of accumulated net deficits cannot simply be inverted and applied to gains and be assumed to be consistent with the policy of break-even over time. For example, the cost of land has not been included in the revenue requirement even though all mailers have benefited from use of facilities located on the land, and, at the same time, gains from the sale of land have been recognized as reductions to the revenue requirement. Since 1971 the Postal Service's investment in land has increased from $155 million to $2,810 million. Accordingly, it is appropriate for the Postal Service to maintain cumulative net income.

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OCA/USPS-T6-18. Please confirm that an alternative method of providing for returning the Postal Service's cumulative net income to zero, rather than adjusting the revenue requirement as suggested in OCA/USPS-T6-17, is for the Postal Service to defer implementing a rate increase beyond the date that the test year may demonstrate an annual loss until such time as the cumulative net income will be drawn down to approximately zero.

Response:

See my response to OCA/USPS-T6-17.

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OCA/USPS-T6-19 Please confirm that Table 10, page 15, of your testimony indicates the Postal Service had debt outstanding to the Federal Financing Bank of $1,800 millions at the end of FY 2004. If you do not confirm, please explain.

Response:

Confirmed.

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OCA/USPS-T6-20 Please confirm that Table 10, page 15, of your testimony indicates the Postal Service is projected to have debt of $1,000 millions, as of September 30, 2005, the end of FY 2005. If you do not confirm, please explain.

Response:

Confirmed.

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OCA/USPS-T6-21. Please confirm that Table 10, page 15, of your testimony indicates the Postal Service is projected to have before rates debt of $1,999 millions, as of September 30, 2006, the end of FY 2006. If you do not confirm, please explain.

Response:

Confirmed.

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OCA/USPS-T6-22. Please confirm that in Library Reference R2005-1-K-50 at Chapter XII, page 536, titled "BORROW," the Borrowing and Repayment Schedule shows, as of the end of FY 2004, the only Postal Service debt was short-term notes payable to the Federal Financing Bank bearing a final maturity date of May 6, 2005, in the amount of $1,800 million. If you do not confirm, please explain.

Response:

Confirmed. However, it should be understood that these notes are short-term, floating rate, revolving credit facilities that have a final expiration date of May 6, 2005. Loans against these facilities varied. The last day to draw funds was on May 5, and any May 5 draws would have had to mature on May 6.

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OCA/USPS-T6-23. Please confirm that as of the end of FY 2004, the Postal Service had no debt outstanding to the Federal Financing Bank or other U.S. government entity, other than the debt cited in the above interrogatory.

Response:

Confirmed.

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OCA/USPS-T6-24. Please confirm that the Postal Service's Financial and Operating Statements for FY 2005, Accounting Period 1, ending October 31, 2004 indicate outstanding Postal Service debt of $200 million. If you do not confirm, please explain.

Response:

Confirmed.

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OCA/USPS-T6-25. Please confirm that your prepared testimony filed with the Commission on April 8, 2005, states at page 16, lines 4-5, with respect to debt, "The Postal Service plans to continue debt reduction in FY 2005...."

Response:

Confirmed.

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OCA/USPS-T6-26. Please explain with detailed documentation how the estimated year end FY 2005 Postal Service debt of $1.000 billion was calculated.

Response:

Please see USPS LR.K-50, Rollforward Expense Factors, Chapter VI, Section a., page 256 for the factors that were considered in determining FY 2005 end-of-year debt of $1.0 billion.

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OCA/USPS-T6-27. Please confirm that each of the six monthly Postal Service Financial and Operating Statements from November 30, 2004 through April 30, 2005 indicate a Postal Service debt of zero.

Response:

Confirmed.

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OCA/USPS-T6-28. Please confirm that the Postal Service currently has no outstanding debt to the Federal Financing Bank. If you do not confirm, please explain.

Response: Confirmed.

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OCA/USPS-T6-29. Please cite to the portion of the testimony or exhibits in the April 8, 2005 Postal Service application in this docket which indicates the fact that the Postal Service had eliminated all debt to the Federal Financing Bank approximately six months earlier, during November, 2004, and discusses the implications of that fact upon your estimate in Table 10 that debt will be outstanding at the end of FY 2005 year. If there is no such discussion, please explain.

Response:

As demonstrated in USPS LR.K-50, Rollforward Expense Factors, Chapter VI, Section a., page 259, the elimination of outstanding debt was anticipated in October 200~~5~~4. Also, see response to OCA/USPS-T6-22.

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OCA/USPS-T6-30. Please confirm that the budgeted net income for FY 2005 was the basis on which you estimated the borrowing needs of the Postal Service for FY 2006 and FY 2007. If you cannot confirm, please explain.

Response:

Not confirmed. As explained in response to OCA/USPS-T6-33, the FY 2005 budget does not reflect the net income that is reflected in the rate case filing. Please note that there are numerous factors that impact the estimated borrowing needs of the Postal Service. For FY 2006, these are on listed on page 256 of USPS LR.K-50, Rollforward Expense Factors, Chapter VI, Section a. There are no borrowing needs estimated for FY 2007 in this filing.

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OCA/USPS-T6-31. Please confirm that the most recently available FY 2005 Financial and Operating Statement, as of April 30, 2005, page 1, indicates year-to-date budgeted earnings of $701.6 million and actual earning of $2,025.3 millions which are in excess of the budgeted amount by $1,323.7 million. If you do not confirm, please explain.

Response:

Confirmed.

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OCA/USPS-T6-32. Please state whether you expect the Postal Service to incur any debt during the remainder of this fiscal year, FY 2005. If so, please explain and provide your assumptions and calculations.

Response:

See responses to OCA/USPS-T6-20 and 26.

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OCA/USPS-T6-33. If current postal rates are not modified or changed in FY 2006, and taking into account the Postal Service's unanticipated earnings of over $1.3 billion as of April 30, 2005, when do you estimate the Postal Service will again need to borrow funds from the Federal Financing Bank?

Response:

The $1.3 billion in net income over plan as of April 30, 2005 was not anticipated in our FY 2005 Operating Budget, but it was anticipated in this filing. The FY 2005 Postal Service operating budget assumed a net loss of $192 million, this filing assumes a FY 2005 net income of over $1.6 billion. Any need for borrowing in FY 2006, either with or without a rate increase in 2006, would occur in September, 2006. September 30, 2006 is the date that the Postal Service is required to fund the $3.1 billion escrow amount.

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OCA/USPS-T6-34. If the proposed rate changes are implemented as anticipated by the Postal Service in this Docket No. R2005-1 during early 2006, when do you estimate the Postal Service will again need to borrow funds from the Federal Financing Bank?

Response:

After the Test Year.

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OCA/USPS-T6-35. In your Exhibit No. USPS 6I, the Postal Service's net accumulated earnings as of the end of FY 2005 are estimated to be $2,540.712 millions. Your Exhibit No. USPS-6A indicates a test year, before rates loss of $3,041.9 millions. Please confirm that if the FY 2005 net income exceeds the budgeted amount by an amount which at least makes up the difference between those two numbers, or $501.188 millions, then, the accumulated net income would be at least $3,041.9 millions at the end of FY 2005. If you do not confirm, please explain.

Response:

Not confirmed. See response to OCA/USPS-T6-33. The $2,540.712 accumulated earnings as of the end of FY 2005 include the FY 2005 estimated net income of $1.6 billion. The budgeted FY 2005 net loss is $192 million. Therefore, the FY 2005 estimated net income included in this filing exceeds the budgeted amount by $1,835 million, not $501.188 million. However, if actual FY 2005 net income were $2.1 billion instead of $1.6 billion, then the accumulated net income at the end of FY 2005 would be $3,041.9.

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OCA/USPS-T6-36. Please confirm that with five months remaining in the fiscal year and Postal Service year-to-date income of $1.325 billion greater than the budgeted amount, it is now probable the Postal Service will have a net income for FY 2005 of at least $501.188 millions greater than the budgeted net income. If you do not confirm, please explain.

Response:

As stated in response to OCA/USPS-T6-35, this level of net income performance, rather than the FY 2005 budget net income, is included in this filing.

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OCA/USPS-T6-37. Please confirm that, hypothetically, even if the Postal Service rates were not increased during the FY 2006 test year, if the Postal Service's retained earnings at the beginning of FY 2006 exceed the test year FY 2006 losses currently estimated at $3.042 billion and that, in fact, the test year losses are actually that amount or less, then the Postal Service would still have accumulated net income at the end of FY 2006. If you do not confirm, please explain.

Response:

Confirmed.

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OCA/USPS-T6-38. Please refer to your response to OCA/USPS-T6-15. Your response indicates that, in addition to appropriations, property transfers to and from the Postal Service are included in the $1,348.207 million difference between the initial Postal Service equity of $1,685,717 million and "Cumulative Net Income "of $2,540.712 million.

a. Please list the types of properties involved in the transfers to which you are referring (for instance: real, intellectual or plant and equipment).

b. Please confirm that the initial equity position of the USPS in 1971 was $1,685.717 million. If you are unable to confirm, please explain.

c. Please specifically identify, by type, the amount of each type of property included in the original $1.685.717 million equity position. For example: real property, plant and equipment, cash, good will, or intellectual property. In your response, please cite your sources.

d. Please provide a break-out of the amount of net property transfers included in the Postal Service's equity in your Exhibit No. USPS 6I that are related to property used to provide domestic postal services.

e. By year, for FY 1972 through FY 2004, please identify the type and amount of "property transfers" to the Postal Service included in the $1,348.207 million referred to above. Please cite all sources and provide the derivation of all calculated values. Include in your response the annual amount of gain or loss the Postal Service recognized as a result of the property being transferred to the Postal Service.

f. By year, for FY 1972 through FY 2004, please identify the amount of property transferred from the Postal Service included in the $1,348.207 million referred to above. Please cite all sources and provide the derivation of all calculated values. Include in your response the annual amount of gain or loss by year as a result of the property transferred from the Postal Service.

Response:

a. Property transfers have been for real property and equipment. The net transfer values are reflected in the financial statements found in the Annual Reports of the Postmaster General/US Postal Service. The amounts involved are relatively minor and the last transfer occurred in 1992.

b. Confirmed.

c. The Postal Reorganization Act (Public Law 91-375) provided that "The initial capital of the Postal Service shall consist of the equity, as reflected in the budget of the President, of the Government of the United States in the former Post Office

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Department." Essentially, the equity position at Postal Reorganization is equal to the difference between total assets and total liabilities as of June 30, 1971.

d. See my responses to a. and c.

e. Of the $1,348.207 million, $1,000 million relates to 1976 and 1977 appropriations to reduce operating debt and $363.171 million of appropriations to fund the annual leave liability at Postal Reorganization date. The difference between these amounts and the $1,348.207 million ($14.964 million) is the value of net property transfers.

f. See my response to e.

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OCA/USPS-T6-39. Please refer to your response to OCA/USPS-T6-15. Are any items other than the net of property transfers, appropriations and accumulated net income included in the $1,348.207 million difference between the initial equity position of the Postal Service and the sum of accumulated net income and appropriations as shown on your Exhibit No. USPS 6I? If so, please provide a description of the items and the amounts, by year, from FY 1972 through FY 2004.

Response:

None that I am aware of. See my response to OCA/USPS-T6-38.e.

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OCA/USPS-T6-40. Please refer to your response to OCA/USPS-T6-17 in which you indicate the cost of land has not been included in the revenue requirement.

a. Is the cost of land ever included in the revenue requirement? If so, please explain.

b. Are any costs associated with the cost of land included in the revenue requirement, such as the interest on debt used to purchase land or the payments to repay debt incurred to purchase land? If so, please explain your statement that the cost of land has not been included in the revenue requirement.

Response:

a. To date, the cost of land has not been included in the revenue requirement.

b. To the extent that funds are borrowed to finance capital outlays that include the purchase of land, interest on this debt is included in the revenue requirement. Gains and losses on the sale of land are also included in the revenue requirement. As information, payments to repay debt are not included in the revenue requirement.

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OCA/USPS-T6-41. Please refer to your response to OCA/USPS-T6-17 in which you refer to land investment costs and the Postal Service's increased investment in land since 1971 and state, "Accordingly, it is appropriate for the Postal Service to maintain cumulative net income."

a. The accumulated net income or loss of the Postal Service does not appear to bear a relationship to the Postal Service's land investment. Please explain the relationship.

b. What is basis for determining the amount of cumulative net income to be maintained?

c. Is there any maximum amount of cumulative net income appropriate for the Postal Service? If so, is \$5 billion an appropriate maximum cumulative net income? Is \$50 billion an appropriate maximum cumulative net income? If so, please explain and indicate what that amount may be.

d. Please explain why the Postal Service's maintaining a cumulative net income is consistent with a policy for the Postal Service that revenue from postal rates and fees plus appropriations equal the costs of the Postal Service.

Response:

a. There is no specific relationship. However, the maintenance of a cumulative net income would be one way of offsetting the cost to the Postal Service for the cash outlay required to purchase land.

b. Management should be responsible for determining an appropriate amount of cumulative net income. In my opinion, the cost of land would be one factor to consider.

c. See my response to b.

d. See my response to a.

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OCA/USPS-T6-42. Your testimony at page 16 states, "In FY 2006, if rates were not to change, the Postal Service expects that it would need to borrow money to fund the escrow provision."

a. Based on your response to OCA/USPS-T6-33, and considering the Postal Service's earnings as of April 30 of $2,025.3 millions for FY 2005, please confirm that even if the Postal Service rates do not change in FY 2006, borrowing would occur only in the very last days of the fiscal year, and probably only the last day or two of the fiscal year or on September 30, 2006, in order to fund the escrow amount. If you do not confirm, please explain.

b. Based on the Postal Service's earning to date in FY 2005, please state the amount of money, if any, the Postal Service would need to borrow in the last days of September 2006 if the proposed rate change does not become effective during FY 2006. Please provide your calculations and citations supporting your response.

c. Your response to OCA/USPS-T6-33 states the Postal Service filing anticipates an FY 2005 net income of over $1.6 billion. As of April 30, 2005, the Postal Service's Financial and Operating Statement indicates actual earnings of $2,025.3 millions. What amount of net income in FY 2005 will be necessary to avoid borrowing funds in FY 2006, if the Postal Service rates do not change in FY 2006.

Response:

a. As stated on page 5 of my testimony, were it not for the escrow funding requirement imposed by Public Law 108-18, there would be no need to request an increase in postal rates at this time. The foundation of this statement is the strong financial performance reflected in this filing. Through the end of May, FY 2005 year-to-date net income as reported in the Postal Service's Financial and Operating Statement is $1.837 million. This value is consistent with the expected net income through May shown on page 14 of the Errata to USPS-LR-K-50, filed on June 9 (replacing page 260 of USPS-LR K-50 as originally filed). Because the escrow requirement is not due until the last day of September, 2006, that is precisely the date that additional borrowing would occur if there were no rate increase in 2006.

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b. As described in response to a. above, the Postal Service's FY 2005 earnings to date were anticipated in this filing. Accordingly, current financial performance does not alter the basis of this request. However, if there were no rate increase in 2006, as detailed in the errata filed on June 9, 2005, before rates debt is estimated at $1.782 billion.

c. If all other assumptions remained the same as those included in the filing, and the changes to FY 2005 also increase cash over the same time period, a net income of approximately $3.4 billion would be required.

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OCA/USPS-T6-43.. Please refer to USPS-LR-K 50 at page 256 to which you referred in response to OCA/USPS-T6-26. The statement of cash flow indicates for FY 2005 a payment of debt of $800 million when the beginning debt balance was $1.8 billion.

a. When was this cash flow statement originally prepared?

b. Please explain why that cash flow statement does not project a debt payment of $1.8 billion to pay off the entire debt which is what actually occurred early in FY 2005.

Response:

a. The cash flow statement was finalized just prior to the rate case filing.

b. The cash flow statement as originally filed shows the repayment of $1.8 billion of debt in October 2004, and the addition of $1.0 billion of debt in September of 2005. See page 259 of USPS-LR-K-50. Debt of $1 billion at the end of FY 2005 was assumed to provide a cushion against the statutory annual borrowing limitations ($1 billion operating and $2 billion capital).

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OCA/USPS-T6-44. Please confirm that your testimony at page 16, lines 27-29, stating, "If borrowing were used to fund the escrow, we would likely exceed the annual borrowing limit of $3 billion in FY 2007" is based on the assumption that rates would not increase in either FY 2006 or FY 2007 and that it does not apply if rates did not increase in FY 2006 but did increase in FY 2007 pursuant to a rate proceeding. If you do not confirm, please explain.

Response:

The original statement was based on the assumption that rates would not be increased in FY 2006 or FY 2007. However, the statement may or may not apply if rates were to be increased depending on the amount and timing of the increase.

