

**BEFORE THE
POSTAL RATE COMMISSION**

POSTAL RATE AND FEE CHANGES, 2006

DOCKET NO. R2006-1

**RESPONSES OF UNITED PARCEL SERVICE WITNESS GEDDES
TO INTERROGATORIES OF UNITED STATES POSTAL SERVICE
(USPS/UPS-T3-1 through 6)
(October 18, 2006)**

Pursuant to the Commission's Rules of Practice, United Parcel Service hereby files the responses of UPS witness R. Richard Geddes to the following interrogatories of the United States Postal Service: USPS/UPS-T3-1 through 6.

Respectfully submitted,

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USPS/UPS-T3-1. Please refer to page 9 of your testimony, lines 12 - 17, as well as footnote 7.

- a. Please provide a citation for the quote from Docket No. R94-1 in footnote 7.
- b. Please provide specific examples in the past where the Postal Rate Commission has, invoking 39 U.S.C. §3622(b)(5), reduced a markup in order to help the Postal Service “maintain” market share.
- c. Please provide specific examples in the past where the Postal Rate Commission has, invoking 39 U.S.C. §3622(b)(5), reduced a markup in order to help the Postal Service “capture” market share.

RESPONSE:

- a. Docket No. R94-1, Opinion and Recommended Decision, ¶ 5116.
- b.-c. Referring to 39 U.S.C § 3622(b)(4), in Docket No. R94-1, ¶ 5116, the Commission stated, “At present, the Postal Service handles in excess of 70 percent of the volume in the second-day delivery market and is the source of approximately 45 percent of the revenue generated in that market. Tr. 7A/3100. Yet, witness Foster notes that there are signs the Postal Service has had difficulty maintaining its share of volume and revenue. USPS-T-11-94; Tr. 7A/3150. Its share by volume of the second-day package market has declined from 76 percent in 1990 to 72 percent in 1993. Tr. 7A/3100. This decline is a sign of potential market deterioration and supports a below systemwide average rate increase.” Additionally, in ¶ 5317 of its Docket No. R2000-1 decision, the Commission stated, “It is also the Commission’s opinion that restraining coverage ... is appropriate under § 3622(b)(5) to avoid the harm that higher rate levels may cause to the Postal Service’s position as a competitor in the market in which Priority Mail competes.” These statements indicate that the Commission has invoked

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39 U.S.C §3622(b)(5) to lower markups to maintain the Postal Service's volume and market share.

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USPS/UPS-T3-2. Please refer to footnote 9 on page 11 of your testimony, where you assert several reasons why it can be difficult for private sector operators to compete against the Postal Service. Please confirm that there may be countervailing reasons why it can be difficult for the Postal Service to compete against private sector operators. If not confirmed, please explain.

RESPONSE:

Confirmed. Like any firm, the Postal Service may find it difficult to face competition for a variety of reasons, including inefficient operations or lack of use of cutting-edge technology, or many other business decisions. Regarding only legislated reasons for the Postal Service's difficulty in facing competition (such as the universal service requirement), then confirmed with the proviso that those costs to the Postal Service are a very small part of its annual budget. See "Testimony before the President's Commission on the Postal Service," Robert H. Cohen, Director, Office of Rates, Analysis and Planning, Postal Rate Commission, February 20, 2003, pp. 1-2.

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USPS/UPS-T3-3. Please refer to Figure 1 in your testimony.

- a. Please confirm that one reason for the upward trend in First-Class Mail's markup index since Docket No. R84-1 has been an increase in worksharing, which, ceteris paribus, causes the cost coverage to increase. If not confirmed, please explain.
- b. If confirmed, do you think it would be appropriate to first control for the increase in worksharing since Docket No. R84-1 before comparing the trend in First-Class Mail's markup index with that of nonworkshared Priority Mail? If not confirmed, please explain.

