

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

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO INTERROGATORIES OF AMERICAN POSTAL WORKERS UNION
(APWU/USPS-T32-1 THROUGH 12)

The United States Postal Service hereby files the responses of witness
Altaf H. Taufique to the following interrogatories of American Postal Workers
Union, AFL-CIO:

APWU/USPS-T32-1 through 12, filed on July 14, 2006.

The interrogatories are stated verbatim and are followed by the
responses.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
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APWU/USPS-T32-1 The first class rate design you propose involves several types of cost deaveraging, both across shapes and across rate categories.

- a) Did you make the decision to deaverage costs in this way?
- b) If your answer to b above is yes, why did you decide to deaverage across rate categories in addition to deaveraging only across shapes?
- c) If your answer to a above is no, please state how the decision was made.

RESPONSE

- a) As the Pricing witness for First-Class Mail rate design, I made the initial recommendations in the decision-making process that led to the Postal Service's proposals in this case.
- b) I have discussed in detail my reasons to delink the workshare rate design from single-piece in my testimony. Please see USPS-T-32, pages 12 through 17.
- c) Not applicable.

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APWU/USPS-T32-2 You state on page 15 of your testimony that the Postal Service is de-linking single piece and presort letters.

- a) What was the rationale for always linking those two in the past?
- b) What has changed that rationale?

RESPONSE

- a) First-Class Mail Single-Piece and Presort letters were initially linked as the available cost data did not produce independent measures of the costs of both categories. Thus, as a practical matter, the workshare rates were developed because the only available data came from studying the sorting operations that presorted mail was more likely to have avoided. Even though separate costs were eventually measured, the traditional cost avoidance method was employed by the Postal Service, though in the Classification Reform case (Docket No. MC95-1) the Postal Rate Commission rejected a proposal to establish Automation letters as a separate subclass.
- b) In this docket, the Postal Service is not proposing to establish separate subclasses for Single-Piece and Presort Letters in First-Class Mail. The Postal Service, by virtue of the separate line items in the CRA report for Single-Piece and Presort Letters, does have the wherewithal to approach the costing for Single-Piece and Presort Letters in such a way that the costs reflect all of the cost-causing characteristics; therefore, a different approach to the costing and pricing of Single-Piece and Presort Letters was adopted. Please see my testimony USPS-T-32 at pages 12 through 17, where I discuss the approach taken in this case, including the use of a

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RESPONSE TO APWU/USPS-T32-2 (continued):

target of equal unit contribution from the two rate categories. I will also note that, over the past few years, there has been a lot of interest in possible annual rate increases, especially if postal legislative reform were enacted, both of which would argue for the ability to change rates for bulk business customers (Presort) without causing annual disruption by changing rates for Single -Piece mailers who use postage stamp. In order to do that and not create swings in the incentives for worksharing, delinking would be necessary. While that is not driving the proposal in this filing, the reduced linkage does allow for more flexibility. The proposal to use comparable unit contributions keeps the categories linked via the basic notion of efficient component pricing, while more fully utilizing the rich data source of the CRA to capture the broader cost avoidance concepts.

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APWU/USPS-T32-3 Do you consider the proposed methodology to be “bottom-up” pricing?

RESPONSE

No. “Bottom up” pricing implies developing unique cost coverage and contribution proposals. That is not the Postal Service’s proposal. In this instance, the total estimated costs for Presort Letters are tied back to the CRA line item for Presort Letters (which is developed as a bottom-up cost approach), the remainder of the estimated savings from the presort tiers are developed by consideration of only those costs avoided by virtue of the changes in shape and presort activity, not the total array of cost characteristics for those individual presort tiers.

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APWU/USPS-T32-4 Section 3623(d) of the Postal Reorganization Act requires that the Postal Service

“Maintain one or more classes of mail.... the rate for each such class shall be uniform throughout the United States, its territories, and possessions.”

Would you agree with the statement that this requirement of a uniform rate within a class of mail was met in previous rate cases by calculating workshare discounts on the basis of costs avoided using a benchmark metered Single-Piece First Class letter with most of the same characteristics as a typical workshare letter?

RESPONSE

To the extent your question calls for a legal conclusion regarding the meaning of this provision, it is beyond my expertise as an economist. At a technical level pertaining to rate design, no, I do not agree. My proposed rate design or the use of a different benchmark were undertaken for the reasons expressed in my testimony and elsewhere in other interrogatory responses.