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OCA/USPS-T6-45. The following interrogatory refers to the errata filed on June 9, 2005 to USPS Exhibit 6A styled as USPS Exhibits 6A-1 and 6A-2 to your testimony.

a. Please confirm that the revised estimate of net income for FY 2005, from \$1,643.5 million to \$1,679.9 million, resulted in an increase in net income of \$36.4 million. If you are unable to confirm, please explain fully.
b. Please confirm that the revised net loss estimate for FY 2006BR, from a loss of \$3,041.9 million to a loss of \$2,879.9 million, resulted in a reduction in FY 2006BR losses by \$162 million. If you are unable to confirm, please explain fully.
c. Please confirm that the revised estimate of net income for FY 2006AR, from \$112.0 million to \$281.5 million, resulted in an increase in net income of \$169.5 million for FY 2006AR. If you are unable to confirm, please explain fully.
d. Given the errata filed to your testimony, please explain what impact the improvement in the FY 2005 and FY 2006 estimates will have on the implementation of new rates.
e. Please provide an updated copy of the CRA Cost Segment Summary Report for FY 2006AR that details the impact of your errata changes in Exhibit 6A-2 by segment and by classes and sub-classes of mail.
f. Please explain in detail the underlying reasons for the changes filed with respect to increasing the FY 2006 BR investment income revenue by \$145.856 million and reducing the FY 2006 BR interest expense by \$42.455 million.
g. Please explain in detail the underlying reasons for the changes filed with respect to reducing the FY 2006 BR capitalized interest expense by \$18.025 million resulting from changes to interest on debt.

Response

a. Confirmed.

b. Confirmed.

c. Confirmed.

d. As stated on page 54 of my testimony, planned implementation of new rates will not occur before January 2006. Accordingly, these changes would have no impact on the implementation of new rates.

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e. This information is included on the errata filed to LR-USPS-K-59, Attachment 14 a, 6 out of 6. By comparing this sheet to that contained in the original filing, the impact by class of mail can be determined. Please note, that the net interest impact of $30,000 is not reflected.

f. The following explanation was included in the errata to LR-USPS-K-50. The changes made were corrections of errors.

The following corrections were made to IntIncExp_R05

(1) In 2005 and 2006 (BR and AR), investment income was calculated using 2004 quarterly variable interest rates instead of the 2005 and 2006 quarterly variable interest rates which are listed below. These interest rates are included in LR K-50 at Chapter VIa. p. 256 (IntIncExp_R05.xls).

	FY 2004	FY 2005	FY 2006
Interest Rate - Variable Rate Debt Qtr1	1.14%	2.00%	3.50%
Interest Rate - Variable Rate Debt Qtr2	1.09%	2.50%	3.60%
Interest Rate - Variable Rate Debt Qtr3	1.05%	3.00%	3.60%
Interest Rate - Variable Rate Debt Qtr4	1.30%	3.50%	3.60%

(2) In computing the average monthly debt balance and average monthly investment balance for a given year, the model begins with the averages from the prior year and then adjusts those averages for assumptions for the current year that differ. For FY 2006 (BR and AR), the formula used in the initial filing for computing the average investment balance from the prior year treated the prior year balance as a reduction as opposed to an increase in the current year investment balance. This is reflected in the line description of the model ("Less: Average Investment Balance"). In LR K-50, Chapter VIa., pages 264 and 266, this row (row 85 in soft copy) should have been carried forward from the previous year as a negative amount because the formulas in the model treated positives as a reduction in cash and negatives as an increase in cash.

g. The change in capitalized interest relates to the lower levels of interest expense subject to capitalization resulting from correction of errors.

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TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE
BASED ON ERRATA FILED ON JUNE 9, 2005

OCA/USPS-T6-46. Please provide a revised USPS Exhibit 6A reflecting these errata revisions. Please confirm that the test year, FY 2006BR, net deficiency shown on line 30 of a revised USPS Exhibit 6A is reduced from a revenue deficiency of $3,041.9 million to a revenue deficiency of $2,879.9 million.

Response

Confirmed. See attached.

STATEMENTS OF REVENUE AND EXPENSE
($ IN MILLIONS)

Attachment to Response to OCA/USPS-T6-46
USPS 6A Revised

LINE NUMBER		FY 2004 ACTUAL	FY 2005 ESTIMATE	TEST YEAR B/R	TEST YEAR A/R
	REVENUES				
1	OPERATING REVENUE	68,868.0	69,930.4	69,934.4	72,455.8
2	APPROPRIATIONS	128.0	119.6	222.8	222.8
3	INTEREST & INVESTMENT INCOME	32.6	97.6	176.9	239.1
4	**TOTAL REVENUES**	**69,028.6**	**70,147.6**	**70,334.1**	**72,917.7**
	OPERATING EXPENSES				
5	POSTMASTERS	2,035.5	2,175.8	2,317.2	2,310.4
6	MANAGERS, SUPERVISORS & TECHNICAL PERSONNEL	3,883.3	4,080.7	4,275.9	4,242.7
7	CLERKS & MAILHANDERS	18,371.1	18,500.9	18,232.8	18,003.2
8	CLERKS, CAG K POST OFFICES	6.4	6.8	7.0	7.0
9	CITY DELIVERY CARRIERS	15,033.2	15,535.5	15,818.2	15,700.6
10	VEHICLE SERVICE DRIVERS	584.6	608.9	630.2	623.6
11	SPECIAL DELIVERY MESSENGERS	0.0	0.0	0.0	0.0
12	RURAL CARRIERS	5,153.1	5,570.0	5,849.1	5,810.4
13	CUSTODIAL & MAINTENANCE SERVICES	3,006.5	3,087.1	3,196.3	3,181.0
14	MOTOR VEHICLE SERVICES	937.3	991.9	1,005.7	1,000.6
15	MISCELLANEOUS LOCAL OPERATIONS	285.9	300.7	312.9	312.8
16	CONTRACTURAL TRANSPORTATION OF MAIL	4,968.9	5,249.2	5,333.8	5,218.1
17	BUILDING OCCUPANCY	1,855.3	1,924.2	1,968.8	1,968.8
18	RESEARCH & DEVELOPMENT	51.3	57.0	57.0	57.0
19	EQUIPMENT MAINT. & MANAGEMENT TRAINING SUPPORT	49.2	62.7	63.8	63.8
20	SUPPLIES & SERVICES	2,712.8	3,008.5	3,098.1	3,082.8
21	HQ & AREA ADMIN. & CORPORATEWIDE PERSONNEL COSTS	4,507.1	4,724.1	8,364.8	8,364.8
22	DEPRECIATION, WRITE-OFFS, CLAIMS, & INTEREST	2,522.2	2,596.4	2,713.1	2,712.7
23	SUBTOTAL SEGMENTS 16,18, AND 20	9,742.1	10,329.1	14,176.0	14,160.3
24	FINAL ADJUSTMENTS (not allocated to cost segment)		(12.7)	(30.8)	(24.0)
25	**TOTAL ACCRUED COSTS**	**65,963.7**	**68,467.7**	**73,213.9**	**72,636.2**
	NET INCOME (LOSS)	3,064.9	1,679.9	(2,879.9)	281.5
26	CONTINGENCY			0.0	0.0
	NET INCOME (LOSS) WITH CONTINGENCY			(2,879.9)	281.5
27	RECOVERY OF PRIOR YEAR LOSSES			0.0	0.0
28	**TOTAL REVENUE REQUIREMENT**			73,213.9	72,636.2
30	NET SURPLUS (DEFICIENCY)			**(2,879.9)**	**281.5**

NOTE: NUMBERS MAY NOT ADD DUE TO ROUNDING

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE
BASED ON ERRATA FILED ON JUNE 9, 2005

OCA/USPS-T6-47. Please update your previous responses to OCA interrogatories in this proceeding to reflect the errata filed on June 9, 2005 revising your exhibits: USPS 6A styled as USPS 6A-1 and USPS 6A-2, USPS 6F and USPS 6G. More specifically, it appears the following responses must be revised in accordance with the errata: OCA/USPS-1b, e-g, j-m, 8, 10, 20, 21, 26, 30, 32, 33, and 35.

Response

1b: As stated in OCA/USPS-T6-45 a, FY 2005 net income increased $36.4 million.

1 e – g: See response to 1b above.

1 j – m: As stated in OCA/USPS-T6-45 b and c, FY 2006 before rates net loss decreased $162 million and FY 2006 after rates net income increased by $169.5 million.

21: Based on the errata, before rates debt at the end of FY 2006 is $1.782 billion.

35: See response to 1 b above.

8, 10, 20, 26, 30, 32, 33: No change.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE
REDIRECTED FROM WITNESS POTTER
BASED ON ERRATA TO TESTIMONY FILED ON JUNE 9, 2005

OCA/USPS-T1-5. At page 5 of USPS-T-1, you state:

> Allowing for the decline in volumes associated with a rate change, $3.1 billion amounts to about 5.4 percent of our estimated revenue need in FY 2006, as described by Postal Service witness William Tayman (USPS-T-6). Accordingly, the Board of Governors has directed the Postal Service to request that the Commission recommend uniform 5.4 percent increases over existing rates and fees.

On June 9, 2005, witness Tayman filed errata to his revenue testimony, including "Summary of R2005-1 Revenue Requirement Errata Impacts," Exhibit USPS-6A-1, [revised] 6/9/05. Among the changes reported by witness Tayman are that:

(1) If postal rates and fees are increased by 5.4 percent as you requested, net income in the Test Year, After Rates, will be $281.5 million, instead of the $112 million initially presented; and
(2) The net loss that must be covered in the test year is $2.88 billion, not the $3.1 billion you alluded to in the testimony quoted above.

Ceteris paribus, please confirm that the across-the-board increase that best achieves breakeven in the test year under the Postal Service's current financial circumstances (without considering the impact of elasticity of demand on revenues and costs) is approximately 5 percent , not 5.4 percent, i.e., (2.88/3.1 = 0.93 therefore, 0.93 x 5.4 percent = 5 percent rounded).

a. If you do not confirm, then please explain.
b. If you do confirm, then do you plan to modify the pending request. If so, when?
c. Since the need for the money in the test year is less urgent than you believed at the time the rate case was filed, does the Postal Service intend to defer implementation of a recommended rate increase for some period of time, say one month longer than was initially intended? Please explain.
d. The following statement was made at the website of postcom.org on June 17, 2005 (http://www.postcom.org/):
PostCom has learned that because of the radical improvement in USPS finances, postal management had asked the Governors for permission to pull the 2005 postal rate case, but several members of the Board objected.

    i. Do you agree that that there has been a radical improvement in Postal Service finances in April and May of 2005? If not, please explain.
    ii. Do you favor withdrawal of the rate case owing to substantial improvement in the Postal Service's financial condition and the errata to witness Tayman's testimony, as compared to the information filed on April 8, 2005? If not, please explain.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE
REDIRECTED FROM WITNESS POTTER
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Response

a. Not confirmed. The 5.4 percent across-the-board increase continues to best achieve breakeven in the test year given the Postal Service's current financial circumstances. The increase of $169 million to the test year after rates net income based on the errata filed is immaterial relative to the $800 less net income expected in 2006 due to the proposed January 2006 implementation date for new rates.

b. N/A.

c. The filing of the errata does not lessen the urgency for the need for money in the test year to fund the escrow obligation. The January 2006 implementation date for new rates already represents a three-month delay and significant revenue loss over what is assumed in the test year.

d.

i. There has not been any improvement in Postal Service finances in April and May of 2005 over what was assumed in this filing. Through May, actual year-to-date net income is $42 million higher than the monthly net incomes estimated in the rate case. As reflected in the errata, net income for April 2005 was estimated at $120 million and for May 2005, a net loss of $87 million was estimated. Actual net income in April was $60 million and the actual net loss in May was $198 million. This represents a cumulative difference for these two months of $171 million. This difference is not a "radical improvement" but a significant worsening.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE
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ii. As stated above, there has not been substantial improvement in the Postal Service's financial condition over what was depicted in this filing. Additionally, the April 9 errata increased net income only $36 million for FY 2005. Also, as stated in response to OCA/USPS-178, through May of 2005, the actual cash position of the Postal Service is approximately $400 million less than the cash position assumed in this filing (as corrected) for May 2005. Accordingly, the Postal Service's financial condition does not warrant withdrawal of this rate case and in fact supports the need for implementation of the requested increase in January 2006.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T6-1. According to the Postal Service's 2004 Annual Report, page 27, the Postal Service "estimated the 2004 present value of future premium payments [for retiree health care] to be between $48 billion and $59 billion."

a. Please confirm that as of the end of Fiscal Year (FY) 2004 with respect to these future retiree health care liabilities discussed in the Annual Report, the Postal Service had not (i) accumulated any financial reserves, nor (ii) reflected any accrued expense in its income statement, nor (iii) reflected any liability on its balance sheet. If you do not confirm any part of the above, please explain fully.

b. To what extent were any of these future health care liabilities incurred during the ten-year period from 1995 through 2004?

c. Are you aware of any other estimate by any other party (*e.g.*, Congressional Budget Office, Government Accountability Office, Office of Management and Budget, Office of Personnel Management) of the Postal Service's unfunded liabilities for retiree health care? If so, please provide those current estimates, along with the source.

Response:

a Confirmed.

b To my knowledge, this information is not available.

c I am aware that both the Congressional Budget Office and the Office of Personnel Management have calculated retiree health care liabilities that they have attributed to the Postal Service. In the Cost Estimate for H.R. 22, Postal Accountability and Enhancement Act, dated April 25, 2005, CBO estimates the "net present value of the unfunded liability for the health care costs of retirees would be $49 billion at the end of 2006." This value is net of an anticipated $21.2 billion asset transfer in 2006 from the Civil Service Retirement and Disability Fund and Postal Service payments in 2006 of $6.4 billion.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T6-2. According to the Postal Service's 2004 Annual Report, page 27, the Postal Service spent $1,313 million for health care benefits for existing retirees in Fiscal Year (FY) 2004.

a. Please indicate whether any of this $1,313 million spent for health care benefits for existing retirees in FY 2004 was treated as volume variable. If any were so treated, please state the amount, and state the rationale for treating health care costs for existing retirees as volume variable.

b. Were any of the expenditures of $1,313 million for health care benefits for existing retirees in FY 2004 treated as attributable? If so, please indicate (i) the amount of the attribution, (ii) the rationale justifying such attribution, and (iii) the key used to distribute the attributable portion to the classes of mail.

c. In addition to the $1,313 million of expenditures for health care benefits for existing retirees in FY 2004, did the Postal Service's income statement for FY 2004 include any accrued expense for future health care benefits? If so, please indicate the amount and explain what benefits this amount was accrued for.

Response:

a & b. $743.329 million of the FY 2004 retiree health care costs were treated as volume variable. Annuitant health benefit costs are, and always have been, distributed to the same degree as all volume variable postal labor costs. This treatment is used because health care benefits for retirees are considered part of labor costs since we do not accrue costs for future health benefits of current employees.

c. No.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T6-3.

a. Please estimate the amount that the Postal Service expects to spend for health care benefits for existing retirees in FY 2005.

b. Please provide the projected amount of the Postal Service's unfunded health care liabilities at the end of FY 2005.

Response:

a. $1,539,773,000.

b. This information is being developed and will be provided as soon as available.

FURTHER RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN TO INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T6-3b.

b. Please provide the projected amount of the Postal Service's unfunded health care liabilities at the end of FY 2005.

Response:

As noted on page 27 of the FY 2004 Annual Report of the United States Postal Service, the present value of future premium payments for retiree health benefits was estimated to be between $48 billion and $59 billion as of September 30, 2004, based on data as of that date. The range of estimates results from a 1% difference in long-term medical inflation assumptions. Based on the same data used to determine the above estimates, the comparable values at the end of FY 2005 are $51 billion to $62 billion and at the end of FY 2006 are $55 billion to $66 billion.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T6-4.

a. Please provide an estimate of the amount that the Postal Service expects to spend for health care benefits for existing retirees in TY 2006, and indicate whether this amount is included in the roll-forward model for this item.
b. Will any of the anticipated expenditures for retiree health care benefits in TY 2006 be treated as (i) volume variable, and (ii) attributable? If so, please indicate the amount and the basis for attribution.
c. Please provide the projected amount of the Postal Service's unfunded, off balance sheet health care liabilities at the end of TY 2006.
d. During TY 2006, does the Postal Service currently plan to accrue any expense — and set aside any money — for its currently unfunded future retiree health care liabilities?
e. As a hypothetical, please assume that in TY 2006, or some future year shortly thereafter, the Postal Service were to start accruing expenses and setting aside funds for its future health care liabilities. Please (i) state the extent to which you would expect any portion of such accrued expenses to be treated as volume variable or attributable, and (ii) provide the rationale for either attributing or not attributing such expenses.

Response:

a. $1,736,364,000 have been included in the roll-forward model for TY 2006 retiree health care premium expense. See page 274 of LR-K-50.

b. $974,691,000 before rates and $968,562,000 after rates have been treated as volume variable. See response to VP/USPS-T6-2, a.

c. This information is being developed and will be provided as soon as available.

d. No.

e. A change in treatment as proposed under this hypothetical could only be determined after careful review of the language and intent of the governing doctrine establishing a change in accounting treatment of these costs.

FURTHER RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN TO INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T6-4c.

c. Please provide the projected amount of the Postal Service's unfunded, off balance sheet health care liabilities at the end of TY 2006.

