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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

UNITED STATES POSTAL RATE COMMISSION

In the Matter of: POSTAL RATE AND FEE CHANGES

Docket No. R97-1

VOLUME 26

DATE: Wednesday, February 25, 1998

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ANN RILEY & ASSOCIATES, LTD.

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(202) 842-0034

BEFORE THE
POSTAL RATE COMMISSION

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In the Matter of: :

POSTAL RATE AND FEE CHANGES : Docket No. R97-1

- - - - - X

Third Floor Hearing Room

Postal Rate Commission

1333 H Street, N.W.

Washington, D.C. 20268

Volume 26

Wednesday, February 25, 1998

The above-entitled matter came on for hearing,
pursuant to notice, at 9:30 a.m.

BEFORE:

HON. EDWARD J. GLEIMAN, CHAIRMAN

HON. W. H. "TREY" LeBLANC, III, COMMISSIONER

HON. GEORGE W. HALEY, COMMISSIONER

HON. GEORGE A. OMAS, COMMISSIONER

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1	C O N T E N T S				
2	WITNESS	DIRECT	CROSS	REDIRECT	RECROSS
3	HALSTEIN STRALBERG				
4	BY MR. BURZIO	13808			
5	BY MS. DUCHEK		13982		
6	RITA D. COHEN				
7	BY MR. CREGAN	14019			
8	BY MR. YOURSHAW		14141		
9	BY MR. KOETTING		14145		
10	STEPHEN E. SELICK				
11	BY MR. McKEEVER	14155			
12	BY MR. STRAUS		14238		
13	BY MR. MAY		14264		
14	BY MR. KOETTING		14268		
15	RALPH L. LUCIANI				
16	BY MR. McKEEVER	14280			
17	BY MR. MILES		14439		
18	BY MR. CALLENDER		14446		
19	BY MR. MAY		14450		
20	BY MR. REITER		14467		
21					
22	DOCUMENTS TRANSCRIBED INTO THE RECORD:				PAGE
23	Direct Testimony and Exhibits of Roger				
24	Sherman, OCA-T-300				13707
25					

1	DOCUMENTS TRANSCRIBED INTO THE RECORD: [continued]	PAGE
2	Designation of Written Cross-Examination of	
3	Roger Sherman, OCA-T-300	13779
4	Direct Testimony and Exhibits of Halstein	
5	Stralberg, TW-T-1	13811
6	Designation of Written Cross-Examination of	
7	Halstein Stralberg, TW-T-1	13906
8	Direct Testimony and Exhibits of Rita D.	
9	Cohen, MPA-T-2	14022
10	Designation of Written Cross-Examination of	
11	Rita D. Cohen, MPA-T-2	14074
12	Direct Testimony and Exhibits of Stephen E.	
13	Sellick, UPS-T-2	14157
14	Supplemental Testimony and Exhibits of	
15	Stephen E. Sellick, UPS-T-2	14182
16	Designation of Written Cross-Examination of	
17	Stephen E. Sellick, UPS-T-2	14191
18	Direct Testimony and Exhibits of Ralph L.	
19	Luciani, UPS-T-4	14283
20	Designation of Written Cross-Examination of	
21	Ralph L. Luciani, UPS-T-4	14355
22	Supplemental Testimony and Exhibits of	
23	Ralph L. Luciani, UPS-ST-4	14434
24		
25		

1	E X H I B I T S		
2	EXHIBITS AND/OR TESTIMONY	IDENTIFIED	RECEIVED
3	Direct Testimony and Exhibits of		
4	Roger Sherman, OCA-T-300	13706	13706
5	Designation of Written Cross-		
6	Examination of Roger Sherman,		
7	OCA-T-300	13778	13778
8	Direct Testimony and Exhibits of		
9	Halstein Stralberg, TW-T-1	13810	13810
10	Designation of Written Cross-		
11	Examination of Halstein		
12	Stralberg, TW-T-1	13905	13905
13	Direct Testimony and Exhibits of		
14	Rita D. Cohen, MPA-T-2	14021	14021
15	Designation of Written Cross-		
16	Examination of Rita D. Cohen,		
17	MPA-T-2	14073	14073
18	Direct Testimony and Exhibits of		
19	Stephen E. Sellick, UPS-T-2	14156	14156
20	Supplemental Testimony and		
21	Exhibits of Stephen E. Sellick,		
22	UPS-ST-2	14156	14156
23	Designation of Written Cross-		
24	Examination of Stephen E.		
25	Sellick, UPS-T-2	14190	14190

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4	Ralph L. Luciani, UPS-T-4	14282	14282
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6 Examination of Ralph L.

14354 14354

9 Exhibits of Ralph L. Luciani,

14433 14433

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P R O C E E D I N G S

[9:30 a.m.]

1
2
3 CHAIRMAN GLEIMAN: Good morning. Today we
4 continue hearings in Docket R97-1. We are scheduled to
5 receive testimony from Time-Warner Witness Stralberg;
6 Magazine Publishers of America Witness Cohen; United Parcel
7 Service Witness Sellick, representing both direct and
8 supplemental testimony; and United Parcel Service Witness
9 Luciani; and the Office of Consumer Advocate Witness
10 Sherman.

11 Does any participant have a procedural matter to
12 raise before we begin this morning? Mr. Koetting?

13 MR. KOETTING: Thank you, Mr. Chairman. I would
14 just like to alert the Commission that there are some
15 hearings scheduled for early next week on the mail
16 processing notice of inquiry. Postal Service Witness
17 Bradley filed some testimony. MPA had a Witness Higgins.
18 UPS had Witness Neels.

19 Those of us who are involved with those witnesses
20 were trying to work out -- it might be possible that we can
21 get by without having hearings on next week.

22 Some of the witnesses might be up on Friday. We
23 might try to handle some of that.

24 We just wanted to give the Commission the heads-up
25 that we are working to avoid if possible, and there are some

1 issues outstanding, but the need for hearings and I just
2 thought it might be helpful for the Commission to be aware
3 of that.

4 CHAIRMAN GLEIMAN: Thank you. To the extent that
5 parties can work things out that would obviate the need for
6 oral cross-examination it is always to all of our benefit
7 except perhaps the reporting company, and we appreciate your
8 efforts and we will look forward to hearing from you, Mr.
9 Koetting, or others at the Postal Service regarding what
10 arrangements have been made.

11 Office of Consumer Advocate Witness Roger Sherman
12 was scheduled to appear as our last witness today.

13 The Postal Service and the Newspaper Association
14 of America have indicated that they no longer wish to
15 cross-examine Witness Sherman.

16 As in previous instances when no requests for oral
17 cross-examination have been received, it is my intention to
18 allow Witness Sherman's testimony to be received into
19 evidence at this point, accompanied by a statement of
20 authenticity.

21 Mr. Richardson, representing OCA, are you prepared
22 to move Witness Sherman's testimony and designated written
23 cross into evidence at this time?

24 MR. RICHARDSON: Yes, I am, Mr. Chairman.

25 I would at this time move the direct testimony of

1 Roger Sherman on behalf of the Office of Consumer Advocate,
2 his OCA-T-300 testimony together with accompanying
3 appendices, Appendix A, and with the stipulation that
4 because of the lateness of the hour determining that there
5 was not going to be cross-examination today that we will
6 file a declaration appropriately signed by Mr. Sherman when
7 we can receive it in the next day or two.

8 CHAIRMAN GLEIMAN: Are there any objections to
9 going ahead under that arrangement?

10 [No response.]

11 CHAIRMAN GLEIMAN: If not, then thank you, and the
12 testimony and exhibits of Witness Sherman are received into
13 evidence, and I direct that they be transcribed into the
14 record at this point.

15 [Direct Testimony and Exhibits of
16 Roger Sherman, OCA-T-300, was
17 received into evidence and
18 transcribed into the record.]

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Revised January 29, 1998
OCA-T-300
Docket No. R97-1

DIRECT TESTIMONY
OF
ROGER SHERMAN

ON BEHALF OF
THE OFFICE OF THE CONSUMER ADVOCATE

December 30, 1997

TABLE OF CONTENTS

STATEMENT OF QUALIFICATIONS	2
I. PURPOSE OF TESTIMONY	3
II. RAMSEY PRICING	4
A. Introduction.....	4
1. The Idea of Ramsey Prices	4
2. Variables and Data	6
2.1. Costs, Prices, Volumes and Demand Functions	7
2.2. Demand Elasticities: Long-Run or Short-Run?	8
3. Welfare Measurement	10
4. Summary of Estimated Ramsey Prices	13
B. Ramsey Prices by Subclass of Mail	17
1. Degrees of Ramsey Pricing	18
2. Representing Welfare Losses	24
C. Welfare Comparisons	27
1. Welfare Losses	27
2. Welfare Loss Per Unit of Contribution	32
D. Worksharing Discounts	38
1. Ramsey Pricing for Single-Piece and Worksharing Letters	39
2. The Relationship between Discount Elasticities and Cross Elasticities	41
3. Implied Cross Elasticities of Demand are Large	45
4. Formulating the Ramsey Pricing Problem	47
III. THE COST BASIS FOR PRICING	50
IV. PREPAID REPLY MAIL AND QUALIFIED BUSINESS REPLY ML	55

1

STATEMENT OF QUALIFICATIONS

2

My Name is Roger Sherman. I am Brown-Forman Professor of Economics at the

3

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1 I. PURPOSE OF TESTIMONY

2 The purpose of my testimony is to review theoretical foundations of the Postal
3 Service pricing proposals in Docket R97-1. Approaches to estimating Ramsey prices
4 will be examined. The economic welfare advantages of Ramsey prices over the prices
5 proposed by the Postal Service will be identified and estimated, and the role of Ramsey
6 pricing for workshare discounts will be discussed. Costing principles will be discussed
7 briefly. The newly proposed forms of reply mail will also be examined.

1 II. RAMSEY PRICING

2 A. Introduction

3 Ramsey prices will be described briefly here, and then the data needed to
4 estimate them will be noted. Welfare measures will be illustrated and a summary of
5 Ramsey prices and their effects will be presented and compared with Postal Service
6 proposals in Docket No. R97-1 at the level of the major mail classes. Part B explores
7 Ramsey prices in more detail by defining various degrees of Ramsey pricing,
8 depending on the different constraints that may be imposed, and by presenting prices
9 and their effects for the main subclasses of mail and comparing them with Postal
10 Service proposals. Part C presents welfare effects of Ramsey prices compared with
11 rates proposed by the Postal Service in Docket R97-1. And Part D considers
12 worksharing discounts.

13 1. The Idea of Ramsey Prices

14 If the Postal Service were to set prices for all mail service subclasses at their
15 marginal costs (represented, say, by accurate volume variable costs), the outcome
16 would be efficient, in that consumers could decide their usage of mail services based
17 on the true marginal costs of those services. But a large deficit would result, because
18 revenues would not be sufficient to cover fixed and other costs that are not counted as
19 volume variable. Such a deficit can be avoided by pricing above marginal cost, but
20 doing so will cause welfare losses. Pieces of mail that would benefit consumers if prices

1 were at marginal costs will no longer be sent at higher prices, and that causes welfare
 2 losses. The remarkable property of Ramsey prices is that they minimize the resulting
 3 welfare losses.

4 Pricing above marginal cost is preferred on fairness grounds to pricing at volume
 5 variable costs and meeting the consequent deficit out of general tax revenues. The
 6 latter course would not be perfectly efficient because general tax revenues are raised in
 7 ways that impose some welfare losses. General tax revenues could be a more efficient
 8 source than pricing postal services considerably above their marginal costs, though,
 9 because the welfare losses can be lower when spread over many goods. The main
 10 objection to such a course, however, is that taxes to cover the postal deficit may fall
 11 partly on those who do not use the Postal Service, which is unfair. Requiring that users
 12 of postal services pay all their costs avoids such an unfair outcome. Forbidding cross
 13 subsidy accomplishes the same end by preventing one group from paying for another
 14 group's consumption.

15 Ramsey prices depend on costs and demand elasticities. If cross elasticities of
 16 demand are zero, as is true for most subclasses of mail, the Ramsey price takes an
 17 especially simple form,

18 (1)

$$\frac{P_i - MC_i}{P_i} = -\frac{k}{E_{ii}}$$

19

1 where P_i is price for the i th service, MC_i is marginal cost, E_{ii} is own price elasticity of
 2 demand, and k is a constant between zero and one. Because the ratio, price minus
 3 marginal cost over price, is inversely related to demand elasticity, this pricing formula is
 4 often called the inverse elasticity rule. The more general formula for the j th service is
 5 (2)

$$\sum_i (P_i - MC_i) \frac{E_{ji}}{P_i} = -k$$

6
 7
 8 where E_{ji} is the cross-price elasticity, showing the effect on volume j of a change in
 9 price i . One term in the summation over all i on the left side of equation (2), the case
 10 where $i = j$, will be equivalent to equation (1). And the other terms will disappear when
 11 crosselasticities are zero, reducing equation (2) to equation (1).

12 2. Variables and Data

13 From a given starting point, the costs and demand functions estimated by the
 14 Postal Service can be used to estimate Ramsey prices, and such prices are presented
 15 by Witness Bernstein (USPS-T-31). I shall also present Ramsey price estimates, using
 16 the same starting point as briefly noted in section 2.1. While using the same long-run
 17 elasticities in Ramsey price formulas as Witness Bernstein, I differ by using long-run
 18 elasticities in forecasting volume responses, which affects the contribution that will be

1 raised to cover other costs. Witness Bernstein used short-run elasticities in those
2 volume forecasts, consistent with the Postal Service plan, which focuses on the test
3 year. As explained below in section 2.2, the approach I use is more conservative, in
4 that volumes will tend to be lower with the long-run elasticities, but that is what should
5 be expected over the longer life of the proposed postal prices. The Ramsey prices I
6 estimate are not very different from Witness Bernstein's, and I join him in praising such
7 prices for their welfare effects. I also illustrate them in some additional ways, such as
8 comparing them and their welfare effects with the Postal Service pricing proposals in
9 R97-1.

10 2.1. Costs, Prices, Volumes and Demand Functions

11 To estimate Ramsey prices requires information on costs, demands, and
12 demand elasticities. The costs of mail services are taken from the record in the case;
13 they are summarized by Witness Bernstein (USPS-T-31, p. 55). I accept the
14 logarithmic form of demand function used in Postal Service estimates of demand
15 (Witness Thress, USPS-T-7, and Witness Musgrave, USPS-T-8). As a starting point for
16 that function, I use the before-rates record of rates and quantities in Witness
17 Bernstein's Testimony (USPS-T-31, p. 4 and p. 40). This initial reference point fixes the
18 functions numerically. Then effects on volumes of any changes, say in prices, can be
19 estimated from that starting point. Data and procedures are described in OCA-LR-5.
20 One variable that requires some discussion is demand elasticity.

1 2.2. Demand Elasticities: Long-Run or Short-Run?