RESPONSE:

- a. Confirmed that, as discussed by Postal Service witness O'Hara in his response to DFS & MSI-T31-1 (Tr. 17/5073-75), increased worksharing in a subclass will tend to lead to cost coverage increases if contribution per piece for the subclass is held constant.
- b. Such an analysis is worthwhile. Although I agree with the Commission that its markup index "remains the most useful tool available for measuring relative burdens over time" (Docket No R2001-1, ¶ 2058), Dr. O'Hara views contribution per piece as a way to normalize cost coverage comparisons as worksharing increases. Response of Dr. O'Hara to DFS & MSI-T31-1 (Tr. 17/5073-75). A review of contribution per piece for First Class Letters and Priority Mail from Docket Nos. R84-1 to R2005-1, shown below, indicates that the contribution per piece for First Class Letters increased from 8.79¢ to almost 21¢ per piece -- approximately 138% -- from R84-1 to R2005-1, while the contribution per piece for Priority Mail has actually decreased. Thus, even on a contribution per piece basis, Priority Mail's contribution has declined, while the contribution for First Class Letters has increased substantially. The settlement in Docket No R2005-1 alone resulted in a 20% decline in Priority Mail's contribution per

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piece – a 10% decline compared to Docket No R2000-1, the last litigated case – while that for First Class Letters increased by 33% since Docket No R20001.

			[A] Contribution to Institutional Cost Per Piece	[B] Ratio to Total Mail & Services	[C] Percent Increase From Prior Case	<i>Sources:</i> <u>Col. B</u>	<u>Col. C</u>
[1]	R2005-1	First Class Letter	20.91	1.41	13.4%	A1/A3	A1/A4-1
[2]		Priority Mail	157.25	10.61	-19.9%	A2/A3	A2/A5-1
[3]		Total Mail & Svcs	14.82	1.00	7.4%	A3/A3	A3/A6-1
[4]	R2001-1	First Class Letter	18.44	1.34	17.2%	A4/A6	A4/A7-1
[5]		Priority Mail	196.28	14.23	12.4%	A5/A6	A5/A8-1
[6]		Total Mail & Svcs	13.80	1.00	12.8%	A6/A6	A6/A9-1
[7]	R2000-1	First Class Letter	15.74	1.29	7.3%	A7/A9	A7/A10-1
[8]		Priority Mail	174.62	14.28	15.5%	A8/A9	A8/A11-1
[9]		Total Mail & Svcs	12.23	1.00	10.1%	A9/A9	A9/A12-1
[10]	R97-1	First Class Letter	14.67	1.32	-0.5%	A10/A12	A10/A13-1
[11]		Priority Mail	151.14	13.62	-15.2%	A11/A12	A11/A14-1
[12]		Total Mail & Svcs	11.10	1.00	0.5%	A12/A12	A12/A15-1
[13]	R94-1	First Class Letter	14.75	1.34	0.1%	A13/A15	A13/A16-1
[14]	Further	Priority Mail	178.32	16.15	-0.2%	A14/A15	A14/A17-1
[15]		Total Mail & Svcs	11.04	1.00	0.1%	A15/A15	A15/A18-1
[16]	R94-1	First Class Letter	14.74	1.34	19.1%	A16/A18	A16/A19-1
[17]		Priority Mail	178.68	16.20	8.1%	A17/A18	A17/A20-1
[18]		Total Mail & Svcs	11.03	1.00	15.0%	A18/A18	A18/A21-1
[19]	R90-1	First Class Letter	12.37	1.29	2.0%	A19/A21	A19/A22-1
[20]	Remand	Priority Mail	165.22	17.23	0.0%	A20/A21	A20/A23-1
[21]		Total Mail & Svcs	9.59	1.00	3.0%	A21/A21	A21/A24-1
[22]	R90-1	First Class Letter	12.12	1.30	20.4%	A22/A24	A22/A25-1
[23]		Priority Mail	165.24	17.75	20.1%	A23/A24	A23/A26-1
[24]		Total Mail & Svcs	9.31	1.00	21.4%	A24/A24	A24/A27-1
[25]	R87-1	First Class Letter	10.07	1.31	14.6%	A25/A27	A25/A28-1
[26]		Priority Mail	137.61	17.94	-15.3%	A26/A27	A26/A29-1
[27]		Total Mail & Svcs	7.67	1.00		A27/A27	
[28]	R84-1	First Class Letter	8.79				
[29]		Priority Mail	162.39				
[30]		Total Mail & Svcs	NA				