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APWU/USPS-T32-5 You state at page 15 of your testimony that

“[t]he Postal Service de-links the cost and rate development for Single-Piece Letters from the cost and rate development for Presort Letters.”

Setting aside the question of whether it has happened in this case, doesn't this approach to rate-setting create the possibility that, by “de-linking” the rates for Single-Piece and Presort letter mail you have created a system in which rates for First Class Single-Piece Mail and Workshared Mail may no longer be uniform?

RESPONSE

Please see my response to APWU/USPS-T32-4.

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APWU/USPS-T32-6 You have stated at pages 15-16 of your testimony that the Postal Service's "objective...is to gradually achieve a rate design paradigm in which both workshare and single-piece mail contribute equally to institutional costs on a unit contribution basis."

- a) Is it the position of the Postal Service that a rate design system that seeks to equalize contribution to institutional costs by different types of letters within the same rate class meets the requirement that "[t]he rate for each...class shall be uniform throughout the United States and its Territories"?
- b) If the answer to question a above is in the affirmative, did the failure of the Postal Service to seek this outcome in previous cases violate the requirement that rates be uniform within the same rate class?
 - a. If the answer to question b above is in the negative, is the Postal Service re-defining uniformity of rates for purposes of Section 3623(d) of the PRA?

RESPONSE

- a) To the extent your question calls for a legal conclusion regarding the meaning of this provision, it is beyond my expertise as an economist.

From a rate design perspective, I do not view the two to be related.

Equalizing contribution is simply a way of maintaining fairness within the rate structure and continuing the long-standing tradition of having a target of 100 passthroughs so that the discounted pieces pay unit contribution comparable to that paid by the single-piece counterparts. The Postal Service has expressed the position that mailers should experience rates that reflect the worksharing cost savings to the Postal Service but still pay similar unit contribution as the rest of the subclass.

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RESPONSE TO APWU/USPS-T32-6 (continued):

- b) To the extent your question calls for a legal conclusion regarding the meaning of this provision, it is beyond my expertise as an economist. In previous cases, by trying to target passthroughs of 100 percent or lower, the Postal Service was, in essence, trying to maintain comparable unit contributions across workshare tiers.

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APWU/USPS-T32-7 You referred in your testimony (at pages 12, 15) to “considerable controversy” and “irreconcilable divisions” related to the Postal Service’s use of a benchmark piece of First Class Mail as a basis for calculating Workshare discounts.

- a) Does section 3623(c) of the Act provide a policy that controversy and divisions should be avoided in the setting of rates?
- b) If you had not changed your approach in this case, can you point to a controversial issue that would have arisen that did not arise and get resolved by the PRC and the Board of Governors in previous cases?
- c) Will the use of the newly-devised method of establishing rates eliminate controversy and divisions in the rate-setting process?

RESPONSE

- a) There is no explicit factor that mentions avoiding controversy, although I would argue that the considerations that were involved in the development for the delinking proposal would certainly be covered by Criterion 9. On the other hand, actively generating controversy or divisions is not a factor, either. I was noting, as part of the background for the proposal, the presence of “controversy” and “irreconcilable divisions”. Sometimes, in such an environment, it is worthwhile to examine the status quo to see if prudent changes can be made.
- b) I’m not sure that controversial issues are always “resolved” per se by Postal Rate Commission or Governors Decisions. In fact, many of the issues that are appearing in this case were arguably “resolved” in previous Decisions.
- c) No. But I think that examining and sometimes responding to issues of controversy in previous proceedings leads to potential improvements in rate design.

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APWU/USPS-T32-8 Section 3623(c) of the PRA requires that the Commission make a recommended decision on changing the rate schedule “in accordance with the policies of this title and” six listed factors.

- a) does your testimony make reference to any policy of the Act other than the six factors listed in Section 3623(c)?
- b) If your answer to question a above is yes, point out the place or places in your testimony where that reference(s) is made, point out where in the Act the policy in question is stated, and explain how your reference weighs the policy in question.
- c) If your answer to question a above is no, is it the position of the Postal Service that the phrase “in accordance with the policies of this title” adds nothing to the requirement that the recommended decision be in accordance with the six listed factors?