2 In making comparisons between Postal Service proposals and Ramsey prices, a
3 choice of demand elasticities must be made. Postal Service Witness Bernstein, who
4 provides Ramsey price estimates for the Postal Service (USPS-T-31), based the prices
5 on long-run demand elasticities but used short-run rather than long-run elasticities in
6 creating volume estimates. Ramsey pricing formulas would appear to be properly
7 based on long-run elasticities, which should yield correct prices for the period over
8 which the prices are to be effective. Using short-run elasticities in volume estimates will
9 take account of the gradual adjustment of volume to a change in price so the test-year
10 volume can be forecast, and test-year results can be predicted. Each short-run
11 demand elasticity is a weighted average of the gradually increasing quarterly responses
12 to a price change. For any set of new rates, these short-run elasticities yield volumes
13 comparable to those forecast for proposed Postal Service rates in the test year, on the
14 assumption that the new rates will take effect on January 1 (USPS-T-31, p.42-44).

15 As one should expect, the short-run response to price change tends to be less
16 strong than a long-run response will be. Short-run elasticities will ordinarily be smaller
17 in absolute value (at least not larger) than long-run elasticities, because they allow less
18 time for consumers to adjust to the new prices. So volume forecasts for price increases
19 based on short-run elasticities will be greater than those based on long-run elasticities.
20 Thus, using the long-run elasticities will tend to forecast smaller volumes than use of
21 short-run elasticities would, and that will make it harder to raise money as contribution

1 to costs other than volume variable costs. Notice that the use of long-run elasticities to
2 forecast mail volumes is more conservative than forecasting for the test year alone,
3 because over the longer-run time period volumes can be expected to shrink slightly.

4 Now, even if long-run elasticities are applied to Ramsey pricing formulas, those
5 Ramsey prices will be affected by the use of short-run elasticities in volume forecasts.
6 The reason is that volumes will differ when long-run rather than short-run elasticities are
7 used in forecasting them, so contributions will be affected. Since a target level of
8 contributions is to be raised by proposed prices, differences in forecast volumes will
9 cause differences in Ramsey (or other) prices. As it turns out, these differences are not
10 great.

11 What elasticity is best to apply depends on the time period the application will be
12 in effect. Since the Postal Service prices that are adopted can be expected to be in
13 place beyond the period of the test year, the use of a longer-run elasticity is advisable.
14 In order to consider the long run situation, after full adjustment to any new prices, long-
15 run elasticities are needed, both in the Ramsey price formulas and in forecasting
16 volumes to go with those prices. Long-run elasticities are provided by Witness Thress
17 (USPS-T-7) and Witness Musgrave (USPS-T-8) and summarized by Witness Bernstein
18 (USPS-T-31).

19 In carrying out estimates on this long-run basis, comparability with the Postal
20 Service proposal is not easily maintained. The reason is that, generally, higher prices
21 will be needed when the greater (in absolute value) long-run elasticities are used, in
22 order to raise the same level of contribution. Not wanting to alter the Postal Service

1 price proposals, however, I shall keep the proposed rates the same, but will accept as a
2 reference point the lower contribution that results from their use with volume forecasts
3 that rely on long-run rather than short-run demand elasticities. The contribution
4 obtained in this way from proposed test-year prices will be raised also from Ramsey
5 prices, so comparisons between prices are possible.

6 3. Welfare Measurement

7 If postal prices were set equal to marginal (volume variable) costs, the Postal
8 Service would not cover all of its costs, which by statute (39 U.S.C. § 3622(b)) it is
9 required to do. To prevent a deficit, postal prices must exceed average volume variable
10 costs. Indeed, they are supposed to raise enough revenue to cover all costs. The idea
11 of covering all costs, as required by statute, derives from fairness considerations, as
12 noted above. Ensuring that those who use postal services pay all their costs saves
13 nonusers from having to help pay for a postal deficit they did not create. But there are
14 losses in economic welfare when prices exceed marginal costs. The advantage of
15 Ramsey prices is that they minimize such welfare losses.

16 Let us briefly restate and illustrate the welfare loss from pricing above marginal
17 cost. In Figure 1, the welfare maximizing price would equal marginal cost at point A,
18 where marginal consumers value the service at exactly what it costs. Figure 1 also
19 shows the contribution that can be obtained by raising the price of a service above its
20 marginal cost. The rectangular area identified as "contribution" $((P-MC) V_p)$ represents
21 both lost consumer surplus, in that consumers must pay $P-MC$ more for each of the V_p

1 units they continue to consume, and the contribution obtained from the consumers
 2 which can be used to cover fixed costs. Since covering costs is a benefit, and the
 3 contribution for that purpose equals lost consumer surplus, these two amounts offset
 4 each other. But there remains the shaded area ABC in Figure 1 that would be
 5 consumer surplus if price equaled marginal cost; it is lost when price is raised to P ,
 6 because those units $V_{MC}-V_P$ simply are not consumed at the higher price, P . Although it
 7 would only cost MC to provide a unit of service, the consumers are asked to pay P , so
 8 the consumer at B now values the service at the level of P . When price is raised to P , a
 9 range of possible consumption from A to B is lost. In the volume range from V_P to V_{MC} ,
 10 consumers value the service more than it actually costs but less than they are asked to
 11 pay. The shaded area, ABC, represents the consumer surplus that is lost when price is
 12 raised to P and consumers no longer consume the volume $V_{MC}-V_P$. That area ABC
 13 represents the net welfare loss of raising price above marginal cost in order to cover
 14 fixed costs.

15 The welfare loss can be estimated easily when demands are known and are
 16 linear. Suppose demand is $V = a - bP$. When price is raised above marginal cost the
 17 triangular welfare loss in Figure 1 (area ABC) is approximated by the price-minus-
 18 marginal-cost difference times the quantity difference times one half (from the rule for

1 calculating a triangular area: one half the base times the height). Substituting from the
 2 demand function, this welfare loss can be put in the form:

3 (3)

$$(P - MC)(V_{MC} - V_P) \frac{1}{2} = (P - MC)(a - bMC - (a - bP)) \frac{1}{2} = (P - MC)^2 \frac{b}{2}$$

4

5 Recall that V_{MC} represents volume at marginal cost prices and V_P represents volume at
 6 prices P . Notice that welfare loss varies with the square of the difference between
 7 price and marginal cost.

8

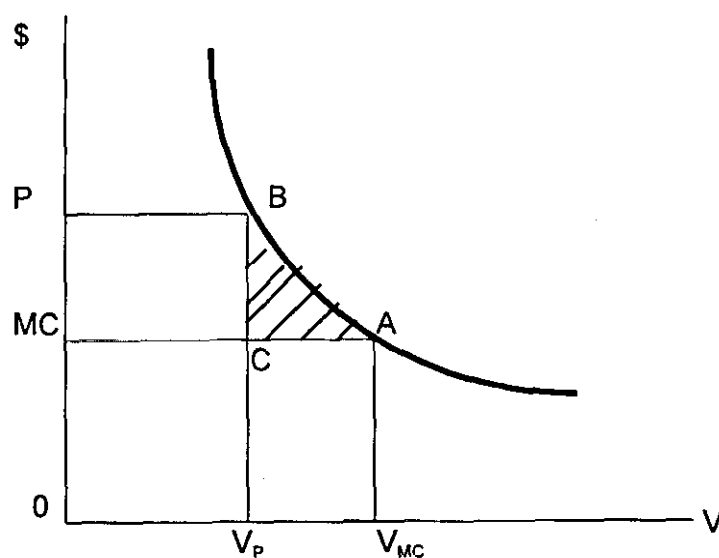


FIGURE 1

1 Equation (3) above indicates that large differences between price and marginal
2 cost are to be avoided, if possible, because the welfare loss rises with the square of the
3 price difference. On the other hand, the purpose of the rise in price is to make a
4 contribution to fixed cost, so a greater contribution should justify a greater difference
5 between price and marginal cost. Ramsey prices balance these two considerations,
6 making the marginal welfare loss per unit of marginal contribution equal across all
7 services.

8 Other considerations can warrant departures from the Ramsey prices that keep
9 welfare losses small. But departures from Ramsey prices should consider the
10 consequences they have for welfare loss, which is essentially the cost of departing from
11 Ramsey prices.

12 4. Summary of Estimated Ramsey Prices

13 We begin with a summary that focuses on five major classes of mail. Table 1
14 presents average revenue per piece for the major mail classes as proposed by the
15 Postal Service (TY98 After Rates) and as they might be with Ramsey prices at this
16 aggregative level. The Ramsey prices represented here take into account the RFRA,
17 which imposes prices on so-called preferred services, and they comply with incremental
18 cost tests that avoid cross subsidy. Levels of contribution to other costs that are
19 obtained from each mail class are also reported in Table 1. Notice that the total
20 contribution is the same under both sets of prices.

1 Table 1 shows that, relative to Ramsey prices, the proposed Postal Service
2 TY98 AR rates raise little contribution to other costs from Periodicals mail or from
3 Special Services, and they raise less revenue from Standard B Mail. Postal Service
4 rate proposals draw a larger contribution than Ramsey prices from Standard A Mail,
5 and they draw substantially greater contribution from First Class Mail, which includes
6 Priority Mail, and from Express Mail. Table 2 reports estimated welfare losses for the
7 classes, and relates those losses to their contribution burdens. Whenever a price is
8 raised above marginal cost in order to raise money as contribution to support other
9 costs, a welfare loss results. At the higher price there is a loss in consumer surplus that
10 equals the product of the price-minus-marginal-cost difference times the volume at that
11 higher price. This product is not counted as a loss because it is offset by an exactly
12 equal contribution to other costs that is raised by the higher price. But, at the higher
13 price, there is a welfare loss that is not offset by contribution. Consumption is reduced
14 by the difference between volume at the marginal-cost price and volume at the higher
15 price. The area below the demand curve and above the marginal cost curve over that
16 lost volume range represents the welfare loss, which would have been consumer
17 surplus but for the price increase.

1

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Table 1. AVERAGE REVENUE AND CONTRIBUTION

Mail Class	Ramsey Average Revenue	TY98 AR Average Revenue	Ramsey Contribution (\$millions)	TY98 AR Contribution (\$millions)
First	.352	.380	16,365	19,372
Express	11.342	13.412	298	419
Periodicals	.601	.207	3,441	118
Standard A	.146	.172	4431	5321
Standard B	1.587	1.663	358	288
Special	2.563	1.556	923	298
Total	--	--	25,816	25,816

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Table 2. WELFARE LOSS RELATIVE TO CONTRIBUTION

Mail Class	Ramsey Welfare Loss (\$millions)	TY98 AR Welfare Loss (\$millions)	Ramsey Advantage (\$millions)	Ramsey Loss per Contribution	TY98 AR Loss per Contribution
First	1,176	1,982	808	0.072	0.101
Express	152	300	148	0.512	0.714
Periodicals	264	1	-263	0.077	0.007
Standard A	393	839	446	0.089	0.158
Standard B	25	18	-7	0.069	0.063
Special	83	19	-64	0.090	0.065
Total/Avg.	2,094	3,159	1,065	0.081	0.122

9

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2 Relative to Ramsey prices, the proposed Postal Service rates cause very little
3 welfare loss in Periodicals and a relatively small loss in Special Services, but they
4 impose greater welfare losses in First Class, Standard A, and Express Mail. And the
5 overall welfare loss is greater under the Postal Service's proposed rates than under
6 Ramsey prices by more than \$1 billion, as the last entry in the middle (Ramsey
7 Advantage) column of Table 2 shows. Thus, the low welfare losses from proposed
8 prices in Periodicals, Standard B Mail, and Special Services, are more than offset by
9 large welfare losses in First Class Mail, Express Mail, and Standard A Mail.

10 Welfare loss per dollar of contribution also is shown by mail class for each set of
11 rates in Table 2. The average welfare loss per dollar of contribution is fairly constant
12 across mail classes under Ramsey prices (at the margin they should be equal to
13 minimize welfare loss, but average values here may not be equal, and besides, they
14 are affected by constraints on prices for preferred classes and to avoid cross subsidy),
15 ranging from 0.069 to 0.090 over classes with modest constraints and up to 0.512 for
16 Express Mail where rates substantially above Ramsey rates are needed to cover
17 incremental cost. The loss per contribution varies much more across mail classes
18 under the Postal Service proposal, from a low of 0.007 to a high of 0.158 in classes with
19 modest constraints and 0.714 in Express Mail, where the Postal Service rate is higher
20 than the incremental cost test requires. Whenever the ratio of welfare loss incurred per
21 unit of contribution to other costs is much greater in some mail classes than others, the

1 overall welfare loss will be greater. The overall welfare loss is 12 cents per dollar of
2 contribution under the Postal Service's proposed rates, but only 8 cents per dollar of
3 contribution under the constrained Ramsey prices.

4 These observations are not necessarily criticisms of the Postal Service rate
5 proposals in R97-1. The Postal Service must serve goals beyond economic efficiency.
6 Some of those other goals are incorporated in Ramsey prices as well as in Postal
7 Service proposals, though, through constraints on markups for preferred mail classes
8 and the requirement to cover incremental costs. These constraints affect 8 of the 21
9 subclasses of mail that are considered. The aim here is to provide an overview of the
10 Postal Service rate proposal compared with Ramsey prices and to introduce some
11 terms that will be explained and used in what follows. We now turn to compare the
12 pricing proposals with Ramsey prices across the major subclasses.

13 B. Ramsey Prices by Subclass of Mail

14 Witness Bernstein (USPS-T-31) showed advantages of Ramsey pricing through
15 a comparison of estimated Ramsey prices with reference prices from R94-1. He
16 showed that roughly \$1 billion more in consumer benefit would be available from the
17 Ramsey prices he presented. Further analysis of Ramsey pricing will be presented
18 here, to add detailed considerations and to allow a fuller evaluation of their advantages
19 by subclass relative to Postal Service proposals in this case. For consistency, an effort
20 is made to use the same data as those used by Witness Bernstein, and variations in
21 method will be noted.

1 The comparison Witness Bernstein presents of Ramsey prices with R94-1
2 markups, while of interest, has little connection to the current Postal Service proposal.
3 In responding to Interrogatories (OCA/USPS-T-31-5, Summary Table 1; NAA/USPS-
4 T31-13, Summary Table 1A; DMA/USPS-T31-2, Table 13A), Witness Bernstein
5 provided comparisons of Ramsey prices with the prices proposed by the Postal Service
6 in R97-1, but did not provide a complete welfare analysis of the proposed rates. The
7 aim here is to present Ramsey prices and compare them and their effects with the
8 prices proposed by the Postal Service in this case.