Source Col. A: *Commission's Opinion and Recommended Decision, Appendix G, Schedule 1*

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USPS/UPS-T3-4. Please refer to Table 1 in your testimony.

a. Please confirm that Priority Mail volume declined by 30.5 percent from FY 2000 to FY 2004.

b. Please confirm that in addition to increasing by approximately 5 percent in FY 2005, Priority Mail volume is on track to increase by about the same amount in FY 2006.

c. Do you believe that two consecutive years of approximately 5 percent volume growth — during a time when real GDP has been growing by 3 to 4 percent — constitutes “recovery” from the 30.5 percent volume decline, from 2000 to 2004? In answering, please refer to your assertion at page 17, lines 8 - 10 that “[t]hese recent volume improvements indicate that whatever Priority Mail’s perceived service performance may be, it has a sufficiently high value that its volume can recover from a series of unfavorable events and rate increases.” When you say “can recover,” do you mean that Priority Mail volume has the potential to recover (which has not yet been manifested)?

d. While Priority Mail volume was declining by 30.5 percent, by how much did UPS volume in the total (ground and air, combined) 2- and 3-day package and document delivery market change from 2000 to 2004? Please provide your response both in absolute and percentage terms.

RESPONSE:

a. Confirmed. I note that the period chosen starts with the year immediately prior to September 11 and the anthrax attacks.

b. Confirmed. If one takes the average of the growth rates for the first three quarters of FY 2006, the result is 5 percent.

c. This question has two parts. The first part asks if I believe that 5 percent volume growth constitutes a recovery from a 30.5 percent decline. Whether or not 5 percent constitutes recovery from a volume decline does not depend on the magnitude of the decline over the previous five years (an arbitrarily chosen period), but instead on the overall historical average growth rate. The average of the annual growth rates in Priority Mail volume from 1971 (the year postal reorganization was implemented)

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through 2000 was about 7.8 percent. A 5 percent annual growth rate is thus significantly more than half of the way to the historical average annual growth rate. If one includes the years 2001 through 2005 (since those are valid observations on volume history), the historical average annual growth rate falls to about 5.8 percent. Therefore, a 5 percent increase is 86 percent of the way to the historical annual growth rate, which I believe constitutes recovery. Regarding the second part of the question, I mean that Priority Mail volumes have recovered from the unfavorable events, which also indicates that they can do so in the future.

d. I have not been asked to examine UPS's volume data, and therefore I do not have it.

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USPS/UPS-T3-5. Please refer to your testimony at page 17, lines 8 - 10, specifically the reference to volume recovering from “a series of unfavorable events and rate increases.” Do you believe that Priority Mail’s volume decline since 2000 is only due to unfavorable events and rate increases, and not possibly also to some more permanent and systemic factors that have potentially reduced the product’s long-term competitiveness? Please explain fully.

RESPONSE:

Please see my response to USPS/UPS-T3-4. Because Priority Mail volume growth rates are approaching the historical growth rate after seven quarters, I do not believe that permanent or systemic factors have reduced the long-term competitiveness of Priority Mail.

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USPS/UPS-T3-6. Please refer to page 21 of your testimony, line 4. Why do you recommend the very same markup for Priority Mail, 63 percent, as proposed by the Postal Service in USPS-T-31, considering that you use a different cost basis for that markup (based on the Postal Rate Commission's cost attribution methodology) than the Postal Service? Please explain fully.

RESPONSE:

In my view, the best recommended cost coverage is not dependent upon the cost basis utilized, as this question implies. Instead, cost coverages should be determined based on the eight non-cost-based ratemaking factors as discussed on pages 4 through 7 of my testimony. The reasons for my recommended cost coverage of 163 percent for Priority Mail are discussed on pages 12 through 21 of my testimony. Note that my recommendation of a cost coverage equal to that proposed by the Postal Service is only a first step toward a coverage above the systemwide average.