

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

Postal Rate and Fee Changes, 2006)
) Docket No. R2006-1
)

RESPONSES OF DIRECT MARKETING ASSOCIATION
WITNESS LAWRENCE G. BUC
TO INTERROGATORIES OF UNITED STATES POSTAL SERVICE
(USPS/DMA-T1-30-33)

(October 16, 2006)

Direct Marketing Association hereby provides the responses of Witness Buc
(DMA-T-1) to the above-referenced interrogatories, filed on October 4, 2006.

Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

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Please refer to your testimony at page 6, line 12 where you state that with regard to supervisor costs, "I made the kind of study that the Postal Service had seen fit not to make."

- a. Please also refer to lines 17-18 on page 6 of your testimony where you state, "The first, second, sixth, eighth, and tenth points clearly show that much of the work for this position is a function of the number of employees supervised." Please provide a mathematical representation of the "function" to which you refer, indicating if the form of that "function" has changed over time. Please also provide the analysis and decision trail used to develop the functional form of that relationship.
- b. Please refer to line 19-21 of page 6 where you state, "supervisory costs do change proportionately with craft costs." Please provide the proportional factor and analysis you performed to develop that proportional factor, and indicate whether that proportional factor has changed over time.
- c. Please refer to your testimony at page 7, lines 10-12 where you indicate that total workhours, excluding Postmasters and Supervisors, were reduced by 11.4 percent and supervisory hours were reduced by 9.5 percent, and you declare that "reductions in craft labor are accompanied by reductions in supervisory hours."
 - i. Is it your testimony that the concurrent reductions of 11.4 percent and 9.5 percent are causal and not simply correlated? Please provide all evidence to support your response.
 - ii. Is it possible that the reductions in both non-supervisory and supervisory hours were the result of rationalization efforts and/or general cost-cutting efforts? Please explain your response.
 - iii. Did your analysis examine the same data for periods prior to 1999? If not, why not. If so, please provide the same information.
 - iv. Please provide the same information separated by year.

Response

(a) A general functional form for this statement is $w = f(n)$, where w equals hours of work for a supervisor and n is the number of employees. This generalized notation has not changed over time.

(b) Because of the piggyback nature of the supervisory costs, the best value of the proportionality factor for cost reduction programs is 1. Thus, a 1 percent reduction in craft hours from cost reduction programs will induce a 1 percent reduction in supervisor hours and a 5 percent reduction in craft hours will induce a 5 percent reduction in supervisors hours in cost

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reduction programs. Pages 2 – 8 of my testimony describe my analysis. The factor has not changed over time.

(c) (i) In my testimony I explain that the aggressive cost reduction programs that the Postal Service has undertaken provide a natural experiment on whether reductions in craft costs induce reductions in supervisors costs. The results of the experiment seem to indicate that they do. But while the data provide additional corroboration that craft cost reductions are accompanied by cost reductions in those who supervise, by themselves they are not sufficient to demonstrate causality. It would also be useful to explore the relationship at a more disaggregate level and DMA requested information from the Postal Service to allow me to do so, but the data were not available (See Tr. 2/143-144).

(ii) If there is a specific postal meaning for “rationalization efforts” and “general cost-cutting efforts,” I am not aware of it. In general parlance, they appear to be cost reduction programs. As such, it is possible (and even very likely) that, whatever percentage of the reductions in non-supervisory hours were caused by rationalization efforts and/or general cost-cutting efforts and/or cost reduction programs, the same percentage reduction in supervisory hours were the result of rationalization efforts and/or general cost-cutting efforts and/or cost reduction programs.

(iii) Yes. Please see my response to USPS/DMA-T1-8 where I state that between 1963 and 1999, total workhours (excluding Postmasters and Supervisors) increased at an annual rate of 1.3 percent and Supervisors workhours increased at an annual rate of 1.4 percent. Again, I would expect that volume increases would cause the two to move together, I also expect that cost reduction programs and other programs also have the same effect.

(iv) I do not understand this question.

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USPS/DMA-T1-31. Please refer to your Table 1 on page 9 of your testimony. Please provide the same chart but use the surplus/deficiency and revenue requirement as recommended by the PRC in each of those cases, not as requested by the USPS.

Response

The requested table follows. Please note that with the exception of the across-the-board settled case in R 2005-1 the recommended surplus/deficiency, both in absolute terms and as a percentage of the recommended revenue requirement, is much smaller than the corresponding measure in the R 2006-1 request.