9 1. Degrees of Ramsey Pricing

10 Witness Bernstein presented modified Ramsey prices, adjusted for requirements
11 of the Revenue Forgone Reform Act ("RFRA"), incremental cost limits, and some
12 judgmental factors. Indeed, of the 21 mail subclasses for which Ramsey prices were
13 presented, the prices were modified away from Ramsey prices for 11 of the subclasses,
14 leaving only 10 prices to be based on Ramsey principles. Ramsey prices will be
15 presented here in four phases, to show effects of pricing modifications. The
16 calculations are described in OCA-LR-5. To begin, there are pure, unadulterated,
17 Ramsey prices that take no other consideration into account. These pure Ramsey
18 prices are useful as a reference point. They do not comply with the RFRA, nor do they
19 pass cross-subsidy tests. We consider adjustments to these benchmark prices in turn.
20 The pure Ramsey prices that serve as a reference point are shown in column (1) of
21 Table 3.

1 The first modifications will reflect requirements of the RFRA, which prescribes
2 markups for six preferred classes of mail. Three Periodicals subclasses, In-County,
3 Nonprofit, and Classroom, are to have a markup equal to one-half the markup on
4 Periodicals Regular mail. Standard A Nonprofit and Nonprofit Enhanced Carrier Route
5 mail are to have markups equal to one-half the markups of the corresponding members
6 of their subclass, Standard A Regular and Enhanced Carrier Route. And Standard B
7 Library Rate is to have a markup equal to one-half the markup of Standard B Special
8 Rate. Modified Ramsey prices that reflect these mandated markup requirements
9 appear in column (2) of Table 3, identified by PFD in the column heading and marked
10 by asterisks where prices are affected.

11 Second, since it is possible for a Ramsey price to lie below the average
12 incremental cost of a service subclass, tests for that possibility are appropriate. The
13 logic is compelling: If the price is below average incremental cost for any subclass,
14 eliminating that subclass would benefit other mail service users. The cost saved (total
15 incremental cost) by eliminating the service would exceed the revenue that had been
16 raised, which means that the service was being subsidized by other services. To avoid
17 such cross subsidy, the price of each service should be set to cover the incremental
18 cost of that service. The Ramsey prices for Express Mail and Registry are below their
19 average incremental costs, and modified prices are introduced for those services in
20 order to avoid cross subsidy. Modified Ramsey prices that take into account both the
21 RFRA and these incremental cost requirements are shown in column (3) of Table 3,

1 denoted IC + PFD in the column heading and marked by asterisks. These constrained
2 Ramsey prices were used for comparisons by major mail class in Tables 1 and 2 of
3 Part A.

4 Third, at this point some Ramsey prices are quite high. To avoid high prices,
5 Witness Bernstein imposed a judgmental limit on markups, requiring that no markup
6 exceed the First Class letter markup by more than 10 percent. This is quite restrictive,
7 for if the same limitation was applied to the Postal Service proposal, the price for
8 Standard A Enhanced Carrier Route Mail would have to be lowered. This markup
9 limitation affects the Ramsey prices of Regular Periodical mail (and, since they depend
10 on it through the RFRA, three preferred subclasses of Periodicals mail) and the prices
11 of two special services, Insurance and COD Mail. Prices that also take these additional
12 constraints (denoted TH for too high) into account appear in column (4) of Table 3 and
13 are marked by asterisks. Finally, column (5) of Table 3 contains average revenues for
14 the Postal Service price proposals in R97-1.

15 In moving from pure Ramsey prices to the constrained Ramsey prices that
16 benefit preferred classes in column (2), only two subclasses of mail are actually
17 favored: Standard A Nonprofit and Standard A Nonprofit Enhanced Carrier Route, but
18 these prices are cut by more than 50 percent. Given a Ramsey price regime, the other
19 four preferred classes would have lower prices than those dictated by the RFRA. Two
20 subclasses are penalized by the incremental cost tests reflected in column (3): Express
21 Mail and Registry. And three subclasses have prices reduced by Witness Bernstein's

- 1 judgmental constraint on markups that are shown in column (4): Periodicals Regular,
 2 Insurance, and COD.

3 Table 3. Average Revenue
 4

Mail Subclass	Pure Ramsey (1)	Ramsey PFD (2)	Ramsey IC+PFD (3)	Ramsey IC +PFD+TH (4)	TY98 AR Proposed (5)
Letters	\$0.3253	\$0.3374	\$0.3362	\$0.3556	\$0.3518
Cards	\$0.1361	\$0.1376	\$0.1375	\$0.1397	\$0.1972
Priority	\$2.2379	\$2.2538	\$2.2523	\$2.2759	\$3.7770
Express	\$7.3565	\$7.3931	\$11.3421*	\$11.3421	\$13.4120
PerInCo	\$0.1102	\$0.1943*	\$0.1930	\$0.1416	\$0.0928
PerNP	\$0.2652	\$0.3306*	\$0.3284	\$0.2409	\$0.1585
PerClssrm	\$0.2936	\$0.5804*	\$0.5765	\$0.4229	\$0.2168
PerReg	\$0.6688	\$0.7308	\$0.7244	\$0.4724*	\$0.2363
StdA Reg	\$0.2440	\$0.2513	\$0.2505	\$0.2619	\$0.2132
StdA ECR	\$0.0796	\$0.0802	\$0.0801	\$0.0811	\$0.1500
StdA NP	\$0.3659	\$0.1475*	\$0.1472	\$0.1515	\$0.1281
StdA NPECR	\$0.1712	\$0.0554*	\$0.0554	\$0.0557	\$0.0783
StdB Parcel	\$3.9454	\$3.9786	\$3.9754	\$4.0248	\$3.3364
StdB BPM	\$0.8290	\$0.8432	\$0.8418	\$0.8633	\$0.9128
StdB Spl	\$1.7500	\$1.7768	\$1.7742	\$1.8148	\$1.7572
StdB Lib	\$2.0165	\$2.0379*	\$2.0361	\$2.0631	\$1.8249
Registry	\$6.7170	\$6.8030	\$8.4147*	\$8.4147	\$8.5808
Insurance	\$16.1119	\$29.5219	\$27.3506	\$2.9067*	\$2.4331
Certified	\$1.6894	\$1.7257	\$1.7222	\$1.7778	\$1.4993

COD	\$9.2372	\$9.6892	\$9.6442	\$9.3372*	\$4.6381
Money Ord	\$0.8251	\$0.8365	\$0.8354	\$0.8525	\$1.0136

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3 To make up for lost revenue in moving from Ramsey prices to lower rates for the
4 preferred classes, other rates must be raised. For example, the First Class letter rate
5 has to increase by slightly more than 1 cent per piece. Incremental cost tests raise two
6 prices and allow slight reductions in others. The judgmental markup limitations in
7 column (4) cause the greatest loss in revenue, and they require the First Class letter
8 rate to increase by roughly 2 more cents. One reason these latter limitations are so
9 costly is that lowering the Periodicals Regular markup affects also the prices of three
10 preferred classes that have their markups tied to it. Thus, departures from pure
11 Ramsey prices have important effects, such as causing the letter mail price to be 3
12 cents higher than the pure Ramsey prices would produce.

13 For First Class Mail, Postal Service rate proposals are higher than even the most
14 constrained Ramsey prices. In letters, the proposed average rate is 1.6 cents higher
15 than the Ramsey price in column (3) that reflects RFRA dictates and incremental cost
16 tests against cross subsidy, although the proposed rate is 0.4 cents lower than the
17 Ramsey price in column (4) that reflects Witness Bernstein's markup limitation. The
18 Postal Service proposal is 41 percent higher than the most constrained Ramsey price
19 for cards, and 66 percent higher than the most constrained Ramsey price for Priority
20 mail. In Express Mail, the proposed price is 18 percent higher than the most
21 constrained Ramsey price, which meets the incremental cost test.

1 In the Periodicals Mail Class, rates proposed by the Postal Service are very low,
2 roughly two-thirds to one-half of the constrained Ramsey prices. The proposed rates
3 for Periodicals Classroom are even below some estimates of volume variable costs
4 (Witness Kaneer, USPS-T-35). The crucial rate here is that for Periodicals Regular,
5 because other markups are tied to that subclass's markup through the RFRA. The
6 Postal Service's proposed rate for that subclass is one half the most constrained
7 Ramsey rate. Half the subclasses in Standard A Mail are also subject to the RFRA.
8 One of the unconstrained Standard A subclasses, Standard A Regular, has a lower
9 price proposed than the constrained Ramsey price, while the other, Standard A
10 Enhanced Carrier Route, has a price almost twice as high as its constrained Ramsey
11 counterpart. The two preferred Nonprofit subclasses that are set by terms of the RFRA
12 reflect these price differences.

13 Overall, the Standard B rates and Special Services rates proposed by Postal
14 Service tend to be lower than constrained Ramsey prices. The Standard B Parcel Post
15 rate is about 17 percent lower than the most constrained Ramsey price. The proposed
16 rate for Bound Printed Matter is higher than the constrained Ramsey price, while the
17 Special Rate, and thus by the RFRA the Library Rate, is lower. In Special Services,
18 proposed rates are higher for Registry and Money Order, but lower in all other cases,
19 up to, in the case of COD, roughly half. Thus, the proposed rates differ considerably
20 from the Ramsey prices that have been constrained in eleven of the 21 subclasses
21 being studied.

1 2. Representing Welfare Losses

2 Witness Bernstein made welfare comparisons between his modified Ramsey
3 prices and R94-1 reference prices. A drawback of this procedure is that any estimated
4 advantage of Ramsey prices will depend on the reference point that is chosen. A more
5 complete analysis would estimate the entire welfare loss for each set of prices, relative
6 to the ideal welfare benchmark of marginal cost prices (prices which cause no welfare
7 loss). Then, with such a measure of total welfare loss, it would be possible to evaluate
8 the welfare loss for each subclass relative to the contribution raised from that subclass.

9 The comparison with other prices advanced by Witness Bernstein offers an
10 advantage. Because they involve differences in prices that are not great, the welfare
11 loss approximations from the comparison may be reasonably accurate. These
12 approximations arise from using triangular representations of welfare loss, as shown
13 above in Figure 1, which assume the demand curve is linear, when the demand curve
14 actually is not linear. The linear approximation to a curve is of course better over short
15 distances, as between prices that are not very far apart. Comparing any set of prices
16 that will cover all fixed costs with marginal cost prices will involve large price
17 differences, which may lead to poorer welfare loss approximations.

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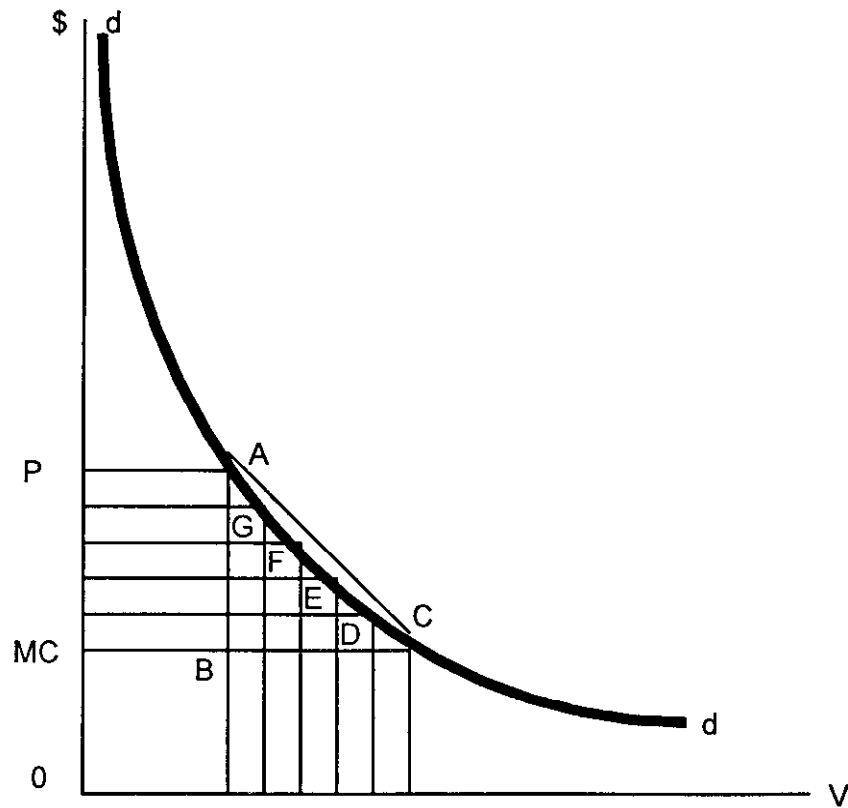


Figure 2

27 The simple linear approximation to demand will tend to overstate the welfare loss
 28 from a price above marginal cost. Figure 2 shows a nonlinear demand curve, dd , of the
 29 type actually estimated for the subclasses of mail. A linear approximation to the welfare
 30 loss from pricing at marginal cost is represented by the area ABC . What is wanted is
 31 the area under the demand curve and above marginal cost between B and C , because
 32 the demand curve represents consumers' valuation of the service and the difference
 33 between that and marginal cost is potential consumer surplus. That potential consumer

1 surplus is lost when price exceeds marginal cost. It should be clear from Figure 2 that
2 the area under the demand curve is smaller than area ABC.

3 It is possible to limit the error from linear approximation, however, by estimating
4 the welfare loss in parts. In Figure 2, the difference between P and MC has been
5 divided into five equal parts. The point where each of these imagined intermediate
6 prices meets the demand curve is labeled with letters, D, E, F, G. Now if linear
7 approximations are made for each of the resulting five demand segments, along line
8 segments CD, DE, EF, FG, and GA, and areas under these five segments down to
9 marginal cost are measured (rather than ABC), the resulting error will be much smaller,
10 as inspection of Figure 2 will show. This procedure was followed in developing welfare
11 loss estimates by subclass, for each of the price variations in Table 3, and the results
12 are contained in Table 4.

13 It should be noted that these estimates still depend on the demand functions that
14 have been estimated and are assumed to hold. Even if the procedure described here
15 captures well the loss in welfare -- according to the demand function -- from any prices
16 that avoid a deficit, there may still be an error if the demand functions are incorrect.
17 While it is possible for such errors to exist, the consistent estimates of these demand
18 functions, with comparable results over time, indicates that they are probably
19 reasonable.

1 C. Welfare Comparisons

2 1. Welfare Losses

3 Highlights of the welfare loss estimates in Table 4 are worth noting not only for
4 differences by subclasses of mail between Ramsey and Postal Service prices, but also
5 because they show consequences of modifying Ramsey prices in different degrees.
6 The total welfare loss, in the first row of Table 4, increases every time more constraints
7 force prices farther from their pure Ramsey levels, with the difference in welfare loss
8 between pure and most constrained Ramsey prices amounting to \$300 million.
9 Unconstrained Ramsey prices cause a total welfare loss of \$1.866 billion, while the
10 most constrained Ramsey prices impose a total welfare loss of \$2.166 billion. As
11 shown in the right most column of the first (Total) row of Table 4, the prices proposed
12 by Postal Service (in the right most column of Table 3) impose a welfare loss of \$3.159
13 billion, or about \$1 billion more than constrained Ramsey prices.