Response:

See response to VP/USPS-T6-3b.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T6-5.

a. Please confirm that on September 30, 2003, in response to a request by Congress, the Postal Service submitted "Postal Service Proposal: Use of Savings for Fiscal Years after 2005, P.L. 108-18," containing two alternate proposals, labeled Proposals I and II, respectively, on purposes to which any money accumulated in the escrow fund should be allocated. Please provide a copy of the Postal Service's September 30, 2003 submission to Congress.

b. Please confirm that under Proposal I (which assumes that the existing escrow requirement would be eliminated), beginning in FY 2006, the Postal Service would make annual payments into a new Retiree Health Fund, estimated at $1.2 billion in FY 2006, which would be used to pay for retiree health insurance premiums in the future. If you do not confirm, please explain.

c Please assume that Congress were to accept the Postal Service's Proposal I. That is, please assume (i) the escrow requirement would be eliminated, and (ii) a new Retiree Health Fund were established to pay future health care liabilities. Would you expect that any future payments into such a Retiree Health Fund would be treated as (i) volume variable, and/or (ii) attributable? Please explain the rationale for either attributing or not attributing such expenses.

Response:

a Confirmed. Copy attached.

b Not confirmed. The FY 2006 payment for retiree health benefits under

Proposal I was $5.0 billion.

c See response to VP/USPS-T6-4(e).

JOHN E. POTTER
POSTMASTER GENERAL, CEO

UNITED STATES POSTAL SERVICE

POSTAL SERVICE PROPOSAL
USE OF SAVINGS FOR FISCAL YEARS AFTER 2005
P. L. 108-18

BACKGROUND

Public Law 108-18, the Postal Civil Service Retirement System Funding Reform Act of 2003, signed by the President on April 23, 2003, modifies Postal Service funding of its obligations to the Civil Service Retirement System (CSRS) to preclude over-funding of those obligations by an amount that the Office of Personnel Management (OPM) estimates at $78 billion. The Act identifies the amount of the averted potential over-funding as "savings" to the Postal Service. "Savings" are defined as the difference between the contributions that the Postal Service would have made for such fiscal year if this Act had not been enacted and the contributions made by the Postal Service for such fiscal year under the Act.

The funds characterized as "savings" under the Act are nothing more than the potential amount of over-funding of CSRS pension costs in any given year had corrective legislation not been enacted. Accordingly, the Act does not eliminate CSRS over-funding. It describes how the over-funding amounts should be used in Fiscal Years 2003 through 2005, and in any fiscal year after 2005, the Act requires that the "savings" or over-funding amount be considered an operating expense of the Postal Service and, until otherwise provided by law, held in escrow.

REALIZATION OF "SAVINGS" UNDER THE ACT

"Savings" or over-funding under the Act, as calculated by OPM, in FY 2003 through 2005 are consumed by liquidating outstanding debt and maintaining current postage rates. In addition to debt reduction in FY 2003 and 2004, the over-funding will be used to absorb inflationary pressures on expenses as well as normal expense growth associated with delivery network growth in FY 2005. Accordingly, by the end of FY 2005, the $9.2 billion estimated amount of CSRS over-funding generated through current postage rates since FY 2002 will have been completely consumed in holding postage rates constant. As noted in the March 27, 2003 committee report accompanying the reform legislation, as the law now stands, it will be necessary to include the "savings" as an expense in the revenue requirement of future rate filings. Therefore, in order to obtain funds to place in an escrow account in FY 2006, a double-digit increase in postage rates will be required unless the escrow requirement has been terminated by legislation prior to that date.

The $3.2 billion FY 2006 "savings" estimated by the Office of Personnel Management will require an additional postage rate increase of 5.4 percent, including a 2-cent increase in the price of a First-Class stamp that year (on top of whatever is required by any changes in all other cost and revenue elements since the last rate increase). Further, if it is not eliminated, the escrow requirement will permanently necessitate bi-annual postage rate increases between 1.0% and 1.5% just to generate the increase in annual "savings" amounts for the required escrow over the next 15 years.

The table below demonstrates the current estimate of annual and cumulative "savings" or over-funding by fiscal year through 2022.

TABLE A: Annual and Cumulative "Savings" or Over-Funding Under P. L. 108-18

Fiscal	"Savings" or Over-funding		Fiscal	"Savings" or Over-funding	
Year	Annual	Cumulative	Year	Annual	Cumulative
2003	$3.5B	$3.5B	2013	$5.7B	$44.6B
2004	$2.7B	$6.2B	2014	$6.2B	$50.8B
2005	$3.0B	$9.2B	2015	$6.4B	$57.2B
2006	$3.2B	$12.4B	2016	$6.7B	$63.9B
2007	$3.5B	$15.9B	2017	$7.1B	$71.0B
2008	$3.9B	$19.8B	2018	$7.5B	$78.5B
2009	$4.2B	$24.0B	2019	$7.8B	$86.3B
2010	$4.6B	$28.6B	2020	$8.1B	$94.4B
2011	$5.0B	$33.6B	2021	$8.2B	$102.6B
2012	$5.3B	$38.9B	2022	$8.4B	$111.0B

The "savings" requirement of the Act will result in not only increased postage rates but also more frequent postage rate increases as the over-funding amounts escalate. Put another way, looked at from the standpoint of the postal ratepayer, there are no "savings" under P.L 108-18 after FY 2005, so long as the escrow continues in effect as currently written. The purpose of the escrow provision, as we understand it, was to serve as a temporary forcing mechanism to compel all parties to face up to, and the Congress then to take action on, the important financial issues identified in the legislation's statement of the Sense of Congress. Based upon its impact on postage rates and the resulting negative consequences on the mailing industry, the general public, and the economy as a whole, the Postal Service recommends that the escrow requirement be eliminated.

REPORTING REQUIREMENTS

The Act requires the Postal Service to file two proposals to the President, the Congress, and the General Accounting Office on September 30, 2003. One document is to address "...whether and to what extent the Department of the Treasury or the Postal Service should be responsible for the funding of benefits attributable to the military service of current and former employees of the Postal Service that, prior to the enactment of this Act, were provided for under section 8348(g)(2) of title 5, United States Code." The second proposal, which this paper addresses, is the Postal Service proposal on the use of over-funding amounts or "savings" beyond FY 2005 as a result of this Act.

Accompanying this proposal is the Postal Service position addressing the responsibility for funding the cost of CSRS benefits earned by military service. In provisionally relieving the Treasury of its historic responsibility for the costs of military service, the law has created a direct cost transfer of $27 billion from U.S. taxpayers to Postal ratepayers. For reasons explained in the accompanying proposal, the Postal Service recommends that the United States Treasury should be consistently and solely responsible for funding CSRS benefits attributable to military service of current and former employees, whether postal or not. Charging the CSRS cost of military service to the Postal Service is not justified because the military service had no connection with the functions or operations of the Postal Service. Additionally, the overwhelming majority of this cost relates to military service performed before the creation of the Postal Service. This position is consistent with the recommendation contained in the Report of the President's Commission on the Postal Service that concludes, "taxpayers, not ratepayers, should finance military pensions."

This proposal responds to the Act's requirement that the Postal Service submit a proposal detailing how any "savings" attributable to any fiscal year after Fiscal Year 2005 should be expended. The Act indicates that, in preparing its proposal, "...the Postal Service shall consider whether, and to what extent, those future "savings" should be used to address debt repayment; pre-funding of postretirement healthcare benefits for current and former postal employees; productivity and cost saving capital investments; delaying or moderating increases in postal rates; and any other matter; and the work of the President's Commission on the United States Postal Service...."

The Act records as the Sense of Congress that, "...because the Postal Service still faces substantial obligations related to postretirement health benefits for its current and former employees, some portion of the savings ... should be used to address those unfunded obligations...." Although the President's

Commission did not directly address the use of "savings" in their report, they did recommend that the Postal Service consider funding a reserve account to finance its retiree health benefit obligation, to the extent its financial condition allows, so that future ratepayers are not forced to pay for postal services delivered to the nation today.

The Postal Service responds to all of these concerns in the proposals for "savings" utilization presented here.

PROPOSED OVER-FUNDING OR "SAVINGS" UTILIZATION

The Postal Service has developed the following two proposals pertaining to the use of "savings" for fiscal years after 2005. The first proposal assumes the current legislation is amended and that the United States Treasury funds the CSRS costs associated with the military service of Postal employees and retirees. The second proposal assumes that responsibility for funding military service costs is transferred to the Postal Service.

In these proposals, to determine "savings" under the Act, the Postal Service has used OPM's "Projected Postal Service Payments", provided in Appendix A. Actual "savings" in any particular year will be determined by OPM's annual calculation of the Postal supplemental liability, the first calculation to be made by June 30, 2004. With the exception of reporting on "savings" utilization in fiscal year 2003, it will be these calculations on which the Postal Service will base its reporting on the utilization of "savings" or over-funding in its Annual Report as required by the Act. For FY 2003, the "savings" amount will be based on the value in Appendix A.

In developing these proposals, the Postal Service was guided by the "matters to consider" and the Sense of Congress stated in the Act. Further, it evaluated the financial and economic implications associated with the possible utilization of the "savings". The Postal Service also placed significant emphasis on the recommendation of the President's Commission regarding financing retiree health benefit costs and on the previous recommendations of the General Accounting Office (GAO), made when it placed the Postal Service on its "High-Risk" list because of growing financial and operational difficulties.

Specifically, the President's Commission recommended that if the financial condition of the Postal Service improves, it should consider funding a reserve account to begin paying down its obligation for retiree health benefits. That recommendation was consistent with the January 2003 report "High-Risk Series: An Update", in which GAO indicated that the Postal Service should "address long-term financial concerns, such as outstanding debt and postretirement health benefit obligations."

The Act is very specific in addressing outstanding debt by requiring that the FY 2003 and 2004 "savings" be used to reduce outstanding debt. The Postal Service has complied with this direction. In its FY 2004 Integrated Financial Plan, the Postal Service estimates that it will end FY 2004 with outstanding debt well below the levels required by the Act. The other primary emphasis in the Act relates to funding retiree health benefits. As stated in the FY 2002 Annual Report of the Postmaster General, the Postal Service obligation for postretirement health benefits is estimated to be between $40 and $50 billion, depending on the long-term medical inflation assumption used, at the end of FY 2002. Both proposals address funding this obligation.

The proposals presented here by the Postal Service place a priority on addressing these important concerns of Congress, the President's Commission and GAO. At the same time, they are designed to provide the maximum benefit to the nation's postal system, its customers, employees, taxpayers and the economy as a whole.

Proposal 1: (Preference) If U.S. Treasury Funds CSRS Cost of Military Service

As reported by the General Accounting Office, the modification of prior law by P. L. 108-18 to provisionally begin charging the Postal Service for the CSRS cost associated with military service would produce a cost transfer of $27 billion from the United States Treasury to the Postal Service. With reversal of this charge, as proposed by the Postal Service, the "savings" or over-funding to be realized under the Act would increase from $78 billion to $105 billion and it would be necessary to recognize that the Postal Service had not only fully funded its CSRS obligations as of the end of FY 2002; it had over-funded these CSRS obligations by $10 billion.

While the Postal Service believes the military service charge should be returned to the Treasury, it proposes that the $10 billion in over-funding not be withdrawn, and that it remain in the Civil Service Retirement and Disability Fund in a separate account designated as the "Postal Service Retiree Health Benefit Fund." With this change, the Postal Service would be in a financial position to pre-fund retiree health benefits for employees and retirees. This would satisfy concerns underlying the expression of the Sense of Congress for the use of "savings" under the Act. This change would also significantly reduce the Postal Service net postretirement health benefit obligations and outstanding debt, a major source of concerns identified by the Comptroller General regarding the Postal Service's financial condition.

Returning the funding of CSRS costs of military service to the Treasury increases the "savings" under the Act, and makes available additional funds that can be used to pre-fund retiree health benefits for both CSRS and FERS employees. Under this scenario, which is fair and justified, the Postal Service would be the only federal agency to both fully recognize and fund all pension and postretirement health benefits for its employees and retirees. Additionally, with this modification, the budgetary scoring of the legislation should be virtually unchanged, and over time should in fact improve the unified federal budget position based on accelerated funding by the Postal Service for postretirement health benefit obligations.

Consistent with the Act, this proposal assumes that "savings" in FY 2003, 2004 and 2005 are used to reduce outstanding debt and defer postage increases. Additionally, it assumes continuation of the CSRS dynamic normal cost contributions and the supplemental liability payments for these three fiscal years. This accomplishes two objectives. First, it should not appreciably alter federal budgetary scoring of the proposed legislation for the years relied upon when the law was enacted. Second, these contributions would be reclassified as part of the new Postal Service Postretirement Health Benefit Fund, responding to concerns underlying the expressed Sense of Congress.

With these additional payments being converted to the Health Benefit Fund in FY 2006, when pre-funding of Postal Service postretirement health benefits would start, the beginning balance of the fund is estimated at $18 billion ($10 billion CSRS over-funding at the end of FY 2002 plus $5.5 billion in CSRS payments in FY 2003, 2004 and 2005 plus interest of $2.4 billion). In FY 2006, the "savings" from the Act would be used to fund the "full cost" of retiree health benefits on a current basis. The remaining "savings" amount would be used to reduce debt, as reflected in Table 2.

NOTE: "SAVINGS" AMOUNTS ARE BASED ON VALUES CONTAINED IN APPENDIX A ADJUSTED TO REFLECT FULL FUNDING BY THE POSTAL SERVICE OF ALL CSRS OBLIGATIONS.

TABLE 1: USPS Proposal for "Savings" Assuming Treasury Funds CSRS Cost of Military Service

Fiscal Year	Savings	Retiree Health Benefits	Debt Reduction	Total
2006	$5.2B	$5.0B	$0.2B	$5.2B
2007	$5.4B	$5.2B	$0.2B	$5.4B
2008	$5.7B	$5.3B	$0.4B	$5.7B
2009	$5.8B	$5.5B	$0.3B	$5.8B
2010	$6.0B	$5.6B	$0.4B	$6.0B

Having addressed the financial obligations for funding all postretirement benefits, and having addressed other major considerations contained in the Act, these reforms should replace the present escrow requirement of the Act, which accordingly, should be repealed.

The Postal Service considers this proposal to be in the public interest and recommends that it be adopted.

Proposal 2: If Postal Ratepayers Are Required to Fund Military Service Costs of CSRS

Under this scenario, the Postal Service proposes the use of "savings" or over-funding realized under the Act, in priority sequence: first, to fund and pre-fund postretirement health care benefits; second, to repay debt; and third, to fund productivity and cost saving capital investments. Under this proposal, there is an indirect benefit achieved that addresses the consideration of Congress relating to delaying or moderating increases in postal rates. This results from the proposed utilization of "savings" for funding the annual cash payment of retiree health benefits, and the allocation of funds to reduce debt and fund cost reduction capital investments. By debt reduction, interest expense is reduced. With cost reduction capital investments, cost savings are achieved, thus minimizing expenses and freeing up traditional funding sources for capital investments, such as depreciation. These funds would then be used for financing inflationary expense growth as well as the cost to serve an increasing delivery network required to maintain universal service.

To address the larger retiree health benefit obligation, this proposal implements a solution for fully funding postretirement health benefits. This proposal pre-funds the current service cost of these benefits, beginning in FY 2006, for all new employees hired after FY 2002. These costs will be fully funded for all new hires dating from FY 2003, the effective date of P. L. 108-18. Additionally, it provides a funding source for the annual cost of these benefits for all retirees, accomplishing a fully financed postretirement health benefit program.

Table 2 provides the consequent allocation of "savings" to each category among Postal priorities for FY 2006 through FY 2010.

NOTE: "SAVINGS" AMOUNTS ARE BASED ON VALUES CONTAINED IN APPENDIX A. ACTUAL "SAVINGS" AMOUNTS WILL BE CALCULATED BY OPM ON AN ANNUAL BASIS.

TABLE 2: **USPS Proposal for Savings Assuming It Funds CSRS Cost of Military Service**

		Retiree Health Benefits			
Fiscal Year	**Savings**	**Pymt.**	**New Empl.**	**Debt & Cap.**	**Total**
2006	$3.2B	$1.8B	$0.1B	$1.3B	$3.2B
2007	$3.5B	$2.0B	$0.1B	$1.4B	$3.5B
2008	$3.9B	$2.3B	$0.2B	$1.4B	$3.9B
2009	$4.2B	$2.6B	$0.2B	$1.4B	$4.2B
2010	$4.6B	$2.9B	$0.3B	$1.4B	$4.6B

OPM DETERMINATION OF "SAVINGS" METHODOLOGY AND USPS RIGHT TO REQUEST RECONSIDERATION

To determine the amounts representing "savings", the Act requires the Office of Personnel Management to "...formulate a plan specifically enumerating the actuarial methods and assumptions by which the Office shall make its computations...." The Act further requires that the OPM plan "...be formulated in consultation with the Postal Service and shall include the opportunity for the Postal Service to request reconsideration of computations...."

The Postal Service disagrees with the plan developed by OPM. Specifically, the Postal Service finds that the allocation methodology used by OPM to attribute CSRS pension costs of the pre-July 1, 1971 (Postal Reorganization Date) service assigns an unreasonably low portion of that benefit to be paid to the Postal Service. The Postal Service, in a letter dated July 22, 2003, requested OPM to reconsider its proposed methodology and consider an alternate allocation methodology proposed by the Postal Service. That proposed alternative allocation methodology was consistent with the approach previously used by OPM to allocate the increase in CSRS pension costs created by annual cost-of-living-adjustments (COLAs) granted to retirees. On July 31, 2003, OPM rejected this Postal Service proposal.