In the ten cases before R 2005-1, no recommended surplus/deficiency was greater than \$30 million and no recommended surplus deficiency was greater than .051 percent of the revenue requirement. In contrast, the requested surplus in this case is \$172.6 million, over 5 times larger than approved requested surplus in the first 10 cases and the requested surplus as a percent of the revenue requirement is over 4 times larger than any approved surplus in the first ten cases.

Docket	Surplus/ Deficiency (millions)	Revenue Requirement (millions)	Sur/Def as a percent of RR
R 76-1	\$1.2	\$14,170.8	.008%
R 77-1	1.2	17,585.2	.007%
R 80-11	9.7	22,013.6	.044%
R 84-1	-20.6	29,707.3	-.069%
R 87-1	-6.1	38,780.4	-.016%
R 90-1	24.5	47,965.7	.051%
R 94-1	2.0	54,517.2	.004%
R 97-1	19.7	60,871.7	.032%
R 2000-1	17.7	68,819.1	.026%
R 2001-1	29.4	74,721.3	.039%
R 2005-1	184.7	72,712.4	.254%
R 2006-1	172.6	77,511.0	.222%

Source: Opinion and Recommended Decisions R76-1 through R2005-1

- 1: The values for the R80-1 were adjusted by hand without explanation on the electronic version of the Opinion and Recommended Decision on the PRC website.
- 2: R2006-1 values are Surplus/Deficiency and Revenue Requirement in the current case as requested by the USPS.

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USPS/DMA-T1-32. Please refer to page 11 of your testimony at lines 1-3 where you indicate that the PRC should take into account higher net income, should it occur in FY 2006. Please confirm that the only effect of such net income on the test year would be on the calculation of Prior Year Loss Recovery. If you confirm, please provide an estimate of this amount. If you do not confirm, please explain fully.

Response

I cannot confirm. Actual net income will be more in FY 2006 than estimated by the Postal Service in its filing only if actual costs were less than estimated, actual revenues were more, or a combination of the two. But regardless of the reason, a more favorable starting point for estimating FY 2007 and then FY 2008 will, *ceterus paribus*, result in an increased net income in the Test Year, and the revenue requirement should be adjusted to reflect this. I would also note that a better net income in 2006 will also increase equity in 2006, and should also increase it in 2007 and 2008 Before Rates.

Further, if, in fact, changes in equity since the Postal Reform Act were estimated to be positive, I would advocate the establishment of a Restitution of Prior Year Gains (RPYG) program, symmetric with the Recovery of Prior Years Losses and thus returned to mailers over a nine year period.

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USPS/DMA-T1-33. Please refer to page 15 of your testimony where you compare the USPS cash balance projected for R2005-1 and R2006-1.

- a. Please confirm that the test year in R2005-1 was FY 2006, two years into the future from the base year of FY 2004, whereas the test year in this case is FY 2008, three years into the future from the base year. If you do not confirm, please provide the correct information.
- b. Please confirm that the further into the future, the larger the uncertainty surrounding forecasts. If you do not confirm, please explain fully.

Response

- (a) Confirmed.
- (b) Confirmed, In R 2000-1, I testified

As forecasting horizons become longer, outcomes become more uncertain and the risk of an outcome lying well outside of the forecast increases. As forecasting horizons become shorter, outcomes become more certain and the risk of an outcome lying outside of the forecast decreases. The contingency should be reduced to reflect the reduction in risk given the new forecast. Supplemental Testimony of Lawrence G. Buc on behalf of DMA et al, page 5, lines 17-21.

Because of this, in assessing the need for a contingency, the Rate Commission should take into account the fact that it need only project the need for a contingency less than two years into the future, the actual results for FY 2006, and whether any adverse outcomes provided for by the contingency have occurred.

Please also note that USPS witness Loutsch may not agree with this proposition. In its interrogatory DMA/USPS-T6-4, DMA asked: "As a general proposition, do you believe that predictions about the future are more accurate the closer they are made to the events being predicted? Please explain the reasoning underlying your belief." See Tr. 2/110. His response was, "Not necessarily," and he went on to make an analogy between the contingency and horse races. Thus it appears that the Postal Service does not believe that the amount of a necessary contingency is related to the time until the onset of the Test Year.