1 Table 4. Welfare Losses (\$millions)

Mail Subclass	Pure Ramsey	Ramsey PFD	Ramsey IC+PFD	Ramsey IC +PFD+TH	TY98 AR Proposed
Total	1865.756	1976.315	2094.094	2165.660	3158.615
Letters	999.873	1131.765	1118.563	1336.531	1288.456
Cards	21.188	23.336	23.128	26.502	135.732
Priority	32.099	35.074	34.784	39.382	557.354
Express	8.425	9.189	152.490*	153.224	299.634
PerInCo	0.859	12.774*	12.547	4.370	0.016
PerNP	12.702	26.311*	25.809	8.448	0.038
PerClssrm	0.041	2.529*	2.491	0.984	0.308
PerReg	189.497	227.287	223.331	80.343*	0.508
StdA Reg	315.890	355.074	351.207	415.040	173.835
StdA ECR	31.417	34.360	34.072	38.629	660.354
StdA NP	158.081	8.045*	7.950	9.529	2.372
StdA NPECR	24.269	0.107*	0.106	0.121	2.503
StdB Parcel	9.434	10.332	10.245	11.637	0.075
StdB BPM	7.597	8.399	8.320	9.586	12.725
StdB Spl	5.125	5.654	5.602	6.434	5.265
StdB Lib	0.418	0.473*	0.469	0.542	0.064
Registry	1.354	1.489	4.743*	4.743	5.139
Insurance	33.169	68.198	62.477	1.647*	0.914
Certified	10.639	11.823	11.706	13.594	5.205
COD	1.029	1.179	1.164	1.062*	0.005
Money Ord	2.649	2.917	2.890	3.311	8.112

2
3

1 Beginning with First Class Mail categories and Express Mail, departures from
2 pure Ramsey prices clearly raise the welfare loss burden when the RFRA markups are
3 applied in the second column. Welfare losses increase in First Class and Express Mail
4 by almost \$140 million as a result of the Act, with most of that added loss (\$130 million)
5 in First Class letters. Then adding the requirement of meeting incremental cost in the
6 third column raises prices in Express Mail (and in Registry), where it causes welfare
7 losses to jump from \$9 million to \$152 million (and in Registry from \$1.5 million to \$4.7
8 million), but lowers prices and losses modestly elsewhere. The welfare loss in First
9 Class Mail goes down nearly \$14 million, as the loss increases in Express Mail by \$143
10 million. The judgmental reductions of "high" markups in the fourth column reduce
11 welfare losses in three subclasses that benefit, Periodicals Regular, Insurance, and
12 COD, but raise them elsewhere. For instance, to replace revenue lost by the
13 judgmental reductions from Ramsey markups in these three subclasses, the welfare
14 loss in First Class letters increases from \$1,116.559 million to \$1,311.796 million, or an
15 increase of almost \$200 million dollars.

16 Welfare losses for the group comprising First Class Mail and Express Mail are
17 substantially greater under the Postal Service proposal than under the most modified
18 Ramsey prices, for which welfare losses are presented in the fourth column of Table 4.
19 In that comparison, the Postal Service prices impose an added welfare loss of \$725
20 million on First Class and Express Mail together, with a slightly lower loss in letters but

1 a greater loss of about \$110 million in cards, \$490 million in Priority Mail and \$145
2 million in Express Mail.

3 In the Periodicals Class, the move from pure Ramsey prices to prices that are
4 prescribed by the RFRA actually raises prices for the three preferred classes. The
5 reason is that the Revenue Forgone Act reduces other preferred prices -- and their
6 contributions -- so much that remaining prices must go up. One of those prices that
7 must be raised is Periodicals Regular, which is the basis for markups in the preferred
8 periodicals subclasses. Periodicals Regular has an own-price elasticity of demand of
9 only -0.143, so its pure Ramsey markup is high. And when markups must increase, to
10 replace the contribution lost from other preferred classes, the Ramsey markup on
11 Periodicals Regular rises from 3.02 to 3.30. The preferred Periodicals subclasses have
12 high demand elasticities and thus low Ramsey markups, so their pure Ramsey prices
13 are low. But when their markups are tied as they are by the Revenue Forgone Act to
14 Periodicals Regular, which has a high markup (made even higher by effects of the Act)
15 those preferred Periodicals markups -- and thus prices -- are higher.

16 Prices proposed by the Postal Service for the Periodicals class are considerably
17 lower than any version of Ramsey prices, so welfare losses from the proposed Postal
18 Service prices are much lower for the Periodicals class. The proposed rate for
19 Periodicals Classroom is even lower than estimated test-year, after-rates cost. If those
20 costs are correct (Witness Kaneer in USPS-T-35 suggests they may not be), there is a
21 welfare loss from having the price below marginal cost. At the same time, there is a

1 negative contribution to other costs, so welfare losses will have to be greater in other
2 subclasses to make up for that lost contribution.

3 In Standard A Class, the RFRA reduces nonprofit prices markedly and thus
4 reduces welfare losses from the pure Ramsey levels. The nonprofit rates proposed by
5 the Postal Service reflect the Act and they yield low welfare losses. The rates proposed
6 by Postal Service for Standard A Enhanced Carrier Route are almost twice as high as
7 Ramsey prices for that subclass, however, while the rates proposed for Standard A
8 Regular are somewhat lower. Overall, the welfare loss for the class is substantially
9 greater under the Postal Service proposal than under Ramsey prices. Under the most
10 constrained Ramsey prices in the fourth column, the welfare loss would be about \$380
11 million lower than under Postal Service proposals.

12 Welfare losses from Postal Service proposals are quite low for all services of the
13 Standard B Class, being highest in Bound Printed Matter. They are far lower under
14 Standard B Parcels rates proposed by the Postal Service than under any of the
15 Ramsey price versions for that service. There is hardly any difference between the
16 Standard B Library rates under Ramsey pricing or under the RFRA requirements.
17 Because the Postal Service's proposed Standard B Special rates are lower, the
18 proposed Library rates are also lower, and welfare losses accordingly are smaller. In
19 Special Services, the incremental cost test forces a substantial increase in the Registry
20 price in order to avoid cross subsidy. And the extremely low elasticity of -0.105 for the
21 Insurance subclass causes a very high Ramsey price markup, which is reduced by

1 Witness Bernstein's markup limitation. As a result, the constrained Ramsey price is
2 much lower in column (4) of Table 3 than in column (3), and welfare loss falls to less
3 than one-tenth of what it was without that limitation. But even after being judgmentally
4 limited in this way, the Ramsey price is still higher than the Postal Service proposal, so
5 welfare loss is lower in the Postal Service proposal.

6 2. Welfare Loss Per Unit of Contribution

7 This examination of prices by subclass reveals the same broad effects by major
8 mail classes that were noted in Part A. It also shows how variations in Ramsey prices
9 affect the losses in welfare, and how they are distributed across the subclasses of mail.
10 Ramsey prices, with various degrees of modification, have traded off the welfare loss
11 from raising price above marginal cost against the gain achieved in raising contributions
12 to cover other costs. Table 5 presents the contributions made under all pricing
13 arrangements by the individual subclasses of mail. And Table 6 shows average welfare
14 loss per dollar of contribution for the same pricing arrangements and subclasses.

15 Notice first that total contribution in the first row of Table 5 is the same for every
16 alternative set of prices. The amount contributed by proposed Postal Service rates,
17 when long-run elasticities were used to forecast volumes, was taken as the benchmark
18 level of contribution, and all other prices were set to raise the same contribution. The
19 Postal Service proposes to raise slightly less revenue from letters than constrained
20 Ramsey prices would yield, but substantially more from cards, Priority Mail and Express
21 Mail. Much less revenue is raised from Periodicals Mail by the Postal Service, \$1.5

1 billion less in Periodicals Regular alone. But more is raised from Standard A Mail. Less
2 revenue is raised from Standard A Regular than constrained Ramsey prices would call
3 for, but much more is raised from Standard A Enhanced Carrier Route. Having rates
4 for one subclass higher than Ramsey prices and for another subclass lower in this way
5 will tend to produce more welfare loss overall. The Postal Service also raises less
6 contribution from Standard B Mail than constrained Ramsey prices would. Only about
7 one tenth of the contribution of constrained Ramsey prices is derived from Parcel Post
8 under proposed Postal Service rates. The Postal Service raises more money from
9 Bound Printed matter than constrained Ramsey prices do, but less from the other two
10 Standard B subclasses.

Table 5. Contributions (\$millions)

Mail Subclass	Pure Ramsey	Ramsey PFD	Ramsey IC+PFD	Ramsey IC +PFD+TH	TY98 AR Proposed
Total	25816.420	25816.420	25816.420	25816.420	25816.420
Letters	14641.210	15704.370	15600.140	17267.620	16885.940
Cards	207.119	217.513	216.523	232.048	485.438
Priority	526.910	550.302	548.066	582.427	2000.351
Express	94.322	98.329	298.048	299.483	419.496
PerInCo	16.187	62.524*	61.960	36.458	2.231
PerNP	214.589	323.756*	320.210	171.581	10.576
PerClssrm	0.799	4.655*	4.634	3.333	-2.529
PerReg	2748.102	3089.142	3054.176	1621.242*	107.886
StdA Reg	3214.029	3426.319	3405.802	3733.687	2363.994
StdA ECR	597.012	624.042	621.456	661.239	2664.452
StdA NP	2228.057	389.635*	387.135	426.939	204.154
StdA NPECR	342.064	16.660*	16.584	17.755	87.995
StdB Parcel	104.450	109.198	108.749	115.734	11.007
StdB BPM	136.892	144.243	143.534	154.566	179.365
StdB Spl	93.216	98.069	97.602	104.857	94.527
StdB Lib	7.974	8.476*	8.359	9.061	3.155
Registry	24.973	26.215	47.547*	47.547	49.571
Insurance	365.975	655.740	610.043	45.892*	32.431
Certified	187.541	198.383	197.333	213.761	128.721
COD	16.402	17.770	17.634	16.706*	1.021
Money Ord	48.595	51.055	50.819	54.484	86.642

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Table 6. Average Welfare Loss per Dollar of Contribution

Mail Subclass	Pure Ramsey	Ramsey PFD	Ramsey IC+PFD	Ramsey IC +PFD+TH	TY98 AR Proposed
All	0.072	0.077	0.081	0.084	0.122
Letters	0.068	0.072	0.072	0.077	0.076
Cards	0.102	0.107	0.107	0.114	0.280
Priority	0.061	0.064	0.063	0.068	0.267
Express	0.089	0.093	0.512*	0.512	0.714
PerInCo	0.053	0.204*	0.202	0.120	0.007
PerNP	0.059	0.081*	0.081	0.049	0.004
PerClssrm	0.051	0.543*	0.538	0.295	-0.122
PerReg	0.069	0.074	0.073	0.050*	0.005
StdA Reg	0.098	0.104	0.103	0.111	0.074
StdA ECR	0.053	0.055	0.055	0.058	0.248
StdA NP	0.071	0.021*	0.021	0.022	0.012
StdA NPECR	0.071	0.006*	0.006	0.007	0.028
StdB Parcel	0.090	0.095	0.094	0.100	0.007
StdB BPM	0.055	0.058	0.058	0.062	0.071
StdB Spl	0.055	0.058	0.057	0.061	0.056
StdB Lib	0.052	0.056*	0.056	0.060	0.020
Registry	0.054	0.057	0.100*	0.100	0.103
Insurance	0.090	0.104	0.102	0.036*	0.028
Certified	0.057	0.060	0.059	0.064	0.040
COD	0.063	0.066	0.066	0.064*	0.005
Money Ord	0.054	0.057	0.056	0.061	0.094

1
2
3 Raising revenue in the form of contribution to cover other, largely fixed, costs is
4 necessary, as we have noted, but it is desirable to keep the welfare loss that follows
5 from raising such funds as low as possible. To examine how effectively the contribution
6 is being raised we can look at welfare loss per unit of contribution for every subclass of
7 mail and for all subclasses together (total welfare loss against total contribution). Ratios
8 of welfare loss per dollar of contribution are presented in Table 6. On an overall basis,
9 shown in the first row of Table 6, unconstrained Ramsey prices impose a cost of about
10 7 cents per dollar of contribution, whereas the most constrained Ramsey prices impose
11 a cost of roughly 8 cents per dollar of contribution. For comparison, the Postal Service
12 proposal imposes a cost of about 12 cents per dollar of contribution raised.

13 Unconstrained Ramsey prices have roughly equal values for welfare loss per
14 dollar of contribution across the subclasses of mail. Complying with the RFRA raises
15 welfare loss per contribution dollar markedly in preferred Periodicals subclasses
16 (marked by asterisks in the second column). Indeed, the welfare loss per dollar of
17 contribution in Periodicals Classroom rises ten fold when the Act is applied to Ramsey
18 prices, which already favor preferred Periodicals subclasses because of their high (in
19 absolute value) demand elasticities. The Standard A ratio of welfare loss per dollar of
20 contribution falls substantially in the two Nonprofit subclasses, which have their rates
21 lowered by the RFRA. When Ramsey prices for Express Mail and Registry are set
22 equal to incremental cost in the third column, the welfare loss per dollar of contribution
23 for each of those subclasses rises dramatically. This is especially true for Express Mail

1 where the ratio reaches 0.512. Because more contribution results from these price
2 increases, the burdens on other classes ease, and so the ratios for other classes of
3 mail fall slightly. Imposing an arbitrary upper limit on Ramsey markups in the fourth
4 column limits the welfare losses in the three affected subclasses, Periodicals Regular,
5 Insurance, and COD. But to make up for the contribution that is consequently lost,
6 welfare-loss-to-contribution ratios have to increase in most other classes.

7 Despite the variations introduced by constraints on Ramsey prices, the welfare
8 loss ratios for the most constrained Ramsey prices are more similar than those for the
9 Postal Service's rate proposal. The loss per dollar of contribution under Postal Service
10 rates is very high for cards, Priority Mail and Express Mail (where it reaches 0.714), and
11 very low for Periodical Mail subclasses. The loss per dollar is again high for Standard A
12 Enhanced Carrier Route (0.248) and then very low for Standard B Parcel Post (0.007).
13 These variations in welfare loss per dollar of contribution across subclasses of mail lead
14 to greater overall welfare loss. High prices are accompanied by bigger welfare losses
15 than low prices can save when they are low, in part because welfare losses rise roughly
16 with the square of the difference between price and marginal cost (see equation (3)
17 above). So a side effect of great variations in welfare loss per dollar of contribution
18 raised is that the total welfare losses become larger. That result is evident in the Postal
19 Service's loss of 12 cents per dollar of contribution raised, compared to 8 cents per
20 dollar under constrained Ramsey prices.

