

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

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

NOTICE OF THE UNITED STATES POSTAL SERVICE  
OF FILING REPLACEMENT PAGES 3 AND 4 FOR USPS-T-15, DIRECT TESTIMONY  
OF JOHN P. KELLEY [ERRATA] (July 27, 2006)

In accordance with the Response of United States Postal Service Witness John P. Kelley to UPS/USPS-T15-5, filed this day, the United States Postal Service hereby files replacement pages 3 and 4 to the Direct Testimony of John P. Kelley on behalf of the United States Postal Service. The attached replacement pages 3 and 4 should replace the original pages 3 and 4, respectively, which were filed on May 3, 2006.

The phrase "schedule period" has replaced the phrase "schedule block" on lines twelve and thirteen of page three, in the footnote on page three, and on line one of page four. These changes have been bolded. No other changes have been made.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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1 rate structure results in a marginal cost that declines with increases in capacity  
2 purchase. This means that in the higher tiers, the marginal cost is less than the  
3 average cost. The implication for the variability is straightforward. Volume variability is  
4 defined as the cost elasticity with respect to volume. When there is a single cost driver,  
5 the variability can be shown to equal the ratio of marginal cost (MC) to average cost  
6 (AC). Said otherwise, when  $MC < AC$  then the variability  $\frac{MC}{AC}$  is less than one.

7         Witness Bradley in Docket No. R2005-1 (USPS-T-31, Section II) presented the  
8 analytical method for calculating a variability when costs are characterized by declining  
9 block rates. On the basis of this theoretical construct, I will describe the development  
10 and application of the variability using FedEx operational and contractual data. The  
11 calculation of the variability is conceptually straightforward. Using actual invoicing data,  
12 I calculate the average daily cubic volume of mail by FedEx schedule **period**.<sup>1</sup> I then  
13 flow the schedule **period** average daily volumes through the rate tiers to determine the  
14 marginal cost. The marginal cost is simply the last tier rate. To find the variability, this  
15 marginal cost is multiplied by the average daily volume and then divided by the total  
16 cost for transporting the entire average daily volume based on the declining rate  
17 structure.

18         The variability calculation takes into account any changes in rates that may be  
19 due to new addenda, changes due to scheduled annual increases in contract rates,  
20 differences in rates and volumes for weekday service and weekend service, and a  
21 ceiling placed on additional expenses incurred by applying the annual scheduled  
22 increases to the rate tiers. Using this calculation, I derive the marginal cost of non-fuel

<sup>1</sup> FedEx schedule **periods** are the periods of time over which the Postal Service calculates tier based payments.

1 transport and the average of non-fuel transport for each schedule **period**. Aggregating  
2 across quarters, I calculate the quarterly marginal and average costs. The variabilities  
3 that result from this calculation are 0.7409, 0.7356, 0.7229, and 0.7583 for quarters one  
4 through four respectively. These factors are applied to the accrued costs for non-fuel  
5 transport charges in the Cost Segment 14 Excel workbook on the 'Inputs – Variabilities'  
6 worksheet which is used in the CRA Workpapers (USPS-LR-L-5) sponsored by witness  
7 Milanovic (USPS-T-9) These calculations are described in USPS-LR-L-35.

8         When the variability is less than one, there will be some non-volume variable  
9 costs incurred in the provision of the network. Witness Bradley (USPS-T-14) has  
10 explained that these non-volume variable costs should be included in the incremental  
11 costs of the group of products that caused the FedEx Day Turn network to arise.  
12 Witness Pajunas (USPS-T-45) indicates that the FedEx Day Turn network was created  
13 for the transportation of First Class Mail and Priority Mail. As a result, the non-volume  
14 variable cost of the FedEx Day Turn network are included in the incremental cost for the  
15 product group that comprises of First Class Mail and Priority Mail. Refer to USPS-LR-L-  
16 72 sponsored by witness Pifer (USPS-T-18) for more information about the incremental  
17 cost for the product group comprised of First Class Mail and Priority Mail.

18         To the extent that, in response to Commission Rule 53, I discuss and compare  
19 PRC versions of transportation costs, I do not sponsor those materials, or in any way  
20 endorse the methodologies used to prepare them. In its Order No. 1380 adopting the  
21 roadmap rule, the Commission included the following statements regarding the role  
22 played by Postal Service witnesses under these circumstances:

23                 The comparison required by this exercise cannot be equated with  
24                 sponsoring the preexisting methodology. It merely identifies and

## **CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

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July 27, 2006