Recognizing that both the OPM methodology and the Postal Service proposal based on OPM's methodology for allocating COLAs represented the two extreme methodological approaches for allocating pension costs, the Postal Service subsequently submitted a new alternate proposal. This formal proposal more equitably allocates the CSRS pension costs for the pre-July 1, 1971 and post-June 30, 1971 between the Postal Service and the Post Office Department.

The Act entitles the Postal Service to request the Board of Actuaries of the Civil Service Retirement System to review and make adjustments to OPM computations. Such a request must be accompanied by a signed report prepared by professional actuaries. The filing of such an appeal remains under consideration.

Appendix A

Projected Postal Service Payments

dollars in billions

Fiscal Year	Old Law: 7% Agency Contribution	Old Law: 30-Year Payments	Old Law: 15-Year Payments	Old Law: Total USPS CSRS Payment	New Law: 17.4% Agency Contribution	New Law: 40-Year Amortization Payment	New Law: Total USPS CSRS Payment	Change in Total USPS CSRS Payment
2003	0.754	2.724	1.275	4.753	1.314	0.000	1.314	-3.439
2004	0.714	2.783	1.432	4.929	1.775	0.422	2.197	-2.732
2005	0.671	2.872	1.600	5.144	1.668	0.422	2.090	-3.054
2006	0.625	2.822	1.758	5.205	1.555	0.422	1.977	-3.228
2007	0.578	2.862	1.965	5.405	1.437	0.422	1.859	-3.546
2008	0.528	2.923	2.206	5.657	1.313	0.422	1.735	-3.922
2009	0.476	2.856	2.461	5.793	1.183	0.422	1.605	-4.188
2010	0.422	2.887	2.733	6.042	1.050	0.422	1.472	-4.570
2011	0.368	2.927	3.033	6.328	0.916	0.422	1.338	-4.990
2012	0.315	2.830	3.349	6.494	0.784	0.422	1.206	-5.288
2013	0.265	2.855	3.713	6.833	0.659	0.422	1.081	-5.752
2014	0.218	2.841	4.122	7.180	0.543	0.422	0.965	-6.215
2015	0.177	2.557	4.502	7.236	0.439	0.422	0.861	-6.375
2016	0.141	2.527	4.843	7.511	0.351	0.422	0.773	-6.738
2017	0.112	2.501	5.227	7.839	0.278	0.422	0.700	-7.139
2018	0.088	2.352	5.669	8.109	0.219	0.422	0.641	-7.468
2019	0.069	2.316	5.982	8.367	0.171	0.422	0.593	-7.774
2020	0.054	2.286	6.272	8.612	0.133	0.422	0.555	-8.057
2021	0.042	2.175	6.538	8.755	0.104	0.422	0.526	-8.229
2022	0.032	2.066	6.775	8.873	0.080	0.422	0.502	-8.371
2023	0.025	2.025	6.981	9.031	0.061	0.422	0.483	-8.548
2024	0.019	1.970	7.153	9.141	0.046	0.422	0.468	-8.673
2025	0.014	1.837	7.289	9.140	0.035	0.422	0.457	-8.683
2026	0.011	1.611	7.388	9.010	0.026	0.422	0.448	-8.562
2027	0.008	1.578	7.449	9.035	0.020	0.422	0.442	-8.593
2028	0.006	1.527	7.472	9.005	0.015	0.422	0.437	-8.568
2029	0.004	1.480	7.459	8.943	0.011	0.422	0.433	-8.510
2030	0.003	1.372	7.409	8.785	0.008	0.422	0.430	-8.355
2031	0.002	1.350	7.326	8.677	0.005	0.422	0.427	-8.250
2032	0.001	1.278	7.212	8.491	0.004	0.422	0.426	-8.065
2033	0.001	1.148	7.070	8.219	0.002	0.422	0.424	-7.795
2034	0.001	1.020	6.902	7.923	0.002	0.422	0.424	-7.499
2035	0.000	0.897	6.712	7.609	0.001	0.422	0.423	-7.186
2036	0.000	0.781	6.501	7.282	0.000	0.422	0.422	-6.860
2037	0.000	0.671	6.272	6.942	0.000	0.422	0.422	-6.520
2038	0.000	0.569	6.027	6.596	0.000	0.422	0.422	-6.174
2039	0.000	0.476	5.769	6.245	0.000	0.422	0.422	-5.823
2040	0.000	0.393	5.499	5.892	0.000	0.422	0.422	-5.470
2041	0.000	0.320	5.219	5.539	0.000	0.422	0.422	-5.117
2042	0.000	0.257	4.933	5.190	0.000	0.422	0.422	-4.768
2043	0.000	0.205	4.641	4.845	0.000	0.422	0.422	-4.423
2044	0.000	0.161	4.346	4.507	0.000	0.000	0.000	-4.507
2045	0.000	0.126	4.050	4.175	0.000	0.000	0.000	-4.175

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T6-6. The GAO report on the Postal Service's proposed options for disposition of the "savings"(Report No. GAO-04-238, p. 3, issued November 26, 2003) states that: the legislation [P.L. 108-18] stated that the Service should also consider the work of the President's Commission on the United States Postal Service (the Commission), whose report, issued in July 2003, identified the need for the Service to operate more efficiently.4 [Footnote 4 omitted.] The Commission's report recommended, among other things, that:

- "the Service should review its current policy relating to the accounting treatment of retiree health care benefits, and work with its independent auditor to determine the most appropriate treatment of such costs in accordance with applicable accounting standards and in consideration of the Postal Service's need for complete transparency in the reporting of future liabilities; and
- the Postal Service should consider funding a reserve account for unfunded retiree health care obligations to the extent that its financial condition allows...."

a. Has the Postal Service reviewed and prepared a report on its current policy relating to the accounting treatment of retiree health care benefits, and determined the most appropriate treatment of such costs in accordance with applicable accounting standards? If so, please provide a copy of such report and the current policy relating to the accounting treatment of retiree health care benefits.

b. Please explain what consideration, if any, the Postal Service has given to funding of a reserve account for retiree health care obligations since release of the above-referenced GAO report.

Response:

a. The quote cited above was taken out of context in the GAO report. The above statement was directed to "the new Board of Directors." Further, on page 124 of the Commission's report, they recognized the following:

> [T]he retiree health care obligation is funded on a "pay-as-you-go" basis that focuses on obligations due today rather than the larger figure of obligations earned by and owed to employees today. The Commission wishes to make clear that the Postal Service's independent auditor has indicated that such an approach is in compliance with current applicable accounting standards governing the reporting of retiree health care costs.

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b. As referenced in the "Postal Service Proposal: Use of Savings for Fiscal Years after 2005, P.L. 108-18," two alternate proposals, labeled Proposals I and II presents consideration given to funding a reserve account for retiree health care obligations. Proposal I requires that the retroactive transfer of CSRS military service costs imposed on the Postal Service under Public Law 108-18 is returned to the U.S. Treasury. Under this proposal, the Postal Service would fund the current service cost of post-retirement health benefits and the net interest on the unfunded obligation. Proposal II is based on the Postal Service's funding of $27 billion in CSRS military service costs. With this added burden, the Postal Service proposed funding the current service cost for Postal Service employees hired after FY2002.

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VP/USPS-T6-7. Please suppose the Postal Service is viewed as having two kinds of expense obligations, regular operating expense obligations and escrow expense obligations. Suppose further that the appropriate procedure for covering these expenses is in two steps. First, rates are set in a normal Commission proceeding to cover the regular operating expenses. Second, layered on top of the first step, a uniform proportionate surcharge is applied to cover the escrow.

a. If at some point in the future the escrow expense were removed, please explain why it would not be appropriate to remove the proportionate surcharge as well.

b. If the government placed a 10 percent surcharge on all postal rates in order to help pay for a war, please explain why you would not expect the surcharge to be removed after the war ended.

c. If the escrow obligation was not removed and additional revenues were needed, please explain whether the analysis supporting the rate change should focus on the base rates or on the rates plus the surcharge.

Response:

a. It would not be appropriate if the regular and escrow rates were not covering Postal Service operating costs.

b. Based on past experience with the federal budget process, it might be more likely that the size of the federal budget deficit, as opposed to the end of the war, would determine if the surcharge were removed. It could also be possible that the surcharge would not be removed, and a new requirement would be established for funds generated from the surcharge to be held in "escrow."

c. The analysis supporting the rate change would be based on all sources of revenue and expense.

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VP/USPS-T6-8.

Please suppose that the Postal Service is viewed as having two kinds of expense obligations: (i) regular operating expenses; and (ii) escrow expenses.

a. Can you envision any outcome in which the escrow funds ultimately would not be expended for a purpose that otherwise would appropriately be funded by ordinary (non-escrow) revenues?

b. If you can envision such a possibility, please explain and indicate the likelihood of such an outcome. If you cannot envision such a possible outcome, then why is it reasonable to view the requirement to set aside escrow funds as different from any other expense obligation? Please explain.

Response:

a & b. In accordance with Public Law 108-18's provision that Congress shall decide how the escrow funds will be expended, it is possible that these funds could be expended for a purpose that otherwise would not be funded by ordinary (non-escrow) revenues. A case in point would be the retroactive charge for CSRS military service costs that by law were previously the responsibility of the U.S. Treasury and transferred by Public Law 108-18 to the Postal Service. Another example would be the transfer of Post Office Department workers' compensation costs to the Postal Service.

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VP/USPS-T6-9.

a. As a hypothetical, please assume Congress were to enact legislation that relieved the Postal Service of its $3.1 billion obligation to the escrow account, but required that $1.2 billion be paid into a new Retiree Health Care Fund, as suggested by the Postal Service in its Report to Congress "Postal Service Proposal: Use of Savings for Fiscal Years after 2005, P.L. 108-18," September 30, 2003.

   (i) Under these circumstances, would you see good reason for the Postal Service to amend and reduce the revenue requirement to reflect the lower Congressional mandate?

   (ii) Regardless of whether you were to see good reason to reduce the revenue requirement or keep it unchanged, would you still consider an across-the-board rate increase to be appropriate under these circumstances? Please explain why or why not.

   (iii) Under what legislative scenario would there be good reason for withdrawing the pending request and resubmitting a more traditional rate case; i.e., one that did not reflect an across-the-board rate increase?

b. As a second hypothetical, please assume Congress were to enact legislation requiring that the entire $3.1 billion payment in FY 2006 be paid to a new Retiree Health Care Fund. Under the circumstances of this hypothetical, would you still consider an across-the-board rate increase to be appropriate?

Response:

a. (i) Assuming that the $1.2 billion payment cited above relates to the difference between our proposed funding of $5.0 billion less former CSRS and retiree health benefit premium payments, it would be appropriate for the Postal Service to withdraw this case and file a new case.

(ii) See response to part (i). The timing of when such legislation were enacted and other provisions contained in that legislation would determine what course of action the Postal Service would take.

(iii) See response to part (i).

b. See response to part (a)(ii).

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TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T6-10. Your testimony (USPS-T-6, as revised on June 9, 2005) set out the basis for the Rate Request at pages 16-19. We seek to contrast the Civil Service Retirement System ("CSRS") escrow fund basis for this rate case with similar expenses incurred by the Postal Service in the past.

a. Please indicate the total expenses that the Postal Service was obligated to incur as a result of the Omnibus Budget Reconciliation Act ("OBRA") of 1990.
b. What was the purpose, or purposes, of the expenses mandated by the 1990 OBRA?
c. Was there precedent for the 1990 OBRA as it affected the Postal Service, or was it an unprecedented event for the Postal Service? Please explain any precedent.
d. At the time the 1990 OBRA was enacted, would it be reasonable to describe it as a unique event, or did it fall into a pattern that might be described as a follow-on to some prior event or existing trend? If the latter is the case, please explain.
e. Would it be reasonable to describe the effect of the 1990 OBRA as a "tax" on postal ratepayers?
f. To the best of your knowledge, was a "tax" metaphor used at the time it was under consideration by Congress and immediately following its enactment?
g. Of the total obligation provided in response to preceding part a, how much, or what percentage, did the Postal Service treat as operational expenses?
h. How much (or what percentage) of the expenses caused by the 1990 OBRA was retroactive, and how much (or what percentage) was for expenses incurred either in FY 1990 or in FY 1991?
i. Of that amount of the 1990 OBRA expenses that the Postal Service treated as operational expenses, (i) how much was attributable, and (ii) what was the basis for attribution?

Response

a. As reflected on the attached schedule, the total cost through FY2004 was $21.099 billion.

b. The OBRA of 1990 made the Postal Service responsible for CSRS COLAs and the employer's share of FEHBP insurance premiums for postal annuitants who retired after June 30, 1971 and their survivors, apportioned to reflect only Federal civilian employment service occurring after June 30, 1971.

c. The OBRA of 1990 reflected the continuation of the trend seen in previous legislation for the transfer of costs related to Postal Service retirement and annuitant health benefits previously funded by the U.S. Treasury.

d. See my response to c.

e. No.

f. Not to my knowledge.

g. $18.959 billion was treated as operating expense.

h. $2.140 billion was retroactive. There was no 1990 OBRA expense in FY 1990. The FY 1991 expense was $2.650 billion.

i. (i) These costs have been attributed to the same degree as all volume variable postal labor costs.

(ii) The establishment for this approach to attribution relates to CSRS unfunded liability costs first charged to the Postal Service in 1974. In its Opinion and Recommended Decision, Docket No. R77-1, the PRC stated the rationale for treating prior years' costs as volume variable:

> The best available approximation of the costs that are causally related to the classes and service, therefore, must include a share of the prior year payment in order to reach the costs that have not yet been causally apportioned – but without giving undue weight to obligations that exceed the revenue requirement.

OBRA Costs

($ in billions)

Attachment to
VP/USPS-T6-10

FISCAL YEAR	OBRA 1985	OBRA 1987	OBRA 1989	OBRA 90 CURRENT	OBRA 90 RETRO	OBRA 1993	TOTALS ANNUAL		TOTALS CUM.
1987	0.010	---	---	---	---	---	0.010	b/	0.010
1988	0.053	0.510	---	---	---	---	0.563	b/	0.573
1989	0.100	0.270	---	---	---	---	0.370	b/	0.943
1990	0.166	---	0.074	---	---	---	0.240	b/	1.183
1991	a/	a/	a/	0.749	1.901	---	2.650	b/	3.833
1992	a/	a/	a/	0.871	0.081	---	0.952	b/	4.785
1993	a/	a/	a/	1.061	0.070	0.857	1.988	b/	6.772
1994	a/	a/	a/	1.139	0.054	0.043	1.236	b/	8.009
1995	a/	a/	a/	1.212	0.034	0.045	1.291	b/	9.300
1996	a/	a/	a/	1.247	---	0.047	1.294	b/	10.594
1997	a/	a/	a/	1.365	---	0.032	1.397	b/	11.991
1998	a/	a/	a/	1.440	---	0.016	1.457	b/	13.448
1999	a/	a/	a/	1.496	---	---	1.496	b/	14.944
2000	a/	a/	a/	1.724	---	---	1.724	b/	16.668
2001	a/	a/	a/	1.983	---	---	1.983	c/	18.651
2002	a/	a/	a/	2.226	---	---	2.226	c/	20.877
2003	a/	a/	a/	1.133	---	---	1.133	c/	22.010
2004	a/	a/	a/	1.313	---	---	1.313	d/	23.323
Totals	0.329	0.780	0.074	18.959	2.140	1.041	23.323		

a/ Enactment of the OBRA 1990 superceded prior OBRAs, therefore all costs are now identified as OBRA 1990

b/ Source: Docket R2001-1 Exhibit USPS 6-K

c/ Source: FY 2001-2003 Summary Description

d/ Source: Library Reference USPS-LR-K-50

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VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T6-11. Your testimony (USPS-T-6, as revised on June 9, 2005) set out the basis for the Rate Request at pages 16-19. We seek to contrast the Civil Service Retirement System ("CSRS") escrow fund basis for this rate case with similar expenses incurred by the Postal Service in the past.

a. Please indicate the total obligation that the Postal Service was required to incur as a result of the Omnibus Budget Reconciliation Act ("OBRA") of 1993.
b. What was the purpose, or purposes, of the expenses mandated by the 1993 OBRA?
c. Of the total expenses provided in response to preceding part a, how much, or what percentage, did the Postal Service treat as operational expenses?
d. At the time the 1993 OBRA was enacted, would it be reasonable to describe it as a unique, one-time event? If not, please describe all circumstances (other than the 1990 OBRA) that made it non-unique.
e. Would it be reasonable to describe the effect of the 1993 OBRA as a "tax" on postal ratepayers?
f. To the best of your knowledge, was a "tax" metaphor used at the time it was under consideration by Congress and immediately following its enactment?
g. Of the total obligation provided in response to preceding part a, how much, or what percentage, did the Postal Service treat as operational expenses?
h. How much (or what percentage) of the obligation caused by the 1993 OBRA was retroactive, and how much (or what percentage) was for expenses incurred in either FY 1993 or FY 1994?
i. Of that amount of the 1993 OBRA expenses that the Postal Service treated as operational expenses, (i) how much was attributable, and (ii) what was the basis for attribution?

Response

a. As reflected on schedule attached to response VP-USPS-T6-10, the total cost was $1.041 billion.

b. The OBRA of 1993 required the Postal Service to pay interest on the retroactive assessments due under the OBRA of 1990.

c. None.