1 D. Worksharing Discounts

2 The worksharing discount allows others (in this case, customers) to carry out
3 some of the tasks that are part of a postal service, and, in return, to receive the service
4 for a lower price. The discounts are comparable to "access" charges that allow one
5 supplier of a service to use the resources of another supplier, as when a long distance
6 carrier uses a local telephone network or one railroad uses another railroad's tracks.
7 The practical and appealing "efficient components pricing" (ECP) principle of access
8 pricing calls for the resource owner to be compensated for its own cost, including
9 opportunity cost, when granting access to others. Lost profit would be counted as part
10 of opportunity cost. Allowing an access price consistent with this principle has the
11 advantage of motivating the resource owner to allow access. It will also invite low cost
12 suppliers to participate in supplying the service. The result can be ideal, even when the
13 resource owner is a monopoly, although regulation of the final service price may then
14 be in order.

15 The ECP idea assumes that volume shifts will be made abruptly. All suppliers of
16 worksharing effort can afford to serve at the same access price, for instance, and when
17 that price is reached they will all participate. When cross elasticities are not infinitely
18 elastic at the crucial access price in this way, then the cross elasticities should be taken
19 into account in setting optimal prices. And a ready-made means of doing so exists in
20 Ramsey prices. The Postal Service examines this possibility by treating worksharing as

1 another service, and Ramsey principles are applied in choosing prices to maximize
2 welfare as in other multi-service optimal pricing situations.

3

4 1. Ramsey Pricing for Single-Piece and Worksharing Letters

5 The most significant example of worksharing occurs in First Class letters, which
6 can be divided into single-piece letters and worksharing letters. Application of Ramsey
7 pricing to these mail categories was studied by Witness Bernstein (USPS-T-31).
8 Several problems complicate the estimation of Ramsey prices using information
9 presently available. The first problem is caused by the wide range of mail pieces in the
10 two mail streams, which complicates cost estimation for single-piece and worksharing
11 letters. Another problem arises in the use of demand elasticity and cross elasticity
12 information for the calculation of Ramsey prices.

13 Having a mixture of mail in a particular category complicates the separate
14 analysis of single-piece and workshare portions of First Class Mail. One consequence
15 is that costs, and also prices, of these two letter-mail categories differ because their
16 contents differ. That is, in addition to worksharing, there are other differences in the
17 costs of these two mail categories (the mixtures of mail in the two categories differ: e.g.,
18 relatively more pieces of single-piece mail weigh two-ounces or more). As a result, the
19 worksharing discount does not equal the difference between single-piece and
20 worksharing prices. Moreover, it is not easy to predict the cost of the mail that moves,
21 say, from single-piece to worksharing when the discount increases.

1 The Postal Service has initially tackled the difficult problem of finding Ramsey
2 prices by treating single-piece and worksharing letters as two services. In estimating
3 demands for these two services, own-price elasticities were estimated, plus elasticities
4 of each service with respect to the workshare discount. These discount elasticities
5 were not included in the Ramsey pricing formulas (USPS-T-31, p. 83), but were
6 included in the volume forecasting formulas. In responding to POIR-3-1, Witness
7 Bernstein said the cross elasticities are not needed in the pricing formulas, essentially
8 because equal (except for sign) derivatives with respect to the discount are assumed
9 for both letter categories (condition (6) below). Those equal derivatives might prevent
10 any effect on relative prices if both services had the same elasticity and thus the same
11 markup.

12 But equal derivatives will not ensure the same elasticity or markup, and if
13 differing markups produce differing contributions per unit, one service might be favored
14 when shifting volumes between the services is possible. The ease of shifting, or the
15 strength of elasticity responses, might then matter. More importantly, if optimal pricing
16 equations are derived directly from a welfare maximizing problem involving the two
17 services, the cross-price effects will clearly appear in the resulting Ramsey-price
18 equations, just as they do in Witness Bernstein's formula for Ramsey prices (USPS-T-
19 31, p. 17). With cross effects omitted from the Ramsey pricing formulas, relative prices
20 cannot reflect them, and the resulting price structure will not reliably be correct.

21 Estimation by the Postal Service of separate demands for single-piece and
22 worksharing letters assumed that the letters moved from one letter category to the other

1 in response to a change in the workshare discount (USPS-T-7, p. 20). This assumption
 2 of equal (but opposite sign) derivatives with respect to the discount is somewhat like the
 3 assumption of equal cross derivatives underlying the Slutsky-Schultz condition (USPS-
 4 T-7, p. 143). The assumption simplifies the relationship between discount elasticities
 5 for single-piece and worksharing letters. And it allows estimation of the elasticity of
 6 single-piece letters with respect to the discount by using the results from estimating the
 7 elasticity of worksharing letters with respect to the discount. The cross elasticities
 8 implied by these estimated discount elasticities are very large, however, as the next two
 9 subsections will show. When included in the pricing formula, large cross elasticities can
 10 prevent the calculation of Ramsey prices, because they can upset an equilibrium.
 11 When own-price elasticities dominate, they support equilibrium tendencies; when a
 12 service price goes up, the volume of that service will fall, and vice versa. Cross
 13 elasticities lack this stabilizing property of own-price elasticities, because they simply
 14 intrude into other markets. When they are large they can overwhelm the own-price
 15 effects and prevent an equilibrium, which, in turn, can prevent the calculation of
 16 Ramsey prices.

17

18 2. The Relationship between Discount Elasticities and Cross Elasticities

19 It is possible to relate the discount elasticities to more standard cross elasticities. First,
 20 let us represent the discount as $d = p_s - p_w$, where p_s is the price of single-piece letters
 21 and p_w is the price of worksharing letters. As noted above, the discount does not

1 exactly equal this difference in prices. But if a constant, c , can be subtracted from the
 2 difference, d , to capture the effects of different mixtures of letters, as proposed, then
 3 $d = p_s - p_w - c$, and the results will be unaffected. This latter definition will be used in
 4 what follows. Elasticities of single-piece and worksharing letters are
 5 (4)

$$\beta_s = \frac{\partial V_s}{\partial d} \frac{d}{V_s}$$

6 and (5)

$$\beta_w = \frac{\partial V_w}{\partial d} \frac{d}{V_w}$$

7

8

9 where V_s is single-piece volume and V_w is worksharing volume. Witness Thress
 10 (USPS-T-7, p.20) assumed that the discount shifts mail from one letter category to the
 11 other, or that
 12 (6)

$$\frac{\partial V_s}{\partial d} = -\frac{\partial V_w}{\partial d}$$

13

1 Using this condition with the elasticity equations above implies that

2 (7)

$$\beta_s = -\beta_w \frac{V_w}{V_s},$$

3

4 which allows estimation of the single-price elasticity from the worksharing elasticity plus
5 information about volumes.

6 Now consider the form of ordinary cross elasticities. (Recall that s identifies
7 single price letters and w denotes worksharing.) The cross elasticity of single-price
8 letters with respect to the worksharing price, E_{sw} , is

9 (8)

$$E_{sw} = \frac{\partial V_s}{\partial p_w} \frac{p_w}{V_s}.$$

10

11 We can interpret this cross elasticity and relate it to the discount elasticity above in (4),
12 the elasticity of single-price letters with respect to the discount. First, (8) can be
13 expressed as

$$E_{sw} = \frac{\partial V_s}{\partial p_w} \frac{p_w}{V_s} = - \frac{\partial V_s(p_s - p_w - c)}{\partial d} \frac{p_w}{V_s (p_s - p_w - c)},$$

15

16 because

$$\frac{\partial V_s}{\partial p_w} = \frac{\partial V_s}{\partial d} \frac{\partial d}{\partial p_w}$$

1 and $\partial d / \partial p_w = \partial(p_s - p_w - c) / \partial p_w = -1.$

2 By recognizing (4) and substituting it into $E_{s,w}$, we have

3 (9)

$$E_{s,w} = -\beta_s \frac{p_w}{(p_s - p_w - c)}.$$

4

5 Thus, the cross elasticity of single piece letters in response to the price of worksharing
6 letters equals minus the elasticity of single piece letters with respect to the discount,
7 multiplied by the price of worksharing letters divided by the discount.

8 The cross elasticity effect of the price of single-piece letter mail on the volume of
9 worksharing letter mail can be defined similarly as

10 (10)

$$E_{w,s} = \frac{\partial V_w p_s}{\partial p_s V_w}.$$

11

12

1 By following the same steps for this case, and using equation (5) above, it is possible to
 2 obtain
 3 (11)

$$E_{ws} = \beta_w \frac{p_s}{(p_s - p_w - c)}.$$

4

5 The cross elasticity equals the discount elasticity multiplied by the price of single piece
 6 letters divided by the discount.

7

8 3. Implied Cross Elasticities of Demand are Large

9 It can now be shown that for available discount elasticity estimates, the relations
 10 in (9) and (11) would imply cross elasticities of demand that are large (in absolute
 11 value). Ignoring signs and focusing on size, the cross elasticities will be substantially
 12 larger than their respective discount elasticities, and will even be larger than their own-
 13 price elasticities of demand. Each cross elasticity equals a discount elasticity times
 14 either $-p_w/(p_s - p_w - c)$ or $p_s/(p_s - p_w - c)$, both of which can be expected to be larger than
 15 one in absolute value. For example, Witness Bernstein found single piece and
 16 worksharing Ramsey prices of \$.450 and \$.242, and a Ramsey discount of \$.144
 17 (USPS-T-31, p. 87), yielding price-to-discount ratios of about 3.1 for $p_s/(p_s - p_w - c)$ and
 18 -1.7 for $-p_w/(p_s - p_w - c)$. The discount elasticities themselves are already sizable, with

1 the single piece discount elasticity at -0.164 and the worksharing discount elasticity at
 2 0.222 (USPS-T-7, pp. 40, 41). Indeed, ignoring their signs, estimates of the discount
 3 elasticities are comparable in magnitude to own-price elasticities of demand, which are
 4 -0.189 for single piece letters (versus the -0.164 discount elasticity) and -0.289 for
 5 worksharing letters (versus the 0.222 discount elasticity). Multiplying discount
 6 elasticities by values for the price-to-discount ratios will imply crosselasticities of
 7 demand in (9) and (11) that are larger (in absolute value) than own-price elasticities of
 8 demand:

9 (9)

$$10 \quad E_{sw} = (-0.164)(-1.7) = 0.279, \text{ versus own price elasticity of } E_{ss} = -0.189$$

11 (11)

$$12 \quad E_{ws} = (0.222)(3.1) = 0.688, \text{ versus own-price elasticity of } E_{ww} = -0.289$$

13

14 In such circumstances it is awkward, and possibly even unstable, to have cross
 15 elasticities exceed own-price elasticities (in absolute value). For the volume of one
 16 service can then depend more on the price of another service than on its own price.
 17 This means that one service could lower its price but if the price of the second service
 18 was also lowered the first service actually could lose volume. And the same would hold
 19 true for the second service. Normal price adjustments could then have perverse,
 20 meaning unstable, consequences, with price reductions bringing quantity reductions
 21 and vice versa. A process that depends on convergence of prices to an equilibrium,
 22 such as the method used to calculate Ramsey prices, might not then yield a solution.

1 The cross elasticities implied by estimated discount elasticities thus are so great
2 they can bring instability or deny the possibility of an equilibrium, which is a condition
3 we do not see in the world. So it is likely that the estimated discount elasticities are too
4 large to be plausible. After showing that either discount elasticity could be estimated
5 from the other, Witness Thress said the worksharing elasticity with respect to the
6 discount was used "...because the worksharing discount, as expected, had a larger and
7 more significant impact on worksharing letters than on single-piece letters" (USPS-T-7,
8 p. 20). Since the larger estimated value was selected as the basis for both elasticities,
9 they both could easily have been overestimated. It may not be possible to calculate
10 Ramsey prices with such large estimates of discount elasticities when those elasticities
11 are properly reflected in the Ramsey price equations.

12

13 4. Formulating the Ramsey Pricing Problem

14 The Ramsey pricing problem for worksharing might be formulated in different
15 ways. One possible way has been discussed so far, to consider single-piece letters
16 and worksharing letters as two services. In that case, with nonzero cross elasticities,
17 those cross elasticities should be reflected in the Ramsey-pricing formula. Otherwise,
18 the interdependence of the prices will not be reflected in the structure of prices. This
19 omission may not be important in the present effort of the Postal Service, where finding
20 Ramsey prices is limited to an illustrative role. Various ad hoc costing assumptions are
21 needed, for different possible volume shifts, and these assumptions are difficult to

1 implement. And there may be a problem with convergence of the Ramsey price
2 calculations, because of the large cross elasticity terms.

3 An alternative formulation would focus on the single-piece letter price as
4 determinant of the total volume of letter mail. The discount from that price for
5 worksharing would invite some fraction of that letter mail volume to become
6 worksharing letters. The relevant discount elasticity would then be a supply elasticity, a
7 willingness of mailers to provide worksharing effort in response to changes in the
8 discount. The worksharing discount elasticity estimated by Witness Thress (USPS-T-7)
9 might even be interpreted as an estimate of this supply elasticity, although its value
10 might be affected by concurrent estimation of other influences that would not be
11 relevant in this model. With this formulation, there would be no need for a single-piece
12 letters discount elasticity. Nor would there be any role for an own-price elasticity of
13 demand for worksharing letters.

14 Suppliers of worksharing would simply be seen as mailers making a profit-
15 maximizing decision to workshare, based on the level of the discount. And their
16 behavior would be reflected in the supply elasticity. There would be no separate
17 demand for worksharing letters. Instead there would be a willingness to supply
18 worksharing service, based on the level of the discount offered, for mail already
19 decided on based on its price relative to alternative options. The volume of letters
20 would depend on the price of letters and other factors, including the prices of other
21 services that had nonzero cross elasticities with letters, but not on the level of the
22 discount.

1 This formulation reflects the spirit of the Postal Service approach, in which the
2 discount is assumed only to determine the division between workshared letter mail and
3 nonworkshared letter mail. But the Postal Service creates more elasticities than can be
4 managed in a consistent treatment of Ramsey prices. Genuine differences in the mail
5 streams, and costs, of single-piece and worksharing letters encourage the modeling of
6 separate demands, and the corresponding estimation of different elasticities. But by
7 focusing on the demand for letter mail, together with the supply of worksharing, the
8 problem can be formulated more simply and solved more effectively.

9 Further progress in developing Ramsey prices for single-piece and worksharing
10 letters will benefit from better information about costs. Elasticity estimates are always
11 difficult to obtain but are important. The effort should also be based on a carefully
12 chosen formulation for access pricing according to Ramsey principles. Worksharing
13 has become a significant factor in postal operations and that makes a Ramsey basis for
14 pricing it a very desirable goal.

