

DOCKET SECTION

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

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 1997

Docket No. R97-1

REVISED RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE (OCA/USPS-71 through 76)

The United States Postal Service hereby provides a revised response to the following interrogatories of the Office of the Consumer Advocate: OCA/USPS-71 through 76, filed on September 16, 1997. This revised response is provided pursuant to Order No. 1203, issued December 9, 1997.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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OCA/USPS-71. Please refer to the response to MMA/USPS-T32-37b. This response lists the steps necessary to compute the test year mail processing unit cost for bulk metered First-Class single-piece letters when mail processing costs are assumed to be 100 percent variable. Please provide an analogous list of necessary steps for each rate element for each of the rate design witnesses in this docket.

OCA/USPS-72. Please refer to the response to MMA/USPS-T32-37b. The first step to develop the requested unit cost is to "Calculate the Base Year Attributable costs (USPS-T5-A and supporting workpapers) by rerunning the base year model using the 100% volume variability for mail processing labor costs."

- a. Please identify by page, row, and column number the portions of each supporting workpaper that would need to be modified.
- b. Please identify by page number and line number all needed changes to the "base year model" needed to calculate the base year attributable costs.
- c. Please identify by page, row, and column number the portions of USPS-T-5A that would need to be changed.

OCA/USPS-73. Please refer to the response to MMA/USPS-T32-37b. The second step to develop the requested unit costs is to "calculate the Test Year Attributable Costs (USPS-T-15E and supporting workpapers) by using the Base Year from step 1 (and possibly other modifications) and rerunning the rollforward model."

- a. Please identify by page, row, and column number the portions of each supporting workpaper that would need to be modified.
- b. Please identify by page number and line number all needed changes to the "rollforward model" needed to calculate the test year attributable costs.
- c. Please identify by page, row, and column number the portions of USPS-T-15E that would need to be changed.

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- d. Please list the other possible modifications needed to produce the test year costs.

OCA/USPS-74. Please refer to the response to MMA/USPS-T32-37b. The third step to develop the requested unit cost is to "calculate piggyback factors as done in LR-H-77, using the Test Year from step 2."

- a. Please identify all modifications to LR-H-77 required to produce the piggyback factors.
- b. Please describe all changes needed to the LR-H-146 PIGGYF96 program to produce the piggyback factors needed under a 100 percent variability assumption.

OCA/USPS-75. Please refer to the response to MMA/USPS-T32-37b. The fourth step to develop the requested unit cost is to "Calculate the costs by shape (or benchmark costs) as requested by modifying LR-H-106 and LR-H-146, using inputs from all previous steps."

- a. Please identify the LR-H-146 SAS programs and specific lines of code that must be modified.
- b. Please identify by page number and line number all needed changes to LR-H-106.

OCA/USPS-76. Please refer to the response to MMA/USPS-T32-37b. This response lists the "primary steps" necessary to compute the test year mail processing unit costs or bulk metered First-Class single-piece letters when mail processing costs are assumed to be 100% variable. Please list all other steps in addition to the "primary steps."

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OCA/USPS-71 through 76 RESPONSE:

In accordance with Order No. 1203, the United States Postal Service has calculated unit mail processing costs for worksharing categories of the First-Class, Periodicals, Standard A and Standard B mail classes using, as best as it was able, the prior methodology concerning the volume variability of mail processing labor costs and the distribution methodology from the instant docket. This information is presented in the following library references, filed today:

- | | |
|-------|--|
| H-315 | Order No. 1203/MODS-Based Costing, Description of Workpapers and SAS Programs (Revised Pages) (Hard Copy) |
| H-316 | Order No. 1203/Base Year 1996 A and Selected B Workpapers (Revised Pages) (Hard Copy and B Workpaper Diskette) |
| H-317 | Order No. 1203/Rollforward Workpapers (Interim FY 1997 and Test Year 1998 Before Rates) (Hard Copy) |
| H-318 | Order No. 1203/Development of Piggyback and Related Factors (Hard Copy and Diskette) |
| H-319 | Order No. 1203/Base Year/Rollforward (Revised Files) (Diskette and CD-ROM) |
| H-320 | Order No. 1203/Mail Processing Unit Costs by Shape (Diskette) |
| H-321 | Order No. 1203/Dropship Savings for Periodicals and Standard (A) (Revised Pages) (Diskette) |

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- H-322 Order No. 1203/Standard Mail (A) Mail Processing
ECR Costs (Revised Pages) (Diskette)

- H-323 Order No. 1203/Standard Mail (B) Parcel Post Mail
Processing and Window Service Costs (Revised
Pages) (Diskette)

