

DOCKET SECTION

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

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POSTAL RATE AND FEE CHANGES, 1997

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Docket No. R97-1
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**RESPONSE OF MAJOR MAILERS ASSOCIATION
WITNESS RICHARD E. BENTLEY TO INTERROGATORIES
OF UNITED STATES POSTAL SERVICE
(USPS/MMA-T1-1 THROUGH 6)**

Major Mailers Association (MMA) hereby provides its witness' Responses to the above-described interrogatories, filed on January 12, 1998.

Respectfully submitted,



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January 26, 1998

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Major Mailers Association Witness Richard E. Bentley
Answers to USPS Interrogatories USPS/MMA-T1-1 Through 6

USPS/MMA-T1-1. Please refer to page 4 of your testimony, lines 20 and 24, where, among many other places in your testimony, you discuss the Postal Service's proposed new "costing Methodology." By "costing methodology," are you referring to the proposed new treatment of mail processing costs, or the combined effect of all proposed costing changes in all cost segments, or something else? Does it mean the same thing throughout your testimony? Please explain fully.

RESPONSE:

The Postal Service's proposed new costing methodology varies from the Commission's established methodology in many ways. The most important differences concern the attribution of direct labor costs and delivery costs. See MMA-1A W/P V for a segment by segment comparison for base year 1996.

With respect to base and test year costs (MMA-T-1, pages 2 -7, 15), my analysis of the Service's new costing methodology is limited to the combined effect of all proposed methodological changes. With respect to the measurement of First-Class Automated cost savings (MMA-T-1, pages 9 - 10), my reference to the Postal Service's cost methodology pertains more specifically to its proposed treatment of mail processing and delivery (labor) costs.

With respect to cost reduction attributes omitted from the Service's mail flow/cost models (MMA-T-1, pages 16 -18) and two-ounce letters (MMA-T-1, pages 18 - 20), my analyses pertain to either the Postal Service's or Commission's cost methodologies.

Major Mailers Association Witness Richard E. Bentley
Answers to USPS Interrogatories USPS/MMA-T1-1 Through 6

USPS/MMA-T1-2. Please refer to the statement on page 4 of your testimony that "The Service's Methodology is designed to Mask the Service's Failure to Relieve First-Class Mail of an Excessive Share of the Service's Institutional Costs." Please confirm that you have no direct and objective information to refute the fact that each costing change proposed by the Postal Service in this case was designed to improve the accuracy of the cost information available for ratemaking. If you cannot confirm, please provide all direct and objective information necessary to support your statement, and explain fully.

Response

Although it is possible that one of the Service's motivations may have been to improve the accuracy of costing information, I cannot regard it as accidental that the result of the Postal Service's cost methodology tends to "mask" the Service's failure to abide by the Commission's longstanding objective regarding the pricing of First-Class and Commercial Standard A Mail.

Certainly the Service's newly proposed methodology has that result. The Postal Service's new methodology makes it inappropriate to compare markup indices, at the Service's proposed rates, to markup indices that result from previous Commission recommendations. Thus, a review of the Service's test year finances at proposed rates provides no clear indication of whether or not the Commission's goal has been met.

A comparison of markup indices using the Commission's cost methodology indicates that the markup indices are, in fact, not "roughly equivalent" (See Docket No. MC95-1 Op., page I-8). The Service's proposed markup indices for First-Class and Commercial Standard Mail A are 119 and 106, respectively. (See

Exhibit MMA-1A) Therefore, one result of the Service's proposed cost methodology changes is to "mask the Service's failure to relieve First-Class mail of an excessive share of the Service's institutional costs."

My view that this result is not accidental takes account of the Service's insistence, in case after case, to deviate from the Commission's established costing methodology and its reluctance, also in case after case, to disclose the results of its rate proposals as measured by the Commission's methodology. Thus, in Docket No. R94-1, the Service proposed "departures from the cost attribution methods and pricing principles used by the Commission in the previous omnibus rate case" (POR No. R94-1/38, pages 1-2). When MMA filed interrogatories asking the Service to provide information showing the effect of those departures, using the Commission's established methodology, the Service refused to do so. Even after the Commission directed the Service to provide that information (POR No. R94-1/18), the Service declined to comply, causing the Commission to provide that information itself in the form of a library reference (POR No. R94-1/38). And when I relied upon that library reference in my testimony, the Postal Service attempted to strike my testimony (POR R94-1/63).