15

16

17

1 III. THE COST BASIS FOR PRICING

2 Estimation of volume variable cost, and of incremental cost, is undertaken by the
3 Postal Service in this case. These cost concepts should afford a better representation
4 of marginal cost for pricing purposes. Having them also should better equip the Postal
5 Service to avoid cross subsidy across the various mail services. The conceptions invite
6 some redesign of Postal Service accounting procedures, however, to produce
7 estimates more reliably.

8 As emphasized by Postal Service Witness Panzar (USPS-T-11, p. 41), cost
9 estimates should be based on a Postal Service operating plan, in order to yield
10 consistent results. Of course this operating plan may not deal with questions that the
11 estimation of incremental cost invites -- such as the actions that would be taken if First
12 Class Mail was eliminated -- because the operating plan does not extend to such
13 possibilities. While intelligent interpretation of the existing cost system may allow
14 reasonable approximations of incremental costs, limitations of the system need also to
15 be recognized. The cost system was not designed to produce incremental cost
16 estimates, and more attention to this purpose is desirable.

17 Witness Takis's summary incremental cost estimates by broad classes of mail
18 (USPS-T-41, Ex. USPS-41C) are presented in Table 7 below, along with estimates of
19 volume variable costs and of contributions to other costs by mail class from Witness
20 O'Hara's Direct Testimony (USPS-T-30, Ex. USPS-30B). Total contribution to other
21 costs can be taken as an approximation to the relevant fixed or institutional cost,

1 because that is what the contribution is intended to cover. In large part, the difference
 2 between the total incremental cost and the total volume variable cost for a mail class
 3 often represents the fixed cost traceable to that class. In Table 7, that difference
 4 amounts to only about 11 percent of the total contribution to other costs, which
 5 approximates total fixed costs. And the difference is only about 9 percent of total
 6 volume variable costs. This suggests that the additional costs beyond volume variable
 7 costs, costs included in incremental costs, which are needed to supply all of the service,
 8 are relatively small.

9 Table 7. TEST YEAR 1998 AFTER-RATES VALUES

Mail Class	Volume Variable Cost(VVC) (\$000s)	Incremental Cost (IC) (\$000s)	Contribution to Other Costs (\$000s)	IC minus VVC as percent of VVC	IC minus VVC as percent of Contribution
First	17,439,087	19,067,294	17,264,660	9.34	9.43
Periodical	2,004,843	2,037,615	120,685	1.63	27.15
Standard A	8,311,021	8,769,081	5,567,869	5.51	8.23
Standard B	1,413,339	1,442,621	298,941	2.07	9.80
Priority/ Express	2,607,840	3,339,395	2,586,070	28.05	28.29
Total	31,776,129	34,656,006	25,838,225	9.06	11.15

10
11

12 Although at this point it is difficult to judge the reasonableness of these
 13 incremental cost estimates, one might expect that, in total, more than 11 percent of
 14 fixed costs could be traced to classes of mail. It is also surprising that incremental
 15 costs exceed volume variable costs only by about 2 percent in both Periodicals class

1 and Standard B class mail, indicating that fixed costs amount to only about 2 percent of
2 the variable costs of those classes. If fourth class mail was terminated, for instance, any
3 consequent savings in the costs of Bulk Mail Centers --which should be part of
4 incremental cost -- would seem to amount to more than 2 percent of that mail's variable
5 costs.

6 The incremental costs shown in Table 7 are estimated for the group of
7 subclasses that make up the major classes of mail. The incremental costs that are
8 traced to individual subclasses are slightly smaller. When added together, the TY1998
9 estimated incremental costs for subclasses in Exhibit USPS-T-41B add to
10 \$34,225,094,000, a total that is just 1.24 percent smaller than the total incremental cost
11 of \$34,656,006,000 in Table 7 based on estimates at the level of the mail classes. The
12 largest difference between incremental cost for the class and for the sum of subclasses
13 occurs in Standard A Mail. There, estimated TY1998 incremental costs for the group
14 that makes up the class exceeds the sum of incremental costs for the subclasses by
15 2.8 percent. The incremental costs at the levels of the major classes of mail thus are
16 not estimated to be much greater than the incremental costs of the subclasses. This
17 assessment of incremental costs means that eliminating an entire class of mail would
18 save little more than could gradually be saved by eliminating one subclass at a time.

19 In his testimony (USPS-T-41), Witness Takis gives little attention to the
20 imputation of fixed costs when they are caused by more than one service. If a fixed
21 cost is shared by, say, two services, an incremental cost for those two services together
22 can be estimated. Then a test for cross subsidy can be carried out for that two-service

1 group, to determine whether the two services are being subsidized. Sometimes it is
2 possible to trace the cost of a facility that is shared by more than one service to only
3 one of the services. That possibility is shown in discussion of the Eagle Network
4 (USPS-T-41, p. 12), which serves Express, Priority, and First-Class Mail, but can be
5 imputed to Express Mail because it is deemed necessary only to that service.

6 Other shared costs would seem to deserve careful analysis and explanation. For
7 example, Bulk Mail Centers process second, third, and fourth class mail. Are they
8 regarded as necessary to one of those classes, as the Eagle Network is to Express
9 Mail? If so, the appropriate cost should be counted as specific fixed cost, and thus be
10 part of incremental cost, for that class. If not, are the Bulk Mail Centers necessary for
11 two mail classes? For three? Answers to these questions determine the level at which
12 cross-subsidy tests should be carried out. In some cases, incremental costs should be
13 estimated for combinations of classes, and then tests for cross subsidy should be
14 conducted for that combination of classes. The present effort seems essentially to
15 focus on incremental cost estimates for only one class at a time. It is possible that when
16 fixed costs that are shared by services are imputed to those services, a larger portion of
17 total costs would be identified as incremental, and more incremental cost tests could
18 then be carried out.

19 A puzzle arises in several special services (certified, insurance, C.O.D., special
20 handling) and in mailgrams, subclasses for which incremental costs are lower than
21 volume variable costs. While such a result is clearly possible, it implies that marginal
22 cost is increasing with the volumes of those services. The implication is that such

- 1 services could be offered at lower cost by smaller providers. Except for mailgrams,
- 2 however, the services are offered jointly with other postal services, so separate
- 3 provision may not be feasible.

4

1 IV. PREPAID REPLY MAIL AND QUALIFIED BUSINESS REPLY MAIL

2 That the Postal Service will allow a rate concession for prebarcoded reply mail is
3 a development to be welcomed. Proposals that would lower the price for this very
4 clean, low cost mail have been made repeatedly in the last decade, and a price break
5 should encourage its use and thereby increase its benefits. The proposed treatment is
6 not a general one that offers the price break to the appropriate decisionmaker,
7 however, apparently because the Postal Service fears that having two stamp prices
8 would burden and confuse the general public, and would bring administrative and
9 enforcement problems for the Postal Service. So the proposal grants a 3 cent discount
10 for qualifying prebarcoded reply mail, but has recipients of reply mail pay for it at the
11 discounted rate rather than those who deposit it in the mail.

12 Two versions of reply mail are proposed, Prepaid Reply Mail (PRM) and
13 Qualified Business Reply Mail (QBRM). PRM would require the envelope or card
14 provider to prepay the reply mail, based on mailings and an audited average
15 percentage of envelopes or cards returned. The mailer would pay \$100 annually to
16 maintain an account and \$1,000 monthly to cover Postal Service auditing and
17 administrative costs, in addition to discounted rates of 30 cents per letter and 18 cents
18 per card returned. QBRM would be offered at the same rates per mail piece as PRM,
19 but the additional fees would differ. QBRM would have postage-due calculations
20 performed by the Postal Service. The mailer would maintain an advance deposit
21 account, which would be debited based on actual QBRM usage. For carrying out this

1 postage-due calculation, the Postal Service would charge 6 cents per piece. Thus the
2 Postal Service fees for managing the reply mail transactions are \$1,000 per month for
3 PRM (plus \$100 per year) and 6 cents per piece for QBRM.

4 These PRM and QBRM proposals have a serious disadvantage: they make
5 mailing a reply card or letter seem free to the customer. As a result, some customers
6 may choose reply mail even though they would not do so if they faced its full cost,
7 which means the final outcome can be inefficient. It can be inefficient in that some
8 customers who would choose to pay bills by other means, such as stopping at an office
9 on their way to work at a cost they might see as worth 5 or 10 cents, may now pay by
10 mail simply because it seems free to them. And yet the actual cost is greater than their
11 alternative means of payment would be, which means the outcome is not optimal for
12 society.

13 Witness Fronk even suggests (USPS-T-32, p. 38) that an aim of the proposal is
14 to increase mail use by customers who now walk in payments rather than use the mail.
15 While this response of consumers to apparently free reply mail would increase mail
16 volumes, and the resulting contribution to postal profit, it would accomplish that result
17 by misleading customers. Customers are misled when reply-mail service is made to
18 seem free. If they have to pay for the service themselves, some of these customers
19 who now walk in their payments will probably continue to walk them in, even with the
20 reply mail price at 30 cents, because they find that is a less costly way to pay than
21 using the mails. Or they may shift to electronic means, which may actually have lower
22 social cost.

1 If the original mailer who is the recipient of reply mail wishes to pay for it,
2 perhaps that choice should be made available. The recipient may greatly prefer to
3 have the mail used by customers making payments for some reason, for example, and
4 be willing to pay extra to achieve that result. But it is also desirable to have mailers of
5 the reply cards pay for mailing them, in order to have efficient choices made.
6 Developing ways for the Postal Service to discriminate between mailings of differing
7 stamp value at low cost thus is clearly desirable.

8 Many important pricing distinctions, such as a reduction in price for local mail,
9 can be implemented once stamp values can be easily recognized. At present,
10 administrative means of identifying usage of the reply mail, as proposed in this case for
11 PRM and QBRM, impose very large administrative and transaction costs. In the case
12 of QBRM, for example, the proposed 6 cents per piece charge to identify the mail that is
13 to be discounted will cost twice as much as the 3 cent discount per piece that is to be
14 granted. In the case of PRM, the \$1,000 monthly fee means that a mailer needs to
15 save 3 cents--the discount per piece--on more than 33,333 pieces of mail per month in
16 order to break even.

17 Low cost methods of distinguishing the stamp value on mail, such as a separate
18 mail receptacle for local mail, have been proposed before. Of course these methods
19 require that regular First Class mail be screened to ensure that a local mail stamp
20 would not be used for non-local mail. Screening is a general problem that already
21 exists, because there are stamps in use with a face value less than 32 cents and the
22 Postal Service must ensure they are not used to obtain a 32 cent service. It would

- 1 appear that such screening is feasible because it already occurs. Allowing reply
- 2 mailers to decide for themselves whether to mail a courtesy reply envelope at a
- 3 reduced rate would also appear to be feasible, and its efficiency benefits are clearly
- 4 desirable.

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 Faculty of Arts and Sciences Promotion and Tenure Committee (1977-79; 1993-94)
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 Faculty of Arts and Sciences Steering Committee (1988-90)
 Faculty Senate (1989-96)
 Faculty Senate Committee on Faculty Relations (1989-93)
 Faculty Senate Committee on Program Planning (1994-96)
 Director of Program for New Arts and Sciences Chairs (1991, 1992)
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 (Chair) (1992-93)
 Faculty of Arts and Sciences Budget Committee (1992-94)
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 Council of Economic Advisors (1974)
 Postal Rate Commission (1975, 1994, 1995)
 Virginia State Corporation Commission (1975, 1977)
 Electricity Costs Commission of Virginia (1975)
 Civil Aeronautics Board (1977, 1978)
 Virginia Attorney General's Energy Advisory Council (1978-80)
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Bruce Johnson, "Regulation of the Intercity Bus Industry: A Comparison of the Public Interest Theory and the Economic Theory of Regulations," 1984.

Jeffrey Eisenach, "Auto Insurance Ratemaking under Antitrust Immunity," 1985.

John Mullahy, "Cigarette Smoking: Habits, Health Concerns and Heterogeneous Unobservables in a Microeconomic Analysis of Consumer Demand," 1985.

Patricia Clifford, "An Econometric Analysis of Merit Pay for Teachers," 1987.

Walter D. Strack, "Productivity, Technological Change, and Regulatory Reform in the Interstate Trucking industry: General Freight Carriers from 1974 to 1982," 1987.

Michael R. Kehoe, "The Choice of Format and Advertising Time in Radio Broadcasting," 1989

David C. Huffman, "Community Influence Over the Pattern of Firm Location," 1990.

Richard Shipe, "Cost and Productivity in the US. Urban Bus Transit Sector, 1978-1989," 1992.

Zhenhui Xu, "Essays on the Economy of China in the 1980's," 1993.

R. David Mullin, "Enhancing Taxpayer Compliance: Experimental Evidence on Alternative Policies," 1993.

Roger Rodriguez, "The Purchase of Power by Rate-of-Return Regulated Electric Utilities," 1996.

1 CHAIRMAN GLEIMAN: Mr. Richardson, we have two
2 copies of the corrected, what I believe are the corrected
3 designated written cross-examination of Witness Sherman and
4 also you are going to provide, I presume, a statement of
5 authenticity with regard to that at the same time?

6 MR. RICHARDSON: That's correct.

7 CHAIRMAN GLEIMAN: If that is the case, then I
8 will direct that the written cross-examination of Witness
9 Sherman be admitted into evidence and transcribed into the
10 record at this point in time, and we will look forward to
11 receiving the certificates of authenticity.

12 Thank you.

13 [Designation of Written
14 Cross-Examination of Roger Sherman,
15 OCA-T-300, was received into
16 evidence and transcribed into the
17 record.]

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

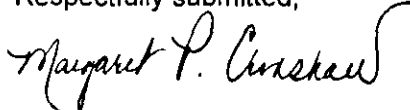
Postal Rate and Fee Changes, 1997

Docket No. R97-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF OFFICE OF THE CONSUMER ADVOCATE
WITNESS ROGER SHERMAN
(OCA-T300)

<u>Party</u>	<u>Interrogatories</u>
Advo, Inc.	ADVO/OCA-T300-1-3, 5
Mail Order Association of America	ADVO/OCA-T300-1-5 NAA/OCA-T300-1-6 USPS/OCA-T300-1-9
Newspaper Association of America	NAA/OCA-T300-1-6 USPS/OCA-T300-4-5, 10
United States Postal Service	ADVO/OCA-T300-1-5 NAA/OCA-T300-1-6 USPS/OCA-T300-1-10

Respectfully submitted,



Margaret P. Crenshaw
Secretary

INTERROGATORY RESPONSES OF
OFFICE OF THE CONSUMER ADVOCATE
WITNESS ROGER SHERMAN (T300)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory:

ADVO/OCA-T300-1
ADVO/OCA-T300-2
ADVO/OCA-T300-3
ADVO/OCA-T300-4
ADVO/OCA-T300-5
NAA/OCA-T300-1
NAA/OCA-T300-2
NAA/OCA-T300-3
NAA/OCA-T300-4
NAA/OCA-T300-5
NAA/OCA-T300-6
USPS/OCA-T300-1
USPS/OCA-T300-2
USPS/OCA-T300-3
USPS/OCA-T300-4
USPS/OCA-T300-5
USPS/OCA-T300-6
USPS/OCA-T300-7
USPS/OCA-T300-8
USPS/OCA-T300-9
USPS/OCA-T300-10

Designating Parties:

ADVO, MOAA, USPS
ADVO, MOAA, USPS
ADVO, MOAA, USPS
MOAA, USPS
ADVO, MOAA, USPS
MOAA, NAA, USPS
MOAA, NAA, USPS
MOAA, NAA, USPS
MOAA, NAA, USPS
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MOAA, USPS
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MOAA, USPS
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MOAA, USPS
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MOAA, USPS
MOAA, USPS
NAA, USPS

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES ADVO/OCA-T300-1-5

ADVO/OCA-T300-1. On pages 4-5, you state:

"If the Postal Service were to set prices for all mail service subclasses at their marginal costs (represented, say, by accurate volume variable costs), the outcome would be efficient. . . . But a large deficit would result. . . . Such a deficit can be avoided by pricing above marginal cost, but doing so will cause welfare losses. . . . The remarkable property of Ramsey prices is that they minimize the resulting welfare losses."