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d. The OBRA of 1993 reflected the continuation of the trend seen in previous legislation for the transfer of costs related to Postal Service retirement and annuitant health benefits previously funded by the U.S. Treasury.

e. No.

f. Not to my knowledge.

g. None.

h. See my response to b. The expenses incurred in FY 1993 and FY 1994 were $857 million and $43 million, respectively.

i. These costs have been attributed to the same degree as all volume variable postal labor costs.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T6-12. Your testimony (USPS-T-6, as revised on June 9, 2005) set out the basis for the Rate Request at pages 16-19. We seek to contrast the Civil Service Retirement System ("CSRS") escrow fund basis for this rate case with similar expenses incurred by the Postal Service in the past.

a. Please indicate the total obligation that the Postal Service was required to incur as a result of the Balanced Budget Act of 1997.
b. What was the purpose, or purposes, of these expenses mandated by the Balanced Budget Act of 1997?
c. Of the total expenses provided in response to preceding part a, how much, or what percentage, did the Postal Service treat as operational expenses?
d. How much (or what percentage) of the expenses caused by the Balanced Budget Act of 1997 was retroactive, and how much (or what percentage) was for expenses incurred either in FY 1993 or in FY 1994?
e. Of that amount of the Balanced Budget Act of 1997 expenses which the Postal Service treated as operational expenses, (i) how much was attributable, and (ii) what was the basis for attribution?

Response

a. In FY 1997, the Postal Service recognized an expense of $258 million.

b. The balanced budget Act of 1997 repealed the authorization for appropriations that had funded the liabilities of the former Post Office Department to the Employees' Compensation Fund. Through FY 2004 the total cost to the Postal Service has been $339 million.

c. As reflected in the FY 1997 Annual Report, none of these costs were treated as operating expenses.

d. All of these expenses were retroactive and related to years prior to Postal Reorganization.

e. (i) None.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

(ii) Because Post Office Department workers' compensation costs relate to the cost of Post Office Department employees, they are classified as institutional.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T6-13. Please refer to your response to VP/USPS-T6-8, where you cite the transfer of the old Post Office Department workers' compensation costs to the Postal Service as an example of expenses not "funded by ordinary (non-escrow) revenues."

a. When did the requirement to fund the Post Office Department's workers' compensation costs take effect?
b. Since the requirement took effect, what has been the cumulative total expenses to the Postal Service?
c. Of the total cumulative expenses provided in response to preceding part b, how much has been treated as operating expenses?
d. How much of the total cumulative expenses provided in response to preceding part b has been treated as attributable, and what has been the basis for attribution?

Response

a. FY 1997

b. $339 million.

c. Prior to FY99, these costs were treated as non-operating expense.

d. None. See response 12.e(ii)

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T6-14.

a. When the Postal Service has been required by Congress to pay large retroactive amounts for expenses incurred in prior years, what was the basis for treating such payments as operational expenses in the year (or years) during which such payments were made?

b. Under what circumstances would you consider it appropriate to recover large retroactive amounts for expenses incurred in prior years via an across-the-board rate increase, and under what circumstances would you consider it more appropriate to recover such large retroactive amounts for expenses incurred in prior years via a rate case that relies fully on the rate-setting procedure specified in the Postal Reorganization Act of 1970?

Response

a. As explained in my answers to questions VP/USPS-T6-10-13, the extraordinary and retroactive portion of these types of expense have not been included in operating expense.

b. The use of an across-the-board rate increase in the filing was based on the unknown nature of the FY2006 escrow requirement. Were it not for this requirement, we would not have filed this case. As stated on page 18 of my testimony, the escrow represents a true tax or burden on the system.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAYMAN
TO INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
REDIRECTED FROM WITNESS ROBINSON

VP/USPS-T27-16.
Please refer to your testimony at page 12 (ll. 11-13) where you state:

> the Postal Service cannot simply ignore its [the escrow requirement's] existence. To do so would be a breach of the financial management responsibilities established under the Postal Reorganization Act.

If the Postal Service cannot afford to ignore the existence of the escrow requirement without breaching the financial management responsibilities established under the Postal Reorganization Act, please explain how the Postal Service can afford to ignore its future unfunded health care liabilities (discussed at page 27 of the 2004 Annual Report of the U.S. Postal Service) which far exceed the FY 2006 escrow requirement of $3.1 billion, without breaching its financial management responsibilities.

Response

The Postal Service has not ignored this responsibility. The Postal Service follows Generally Accepted Accounting Principles and accounts for retiree health benefit costs as a participant in a multi-employer plan.

CHAIRMAN OMAS: Is there any additional written cross-examination for Witness Tayman?

(No response.)

CHAIRMAN OMAS: There being none, this brings us to oral cross-examination. Two parties have requested oral cross: the Office of Consumer Advocate and Val-Pak Direct Marketing Systems, Inc., and Val-Pak Dealers Association.

Is there any other party who would like to cross-examine Witness Tayman?

(No response.)

CHAIRMAN OMAS: There being none, Ms. Dreifuss, would you please begin? Oh, Mr. Richardson?

CROSS-EXAMINATION

BY MR. RICHARDSON:

Q Good morning, Mr. Tayman.

A Good morning.

Q I want to start with discussing the effect of your errata that you filed recently. The errata was filed to cover errors in the interest rate calculations and other adjustments you made.

A That's correct.

Q And that had some effects down the road for Fiscal Year 2005 and 2006. Is that correct?

A That's correct.

Q And one of those effects, I believe, was a longer-term effect of the impact of how much the Postal Service might have to borrow down the road because it would affect some of the potential income. Your original testimony indicated that the outstanding debt for the Postal Service at the end of Fiscal Year 2006 before rates, that is, no rates went into effect during 2006, would be $1.999 billion. Is that correct?

A Yes.

Q And the effect of your errata was to reduce that to $1.782 billion. Is that correct?

A Yes, it is.

Q You previously testified in a response to an interrogatory that the $1.99 billion could be borrowed within the Postal Service's borrowing limits. Is that correct?

A Yes.

Q And since this number, $1.782 billion, is less than that, I assume, and I just want the record to be clear, that it is your testimony that the Postal Service does have the authority to borrow those amounts --

A Yes, it does.

Q -- and that if the rates did not go into effect in Fiscal Year 2006, if you maintained the current rates, your testimony is that you would need to borrow $1.782 billion and that you have appropriate statutory authority to borrow that amount.

A Yes, based on the test year assumptions and rate implementation on October 1, 2005.

Q Thank you. Now I would like you to turn to your Exhibit 6I that was actually discussed a few minutes ago when Ms. Dreifuss was cross-examining Governor Potter. This is the exhibit that discusses the net income loss on a year-to-year basis and the cumulative net income and cumulative equity of the Postal Service. Is that correct?

A Yes, it is.

Q And there was some discussion about the -- this exhibit was not updated in your errata. That's the purpose of my discussion here. I want to make clear that you did not update this exhibit. I just want to get a couple of numbers on the record related to the impact of your errata.

Do you agree it was not updated, Exhibit 6I?

A I do have a revised sheet that I prepared. I thought, in response to one of your interrogatories, it may have been updated, but I do have a revised sheet, if you would like a copy.

Q I don't recall that, frankly. I thought you had revised your other exhibit, 6A, but not Exhibit 6I. Let me just go through a couple of numbers, then.

The Fiscal Year 2005 estimate, as a result of your errata, would increase the net income, as I understand it, from what's shown there on that exhibit of $1643.453 million and would increase it by $36.4 million. Is that correct?

A That's correct.

Q So what would the impact on the cumulative net income be for the Postal Service at the end of 2005?

A It would increase by the same amount, so the new cumulative net income would be $2,577,158,000.

Q Thank you very much. And, of course, then that number would then flow through to the following fiscal year, 2006. Whatever would be the income or the loss for Fiscal Year 2005, that would flow through in the arithmetic.

A That would be the beginning balance for Fiscal Year 2006. That's correct.

Q I would like to also turn now to your Exhibit 6A, which you did revise. Do you have that in front of you?

A Yes, I do.

Q Again, this was discussed in the cross-examination of General Potter. You show a net surplus after your errata in the test year after rates of $281.5 million. Is that correct?

A Yes, it is.

Q Now, that's approximately 10 percent of the rate increase requested here. Is that correct? The rate increase is slightly over $3 billion in the test year.

A It would be slightly less than 10 percent.

Q Would you consider reducing the rate increase by 10 percent because of that $281 million?

A No. As stated earlier by Witness Potter, with the delayed implementation until January, we would basically fall short between what's in the test year and this filing by $800 million, is what we originally estimated.

Q If that were not the case, that the rates were going into effect at the beginning of the year, that is of a magnitude that would require an adjustment in the rate request, would it not? It's not an significant amount. Do you agree with that?

A I would assume it would be an amount the Commission could take into consideration when they rendered their final opinion on rates.

Q But normally when you're designing rates, you would attempt to reach a level where there was less of a surplus than that, would you not?

A That's true.

Q And also on your Exhibit 6A -- this is revised -- the test year before rates, you show a loss of $2.879 billion, rounded to $2.880 billion --

A That's correct.

Q And that is essentially the same as assuming the rates that don't go into effect during Fiscal Year 2006. That would be the loss for the Postal Service for that test year.

A Yes.

Q Now, we've discussed earlier, after your adjustments, the cumulative net income for the Postal Service, in your estimate, would be $2.577 billion, I believe, so that if we took into account the situation where the rates did not increase in Fiscal Year 2006, and that loss would have been taken into account, along with the Fiscal Year 2005 accumulated net income, am I correct that that would show that you would just take the difference of those two, and since that would be a negative number, there would be a cumulative loss of about $303 million?

A That seems about right.

Q Just to get that into perspective, the $303 million loss, I want you to just compare that to your Exhibit 6I, which was just discussed, where you see the cumulative loss column from 1972 through 2005. In fact, except for four years, in the period from 1975 through 2003, there was always a cumulative net loss of over a billion dollars, and in only one of those years was the cumulative net loss less than over $2 billion. Is that correct?

A That's correct.

Q And, in fact, in only four of those years, has an accumulated net loss been less than $300 million, that being the last two years, 2004 and 2005, and the very first two years, 1972 and 1973, where it was in the almost-$200 million-loss range.

A That's correct.

Q So compared to the historical situation, a cumulative net loss of $300 million would not be out of context with the historical past. Would you agree with that?

A From the cumulative net income, that would be accurate, yes.

Q In addition to the errata income that we discussed about adding to the 2005 numbers, I want to discuss a little about where you are so far this year. Now, I understand that the estimates you made in this rate case did not follow the budget of the Postal Service, but you used updated numbers, I guess, more based on your views of what would be the actual situation.

A That's correct. For the 2005 operating budget of the Postal Service, we used Quarter 3, 2004 revenue and buying forecasts. In this filing, we've updated, and we've used actual 2004 results as well as the results from Quarter 1 of 2005, and that's all been incorporated in this filing.

Q And through April, you had a significant profit for the year that was considerably above the budget plan. How much was it above the budget plan in April?

A I don't have the April numbers with me, but it was significantly above. What's in the budget was not necessarily out of line with what we assumed in this rate filing.

Q I believe it was around $2 billion. Would you say that was approximately correct?

A That could be.

Q But now, after the May figures have come in where there was, I believe, a slight loss -- is that correct? --

A I have the May numbers here. We had a net loss in May of $198 million.

Q But in terms of your estimation for Fiscal Year 2005 used in this rate case, do you have the number how far the Postal Service is ahead of its earnings this year?

A From what's included in the rate filing?

Q Yes.

A I think in one of the interrogatories, I believe the cumulative year-to-date actual net income was approximately $42 million above what was assumed in the rate filing.

Q So as of the end of May, at least, you're $42 million ahead of, if all things stayed the same throughout the end of the year, that $42 million would be also --

A I hope we'll be that lucky, but if you look at the results for April and May, we actually were $171 million below what was assumed in the rate filing, so we lost significant ground in April and May, so the $42 million has been going in the wrong direction. It's being reduced as opposed to getting more positive.

Q Okay. Now, I would like to turn to another interrogatory, OCA USPS T-6-43, 43(b), to be precise. Do you have that in front of you?

A Yes, I do.

Q And there you discuss the amount of debt estimated at the end of 2005, September of 2005, and that is in the application in the filing. Is that correct?

A That's correct.

Q And what I want to focus on is your last sentence there. "The debt of $1 billion at the end of Fiscal Year 2005 was assumed to provide a cushion against the statutory annual borrowing limitations ($1 billion operating and $2 billion)."

Could you discuss a little more about what you mean by "cushion?" And let me just preface it by this point, that, as we indicated in some of our interrogatories, and you responded, that the Postal Service currently has no debt. They paid off the debt back in -- I believe it was October of 2004. And you have also indicated that even if the rates did not go into effect at all in Fiscal Year 2006, that you would not need to borrow funds until the very end of 2006, September of 2006, to pay the escrow amount.

And then my question to you is, could you explain why you feel you need a billion-dollar cushion in September of 2005?

A Okay. As you know, as I stated here, we're limited to borrowing a billion dollars for operating purposes on an annual basis and $2 billion for capital. So going into 2006, not knowing the exact outcome of this proceeding, the implementation of rates, if we had to borrow from the escrow, that's defined by law as an operating expense, and so the concern being that by having a billion on the books at the end of the year, that gives us a full billion that we could borrow in the subsequent year for operating purposes as well.

The other thing that's interesting, if you look at the savings under the legislation 108-18 as calculated by the Office of Personnel Management, and you look at 108-18, and the law defines that through 2005 the savings are to be used to pay down debt and hold rates constant, if you take the cumulative debt payment in 2003, 2004, and the $800 million planned in 2005, you'll see that we're very close to having liquidated debt by about the same value. If you take into consideration the delayed implementation until January of the three months, that $800 million, you'll see we're pretty much precisely at what the law called for in liquidation of debt and holding rates constant. So that is factored in there as well.

One other thing to keep in consideration: We manage our cash and our debt on a daily basis. The debt that's on the books at the end of last year and the debt we'll have this year will be short-term debt. We'll probably borrow on September 30th, as we did in this current fiscal year. That debt will be liquidated in essentially the next couple of days, the first two days of October, to minimize interest expense. So we managed to -- in that fashion to minimize expenses in the Postal Service. But it's important to have that on the financial statements because that limits your total debt that you can have outstanding at any one point in time by that $3 billion limit.

Q I notice that in your statements in the library reference that it did indicate that that debt would be paid off, I believe, almost immediately.

A Right.

Q It did not carry forward to Fiscal Year 2006.

A That's right.

Q And you attribute the cost of that billion dollars -- what do you figure the cost of that billion dollars --

A For one day?

Q -- for borrowing?

A For one day?

Q Yes, in this application.

A It's pretty much -- I'm not referring to the spreadsheet. Do you have a spreadsheet there that has a calculation?

A Yes, I do. I have a spreadsheet from Library Reference A-50, a part of your errata. It's page 13 to your errata. And on the right-hand side, there is a billion dollars down about a third of the way down which we've been talking about. Is that correct, that billion?

A That's correct.

Q And it only shows up in September. Between November of 2004 and September of 2005, you show no debt there, --

A That's correct.

Q -- but you do show borrowing a billion dollars in September. And going down to the bottom of the page, I see a number of total variable rate, just below the last line, of 95.89. Is that $95.89 million cost attributable to that billion-dollar debt?

MR. REITER: Mr. Richardson, could you -- I was just going to ask him to clarify what that number is. Did you say 95 million or a thousand?

MR. TISDALE: It's 95 thousand.

MR. RICHARDSON: I see. I said "million," yes.

BY MR. RICHARDSON:

Q That is 95,000?

A Right. At the top left-hand corner, it says "amounts in thousands."

Q Is that the amount attributable to the billion dollars?

A Yes, it would be.

Q Okay. Thank you. Let me ask one more question about that. At this time, is it still your intention to borrow that billion dollars?

A Yes, it is. I should point out that, for overnight borrowing, in essence, it should be a zero-sum game pretty much because what we borrow we would also invest in Treasury, and the interest rate differences pretty much offset one another.

MR. RICHARDSON: I would like to turn back to Exhibit 6A again, a very popular exhibit.

(Pause.)

BY MR. RICHARDSON:

Q Exhibit 6A includes at the top a line for appropriations. Is that correct?

A Yes, it does.

Q And when you include appropriations in that line, are those appropriations -- how are they related to the test year? Are they appropriations you receive in the test year?

A Yes. They would either be received or earned in the test year. I'm not sure without looking at the details, but, for instance, the $29 million appropriation, we're due annually from Congress. Sometimes they defer the payment of that, and we would recognize the receivable as revenue in the year as due to us.

Q And you include appropriations there because of -- I'm not asking you for a legal interpretation, but as you understand the Postal Reorganization Act, 3621, which requires you to include total estimated income and appropriations nearly as equal as practicable to the costs, is that why you use appropriations in that exhibit?

A Yes.

Q Now, in Exhibit I, this is the same subject, related to appropriations, there is an equity column, and I believe you were asked some questions about what makes up the numbers in the equity column besides the cumulative net income. In response to our Interrogatory OCA USPS T-6-38(e), you discussed the fact that a billion dollars of that relates to two appropriations of $500 million each in 1976 and 1977. Is that correct?

A That's correct.