This scenario was repeated in Docket No. MC96-3. There, once again, the Service's filing "departed from the attribution methodologies utilized by the Commission..." and the Commission "directed" the Service "to submit cost presentations that reflect the Commission's...attribution methodology" (Docket No. MC96-3, Order No. 1120, pages 1-2). The Commission rebuffed an attempt by the Service to escape that requirement (Id., Order No. 1126), but the Service

"announced that it will not respond...to [these] two lawful orders of the Commission" (Id., Order No. 1134, page 1). Once again, the Commission sought to make up the gap in the record by providing a library reference that employed the Commission's methodology but, when I used this information in my testimony, the Service sought to strike my testimony. (See Id., Order No. 1143).

The Service's practice was repeated in this proceeding. The Service's proposals in this case seek to substitute new costing methodologies for the Commission's established procedures. Again, the Service refused to answer MMA's interrogatories seeking information regarding the effect of the Service's proposal as measured by the Commission's established methodology. The Commission issued a strongly-worded Order requiring the Service to provide that information (Order 1197). Only then did the Service provide such information, beginning in October, over three months after the proceeding began.

This sequence of events fortifies my testimony to which this Interrogatory USPS/MMA-T1-2 is addressed.

Major Mailers Association Witness Richard E. Bentley
Answers to USPS Interrogatories USPS/MMA-T1-1 Through 6

USPS/MMA-T1-3. Please refer to your statement on page 4 of your testimony that the "Postal Service's costing methodology tends to hinder monitoring of the Service's continued overburdening of First-Class Mail," and your statement on page 6 that "the Service's new methodology would obscure use of the Commission's yardsticks to measure how the Service's current proposal compares with past cases – resulting in a comparison of apples to oranges."

a. Please confirm that it is no more difficult to compute cost coverages, markups, unit contributions, or total dollar contributions under the Postal Service's proposals in this case than it would be under any other costing methodologies, including those employed by the Commission in Docket No. R94-1. If you cannot confirm, please explain fully.

RESPONSE:

Not confirmed. In order to compute cost coverages, markups, unit contributions, or total dollar contributions, it is first necessary to know the test year after rate attributable costs for each subclass and service. The attributable costs by subclass under the Commission's methodology were not available until the Postal Service responded to MMA's motion to compel in late October of 1997. This data was received more than three months after the Service's rate request was filed. Please see my testimony, MMA-T-1, pages 3-4. Prior to then, it was extremely difficult to compute cost coverages, markups, unit contributions, or total dollar contributions under the Commission's Docket No. R94-1 cost methodology.

I am also not clear as to whether this Interrogatory question relates to a computation made within the confines of one case only, or whether it relates to evaluating that computation of benchmarks as between one case and its

predecessors. Of course, within the confines of any one case, considered in isolation, once the revenues, volumes and attributable costs for each subclass and service are known, it is no more difficult to compute cost coverages, markups, unit contributions, or total dollar contributions under the Postal Service's proposals in this case than it would be under any other costing methodologies. But such a computation has only limited value if it cannot be compared with the benchmarks computed in other cases. By proposing to change the methodology for computing these benchmarks, the Service has limited their value since they cannot be compared squarely with the benchmarks used in past cases. Indeed, as I testified (MMA-T-1, page 6), Dr. O'Hara recognized that problem by proposing that the Commission discontinue its traditional markup index yardstick.