If postal prices were marked up on the basis of marginal cost (represented by volume variable cost) and then compared to incremental cost, please confirm that the USPS and the Commission could then determine the welfare losses resulting from pricing above marginal cost and could also avoid subsidies between classes and subclasses. If you cannot, please explain why not.

A. Confirmed.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES ADVO/OCA-T300-1-5

ADVO/OCA-T300-2. Please refer to your discussion at page 38 on Efficient Component Pricing (ECP) which was first applied to telephone company ratemaking. Assume a telephone company faced strong competition for its long-distance service and was facing competition for some of its local service customers as well. Assume also that local service is characterized by scale cost economies. Under that scenario,

- (a) In developing efficient (welfare-loss minimizing) local service prices, would the company and its regulator subsidize long-distance service with higher rates from local service, parts of which face competition? Please explain.
- (b) In developing efficient (welfare-loss minimizing) local service prices, should the company and its regulator consider the cost and demand characteristics of various categories of local customers, specifically including the group of local customers that may be subject to competitive diversion? Please explain.
- (c) Would it be efficient (welfare-loss minimizing) for local service prices to be the same for all local customers, regardless of their cost and demand characteristics? Please explain.
- (d) Would it be efficient (welfare-loss minimizing) for the company to try to increase contribution to common costs from local customers who were most subject to competitive diversion, and to reduce contribution from local customers who were least subject to competitive diversion? Please explain.

A. (a) There is no reason why the company or its regulator would subsidize long-distance service with higher rates from local service.

(b) Yes, cost and demand conditions influence efficient prices. Optimal pricing in the presence of nonzero cross elasticities, from either a private sector competitor or a complementary service, can be complicated. For example, the positive cross elasticity with a private sector substitute can make the Ramsey price higher than the own price elasticity alone would imply.

(c) If different local services had different cost and demand characteristics, it would probably not be efficient to ignore such information while attempting to set efficient prices. As noted in my answer to (b) above, cost and demand conditions are

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES ADVO/OCA-T300-1-5

important to efficient pricing.

(d) As noted in my answer to (b) above, optimal pricing when there are nonzero cross elasticities with private sector goods or services (substitutes or complements) can be complicated. It seems unlikely that more contribution should be recovered from customers most subject to competitive diversion, but any answer will depend on the starting point for the analysis and on the other facts of a specific case.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES ADVO/OCA-T300-1-5

ADVO/OCA-T300-3. On page 49, you state: "Worksharing has become a significant factor in postal operations and that makes a Ramsey basis for pricing it a very desirable goal." Do you believe that Ramsey pricing should play a role in developing efficient pricing within a subclass?

A. Yes, Ramsey pricing is attractive because it will raise necessary contribution with the least possible welfare loss.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES ADVO/OCA-T300-1-5

ADVO/OCA-T300-4. On page 47, you state: "The Ramsey pricing problem for worksharing might be formulated in different ways. One possible way has been discussed so far, to consider single-piece letters and worksharing letters as two services." In implementing such a system,

- (a) Would you envision explicitly estimating separate Ramsey base and discounted prices? Please explain.
- (b) Would USPS marginal costs be measured separately for each service? Please explain.
- (c) Would the marginal costs for non-workshared and workshared mail be separately marked up to determine base and discounted prices, respectively? Please explain.

A. (a) I noted both before and after the quoted passage that there are problems in considering regular letters and worksharing letters as two services. I offered in the next paragraph a formulation in which the single-piece, or base rate would determine the volume of letters and the discount would determine the volume of workshared letters. In that formulation, separate base and discount prices could be sought. The base price for single-piece letter mail could be determined without concern for worksharing. Then the worksharing response of mailers to various discounts would yield a supply elasticity that could be used -- along with information on the cost savings from worksharing -- to determine an optimal discount. Both the base price and the discount could then be obtained by applying Ramsey pricing principles.

(b) USPS marginal cost for letter mail would be used, along with estimates of the cost savings that worksharing would make possible.

(c) With this formulation of the problem, the marginal cost of letter mail would be marked up to obtain the base price. The worksharing discount would be some fraction of the cost savings, which effectively would be passed to mailers in exchange

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES ADVO/OCA-T300-1-5

for their worksharing. Thus, both regular mailers who paid the base price, and worksharing mailers who received the discount, would make contributions to institutional costs.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES ADVO/OCA-T300-1-5

ADVO/OCA-T300-5. On page 50, you state:

"As emphasized by Postal Service Witness Panzer (USPS-T-11, p. 41), cost estimates should be based on a Postal Service operating plan, in order to yield consistent results. Of course, this operating plan may not deal with questions that the estimation of incremental cost invites – such as the actions that would be taken if First Class Mail was eliminated – because the operating plan does not extend to such possibilities. While intelligent interpretation of the existing cost system may allow reasonable approximations of incremental costs, limitations of the system need also to be recognized. The cost system was not designed to produce incremental cost estimates, and more attention to this purpose is desirable."

Assume that if First Class Mail were eliminated from the system, the remaining system could be restructured to save additional costs beyond those estimated on the basis of the operating plan. Would incremental cost estimates that ignore such system reconfiguration cost reductions be considered long-run incremental costs? Please explain.

A. The situation described in this question presumes that the operating plan does not fully reflect the savings that might be experienced on eliminating First Class Mail. If that is actually the case, then the operating plan will not reliably support good estimates of long-run incremental costs.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES NAA/OCA-T300-1-6

NAA/OCA-T300-1. Please refer to the statement at the bottom of page 5 of your direct testimony.

"If cross elasticities of demand are zero, *as is true for most subclasses of mail*, the Ramsey price takes an especially simple form..." (emphasis added)

- a. Please indicate the evidence upon which you based your conclusion that the elasticities of demand are zero for most subclasses of mail.
- b. If two subclasses of mail offered very similar services, is it reasonable to conclude that the cross elasticities of demand are zero? Please explain fully.
- c. Consider Standard A ECR mail and Standard A Regular mail. Both subclasses contain automated presorted letter mail. Is it reasonable to conclude that the cross elasticities of demand are zero for these two subclasses of mail? Please explain fully.

A. a. I did *not* conclude that elasticities of demand are zero for most subclasses of mail, and the quoted passage from my testimony does not say I do. In the quoted passage I say that most *cross* elasticities of demand are zero and I base that statement on the Postal Service demand estimates. (I acknowledge in Section 2.1, "Costs, Prices, Volumes and Demand Functions," at p. 7, that I rely on estimates of Postal Service witnesses Thress (USPS-T-7) and Musgrave (USPS-T-8)). Of the 21 subclasses I examined, a nonzero cross elasticity of demand was reported for only 6.

b. If two subclasses of mail offered services so similar in quality and price that one was a good substitute for the other, it would be reasonable to expect a positive cross elasticity between them. But whether a positive cross elasticity exists is an empirical question.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES NAA/OCA-T300-1-6

c. I am in no position to judge whether Standard A ECR mail and Standard A Regular mail have nonzero cross elasticities of demand. I have not estimated demands or examined data that would bear on the question.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES NAA/OCA-T300-1-6

NAA/OCA-T300-2. At page 17 of your direct testimony, you state that "[t]he Postal Service must serve goals beyond economic efficiency."

- a. In your view, what weight should these non-economic goals receive in the rate setting process?
- b. Did you consider what level of welfare loss is acceptable to achieve these non-economic goals of the Postal Reorganization Act? If so, please state the dollar amount of welfare loss that you find acceptable to meet the non-economic goals specified in the Act.

A. a. My view of the importance of noneconomic goals in statutory postal pricing guidelines does not seem relevant. As an economist my knowledge probably biases me toward economic goals I know about and I am not fully informed about the noneconomic goals the Postal Rate Commission must also evaluate.

b. I did not make any judgment about what economic loss is acceptable in order to achieve noneconomic goals. I attempted to estimate the economic losses that result when departures are made from Ramsey prices, without making a judgment as to what is acceptable.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES NAA/OCA-T300-1-6

NAA/OCA-T300-3. Please refer to page 21 of your direct testimony. Assume that there is a positive and significant cross price elasticity between Standard A ECR mail and Standard A Regular mail. What effect would this cross elasticity of demand have on the "Pure Ramsey" results in Column (1) of your table?

A. The existence of positive cross elasticities of demand between Standard A ECR mail and Standard A Regular mail would ordinarily lead to increases in the pure Ramsey prices for both services. (To illustrate, start from prices for two services that would be appropriate without positive cross elasticities. Then have the positive cross elasticities come into existence. With those positive cross elasticities, increasing prices of both services will be beneficial because raising the price of each service will now increase the demand for the other.)

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES NAA/OCA-T300-1-6

NAA/OCA-T300-4. Please refer to page 26 of your direct testimony. You state that "[I]t should be noted that these estimates still depend on the demand functions that have been estimated and are assumed to hold." Is it reasonable to assume that the demand functions will hold when some of the average rates shown in Table 3, notably for Periodicals, are far in excess of the historic rates used to estimate the demand equations? Please explain your response fully.

A. The estimated demand functions for postal services generally afford a sound basis for predictions of responses to alternative prices. It is true that the predictions will be less reliable when they are based on prices outside the range of data used for the demand estimates. But it is reasonable to trace out the predictions as expected outcomes, even though they may be subject to greater error.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES NAA/OCA-T300-1-6

NAA/OCA-T300-5. Please refer to page 41 of your direct testimony. You state:

"Cross elasticities lack this stabilizing property of own-price elasticities, because they simply intrude into other markets. When they are large they can overwhelm the own-price effects and prevent an equilibrium, which, in turn, can prevent the calculation of Ramsey prices."

- a. If there exist significant, positive cross elasticities of demand among two or more of the subclasses shown in Table 3 at page 21, could these cross elasticities prevent the calculation of Ramsey prices? Please explain why or why not.
- b. If the existence of significant, positive cross elasticities of demand prevented the calculation of Ramsey prices, how do you recommend setting the prices for the subclasses affected?

A. a. As long as the cross elasticities are smaller than the elasticities in absolute value, no problem should follow in reaching an equilibrium. The reason is that a service's own price performs an equilibrating role in its market. And as long as those own-price effects are larger (in absolute value) than cross-price effects, the own-price effects will produce an equilibrium. After all, when the price of a service rises, that discourages consumption of the service. This feedback in response to the price change tends to force moderation, or at least some limitation, on the price that can be set for the service in question, and that restraint moves the market toward an equilibrium, or a general solution that matches supplies and demands. When a price rises that affects consumption in some *other* market, there is no similar feedback. Because the effect is not where the price is adjusted, but instead is elsewhere, it does not force any limitation on the price being set. And if such cross-price effects are large, price changes in one market can throw off other markets where their effects are felt, and upset the general equilibrium among a set of markets.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES NAA/OCA-T300-1-6

b. If cross elasticities are larger than own-price elasticities, no solution may be possible, unless the cross elasticities happen to balance each other in just the right way. Since we do not observe such situations in the world, we tend to expect cross elasticities will be smaller than own-price elasticities, and solutions will then be possible. It is also reasonable that a service's own price will affect its use more than will the price of some other service. We can obtain Ramsey prices in the conditions underlying Table 3. If cross elasticities were so large that a solution would not exist, we simply could not obtain Ramsey prices.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES NAA/OCA-T300-1-6

NAA/OCA-T300-6. Are you recommending that the Commission adopt any form of Ramsey pricing in this proceeding? If so, please state specifically what you are recommending the Commission adopt in this proceeding.

A. My purpose was to review theoretical foundations for Postal Service pricing proposals, and to estimate the welfare cost of departing from Ramsey prices. I did not recommend a specific set of prices.

**ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T300-1-9**

USPS/OCA-T-300-1. Please confirm that Table 3 on page 21 of your testimony shows that limiting the Ramsey price of Periodicals Regular mail (i.e., imposing the "too high" constraint) has the effect of moving the constrained Ramsey prices of Periodicals In-County, Periodicals Nonprofit, and Periodicals Classroom Rate mail closer to their unconstrained Ramsey prices. If you cannot confirm, please explain fully.

A. Confirmed.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T300-1-9

USPS/OCA-T300-2. Please refer to Table 3 at page 21 of your testimony.

- a. Please confirm that the Model (3) Ramsey average revenues for Periodicals In-County, Nonprofit, and Classroom Rate mail are 0.1928, 0.3281, and 0.5759, respectively. If you cannot confirm, please give the correct figures.
- b. Please confirm that the Model (4) Ramsey average revenues for Periodicals In-County, Nonprofit, and Classroom Rate mail are 0.1416, 0.2409, and 0.4229, respectively. If you cannot confirm, please give the correct figures.

A. Because of a production error during the filing of my direct testimony, there are small errors in many of the values in these tables, and significant errors in Model (4) Ramsey Contributions (Table 5). Corrected tables are being filed as errata to my direct testimony. The disk in library reference OCA-LR-5 contains correct figures.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T300-1-9

USPS/OCA-T300-3. Please refer to Table 5 at page at page 34 of your testimony.

- a. Please confirm that the Model (3) Ramsey contributions from Periodicals In-County, Nonprofit, and Classroom Rate mail are \$61.874 million, \$319.668 million, and \$4.630 million. If you cannot confirm, please give the correct figures.
- b. Please confirm that the Model (4) Ramsey contributions from Periodicals In-County, Nonprofit, and Classroom Rate mail are \$70.317 million, \$374.470 million, and \$4.931 million. If you cannot confirm, please give the correct figures.
- c. Please explain how it is possible for the Model (4) Ramsey contributions from Periodicals In-County, Nonprofit, and Classroom Rate mail to be greater than the Model (3) Ramsey contributions from these mail subclasses, when Table 3 shows that the Model (4) average revenues of each these mail subclasses is less than their Model (3) average revenues.