Q And that amount was used to reduce the indebtedness of the Postal Service at that time. Correct?

A There were stipulations on that appropriation indicating how the funds had to be used, and it was to pay down operating debt of the Postal Service.

Q And those appropriations have never been included in a rate case, to your knowledge, in the sense that, on your Exhibit 6A, they were never included as a line item as part of the total overall revenue and appropriations of the Postal Service. Is that correct?

A That's correct.

Q Because if they had been included in an exhibit such as your 6A, they wouldn't be present in this equity column. Is that correct?

A Well, I think what you're asking, if they had been accounted for as revenue, as we account for other appropriations in 1976 and 1977, instead of the equity position increasing by $500 million each year, we would have recorded those sums as revenue appropriations, revenue, and so it would have made its way to the equity section of the financial statements through net income as opposed to contributions from the U.S. government.

Q Those were appropriations, were they not?

A Yes, they were.

Q Is there a reason you would treat those as a different type of appropriation from the appropriations that you do include in the revenue requirement?

A Again, and I don't have the language with me, but my understanding is there were specific requirements -- if you go back and read the footnotes to our annual report for those years, it does indicate that those funds had to be used to pay down operating indebtedness of the Postal Service.

Q But you don't know of any restriction in the statute that would prohibit those appropriations from being taken into account in setting rates, do you?

A As you're familiar, in previous rate filings, we've accommodated that in relation to the recovery-of-prior-year-loss provision, is how it's entered in the past. Again, that's, I believe, consistent with the requirement of the use of those funds to pay down the operating debt.

Q Those funds weren't part of the amount that was recovered from prior year losses to through the one-ninth rule.

A No, they weren't.

Q There is also another amount that you discuss that's included in that equity column, another amount of appropriations of $363.171 million of appropriations related to the annual leave liability of the Postal Service. Is that correct?

A That's correct.

Q That was in T-6-38, our interrogatory, for your information. And those funds were also appropriated. Is that correct?

A Essentially, what that was, at post-reorganization date, there was an annual leave liability for Post Office Department employees. As opposed to being responsible at that point in time, Congress had a series of appropriations, and I'm not sure of the exact formula, but over a period of years -- we received the last payment in 1985, so there was a planned payment schedule on that to make the Postal Service whole for the liability of the Post Office Department, again, for annual leave at post-reorganization.

Q And that related to costs incurred prior to the reorganization.

A That's correct.

Q I see. I want to discuss a little with you your response to OCA USPS T-6-17. There, you say that "treatment in the past of recovering prior years' losses cannot simply be inverted to work down to cumulative net earnings." Is that correct?

A That's correct.

Q And you cite as an example the fact that land has not been included in the revenue requirement. Is that correct?

A That's correct.

Q And land is not included in the revenue requirement because it's a capital expense. Is that correct?

A Under generally accepted accounting principles, land is not depreciated, so it's treated as a capital item, but unlike buildings and equipment that are capital items that are depreciated over the useful life, the useful life of land is, in essence, forever, so it's not depreciated. Accordingly, what I was suggesting here was that since post-reorganization, at post-reorganization, $155 million was the value of the land on the financial statements, and if you look at the value of the land at the end of 2004, it was $2.8 billion. So, accordingly, other than through either borrowing, there is no way to finance that cost of land. It never enters in the revenue requirement, but what's interesting, if we do sell land at a gain or loss, that gain or loss is accommodated in the revenue requirement. If we were to borrow for it, the interest expense would be accommodated, but the actual cost of land is not included.

Q Are there any other categories of assets that you would put into that category which are not depreciated, which are handled like land?

A Land is the only one.

Q So it's only the expenses incurred, even when you purchase a piece of equipment, that's a capital purchase, and that's no cost, per se; it's only once it's depreciated that a cost is incurred that goes into the revenue requirement. Is that correct?

A That's correct.

Q Now, that increase in the land investment has been about over $2.6 billion over this period. Would you say that purchases have been spread fairly evenly over the period?

A I would have to go look at the financial statements. Each annual report shows a change in the value of the land, so I'm not sure exactly, without reviewing that, at what pace land increased or decreased.

Q But as far as you know, it's been fairly constant over the period. There has been no restriction on purchase of land from the beginning of the Postal Service.

A No, no, and it's grown from $155 million to $2.8 billion.

Q Has a particularly large amount of that land been purchased in the last two years?

A I have the annual report from last year. I can look at it real quick and tell you. Land, from 2003 to 2004, increased -- it went from two billion 809 to two billion 810, so it's a million dollars in 2004.

Q Because of that accounting principle, would you know if the Postal Service has ever attempted to recover the cost of land in the revenue requirement?

A Up through this filing, we have not.

Q Because of nonincluding the cost of land in the revenue requirement, does it prevent the Postal Service from expanding the purchase of land over the period of time?

A No. I would suggest that we've purchased land as we've needed to purchase land. We do not speculate in land purchases.

Q Is it your position that the Postal Service could not expand and purchase the land it needs unless management could accumulate net income?

A What I was suggesting was that it would be appropriate to have accumulated net income in consideration of items that don't get entered into the revenue requirement. And I think, if you look at Section 2009 of Title 39, you'll see that the original Postal Reorganization Act, in fact, takes into consideration the existence of surpluses as well as deficits. So I'm suggesting that cumulative net income is appropriate for the Postal Service.

Q You would say that the Postal Service has not been able to purchase land that it would have purchased if the cost of land could be included in their revenue requirement. Is that correct?

A Not to my knowledge, no.

Q In OCA USPS T-6-41, -- do you have that in front of you? --

A Yes.

Q -- 41(b), specifically, you stated: "Management should be responsible for determining an appropriate amount of cumulative net income." Would you place a dollar limit on the amount of cumulative net income the Postal Service should have?

A No. I didn't in my responses here. I did suggest that one could make a case that cumulative net income equal to at least the value of land might be an appropriate consideration, not the only consideration.

Q And how do you square that with the break-even requirement of the Postal Service?

A As I suggested, Section 2009 does reference the surpluses as well as deficits, and I think most of us know what typically happens in economic down cycles. The Postal Service is forced to increase prices at probably the worst time, and one consideration would be the economy, the financial health of the Postal Service, and I don't think there is a set formula that would be appropriate to determine how much cumulative net income should be on hand at any one point in time, but I think it's something that management should take into consideration on a year-by-year basis and would reflect that when they decide to increase prices.

(Pause.)

BY MR. RICHARDSON:

Q If you see that there is not a difficulty in accumulating net income, would you go so far as to recommend or propose a rate increase in a situation where the cumulative net income would be increasing?

A Well, in the current situation, as an example, I would suggest yes. In this current rate filing, R2005-1, as Witness Potter discussed earlier, we have a unique situation that, by statute, a new expenses is being created for the Postal Service that did not occur prior to 2006. By statute, it's defined as an operating expense. It has no purpose. We don't know what it's for. Therefore, in this particular case, it's appropriate to increase prices to fund that expense, as required by law.

Q Let's assume for a moment that the Postal Service has built up a sizable cumulative net income, and assume also that the Congress, through legislation, terminated the Postal Service as we know it, and there was that cumulative net income. Would you agree that that income has accrued to the benefit of the U.S. taxpayer as opposed to the mailer?

A I guess it would depend on how the Postal Service was terminated. Was it sold? The answer to that question may vary based on the exact nature of the termination.

Q But the cumulative net income is part of the value of the Postal Service, -- is that correct? -- and if the Postal Service is valued at that point in time, it would be taken into account in the valuation of the Postal Service.

Is that correct?

A Yes. I guess that's a safe statement.

MR. RICHARDSON: Mr. Chairman, those are all of the questions I have.

CHAIRMAN OMAS: Thank you, Mr. Richardson.

Mr. Olson?

MR. OLSON: Thank you, Mr. Chairman.

CROSS-EXAMINATION

BY MR. OLSON:

Q Mr. Tayman, let me begin again with Exhibit 6I, and you had indicated before that the correct number of cumulative net income at the end of 2005 should be, I believe you said, two five seven seven one five eight.

A That's correct.

Q In the math that we did, we came up with two five seven six six one six. It's very close. Would it be possible to obtain, insofar as you didn't update that particular sheet, you do have a sheet with you that --

A Yes.

MR. OLSON: Mr. Chairman, I would like to ask permission to include that in the record for clarification because I think that would help us all, the copy of the revised Exhibit USPS 6I that Witness Tayman has brought here today which was not provided as a part of the errata there were made previously.

CHAIRMAN OMAS: Any objection?

MR. REITER: Could we have an opportunity to look at that briefly, Mr. Chairman.

CHAIRMAN OMAS: Certainly. Your witness has got it.

(Pause.)

MR. REITER: We have no problem with that, Mr. Chairman, and we are having copies made.

CHAIRMAN OMAS: Thank you.

(The document previously marked as Exhibit No. USPS 6I was received in evidence.)

CHAIRMAN OMAS: Mr. Olson?

MR. OLSON: Thank you.

BY MR. OLSON:

Q Mr. Tayman, all I want to do at the moment is clarify the amount of cumulative net income at the end of Fiscal 06, assuming no rate increase for a moment, and I'm assuming, to get to that number, we would take the $2.577 billion that's in your revised sheet that's now going to be incorporated into the record, and we would add the Fiscal 06 net income before rates. Would that be correct? We would have to subtract out the $3.081 billion payment for the CSRS without a rate increase and without making the payment on June 30, 2006. Is that clear, or should I start over?

A It's not real clear.
Q Okay. Go to your exhibit --0
A I can correct it. It's not June 30th; it's September 30th. Okay. So it wouldn't be a net income; it would be a net loss without rates -- right? -- in 2006. So, in other words, if we end 2005 with a cumulative net income of two billion five seventy seven or thereabouts, and we don't increase rates in 2006, and in the revenue requirement we had a net loss of three billion 041, but the errata changed that to down slightly --
Q $2.879 billion.
A Right. So you would take that $2.879 billion loss, add to the two billion five seventy seven net income, and you would have a negative cumulative net income of somewhere between two and $300 million.
Q Right. And that assumes the payment of the CSR as 3.1, approximately, billion dollars at the end of the fiscal year, does it not?
A It assumes the funding of the escrow fund estimated at three billion, eighty one million. That's correct.
Q So if we were to simply try to identify how large the cumulative net income was of the Postal Service as of the end of Fiscal 06 without making that payment, in other words, comparing the $3.081 billion CSRS payment to

cumulative net income at the end of Fiscal 06 prior to making that payment -- do you see the comparison I'm trying to make? --

A Sure.

Q -- would you agree that there was not a negative amount at the end of '06 but about $202 million net income at the end of '06?

A Essentially, as we said in the filing, were it not for the escrow, we're essentially at a break even in 2006. It's the escrow funding requirement that puts in a significant net loss situation.

Q Could you confirm, then, my number of $202 million net income for Fiscal 2006 without making the CSRS payment?

MR. REITER: Mr. Chairman, can I just ask for a clarification?

Mr. Olson, are you referring to cumulative net income?

MR. OLSON: Cumulative net income, yes.

MR. REITER: Thank you.

BY MR. OLSON:

Q To get to that number, Mr. Tayman, all I did was take the $3.081 billion of CSRS and subtract from it what you have in Exhibit 6A-1 as a net loss for '06 of $2.879 billion, and I get net income for the year of $202 million. Is that correct?

A Yes.

Q Okay.

A That appears to be correct.

Q So if we added that to the $2.577 billion in cumulative net income through the end of '05, we would be somewhere in the range of 2.77 or so billion -- is that correct? -- again, in cumulative net income.

A Yes. That would appear correct.

Q And if you were to contrast that, for a moment, and I'll let you explain why we shouldn't do this, but if we were to contrast that with the amount of money that would be owed to the escrow account, that would be about $303 million shy -- if all of that were available to pay it, it would be about $303 million shy at the end of '06. Would that be correct?

A That would be an accurate statement between the difference between the two, but cumulative net income does not necessarily mean you have a pot of cash sitting there to fund the escrow, and I think what you have to look at is what's in my testimony that says, to fund the escrow in 2006 without increasing rates, we would have to have outstanding debt of a billion, 782 million at the end of 2006. So, in other words, the cumulative net income by itself does not allow us to meet the escrow requirement.

The other thing that we take into consideration is, if you look at our 2004 annual report and look at our total compensation and benefits divided by 26, you'll see that, on a pay period basis, we had nearly $2 billion of expense that has to be met every two weeks. So there's some cushions that one needs to have as far as in the level of cash balances that we operate the Postal Service with.

Q So is it your position, then, that under the Postal Reorganization Act, the relevant touchstone is the amount of cash and cash equivalent the Postal Service has at any given point?

A I'm saying that's one item of consideration. I don't think there is any one item. It's the economic environment. It's the financial condition not only as demonstrated through a cash position but through how much outstanding debt we have and what the economy is looking like and what the prospects for the future look like at that point in time.

Q I have in front of me the quarterly financial report through March 31, 2005, unaudited, showing $1.783 billion in cash and cash equivalents. Is that about right?

A If that's what's in the report, that would be an accurate number, almost enough to pay on payroll.

Q But I suspect a lot better than being in the hole by a couple of billion.

A Absolutely.

Q Let's see. This is Witness Tayman's response redirected from Witness Potter to OCA USPS T-1-5. Do you have that?

A Yes, I do.

Q In your response to Section A, you say that the increase of $169 million to test year after rates net income based on the errata is immaterial relevant to the loss of money from a delayed implementation. First of all, you mean $800 million, don't you, rather than $800?

A Exactly. Thank you.

Q We wouldn't be talking about $800, probably.

A A correction should be made.

Q Okay. And just while we're doing that, on the next page, on the third line, do you see where you reference an April 9 errata?

A Yes.

Q Should that be "June 9 errata"?

A That should be June 9. Thank you. That one, I didn't catch.

Q Okay. When you discussed here and in other responses to various subsections of this interrogatory the losses to the Postal Service in net income in '06 due to a January '06 implementation date, who chose the date on which to file the rate case?

A That came from the board of governors, as far as the actual approval of the filing. The precise date itself -- what we wanted to do in this filing was to be able to use the most current base year possible, and that would be 2004. It's not until the early part of Fiscal Year 2005, after January, that we actually have a draft 2004 base year CRA that can be used for the filing. So in order to incorporate the 2004 CRA, it pretty much dictated that we couldn't file much sooner than the April 8th filing date.

MR. OLSON: I hate to admit it. I do not have my 39 U.S.C. with me, but you referenced Section 2009, and I take it, that's -- oh, you have it.

(Pause.)

BY MR. OLSON:

Q This is the provision that requires the Postal Service to prepare annually a budget, something you would know a great deal about, and submit it to OMB.

A That's correct. I was just suggesting through that reference that in the title it, in fact, takes into consideration that there would be times when the Postal Service would, hopefully, be operating with a surplus and also recognized there would be times when there would be a deficit.

Q So you're referencing particularly the language in the middle of the section that says that "such a submission to OMB should include an analysis of surplus or deficit."

Correct?

A That's correct.

Q And based on that, you're saying you find authority in the Postal Reorganization Act for cumulative net income.

A From my reading of this, it indicates that it was envisioned, in fact, that there would be times when there would be cumulative net incomes, yes.

Q Could that also refer to, if we have, say, a three-year rate cycle, and the first year we make money, the second year we break even, and the third year we lose money, as was the historic pattern for a while, that the first year was a year of surplus, and the third year would be a year of deficit? Could it apply to that also?

A From the aspect that it refers here to the financial condition, what you just cited was "a rate cycle," and examining Exhibit I earlier, I think it was demonstrated that there up to 2004 was the first time there, in fact, was a cumulative net income. So we hadn't reached that point yet.

Q Hadn't had occasion to read the section of the law until now, I guess. What I guess I'm trying to get at is the exercise we're in today is not submitting a budget to OMB but, rather, a rate cycle, and following up on some of OCA's questions, I do wonder if you can identify for me in, for example, Section 3621, and I have a copy, if you would like, where you believe that the authority comes for your conclusion that a cumulative net income in the range we're discussing, up to almost $2.8 billion, is authorized.

A Basically, the section you cite is the one that says, in setting prices, have revenues equal to expenses, including a reasonable provision for a contingency. In this filing, when we took everything into consideration, we looked at the fact that, first off, this was an unusual situation. It's a new operating expense that was established by law. It first occurs in 2006.

We felt, and as stated in my testimony, that to borrow funds, to use outstanding debt, to finance the escrow requirement would be inconsistent with the intent of Public Law 108-18 that required us, by law, to pay down debt for three years. And so despite the fact that we had cumulative net income to mitigate the size of the rate increase and future rate increases, it was a policy decision we felt the best thing to do because this expense, this obligation, is ongoing, and not only is it ongoing; it increases each year until it reaches over $7 billion, not until, I think, 2004, but it is an annual increase. We felt it important to get this cost in our base prices, and since it's unidentified cost, we don't know what it is, it's kind of a tax burden on the system and thus contributed to the across-the-board request, as well as our hopes to settle the case and be able to implement rates in January.

Q Are you saying you have no understanding that the purpose of the escrow might have had something to do with the Postal Service's unfunded retiree health costs?