Major Mailers Association Witness Richard E. Bentley
Answers to USPS Interrogatories USPS/MMA-T1-1 Through 6

USPS/MMA-T1-3. Please refer to your statement on page 4 of your testimony that the "Postal Service's costing methodology tends to hinder monitoring of the Service's continued overburdening of First-Class Mail," and your statement on page 6 that "the Service's new methodology would obscure use of the Commission's yardsticks to measure how the Service's current proposal compares with past cases - resulting in a comparison of apples to oranges."

b. Please confirm that, as explained by Dr. O'Hara in the testimony you cite, it is inherent limitations in the markup index concept itself (when applied in the instance of material costing changes) that can create difficulties in making valid comparisons between present and past cases, and that there is nothing specific to the Postal Service's new costing methodologies which creates these difficulties (other than that their combined effects constitute material costing changes). If you cannot confirm, please explain why.

RESPONSE:

Not confirmed. I do not agree that the markup index concept itself has "inherent limitations." Almost all comparisons over time, not just markup indices, will experience difficulties when significant cost methodological changes are instituted. For this reason, the Commission has been correct in requesting the Postal Service to provide a test year finances presentation, using the Commission's established cost methodology, in Docket Nos. R94-1, MC95-1, MC96-3 and the instant proceeding. See my answer to Interrogatory USPS/MMA-T1-2.

This question highlights the primary reason of why the Postal Service should meet the requirements of amended Rule 54 at the time of a rate filing in the future. It also suggests why the Commission should consider disallowing cost methodology changes during rate cases so that the parties and Commission

can focus solely on the reason for the proceeding—the changing of postal rates.

Certainly, this would greatly simplify the current proceeding. Perhaps cost methodology changes could and should be considered only in separate rulemaking proceedings.

Major Mailers Association Witness Richard E. Bentley
Answers to USPS Interrogatories USPS/MMA-T1-1 Through 6

USPS/MMA-T1-4. Please refer to your statement on page 7 of your testimony that the "Service's Methodology Would Decrease Objective Cost-Based Ratemaking in Favor of Subjective Demand-Oriented Judgments," and your statement on page 8 that the "history of subsequent regulation has been dictated by the Commission's struggle to increase the percentage of costs deemed attributable and subject to apportionment by objective costing criteria."

a. Please confirm that the costing process cannot be truly "objective" if any empirical analysis that shows costs to be less volume-variable (and hence less "attributable") than previously assumed is automatically rejected for that reason alone. If you cannot confirm, please explain full.

RESPONSE:

Not confirmed. There are really several related but separate issues that the Commission must consider. The first is the development of direct and indirect costs, as dictated by section 3622(b)(3) of the Postal Reorganization Act. The second is the apportionment of remaining costs as part of the task of ratemaking. The third is the development of specific rates for each rate element. Another issue, of course, is the requirement that the Postal Service "break even" in the test year. I place the words "break even" in quotes since the Postal Service is allowed to make a profit that reflects prior year loss recovery and contingency.

From the ratemaker's point of view, the amount of direct and indirect costs attributable to each subclass and service is a given. Therefore, it is an objective floor or minimum starting point above which all proposed revenue targets must be set. For this reason, I consider the individual levels of attributable costs to be

"objective costing criteria".

My testimony focuses on the results of the Postal Service's proposed costing methodology. Other witnesses have criticized technical merits or flaws in the Service's presentation, and I have not evaluated their criticisms.

Major Mailers Association Witness Richard E. Bentley
Answers to USPS Interrogatories USPS/MMA-T1-1 Through 6

USPS/MMA-T1-4. Please refer to your statement on page 7 of your testimony that the "Service's Methodology Would Decrease Objective Cost-Based Ratemaking in Favor of Subjective Demand-Oriented Judgments," and your statement on page 8 that the "history of subsequent regulation has been dictated by the Commission's struggle to increase the percentage of costs deemed attributable and subject to apportionment by objective costing criteria."

b. Please confirm that an a priori desire to either increase or decrease "the percentage of costs deemed attributable" would constitute a bias that is inconsistent with objective ratemaking. If you cannot confirm, please explain fully.

RESPONSE:

Not confirmed. The Postal Rate Commission provides a forum for postal ratemaking because of the subjectivity permitted in the allocation of institutional costs and, as is now abundantly apparent, the derivation of attributable costs as well.