RESPONSE

- a) My testimony makes reference to the classification criteria listed in Section 3623 (c) in conjunction with the proposed classification changes proposed for First-Class Mail rate design in this docket. The pricing criteria are not enumerated in my testimony but are usually applied at the subclass level by the rate level witness O’Hara (USPS-T-31). Obviously, my rate design implicitly ensures that the proposed rates meet the requirement of the pricing criteria. One such example is my use of conservative passthroughs for the shape-based rates in order to mitigate the impact on mailers that mail flat and parcel shaped pieces (39 U.S.C. § 3622(b) (4)). The rate design starts with the estimates of volume variable costs and the test year after rates financials ensure that letters and cards subclasses cover their respective volume variable costs (39 U.S.C. § 3622(b) (3)).
- b) Please see my response to subpart a, above.

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RESPONSE TO APWU/USPS-T32-8 (continued):

- c) I think my testimony, either by specific reference to the classification criteria, or by the more general discussions of all of the pricing proposals, is not only consistent with the specified criteria, but other notions embodied in the Act, such as those described in section 101(a).

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APWU/USPS-T32-9 Assume you have two pieces of identical business mail, both are uniform size, both are type-written but one piece is part of a large presort mailing and the other is part of a smaller non-discounted business mailing. Under the proposed system, isn't it likely that the non-discounted business mail will pay more toward the overhead costs of the Postal System than will the identical presort piece?

RESPONSE

Maybe, although by developing my proposal the way that I did, with a target of comparable unit contribution, yet mindful of the requirement for consideration of the impact on mailers and the establishment of smooth and understandable rate schedules, I am maintaining the goal of comparable unit contributions for discounted and non-discounted mailings. I would argue that my proposal is superior to proposals that would request separate subclasses for Single-piece and Presort Letters in that I have not intentionally decreased the contribution target for Presort Letters. Within each category, be it single-piece or presort, there is considerable degree of averaging, and contribution to the overhead costs could widely differ even though two mail-pieces maybe paying identical postage. I would also note that under the current system, it is possible that the smaller, non-discounted mailing provides less of a contribution since the larger mailing is not likely to be credited for the other cost-reducing requirements that are necessary to qualify as a workshare mailing. In the end, I believe the proposed rates are more likely to yield comparable contributions.

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APWU/USPS-T32-10 On page 13 of your testimony you state that a “significant percentage” of single piece letters have handwritten addresses. How many letters in the test year had handwritten addresses? What percentage of handwritten letters are automation compatible?

RESPONSE

We do not have the data on the number of single-piece letters with hand written addresses.

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APWU/USPS-T32-11 On pages 16 and 17 of your testimony you state that “the starting point would be the Mixed AADC rate, a benchmark internal to Presort Letters. However, the discounts are each calculated from the presort level that immediately precedes it in aggregation. Why are the costs avoided and discounts not all calculated from the single benchmark?”

RESPONSE

Given the associative principle of mathematics, with the goal of passthroughs that approach 100%, it would make no difference what the starting point was.

This can be illustrated by the following example. Suppose there are identical cost avoidances of three cents between workshare categories A, B, and C. I can start with a 3-cent rate at A and add another three cents to B (6 cents) and another 3 cents to C (9 cents.) Or I can start with C at 9 (cents) and subtract 3 cents twice to arrive at the 3-cent rate for A.

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APWU/USPS-T32-12 On page 14 you state that the CRA generated costs reflect the full range of cost differences between the groups of letter mail. If one of these groups has higher costs because it is sent to more remote, higher cost areas will the proposed methodology cause that group to bear the full costs of differential itself?

RESPONSE

Not explicitly. Unless the cost-causing characteristic is one that would be reflected in the letter and flats cost models presented by witnesses Abdirahman (USPS-T-22) and Miller (USPS-T-20), to the extent that one group of mail or mailers within the CRA line item of Presort Letters tends to mail to higher cost areas (in terms of distance) or have some other higher cost characteristics, that group within Presort will not bear the additional costs of those characteristics. That is one main distinction between my proposal and “bottom up” pricing. However, if there is a difference between the cost characteristics of Single-Piece and Presort mailers, for instance if Single-Piece mailers sent mail more often to remote, higher-cost areas, this difference would show up between the two CRA line items and the Single-Piece mailers would be covering more of that higher cost – the presort mailers would not be bearing the cost of the Single-Piece mailers mailing patterns.