A Well, in Public Law 108-18, I think it addresses -- I'm not sure if it's under the intent of Congress where it specifies that the "savings," which is the difference between overfunding the Civil Service Retirement System and funding what's appropriate to be funded for that system, it lists in there, I believe, five different items to consider on what those savings could be used for. As you know, we filed our report September 30, 2003, indicating how we thought those savings, in fact, --

Q Still waiting for Congress to act?

A We're still waiting for a response, yes.

So they did indicate five different items or things that "savings" could be used for. The savings itself is an arbitrary amount. It's not directly related to anything other than what we were funding and what was determined to be an inappropriate calculation to what we were funding as to what was appropriate with the transfer of $27 billion of military costs.

Q Do you have any reason to believe that you could identify that Congress is going to require those funds be used for something other than Postal Service expenses, current or future?

A We both know there's two pieces of legislation in the House and Senate that, I think, have come out of committee that abolished the escrow requirement, but in its place has us prefunding the retiree health benefits.

Q So I don't know that you've answered the question. Do you want to take another stab?

A The fact that there has been inaction for so long -- Public Law 108-18 required the filing of reports in a specific time period, required the evaluation of those reports by the now Government Accountability Office in a specified time period. It implied that Congress would take some action to do something. They have not taken any action, and it's going on two years now.

So I don't know. Maybe the desire is to let the escrow fund grow to help balance the federal deficit, because if it's not spent, it just accumulates, and when they score their deficit, they can lower the federal deficit. Maybe that's what they have in mind. I have no idea.

Q Do you have any other reasons to believe that Congress will not eventually cause those funds to be applied to Postal Service expenses?

A Other than just their lack of taking any action at all.

Q Do you have an understanding as to whether the term "retained earnings" is currently in the Postal Reorganization Act?

A I'm not sure that it is contained in there.

Q Are you aware of the fact that it is included for the first time in both -- I'm sorry, what? --

A 662.

Q -- thank you -- 662 and H.R. 22?

A Yes.

Q Let me ask you to refer to your response to T-6-10, Val-Pak, and in your response, you attach that statement of OBRA costs since 1987. Do you recall that?

A Yes.

Q And since 1987, according to your chart, Congress has transferred to the Postal Service a variety of annuitant and health costs that cumulatively amount to, in the far-right total column, $23 billion. Is that correct?

A That's correct.

Q Doesn't this attachment, this chart, show you there are precedents for Congress acting to impose on the Postal Service responsibility for costs that they had not previously been paying?

A I'm kind of struggling with that, responsibility or irresponsibility, from the aspect that some of these costs for the funding of annuitant cost-of-living adjustments for Civil Service retirees contributed to our potential overfunding of the Civil Service Retirement System.

Q I'm not asking you to agree with them. I'm more asking you --

A They have taken various steps over the years to balance their budget, yes.

Q And imposing new responsibilities on the Postal Service to accomplish that.

A Yes.

Q In Part G, you -- the whole question deals with, in specific, OBRA 1990. Correct?

A That's correct.

Q And the total amount of that large burden was $21 billion, roughly. Correct?

A That's correct.

Q And of that, in Section G, you say that 18-plus, almost $19 billion, was treated as an operating expense. Right?

A Yes.

Q And then in H, you say that $2.1 billion, which I guess is the rest, was retroactive. What does "retroactive" mean in that case? I take it, it means it was for expenses that occurred in prior years.

A Off the top of my head, I believe the OBRA of 1990 passed on to the Postal Service the cost of annuitant health benefits as well as annuitant COLAs. It was retroactive to 1971, post-reorganization, and I think that retroactive column there is the interest they charged as interest. I believe that's right.

Q So are you saying the $2.14 billion was treated as an institutional cost?

A I believe so, yes.

Q And are you saying it was not an operating expense?

A In using the term "operating expense" on our financial statements, the income statement, we have operating expenses, and so interest expense is not considered an operating expense, so it's below net income from operations. It's not in that calculation.

Q Well, what I'm trying to get at is what "operating expense" means. You said before that Congress, in Public Law 108-18, identified the CSRS contribution and said that it was to be treated as an operating expense. Correct?

A Yes, 108-18. What they define as "savings," they define it as an operating expense.

Q And in 39 U.S.C. 3621, which, in that break-even requirement that we talked about before of income and appropriations, as nearly as practicable, equaling total estimated cost, "total estimated cost" is defined as including operating expenses. Correct?

A It may be a component, yes.

Q Are you saying there are different definitions of "operating expense"?

A I'm saying there is one definition for financial statement reporting under generally accepted accounting principles. The 108-18, as you point out, uses the term "operating expense," and from that context, it, from our interpretation, equates to include a conclusion, a revenue requirement for setting postage rates.

Q So you have no problem with the notion that the CSRS payment due at the end of '06 is an operating expense as defined in Section 3621.

A For setting rates, yes.

Q Is there some sense it's not?

A No. Absolutely not, for setting rates. It's going to be interesting when it comes down to preparing the financial statements because, as you know, the requirement of 108-18 is to create an escrow fund. We're not disbursing monies to Treasury or OPM or anyone else. We have to have segregated on our balance sheet $3,081,000,000 in cash that we can't expend, we can't use for any purpose, until Congress passes a law and tells us what we can do with that.

So in the aspects of financial reporting, a company usually can't pay itself an expense and record it as an expense on their income statement. So we're going to have a unique situation here between our financial reporting and reporting for establishing rates under Section 3621.

Q And going back to the term "operating expenses" in 3621, would you agree that those operating expenses could be attributed or institutional?

A The escrow?

Q No, generally, first of all.

A Yes.

Q And as to the escrow, I take it, a decision was made that they were not considered attributable.

A Correct. Since there is no indication as to what it is or what it's to be used for, we would have no basis to attribute it.

Q So would you consider it an operating cost which is institutional in nature?

A The savings, as defined by the law, yes.

Q The payment into the escrow account based on the savings.

A Yes, I would.

Q Let me ask you to look at your answer to T-6-10. Let's see if I can find the right section. When this -- just in Section A, the 21 -- 22 -- I'm sorry, $21 billion new obligation of the Postal Service, when this new obligation was placed on the Postal Service back in 1990 or -- or so. Is it '90 or '91?

A The -- the OBRA 90 was -- the first payment was made in '91.

Q Okay. And you had in the first -- in that first year a payment of, is it $2.65 billion?

A That's correct.

Q Okay. So that's under the totals column at the right. If you were to -- if you were to increase that by inflation to today, can we assume that might even be in the approximate range of $3 billion? Just rough numbers.

A Rough numbers, sure.

Q Would you -- in 1991 when that cost was paid, that expense was paid, was that considered an extraordinary expense?

A I believe we disclosed it as a separate line item on our financial statements.

Q Was it -- did it cause a across-the-board rate increase request from the governors --

A I'm trying to think.

Q -- for that reason?

A It did not cause an across-the-board rate increase. I know that. I'm not sure of its implications in what -- you know, what rate filing. I'd have to go back and check.

Q Could you look at your response to T-6-3, please? There you say that the Postal Service will spend something over one and a half billion dollars on retiree health care benefits during '05, correct?

A That's correct.

Q Okay. Is that an actual number or an accrual?

A It's -- it's the cash payment for the premium cost for Postal Service retirees' annuitants, and the amount is prorated based on years of service pre-post -- the postal reorganization did.

Q But it's cash?

A Yes.

Q Because a --

A A cash expenditure made in that year. Pretty much, up to the -- not knowing the exact timing, I believe we're billed -- I don't if we're billed quarterly or monthly from OPM --

Q Thank you.

A -- but there could be some component of accrual, but it's essentially a cash expense.

Q Okay. Then take a look, later you had a further response to 3(b) of that interrogatory, correct?

A Right.

Q It was filed June 22nd.

A That's correct.

Q And there you said "The present value of unfunded retiree health care benefits at the end of '04 range from $48 to $59 billion," correct?
A Yes.
Q Okay. And then, at the end of '05, the range goes from $51 to $62, correct?
A That's correct.
Q So both the bottom number in the range and the top number in the range both went up $3 billion in one fiscal year, correct?
A Right.
Q Okay. And then projecting that to '06, the minimum went from 55 -- it went to $55 and the maximum went to $66, correct?
A Yes.
Q So both those numbers, both the minimum and maximum, went up $4 billion in one year again, correct?
A Right.
Q Okay. And that increase of $3 billion from '04 to '05 and $4 billion from '05 to '06, that increase occurred even after paying the $1.54 billion because --
A Right.
Q -- those were for current --
A Current retirees.
Q -- retirees.

A Yes. The components of this liability estimate, it includes the present value of future obligations for all current retirees; it includes the present value of future obligations for all current postal employees. So the change in the annual expense is primarily a component of the current service costs, in other words, how much expense or how much -- what portion of retiree health benefits is earned in a particular year plus interest on the unfunded amount, so there's in essence two drivers of that in -- of the change in that obligation.

Q Are any of these future obligations accrued in your expense sheets currently?

A No, they're not.

Q Does the Postal Service balance sheet identify those costs?

A No. We -- we file them off the employer accounting as a participant in the federal employees' health benefit program. As such, you account for your current -- your obligations on a cash basis or whatever you're required to fund that year into the plan, and that would be the premium payments for the year. We do disclose this information in our management discussion analysis portion of our annual report.

Q Do you know if those -- well, strike that.

Let me -- let me just say there's a response that was filed by the Postal Service to an interrogatory from the Institute for Research on the Economics of Taxation. I know you didn't respond to that. You didn't file that. But I wanted to see if I could -- I can show it to you. I have a copy.

A Which number? I have some of those here.

Q Oh. It's -- the one I'm going to ask you about is 2 or 3, either 2 or 3. Do you have either of those?

A I have 2. I have 2 and 3 of that.

Q Okay. In 2, it quotes you. It says that Congress has provided no legislative direction concerning the funds, and I think you discussed that today. In Question 3, 3b, this institutional response says, "It is not clear if voluntary prefunded amounts would be considered expenses of the Postal Service under the act."

In other words, if the Postal Service were to voluntarily prefund some of these retiree health costs, is that your view that they would not necessarily be considered expenses -- I guess that means operating expenses -- under the act?

A I mean, what's -- they weren't real specific in their question. I mean, voluntary funding could be one dollar; it could be a billion dollars. And without any indication of exactly what that -- what that is, I'm not sure how the Commission would perceive an arbitrarily determined, you know, prefunding amount by the Postal Service for health benefits. They might construe it as being manipulative to, you know, to something else. I don't know.

It's strict -- in the pure accounting sense of the world as far as it would be inconsistent for us to follow multi-employer accounting, which we do, and then prefunding is more similar with singular employer accounting, and then under singular employer accounting for prefunding, it's very specific as to how the amounts are determined and what the funding level would be, so I think the arbitrary nature of this makes it in question.

Q Are you saying that it's in question as to whether it would be a permissible expense for the Postal Service to incur and then impose on mailers under 3621?

A I mean, from the aspect that we -- again, we follow generally accepted accounting principles and it would be outside the bounds of -- of the principles that we follow, I think it would be questionable.

Q Could you look at your response to T-6-1 of ours? And there you say that $49 billion -- this is the CBO estimate.

A Right.

Q You say the $49 billion is net of an anticipated $21.2 billion asset transfer. Can you explain that asset transfer? What -- where does that money get transferred?

A Okay. It's -- what this is based on is their scoring of HR 22. Under HR 22, the military service costs that were transferred to the Postal Service under 10818 are returned to the Treasury Department. That was a $27 billion transfer. At the end of 2002, were it not for that $27 billion transfer, the Postal Service had actually overfunded its civil service retirement obligation.

So you take the value of the overfunding at the end of September 30, 2002, you add to that in essence the 17.4 percent contributions that the Postal Service has made in 2003, 2004, 2005, and you add to that the present value of the employee's 7 percent contributions, and that's how they come up with the 21 -- and interest on all those monies as well, that's how they derive the $21.2 billion asset transfer, and that would be an asset transfer from the funds in the civil service retirement disability fund.

In essence, what -- what is envisioned is there will be a new sub-part of that fund that will be the Postal Service retiree health benefit fund. So that $21.2 billion would be moving over to the Postal Service retiree health benefit fund.

Q Okay. In response to Valpak T-6-5, you attached a copy of the Postal Service proposal to Congress that has not been --

A Okay.

Q -- responded to, and your -- in your response, you say, "The fiscal '06 payment for retiree health benefits under Proposal 1 was $5 billion," do you see that?

A That's correct.

Q Does the Postal Service proposal anticipate the $5 billion referred to would be treated as an operating expense?

A Yes.

Q Can you -- would you draw a distinction between that $5 billion as an operating expense and the $3.081 billion --

A Sure.

Q -- payment as a CSR?

A I mean, it has -- we know exactly what it -- what it is. It's -- it's the expense of prefunding annuitant health benefits. It's got -- there's three components to the calculation: The current service costs, the interest on the unfunded obligation, and interest earnings on the assets in the fund.

So it's definitive. It has a specific purpose. We know what it -- what it is, unlike the escrow savings amount that's -- that's unidentified and -- and -- and arbitrary. The $5 billion is a specific actuarial calculation in accordance with actuarial principles as well as accounting principles.

Q Okay. I'm going to finish with one last scenario, sort of a hypothetical, and it -- it goes to the issue of suppose this -- the Postal Service needed not just the $3.081 billion that you are requesting, assuming it's needed -- I'm just -- assuming that that is one -- only one element of what was needed -- suppose there was another $2 billion needed by the Postal Service due to its financial condition, its comparison of revenues, and -- and expenses so it had a five point -- a $5 billion revenue requirement in this case -- and we actually asked you a question that began along this line, but I -- it never really finished, so I thought I'd just finish it today.

If we asked you to -- we asked you to assume in Interrogatory 7 that there would be two steps, there would an across-the-board increase for the $3 billion and a regular rate increase for the $2 billion, in your opinion, would it be appropriate to file that as a single rate case? Do you have an opinion? Or whether that should be handled as a two-step process within one rate case, part across-the-board, part conventional rate case?

A Off the top of my head, it seems like we could accommodate it in one filing with two components, an actual increase based on increased costs and an arbitrary expense imposed, you know, by Congress that would treat it from the pricing aspect as across-the-board. And then --

Q You wouldn't point --

A I'm sorry. I was about to say that might be a better question for our rates witnesses to respond to.

Q You wouldn't be able to point to any particular section of the pact which would authorize that expressly, would you?

A None that I'm familiar with.

MR. OLSON: Okay. Thank you, Mr. Tayman.

THE WITNESS: Okay. Thank you.

MR. OLSON: Thank you, Mr. Chairman.

CHAIRMAN OMAS: Thank you, Mr. Olson.

Is there any followup cross-examination?

MR. RICHARDSON: Mr. Chairman, I would like to ask a couple questions.

CHAIRMAN OMAS: Mr. Richardson.

RECROSS-EXAMINATION

BY MR. RICHARDSON:

Q Mr. Tayman, we discussed earlier the amount of borrowing the amount of borrowing that would be necessary if the Postal Service did not increase its rates in Fiscal Year 2006, which would be about $1.782 billion, is that correct?

A That's correct.

Q Now what I didn't ask you is, is that need for that borrowing a similar situation that you have at the end of 2005 where you would -- a billion of that might be as a cushion which would be borrowed only temporarily for a couple of days and then repaid back immediately, and so that in effect you may need to borrow long-term maybe the $782 million and not the $1.78 billion?

A No, it's a totally different situation. At the end of 2006, once we establish the escrow fund, we're required to maintain that fund on our balance sheet. Therefore, we can't borrow to create the fund, which we'd have to do at the end of '06, and then turn around and pay it off the next day as we can do at the end of '05.

So once -- once that escrow requirement is there, is permanent, we have to maintain at all times until the end of 2007 when we add another $3.4 billion to it. We will have to have that 3 -- in essence, $3.1 billion in reserved, restricted cash on our balance sheet. And so the 1.782 determination at the end of 2005 relates to the requirements for an operating cash balance as well as funding the escrow.

Q Does that allow for a certain amount of cash cushion at the end of that year?

A I believe it -- we had about a billion and a half dollars, again less than in -- in essence, less than one payroll was their cash balance we assumed at that point.

Q Would you say that was the normal amount of cushion that you would have at the end of a fiscal year?

A Well, I would say the debts are -- that's management's goal as to what the cash balance would be at the end of the year.

Q My only point is I'm wondering if that amount of borrowing was absolutely necessary if you did not increase your rates or if there is some lesser number that you might be able to get by with borrowing say a billion two or a billion three?

A Clearly, you could adjust your operating cash balance, but it -- that becomes somewhat risky. And I -- you know, it's our opinion that a billion and a half, it's less -- less than one payroll is -- is an appropriate balance to maintain at the end of the year.

MR. RICHARDSON: Thank you.

CHAIRMAN OMAS: Are there any additional cross-examine?

(No response.)

There being none, Mr. Reiter, would you like some time with your witness?

MR. REITER: Just a few minutes, Mr. Chairman.

CHAIRMAN OMAS: All right. Why don't we give you about five minutes.

MR. REITER: Thank you.

(Whereupon, a brief recess was taken.)

CHAIRMAN OMAS: Mr. Reiter.

MR. REITER: Mr. Chairman, I have no redirect for this witness.

CHAIRMAN OMAS: Good. Mr. Tayman, that completes your testimony here today. We appreciate your appearance and your contribution to our record. Thank you, and you are now excused.

(Witness excused.)

MR. TAYMAN: Thank you.