The first goal of the Postal Service (and Commission) is to develop a cost system that attributes direct and indirect costs to all subclasses and services as accurately as possible. If all things are equal, it is better to attribute a pot of costs than not to. A separate but related goal of the Postal Service (and Commission) should be to attribute as high a percentage of costs as is reasonably possible. This makes the task of developing revenue targets less reliant on subjective ratemaking criteria and reduces the risk of offering rates that are unduly discriminatory and result in cross subsidization.

Major Mailers Association Witness Richard E. Bentley
Answers to USPS Interrogatories USPS/MMA-T1-1 Through 6

USPS/MMA-T1-5. Please refer to your statement on page 9 of your testimony that “[g]iven the Service’s propensity to overload First-Class Mail with an excessive share of institutional costs, the Commission should be wary of increasing the Service’s discretionary powers.”

a. In the context of the allocation of shares of institutional costs, please identify the “discretionary powers” of the Postal Service that are not subject to the Commission’s review.

RESPONSE:

In my testimony, I did not state that the Commission lacked power to review the Service’s discretion over the assignment of institutional costs. Although I am not an attorney, it is my understanding that after the Postal Service files its proposed rate changes, the entire rate filing is subject to the Commission’s review. There is, however, a significant difference in the Commission’s ability to review the Service’s apportionment of attributable costs, on the one hand, and the Service’s assignment of institutional (or “overhead”) costs, on the other. As I said in answering Interrogatory USPS/MMA-T1-4, the apportionment of attributable costs is a process that facilitates the use of objective costing criteria and, therefore, the Commission’s review is relatively straightforward. In contrast, the Service prefers to assign overhead costs by demand-related “pricing” considerations, which is, I believe, a much more subjective process and a process that is more difficult for the Commission to review by objective criteria.

Major Mailers Association Witness Richard E. Bentley
Answers to USPS Interrogatories USPS/MMA-T1-1 Through 6

USPS/MMA-T1-5. Please refer to your statement on page 9 of your testimony that “[g]iven the Service’s propensity to overload First-Class Mail with an excessive share of institutional costs, the Commission should be wary of increasing the Service’s discretionary powers.”

b. In your opinion, are the current (i.e., Docket No. R94-1) shares of institutional costs the product of the Postal Service’s exercise of discretion, or the Commission’s exercise of discretion? Please explain fully.

RESPONSE:

I think the answer is both. No case is decided in a vacuum and is dependent upon the current rates at the time of filing and all previous Commission Opinions and Board of Governor Decisions. Specifically, in Docket No. R94-1 the Commission stated its desire to consider a lower First-Class stamp. But it was unable to do so because of the rate shock that would be experienced by other subclasses, in order for the Service to meet its break-even mandate. Instead, it chose to compromise in a way that it found “appropriate in view of the extraordinary considerations in operation here.” (Docket No. R94-1, p. IV-16)

As the major player, the Postal Service plays a significant part in the Commission’s ratemaking role. Indeed, the Commission’s concern about rate shock is the product of a long series of rate actions by the Service that the Commission has accepted with some distaste for the consequences for First-Class Mail. Note the following Commission’s statements:

Docket No. R87-1

We have chosen to recommend First-Class rates which produce a greater contribution towards institutional costs than would have been generated by our target First-Class coverage...In future cases we expect First-Class to return to that traditional level. (Docket No. R87-1, pages 402-3)

Docket No. R90-1

We must comment that the choice between unduly burdening First-Class business and personal correspondence and imposing even greater percentage rate increases on businesses which rely on third-class for essential services is particularly difficult, and the Postal Service and mailers should be aware that the current status is consistent with the Act only as a short-term remedy. (Docket No. R90-1, Pages IV-33-4, footnote 16)

Docket No. R94-1...