- H-324 Order No. 1203/Witness Hatfield's Unit Mail
Processing Costs for First-Class Letters and Cards
(Diskette)

- H-325 Order No. 1203/Witness Seckar's Unit Mail
Processing costs for First-Class, Periodicals and
Standard A Flats (Diskette)

- H-326 Order No. 1203/Witness Daniel's Unit Mail
Processing Costs for Standard A Letters, Certain
Standard A ECR Results, and Certain Standard B
Parcels (Diskette)

- H-327 Order No. 1203/Witness Crum's Unit Mail
Processing Costs for Certain Standard B Parcels
(Diskette)

- H-328 Order No. 1203/Witness Miller's Unit Mail
Processing Costs for PRM and QBRM (Diskette)

It was felt that organizing the materials into the above library references would provide the clearest guide and easiest access to the materials, as well as the most expeditious way for the Postal Service to respond, given the large effort that was required to comply with Order No. 1203. Where it made sense to do so, the above library references were prepared to contain only the pages from the precursor

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testimony, workpaper or library reference that have changed due to the methodological changes required by Order No. 1203. In many instances, the same section, part or page numbers that were used in the precursor materials are used here, making it clear exactly what has changed. For example, Library Reference H-315 contains only some of the parts from its precursor Library Reference H-146 and those parts are numbered the same in both library references. Thus, Library Reference H-315 contains a Part II, but no Part I. Where applicable, the library references contain a cross walk between the above list and their precursor materials as well as a note explaining citation changes. Entirely new footnotes were not prepared; rather, explanations are offered concerning what references in previous footnotes would change. Had the Postal Service not organized and prepared the materials as it did, it likely would not have met the December 23, 1997 deadline.¹

Using the old methodology for purposes of the mail processing labor cost variabilities and the distribution methodology from the instant docket was not an "automatic" exercise and raised a number of concerns. Thus, in reviewing the

¹ The Base Year and Rollforward materials have been supplied in hard copy (LR-H-316 and 317) and the "D" files have been supplied on diskette (LR-H-319); a CD-ROM containing the "D" files as well as interim steps is being prepared and will be furnished shortly to be added to LR-H-319.

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materials filed in response to Order No. 1203, special note should be made of the following.

Background

Variability analysis develops the volume variable cost for pools of accrued cost. Quite naturally, variability analysis is embodied in its two parts -- the formation of cost pools and the calculation of the variabilities for those cost pools. Correct variability analysis thus requires careful linking of cost pools and the method for calculating their variabilities. The exercise specified in Order No. 1203 unfortunately violates this essential characteristic of variability analysis. The Order specifies use of old, untested assumptions about mail processing variabilities in combination with the new activity-specific cost pools. The analysis required by the Order thus erroneously assumes that the old approach would make use of the cost pools as formed by witnesses Degen and Bradley in this case.

Of course, the old assumptions did not lead to cost pool formation as is done in the new method, and the analysis specified in the Order is, at best, a "hybrid." This means that one cannot directly insert the old variability assumptions in the new cost pool structure and immediately generate meaningful results. First and foremost, it is not obvious what variability should be applied to each MODS cost pool. The MODS cost pools, for example, contain some functions (previously known as

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"variable mail processing") that were assumed to be 100 percent volume variable and other functions (previously known as "fixed mail processing") that were assumed to be 0% volume variable. Thus, a method must be constructed to force fit the old assumptions into the new cost pools. That method is described below. Because the *old method did not contemplate the creation of activity-specific cost pools*, the marriage of the two different methods makes it impossible to perform an exact variability analysis and the response herein should be considered only an approximation.

Order No. 1203 directed the Postal Service to apply the "established variability analysis" to its R97-1 cost proposals. The Order recognized that applying 100% variability factors to the mail processing cost pools would not be fully consistent with the past methodology.

There are two issues which need to be dealt with to determine variability factors which are consistent with both the past variability analysis and the new MODS-based cost pool definitions. First, the costs associated with certain mail processing activities were classified as institutional in the old methodology. Second, the MODS-based cost pools include costs which "migrated" from the old methodology window service and administrative components. The migrated costs would not have

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received 100% variabilities in the old methodology. These issues were identified by witness Degen during the October 21, 1997 hearings (see Tr. 12/6695).