CHAIRMAN OMAS: Our next scheduled witness was Karen Meehan. As no participant intends to cross-examine this witness, her testimony will be received by motion. Mr. Reiter.

(The document referred to was marked for identification and received into evidence as Exhibit No. USPS-T-9.)

MR. REITER: Thank you, Mr. Chairman. Mr. Reimer -- my motion for testimony today.

CHAIRMAN OMAS: Everybody's changing on me today. I can't keep up with what's going on.

MR. REIMER: Only one letter of the alphabet difference between the two of us.

CHAIRMAN OMAS: All right.

MR. REIMER: Pursuant to Presiding Officer's Ruling No. R2005-1/32, the Postal Service would like to move for the admission of the testimony of Karen Meehan, USPS-T9, into the record. I have two original declarations signed by Witness Meehan, one of which attests to her testimony as amended by errata. I also have two copies of that testimony. The other declaration attests to the veracity of her answers to interrogatories.

The Postal Service has reviewed the packet of designated cross-examination provided by the Commission and has no suggested changes or revisions to make to it. So the Postal Service moves for the admission of Witness Meehan's testimony.

CHAIRMAN OMAS: Is there any objection?

(No response.)

CHAIRMAN OMAS: Without objection, the written cross-examination of Witness Meehan will be received into evidence and transcribed.

(The document, previously identified as Exhibit No. USPS-T-9, was received in evidence.)

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POSTAL RATE COMMISSION
DOCKET NO. R2005-1
DECLARATION OF KAREN MEEHAN

I hereby declare, under penalty of perjury, that:

I prepared the interrogatory responses, and responses to the Presiding Officer's Information Requests, which were filed under my signature and which have been designated for inclusion in the record in this docket, as amended by errata; and

If I were to respond to these interrogatories and Presiding Officer's Information Requests orally today, the responses would be the same.

Karen Meehan
KAREN MEEHAN

DATE 6/23/05

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Request of the United States Postal Service for a Recommended Decision on Changes in Rates of Postage and Fees for Postal Services

Docket No. R2005-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED STATES POSTAL SERVICE
WITNESS KAREN MEEHAN
(USPS-T-9)

Party	Interrogatories
Office of the Consumer Advocate	OCA/USPS-T9-1, 3-6
	OCA/USPS-T10-1, 5a-b redirected to T9
ılpak Direct Marketing Systems, ,ııc. and Valpak Dealers' Association Inc.	VP/USPS-T9-1

Respectfully submitted,

Steven W. Williams
Steven W. Williams
Secretary

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INTERROGATORY RESPONSES OF
UNITED STATES POSTAL SERVICE
WITNESS KAREN MEEHAN (T-9)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory	Designating Parties
OCA/USPS-T9-1	OCA
OCA/USPS-T9-3	OCA
OCA/USPS-T9-4	OCA
OCA/USPS-T9-5	OCA
OCA/USPS-T9-6	OCA
OCA/USPS-T10-1 redirected to T9	OCA
OCA/USPS-T10-5a redirected to T9	OCA
OCA/USPS-T10-5b redirected to T9	OCA
VP/USPS-T9-1	Valpak

United States Postal Service

Karen Meehan
(USPS-T-9)

RESPONSE OF USPS WITNESS KAREN MEEHAN (USPS-T-9) TO
INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T-9-1. The following refers to Attachment A of your testimony, "USPS and PRC Base Year 2004 Volume Variable Costs."

a. Please confirm that the total for Package Services on Attachment A, for the USPS BY 04 volume variable cost data, should be $1,814.0 million instead of the indicated $2,206.4 million.

b. If you are unable to confirm the $1,814.0 million, please explain.

Response:

a. Confirmed, within rounding error. The USPS BY04 volume variable cost for Package Services on Attachment A should be $1,813.9 million. Also, the USPS BY04 volume variable cost for Total Periodicals should be $2,237.0 million. An errata page with the corrected figures for Attachment A will be filed.

b. See response to OCA/USPS-T9-1a.

RESPONSE OF USPS WITNESS KAREN MEEHAN (USPS-T-9) TO
INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T-9-3 The following refers to USPS-LR-K-4, file name "BY04.cntl," spreadsheet "Comp Master". One of the spreadsheet's column headings includes the acronym "GDEI." Please explain what "GDEI" stands for.

Response:

Global Direct Entry Inbound. This is International Mail that is entered into U.S. post offices by foreign postal administrations. GDEI pieces bear markings and indicia identical to those on domestic mail, so they are not recognized as international by our statistical sampling systems. Using GDEI information from the International team, we move the GDEI portion of costs from domestic mail classes to the International Mail class.

RESPONSE OF USPS WITNESS KAREN MEEHAN (USPS-T-9) TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T9-4. The following interrogatory refers to USPS-LR-K-5, Workpaper B, filename "CS03.xls," spreadsheet "Outputs to CRA," and USPSLR-K-4, filename "BY04.I.xls"

a. Please explain why not all values for the classes and subclasses of mail in filename "CS03.xls" equal those values shown in USPS-LR-K-4, filename "BY04.I.xls." For example, consider USPS component 35. In Workpaper B, filename "CS03.xls," spreadsheet "Outputs to CRA," the value for First-Class single-piece letters in the column labeled "Mail Processing" is $4,221,961 ($000), EXCEL line 11, column D. The value identified in USPS-LR-K-4, filename "BY04.I.xls," line number 38, column CZ, is $4,280,428 ($000).

b. If your response to part a indicates that the values for component 35 in the file named "CS03.xls," spreadsheet "Outputs to CRA," are subsequently redistributed on the basis of one or more distribution keys, please identify the appropriate distribution key(s) and indicate where in the USPS Base Year model those calculations are performed. If the calculations are not performed in the model, please indicate where the values are derived. In your response, show the derivation of all calculated values and cite all sources. Please provide a copy of all source documents not previously filed in this docket.

Response:

(a.) and (b). The premium pay adjustment is applied to mail processing costs before the costs are entered into the CRA Base Year model input file BY04.I.xls. The premium pay adjustment is documented in USPS-LR-K-55, Part V, pages V-18 to V-19. A description/explanation of the premium adjustment is provided in the testimony of witness Van-Ty-Smith, USPS-T-11, section C.1.1b pp. 22-24. This procedural change was first documented in Docket No. R2001-1, in the testimony of witness Meehan, USPS-T-11, page 5, lines 6-9 and witness Van-Ty-Smith, USPS-T-13, pages 18-19.

RESPONSE OF USPS WITNESS KAREN MEEHAN (USPS-T-9) TO
INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T9-5. Please refer to your response to OCA/USPS-T10-1, redirected from witness Waterbury. Please identify and explain any changes in costing methodology between FY 2000 and FY 2004 that affected the estimation of costs for Registered Mail. Describe the effect of those changes on the cost estimates for Registered Mail.

Response: To the best of my knowledge, none of the costing methodology changes described in my testimony between the FY 2000 base year and the FY 2004 base year specifically affected the estimation of Registered Mail costs.

RESPONSE OF USPS WITNESS KAREN MEEHAN (USPS-T-9) TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T9-6. Please refer to your response to OCA/USPS-T10-1, redirected from witness Waterbury, and the table on Registered Mail unit costs.

a. For column [1], "BY 2000 Unit Cost," please confirm that the base year unit costs were calculated by dividing the costs for each cost segment by FY 2000 Registered Mail volume of 8,913,000. (*See* Docket No. R2001-1, USPS-T-11, Exhibit C, page 4.) If you do not confirm, please explain.

b. Please confirm that the FY 2000 Registered Mail volume was 8,930,748. (*See* Docket No. R2001-1, USPS-LR-I-110, Worksheet "Registered Mail," revised January 16, 2002.) If you do not confirm, please explain and reconcile the differences between the cited Registered Mail volumes of 8,913,000 and 8,930,748 for FY 2000.

c. For column [4], "% Change," please confirm that the percent change in the total unit cost of Registered Mail from BY 2000 to FY 2004 is 71.2 (($84,619,000 / 8,930,748) / ($81,269,000 / 5,008,595) – 1) percent. If you do not confirm, please explain.

Response:

a. Confirmed.

b. Not confirmed. In my testimony, USPS-T-11, from Docket No. R2000-1, lines 20-25, I discussed that "in response to a recommendation from the Postal Rate Commission in the Special Services case, Docket No. MC96-3, the FY97 CRA has a new line: 'Ancillary Service Revenue'. This line shows the revenue associated with return receipts and other ancillary revenue (i.e. restricted delivery, COD alteration of charges), which was formerly included with Registry, certified mail, COD, and Insurance."

Similarly, in Docket No. R2000-1 and Docket No. R2001-1, ancillary volumes were also reported on the "Ancillary Services" line.

In Docket No. R2001-1, the Register Mail volume of 8.931 million, cited in your question, includes the volume of restricted delivery Registered Mail of 17.7 million

RESPONSE OF USPS WITNESS KAREN MEEHAN (USPS-T-9) TO
INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

pieces. The cited Registered Mail volume of 8.913 million from my testimony excludes the 17.7 million pieces. Instead, they are reported, along with other ancillary Registry volume immediately below the Registry line in Exhibit USPS-11C, page 4. Both figures (i.e. 8.931 million and 8.913 million) accurately exclude the return receipt Registry volumes.

c. Not confirmed. The unit cost change between BY 2000 and FY 2004 is 64 percent (($77,999,150[1] / 5,009,000[2]) / ($84,619,000[3] / 8,913,000[4]) -1). Note: the formula, as stated in the question, has the unit cost calculation inverted, so that it technically does not equal 71.2 percent, but rather 41.6 percent.

[1] Docket No. R2005-1, USPS-T9, new page 14.
[2] Docket No. R2005-1, USPS-T9, Exhibit C, page C-4
[3] Docket No. R2001-1, USPS-T11, Exhibit A, page 8.
[4] Docket No. R2001-1, USPS-T11, Exhibit C, page 4

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KAREN MEEHAN (USPS-T-9) TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T-10-1. Please refer to USPS-LR-K-5, and the file "ExA_BY04.CRpt.xls,"showing the Development of Cost by Segment and Component – Base Year 2004.Also, please refer to the table below, which presents the FY 2000 and FY 2004 unit costs for Registered Mail by cost segment and component, and the unit cost change and percent change during the period. The table also shows for each cost segment the percent distribution that each unit cost increase bears to the sum of all cost segments experiencing unit cost increases.

a. For Column [1], please confirm the unit costs by cost segment for FY 2000. If you do not confirm, please explain and provide the correct unit costs.

b. For Column [2], please confirm the unit costs by cost segment for FY 2004. If you do not confirm, please explain and provide the correct unit costs.

c. For Column [3], please confirm the change in unit costs by cost segment between FY 2000 and FY 2004. If you do not confirm, please explain and provide the correct change in unit costs.

d. For Column [4], please confirm the percent change in unit costs by cost segment between FY 2000 and FY 2004. If you do not confirm, please explain and provide the correct percent change in unit costs.

e. For Column [5], please confirm the percent distribution of unit cost increases by cost segment. If you do not confirm, please explain and provide the correct percent distribution of unit cost increases.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KAREN MEEHAN (USPS-T-9) TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

Response to OCA/USPS-T-10-1 (continued).

REGISTERED MAIL
FY2000-FY2004

	FY2000 Unit Cost [1]	FY2004 Unit Cost [2]	Unit Cost Change [3]	% Change [4]	% Dist. of Increase [5]
C/S 1	$0.04	$0.06	$0.0185	44.1%	0.3%
CS/2	$0.48	$0.87	$0.3853	80.1%	5.7%
CS/3	$4.93	$9.38	$4.4475	**90.2%**	**66.2%**
C/S 4	$0.01	$0.01	$0.0038	59.5%	0.1%
C/S 6	$0.12	$0.29	$0.1741	148.5%	2.6%
C/S 7	$0.77	$1.14	$0.3654	47.4%	5.4%
C/S 10	$0.28	$0.97	$0.6901	**242.2%**	**10.3%**
C/S 11	$0.53	$0.70	$0.1646	30.9%	2.4%
C/S 12	$0.02	$0.06	$0.0432	241.0%	0.6%
C/S 13	$0.00	$0.00	($0.0010)	-61.8%	
C/S 15	$0.56	$0.70	$0.1477	26.5%	2.2%
C/S 16	$0.23	$0.43	$0.1956	83.7%	2.9%
C/S 18	$0.60	$0.68	$0.0854	14.4%	1.3%
C/S 20	$1.21	$0.93	($0.2706)	-22.5%	
TOTAL	$9.78	$16.23	$6.4496	66.0%	100.0%

Notes and Sources

[1] Docket No. R2001-1, USPS-LR-J-110, worksheet "Registered Mail:" Cost Segments and Components, FY 2000.

[2] USPS-LR-K-115, File: USPST28Cspreadsheets.xls; USPS-LR-K-5, File: ExA_BY04.CRpt.xls

[3] [2] - [1]

[4] [3] / [1]

[5] Distribution in percent of unit cost increases from Column [3].

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KAREN MEEHAN (USPS-T-9) TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

Response to OCA/USPS-T-10-1 (continued).

Response:

(a) Not confirmed, however the orders of magnitude are similar. The corrected source is Docket No. R2001-1, USPS-T-11, Exhibit USPS-11A and Exhibit USPS-11C. A table with the corrected figures is provided.

(b) Confirmed.

(c) - (e) Not confirmed, however the orders of magnitude are similar. A table with corrected figures is provided.

REGISTERED MAIL
BY2000-FY2004

	BY2000 Unit Cost [1]	**FY2004 Unit Cost** [2]	**Unit Cost Change** [3]	**% Change** [4]	**% Dist. of Increase** [5]
C/S 1	$0.04	$0.06	$0.0184	43.8%	0.3%
C/S 2	$0.46	$0.87	$0.4029	86.9%	6.0%
C/S 3	$4.89	$9.38	$4.4915	91.9%	66.7%
C/S 4	$0.01	$0.01	$0.0039	62.1%	0.1%
C/S 6	$0.12	$0.29	$0.1736	147.8%	2.6%
C/S 7	$0.60	$1.14	$0.5376	89.8%	8.0%
C/S 10	$0.28	$0.97	$0.6959	249.5%	10.3%
C/S 11	$0.53	$0.70	$0.1668	31.5%	2.5%
C/S 12	$0.02	$0.06	$0.0451	284.9%	0.7%
C/S 13	$0.00	$0.00	-$0.0007	-55.5%	0.0%
C/S 15	$0.55	$0.70	$0.1492	26.9%	2.2%
C/S 16	$0.23	$0.43	$0.2012	88.3%	3.0%
C/S 18	$0.58	$0.68	$0.1046	18.2%	1.6%
C/S 20	$1.19	$0.93	-$0.2600	-21.8%	-3.9%
TOTAL	$9.49	$16.22	$6.7299	70.9%	100.0%

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KAREN MEEHAN (USPS-T-9) TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T10-5.

a. Please confirm that the cost of Registered Mail pieces used by the Postal Service are treated as institutional costs of the Postal Service.

b. If you do not confirm subpart a. of this interrogatory, please provide the cost of Registered Mail pieces used by the Postal Service by cost segment and component for FY 2000 through FY 2004, and for the TYBR and TYAR.

c. If you do confirm subpart a. of this interrogatory, please provide the institutional cost of Registered Mail pieces used by the Postal Service for FY 2000 through FY 2004, and for the TYBR and TYAR.

Response:

a. Confirmed, as it is the intent of our procedures to separate the costs of Registry that are used by the public from the Postal Service's own internal use.

b. See response to a. above.

c. Redirected to the United States Postal Service.

RESPONSE OF USPS WITNESS KAREN MEEHAN (USPS-T-9) TO INTERROGATORY OF VALPAK

VP/USPS-T9-1. Please refer to your testimony beginning at page 6, line 9, through page 11, line 2, with special attention to page 8, lines 9-14, where you discuss city carrier costs.

a. Does the adjustment for detached address labels ("DALs") contained in the testimony of witness Kelley (USPS-T-16, p. 6) and USPS-LR-K-67 qualify as a new study or change in methodology? If so, please indicate why this part of your testimony makes no reference to the adjustment for DALs.

b. Did your development of Base Year costs include the cost adjustment for DALs? If so, please indicate where that can be found, in both your testimony and your spreadsheets.

Response:

(a)-(b) Witness Kelley's analyses took place "downstream" of the base year FY 2004 CRA. As you will note, in the testimony of witness Kelley (USPS-T-16, p.1), my testimony, as well as the testimony of many others, are inputs to his testimony. Any adjustments witness Kelley made were not, therefore, included in the input witnesses' testimony.

CHAIRMAN OMAS: If there is nothing further, this concludes today's hearings.

We will reconvene tomorrow morning at 9:30 a.m. when we will receive testimony from Postal Service Witnesses Tress, Robinson, and Taufique. Thank you.

(Whereupon, at 12:39 p.m., the hearing in the above-entitled matter recessed to reconvene at 9:30 a.m. on Tuesday, June 28, 2005.)

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REPORTER'S CERTIFICATE

DOCKET NO.: R-2005-1
CASE TITLE: Postal Rate & Fee Changes
HEARING DATE: 6/27/05
LOCATION: Washington, D.C.

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the United States Postal Rate Commission

Date: 6/27/05

Official Reporter
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