...the other consequences of implementing [a reduced First-Class rate] in this case would have included average rate increases of 17 percent for third-class regular rate, 24 percent for second-class regular rate, and even greater increases for the parcel subclasses in fourth-class mail...Rate increases of these magnitudes would cause the Commission serious concern about their effects upon mailers...The Commission regards [its] pricing recommendations as compromises, but compromises that are appropriate in view of the extraordinary considerations in operation here. (Docket No. R94-1, p. IV-16)

In Docket No. MC95-1 the Commission re-classified Commercial Standard Mail into two separate subclasses. In doing so it re-iterated its "view that the largest volume subclasses in First-Class and Standard Mail should have roughly equivalent markup indices". (Docket No. MC95-1, p. I-8)

Major Mailers Association Witness Richard E. Bentley
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USPS/MMA-T1-5. Please refer to your statement on page 9 of your testimony that “[g]iven the Service’s propensity to overload First-Class Mail with an excessive share of institutional costs, the Commission should be wary of increasing the Service’s discretionary powers.”

c. Is it your testimony that the Commission would be justified in employing something other than the very best available measures of subclass costs in order to further particular pricing (i.e., the allocation of institutional costs) objectives? Please explain your answer fully.

RESPONSE:

The Commission should employ the very best available measures of direct and indirect costs in order to support its pricing recommendations to the Board of Governors.

Major Mailers Association Witness Richard E. Bentley
Answers to USPS Interrogatories USPS/MMA-T1-1 Through 6

USPS/MMA-T1-6. Please refer to Section III.C on pages 9-10 of your testimony, where you state that:

Another flaw in the Service's methodology is that it produces mistaken judgments about costs. ...As compared with the Commission's methodology, the Service's methodology understates the costs that are avoided when First-Class mailers presort and prebarcode their mail... ...When a methodology like the Service's leads to such misleading results, its reliability is questionable for any purpose.

a. Please confirm that the only alleged "flaw" you identify in that section relating to the Postal Service's methodology is that the results it produces are different from those produced by what you refer to as the "Commission's methodology." (In other words, you focus exclusively on the results of the methodology, rather than the actual content of the methodology.) If you cannot confirm, please explain fully.

RESPONSE:

In my testimony, MMA-T-1, page 4, I noted that my reasons for concern about the Service's proposed new methodology were "[i]n addition to technical criticisms made by other parties...." I do agree that the difference in the estimates of presort mail's costs is due to the Postal Service's cost methodology (that assumes that labor costs do not vary 100% with volume), and results in First-Class Automated measured cost savings that are reduced by more than 20%. Both the Commission and the Service have assumed for more than two decades that labor costs vary 100% with volume. I should also point out that the unit cost savings that I present in my testimony were provided to me by the Postal Service. See my response to USPS/MMA-T1-9(d).

If the Postal Service had not failed to include other cost savings attributes, as discussed on pages 16 -18 of my testimony, *MMA-T-1*, the First-Class Automated measured cost savings would be reduced by much more than 20%. These additional cost savings result from reduced move updates, enclosed pre-barcoded reply envelopes, and avoided collection and mail preparation costs.

Major Mailers Association Witness Richard E. Bentley
Answers to USPS Interrogatories USPS/MMA-T1-1 Through 6

USPS/MMA-T1-6. Please refer to Section III.C on pages 9-10 of your testimony, where you state that:

Another flaw in the Service's methodology is that it produces mistaken judgments about costs. ...As compared with the Commission's methodology, the Service's methodology understates the costs that are avoided when First-Class mailers presort and prebarcode their mail...
...When a methodology like the Service's leads to such misleading results, its reliability is questionable for any purpose.

b. Please confirm that if one knew with certainty that the Postal Service's proposed methodology produced more accurate cost estimates than the "Commission's methodology," it would follow that it is the "Commission's methodology" that produces mistaken judgments about costs, that overstates the avoided costs, and that leads to misleading results. If you cannot confirm, please explain fully.

RESPONSE:

I cannot make the assumption "with certainty" that the Postal Service's methodology produces cost estimates that are more accurate than the Commission's methodology. As discussed in my testimony on pages 16 – 18 of MMA-T-1, the Postal Service's methodology for measuring First-Class Automation cost savings is very questionable since it fails to include additional First-Class Automation cost savings attributes. See also my answer to part a of this interrogatory. Had I been led to believe that the Postal Service's proposed methodology for attributing labor costs is more accurate *with 100% certainty* than the Commission's methodology for attributing labor costs, I would have attempted to include those additional cost savings attributes in my analysis of First-Class Automated cost savings.