Technique for Approximating the Old Methodology Variability Analysis

The general approach starts with a definition of four cost categories, each with *a distinct variability analysis in the FY 1996 methodology.* (See Table A in Response to Order No. 1203 in LR-H-315.) These are variable mail processing (including "variable overhead"), fixed mail processing, costs migrated from the window service component, and costs migrated from the administrative component. Variable mail processing costs are 100% volume variable, except for costs in the MODS Registry cost pool.² Fixed mail processing are 0% volume variable. Costs migrated from window service are volume variable to the same degree as FY 1996 window service costs (C/S 3.2). Costs migrated from the administrative component are volume variable to the same degree as FY 1996 administrative costs (C/S 3.3). The FY 1996 C/S 3.2 and C/S 3.3 variable cost percentages are 58.1% and 62.1%, respectively.

The distribution key used for the breakdown of each cost pool's cost to the old methodology cost categories is based on the IOCS tallies associated with the cost

² A 26.12% variability factor was applied to the MODS Registry cost pool in an attempt to approximate the old methodology's variability analysis for Registry activity codes.

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pool. This data was provided in response to Presiding Officer's Information Request #3, Question 28. Data provided in response to interrogatories TW/USPS-T12-18 and TW/USPS-T12-19 were used to compute the percentage of tally costs for selected activity codes associated with the fixed mail processing component in the old methodology. Applying the component distributions for each cost pool produces estimated MODS-based cost pool costs associated with the old method's cost categories. Variability factors are then applied as described above to the distributed cost pool costs to produce variable costs. The variability factor for the cost pool is the *ratio of variable costs to cost pool costs*. This method results in an overall variability for all mail processing cost pools of 93.46%. This compares to an overall variability of 76.4% for the MODS-based mail processing costs presented by witness Degen (USPS-T-12, Table 4). The FY 1996 CRA variability for Cost Segment 3.1, using the IOCS-based definition of the cost segment, is 95.57% (the difference between this figure and 93.46% results from "migration" of costs). Clearly, neither the old nor the new variability analysis assumed 100% variability; only the new method is based on a formal statistical analysis of volume variability for activities which comprise the cost segment.

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Issues in Implementing the Old Variability Analysis

Fundamental differences between the old and new Cost Segment 3 methodologies make it impossible to implement the exact variability analysis of one method in the other. For example, IOCS tally costs (the basis for the old method's cost pool formation) and the corresponding MODS-based cost pool costs are not constrained to be equal. This is due in part to sampling error in IOCS (Tr. 17/8135) and in part to differences in cost allocation assumptions between the methods (Tr. 17/8137). Also, the old method incorporated special assumptions for the variability of certain Registry and Special Delivery costs that cannot be implemented using cost pool-level variability factors. In fact, the old methodology Cost Segment 3 worksheet adjustments edit the LIOCATT costs for Registry and Special Delivery for this purpose. Without such adjustments, the variable costs for Registry and Special Delivery resulting from the use of the modified cost pool variabilities will be overstated relative to the "actual" old methodology assumptions.

Issues in Implementing Worksharing Flow Models

The "established variability analysis" for the purposes of the worksharing mail flow models is to use 100 percent volume variability or simply use the average productivity for the calculation of labor costs. In filings prior to R97-1, this was done for all operations, even for platform and acceptance, despite the designation of

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platform and acceptance mail processing costs as partially institutional. For this reason, we indicated in our responses to MMA/USPS-T32-27b and OCA/USPS-71 that the mail flow models would have productivities based on 100% variability. As a result, in responding to Order No. 1203, we have used 100 percent variabilities or average productivities in developing the labor costs in the worksharing mail flow models in LR H-321 and LR H-324 to LR H-328. As discussed below, however, this is not totally consistent with the variabilities which are applied to the mail processing cost pools in LR H-315 to determine the attributable mail processing labor costs.

As discussed above, the "established variability analysis" involves less than 100% variability in all or nearly all cost pools. This is because some portion of the costs of most all MODS mail processing cost pools were previously categorized as administrative costs, which has a 62.1 percent variability as indicated above. The cost pool variabilities shown in LR H-315 are usually in the 95 percent to 100 percent range. For instance the MODS BCS cost pool has a variability of 98.1 percent. *Consistency between the mail flow model costs and the CRA attributable mail processing costs* requires that the same variabilities be used in both calculations. The model productivities which are consistent with the cost pool variabilities shown in LR H-315 would be the ratio of the average productivity to the variability, as done by worksharing modelers in our direct case testimony (see USPS-T-25, at page 8). The

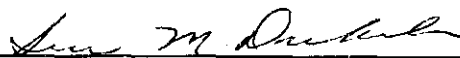
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use of MODS average productivities to develop labor costs for worksharing costing is only consistent with 100 percent cost pool variabilities.

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.

A handwritten signature in cursive script, appearing to read "Susan M. Duchek", is written over a horizontal line.

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