ABA/EEI/NAPM witness Clifton estimates that the additional unit cost savings

due to the Postal Service's mail flow/cost methodology's omission of move update costs is .262 cents. (ABA-EEI-NAPM-T-1, p. 14) The Postal Service estimates that the MODS cost pool 1CancMPP, which represents culling, facing, and cancellation, is .683 cents. (Attachment to Response to POIR No. 5, Question 19 and response to MMA/USPS-T32-29) Together, these two corrections would increase First-Class Automated unit cost savings, as computed under the Postal Service's cost methodology, by almost one full cent. Under the assumption that labor costs vary 100% with volume, the increase in derived cost savings would probably have been higher.

The impact of including qualified pre-barcoded reply envelopes in Automated mailings is not readily quantifiable. However, as I explained in my testimony (p. 17), the impact is significant enough to explain to the Commission why "bulk metered mail, which is presumably 'clean' mail, is *only* 1.16 cents cheaper to process than non-metered mail which presumably includes handwritten addressed mail."

If the Commission finds that the Postal Service costing methodology is superior to the current established methodology, I would urge the Commission to correct the Postal Service's First-Class Automated letter measured cost savings methodology. I would also be somewhat less conservative than I have already been with the recommended percent pass through of those savings, to reflect the change in assumptions regarding cost variability with volume.

I believe I would also come to similar conclusions regarding my recommendations for changes in the Postal Service's proposed rates for First-Class. First, I would recognize that the resulting cost coverage indices of 112 for First-Class

and 98 for Commercial Standard Mail, under the Service's cost methodology, are too far apart. Similarly, the markup indices of 128 for First-Class and 95 for Standard Mail are also too far apart. These conclusions are apparent when viewed in relation to the resulting markup indices that result using the Commission's methodology. Second, the implicit cost coverage of 283 for First-Class presort letters is too high, compared to all other subclasses. Third, it does not seem fair for presorted First-Class letters to make a larger unit contribution to institutional costs than for single piece First-Class letters. (See Exhibit MMA-1B) All this leads me to the same conclusion that First-Class rates are too high, particularly compared to Commercial Standard Mail A, and that First-Class presorted rates should be lowered.

Therefore, I would still recommend First-Class Automated rates that are at least .2 cents lower than those proposed by the Postal Service and a First-Class second ounce letter rate that is at least one cent lower than the 23 cents proposed by the Postal Service.

Major Mailers Association Witness Richard E. Bentley
Answers to USPS Interrogatories USPS/MMA-T1-1 Through 6

USPS/MMA-T1-6. Please refer to Section III.C on pages 9-10 of your testimony, where you state that:

Another flaw in the Service's methodology is that it produces mistaken judgments about costs. ...As compared with the Commission's methodology, the Service's methodology understates the costs that are avoided when First-Class mailers presort and prebarcode their mail.... ...When a methodology like the Service's leads to such misleading results, its reliability is questionable for any purpose.

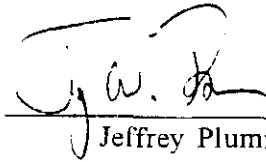
c. Please confirm that you have not presented in your testimony the results of any empirical analysis to counter the empirical analysis offered by the Postal Service's witnesses to support their assertion that the new costing methodologies do present more accurate cost estimates than any previous methodology. If you cannot confirm, please explain fully.

RESPONSE:

I have not analyzed the Postal Service's evidence that labor costs do not vary 100% with volume. I have provided empirical evidence that if labor costs do vary 100% with volume, the Postal Service First-Class Automation mail flow/cost analyses underestimate cost savings by more than 20%. I have also presented evidence that the Postal Service's methodology for estimating cost savings, irrespective of whether labor costs vary 100% with labor, understates the true cost savings.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon the U.S. Postal Service and the other parties requesting such service by First-Class Mail.



Jeffrey Plummer

January 26, 1998