A. a. There are small errors in many of the values in Tables 3-6, and significant errors in Model (4) Ramsey Contributions (Table 5). Corrected tables are being filed as errata to my direct testimony. The disk in library reference OCA-LR-5 contains correct figures.

b. Model (4) Ramsey contributions from Periodicals In-County, Nonprofit, and Classroom Rate mail are \$36.458 million, \$171.581 million, and \$3.333 million.

c. The contributions in revised Table 5 are lower under Model (4) than under Model (3), as is to be expected.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T300-1-9

USPS/OCA-T300-4.

- a. Please confirm that if the pricing criteria of the Act, such as educational, cultural, scientific, and informational (ECSI) considerations, are interpreted to require that the mark-up on Periodicals Regular mail should be less than its Ramsey mark-up, then the most efficient way of recouping the lost contribution from Periodicals Regular mail is from relatively larger increases in the prices of less elastic mail (e.g., First-Class letters) and relatively smaller increases in the more elastic mail (e.g., Standard A Enhanced Carrier Route mail). If you cannot confirm, please explain fully.
- b. Please confirm that for any given amount of reduced contribution from Periodicals Regular mail (relative to its unconstrained Ramsey contribution) based on the pricing criteria of the Act, a constrained Ramsey model should indicate the most efficient way to spread that required contribution increase over the other classes and subclasses. If you cannot confirm, please explain fully.

A. a. It is true that if the markup on Periodicals Regular mail was held at *less* than the Ramsey markup, efficient pricing to make up the lost revenue would call for relatively larger increases for other mail services with less elastic demands. But the Revenue Forgone Reform Act (RFRA) *raises* the markups for Periodicals mail relative to their pure Ramsey levels. RFRA reduces markups on Standard A Nonprofit and Nonprofit Enhanced Carrier Route so much that the rate for Periodicals Regular mail, which has relatively less elastic demand, increases to replace their lost contribution. The rise in markup of Periodicals Regular mail in turn raises markups for all other Periodicals subclasses under the RFRA, and the result is higher markups also in those subclasses than pure Ramsey prices would call for.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T300-1-9

b. I can confirm that if constraints on prices must be imposed, after their effects are taken into account, constrained Ramsey prices will raise necessary revenue most efficiently. In the Periodicals example, however, the effect of RFRA alone would be to increase the revenue from Periodicals Regular rather than to reduce it.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T300-1-9

USPS/OCA-T300-5. Please confirm that if the unconstrained Ramsey price of a mail product is below the product's average incremental cost, then pricing the product at its average incremental cost is more efficient than pricing the product above its average incremental cost. If you cannot confirm, please explain fully.

A. Confirmed. In this example, pricing *at* incremental cost is closer to Ramsey pricing than pricing *above* incremental cost.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T300-1-9

USPS/OCA-T300-6. Please confirm that Ramsey pricing of single-piece and workshared letters cannot be less efficient (in terms of total consumer and producer surplus) than imposition of the efficient component pricing rule in which the discount for workshared letters is set equal to the cost difference between single-piece and workshared letters. If you cannot confirm, please explain fully.

A. Confirmed. Ramsey pricing should only improve efficiency.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T300-1-9

USPS/OCA-T300-7. Please confirm that price elasticities of demand are important to the efficient pricing of single-piece and workshared letters, and to the establishment of the efficient discount for workshared letter mail. If you cannot confirm, please explain fully.

A. Confirmed in part. Price elasticities of demand are important to the pricing of single-piece and workshared letters, but those currently available and used by the Postal Service may not be the ideal ones to use. A willingness on the part of mailers to supply worksharing services, represented in the form of a supply elasticity, may also be important.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T300-1-9

USPS/OCA-T300-8.

a. If there exist two mail categories, A and B, and the volume of each category does not depend on the price of the other or on the price difference between the two mail categories, then please confirm that there is no cross-price or discount elasticity between these two products. If you cannot confirm, please explain fully.

b. Please confirm that if there are no cross-price or discount elasticities between two mail categories, then the efficient prices of these mail categories should be based on their own-price elasticities and own marginal costs, and not on the cost difference between the two mail categories. If you cannot confirm, please explain fully.

A. a. Confirmed.

b. It is possible that the marginal cost of one of the two services can be estimated best from knowledge of a second service's marginal cost and the difference in the two services' marginal costs. In that case the difference in marginal costs would have an influence on price.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T300-1-9

USPS/OCA-T300-9. Have you performed any independent econometric analysis of the price elasticities of First-Class single-piece letters or First-Class workshared letters? If so, please provide a brief summary, and the statistical results of that analysis.

A. No.

ANSWER OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORY USPS/OCA-T300-10

USPS/OCA-T300-10. Please refer to your response to USPS/OCA-T300-8(b). In that subpart, when asked about the efficient pricing of two mail categories in the absence of any cross-price or discount elasticities, you stated that it is "possible" that the marginal cost of one of the two services can be estimated best using information about the other service's marginal cost and the cost difference.

(a) If that possibility were not the case, and you had no reason to believe that the best estimate of the marginal cost of either service came from anywhere other than direct measurement of the marginal cost of that service itself, would you then agree that the efficient prices of these mail categories should be based on their own-price elasticities and own marginal costs, and not on the estimated cost difference between the categories? If you do not agree, please explain fully.

(b) Would you agree that difficulties in measuring or estimating marginal costs may be more of a concern when mail pieces with potentially different cost characteristics are shifting between categories on the basis of relative prices, and are likely to be less of a concern when there is no shifting between categories on the basis of relative price, as assumed in these questions? If you do not agree, please explain fully.

A. (a) If two services have demands that are independent and costs that are totally separate and unrelated, and costs are best estimated by examining the services independently, then it is true that efficient prices could be properly based on each service's cost and demand. The original question in USPS/OCA-T300-8(b) asked me to confirm that the absence of cross-price or discount elasticities between two mail categories alone would make efficient prices free from effects of cost differences, and this claim I could not confirm. With demand independence it is still possible for the cost difference to be relevant. For example, consider a case in which the demand for all letter mail is estimated without any cross-elasticity effect. Suppose that worksharing is offered as an option, and those who workshare are granted a discount from the regular letter-mail rate. The amount of worksharing might then be explained by a supply elasticity, reflecting the response of worksharing mailers to the discount. There is no

ANSWER OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORY USPS/OCA-T300-10

cross elasticity, but the discount clearly should depend on the cost difference.

(b) If mail pieces with potentially different cost characteristics are grouped together in the same mail category, estimating costs for the mail category may be difficult. Merely having a change in the mixture of the pieces can affect measured cost, which is undesirable. And if pieces are shifting between classes when relative prices change, that may cause costs to be badly estimated, since they would have been based on the mixture before the shift. Such shifting is possible, but I didn't think it had always been "assumed in these questions."

1 CHAIRMAN GLEIMAN: Mr. Burzio, would you like to
2 identify your witness, so that I might swear him in?

3 MR. BURZIO: Good morning, Mr. Chairman.

4 For the record, I am John Burzio, representing
5 Time-Warner. Appearing with me today is my partner, Tim
6 Keegan --

7 CHAIRMAN GLEIMAN: We are just not used to hearing
8 mind-mannered attorneys.

9 MR. BURZIO: Our witness today is Halstein
10 Stralberg.
11 Whereupon,

12 HALSTEIN STRALBERG,
13 a witness, was called for examination by counsel for
14 Time-Warner, Inc. and, having been first duly sworn, was
15 examined and testified as follows:

16 CHAIRMAN GLEIMAN: Mr. Burzio?

17 DIRECT EXAMINATION

18 BY MR. BURZIO:

19 Q Please state your name and occupation for the
20 record?

21 A My name is Halstein Stralberg. I am a Senior
22 Scientist at Universal Analytics in California.

23 I am a mathematician and a management consultant.

24 Q Do you have with you a document entitled "Direct
25 Testimony of Halstein Stralberg" which has been marked for

1 identification as TW-T-1?

2 A Yes, I do.

3 Q Did you prepare that document?

4 A Yes, I did.

5 Q Do you have any corrections or revisions to make
6 to it?

7 A Yes. I have, first of all, one minor typing error
8 that I was alerted to yesterday, which is in Footnote 2 on
9 page 8, where there is a reference to the Commission's R94
10 decision.

11 It says R9401 and it should be R94-1.

12 In addition to that, there were some revisions
13 filed on February 20th that corrects a spreadsheet error in
14 the preparation of the tables in A-6 and A-7 of my Appendix
15 A, which basically caused some misallocation of mixed mail
16 costs with activity codes 5301 to 5345.

17 Those are the mixed mail codes that result from
18 counted items.

19 In addition to the two tables, there were some
20 other tables that needed minor revisions, and this has all
21 been included in the testimony, in the current copy of the
22 testimony, I believe, but also Tables 1.1, 1.3, 1.4, 2.1,
23 3.1, A-9 and B-7 required some revisions.

24 Q Would you state for the record what the effect of
25 those changes was?

1 A Well, it essentially -- yes -- it does not really
2 effect the conclusions in my testimony.

3 It does reduce the attribution I proposed for
4 First Class mail by about \$4.4 million. It reduces
5 periodicals costs by about \$0.8 million. It raises Standard
6 A mail costs by \$5.3 and reduces Standard B costs by
7 \$38,000.

8 That is the extent of the effect.

9 Q With those corrections and revisions, if you were
10 to testify orally here today, would your testimony be the
11 same as contained in this document?

12 A Yes, it would.

13 MR. BURZIO: Mr. Chairman, I move that TW-T-1 be
14 received in evidence and transcribed in the record.

15 CHAIRMAN GLEIMAN: Are there any objections?

16 Hearing none, Mr. Stralberg's testimony and
17 exhibits are received into evidence and I direct that they
18 be transcribed into the record at this point.

19 [Direct Testimony and Exhibits of
20 Halstein Stralberg, TW-T-1, was
21 received into evidence and
22 transcribed into the record.]

23

24

25

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

POSTAL RATE AND FEE CHANGES, 1997

Docket No. R97-1

DIRECT TESTIMONY
OF
HALSTEIN STRALBERG

ON BEHALF OF
TIME WARNER INC.

CONCERNING
DISTRIBUTION OF CLERK AND MAILHANDLER COSTS

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DECEMBER 30, 1997

TABLE OF CONTENTS

	<u>Page:</u>
AUTOBIOGRAPHICAL SKETCH	1
I PURPOSE OF TESTIMONY	3
II SUMMARY.....	3
III BACKGROUND.....	6
IV COST POOLS.....	9
V MIXED MAIL COSTS	12
A. MIXED AND EMPTY ITEM COSTS	15
1. Mixed Item Costs	15
2. Empty Item Costs	18
B. MIXED AND EMPTY CONTAINER COSTS	19
1. Mixed Container Costs	19
2. Empty Container Costs	23
C. PALLETS SHOULD BE TREATED AS CONTAINERS	23
D. MIXED MAIL SUMMARY	25
VI NOT HANDLING COSTS	26
A. AUTOMATION HAS CAUSED A LARGE INCREASE IN NOT HANDLING COSTS, MUCH OF WHICH THE LEAST AUTOMATED MAIL HAS WRONGLY BEEN FORCED TO ABSORB	27
B. DEGEN'S POOL-BY-POOL METHOD FURTHER DISTORTS THE RELATIONSHIP BETWEEN DIRECT AND NOT HANDLING COSTS...	32
1. The Pool-By-Pool Approach Unfairly Attributes Excessive Not Handling Costs To The Least Automated Mail	32
2. Degen Ignores All Information About The Nature Of Each Type Of Not Handling Activity	33
a. Class And Activity Specific Not Handling Costs	33
b. Shape Specific Not Handling Costs	34
c. General Overhead Not Handling Costs	35
d. Not Handling Costs Related To Special Services	36
C. A BETTER WAY TO DISTRIBUTE NOT HANDLING COSTS	37
VII CONCLUSIONS.....	38

LIST OF EXHIBITS

		<u>No. Of Pages:</u>
1.	ALTERNATIVE ATTRIBUTION OF MAIL PROCESSING COSTS....	5
2.	MODIFIED ATTRIBUTION OF BY96 SEGMENT 3 COSTS	1
3.	ATTRIBUTED BY96 CLERK & MAILHANDLER WAGE COSTS	1
4.	DIRECT, COUNTED, UNCOUNTED & EMPTY ITEM COSTS	3
5.	DIRECT & COUNTED ITEM COSTS BY MAJOR CLASS	2
6.	COSTS OF LOOSE ITEMS AND ITEMS IN CONTAINERS AT MODS COST POOLS	3

LIST OF APPENDICES

		<u>Page:</u>
A.	DATA SOURCES AND METHODOLOGY	A-1
1.	SAS Programs Used To Access The IOCS Data Base	A-1
2.	Spreadsheets.....	A-2
3.	IOCS Tally Costs And Volume Variable Costs	A-3
4.	Use Of CAG And Basic Function	A-4
a.	Distribution Within CAG	A-4
b.	Distribution Within Basic Function	A-5
5.	Distribution Of Mixed Mail And Not Handling Costs	A-6
a.	Mixed Mail Costs	A-6
b.	Window Service And Administration - Support Costs	A-7
c.	Specific Class Or Service Related Costs	A-7
d.	Shape Related Not handling Costs	A-8
e.	Mixed Shapes And Overhead Costs	A-9
f.	Other Not Handling Costs	A-10
6.	Further Mail Processing Cost Adjustments	A-12
B.	WINDOW SERVICE AND ADMINISTRATIVE COSTS	B-1
1.	Window Service Costs	B-2
2.	Administration - Support Costs	B-3
3.	Reallocated Overhead Costs	B-6

LIST OF TABLES

		<u>Page:</u>
	Direct & Counted Item Costs All Offices	16
	Direct And Loose-In-Container Item Costs At MODS Platforms/Opening Units	21
A-1	Class/Service Specific Not Handling Costs (All Offices)	A-8
A-2	Mixed & Overhead Not Handling Mail Processing Costs	A-9
A-3	Direct, Mixed & Not Handling Costs By CAG	A-13
A-4	Shape Related Direct & Not Handling Costs in MODS Cost Pools	A-14
A-5	Distribution Of MODS Direct, Mixed And Not Handling Costs	A-15
A-6	Distribution Of NonMODS Direct, Mixed And Not Handling Costs	A-16
A-7	Distribution Of BMC Direct, Mixed And Not Handling Costs	A-17
A-8	LIOCATT Based Distribution Keys For Certain Not Handling Costs	A-18
A-9	Adjustments To Redistributed Mail Processing Costs	A-19
B-1	Not Handling Costs That Should Be Returned To Segments 3.2 & 3.3 ...	B-1
B-2	Window Service Costs Returned To Segment 3.2	B-9
B-3	Modified Attribution Of Window Service Costs	B-10
B-4	Administration - Support Costs Returned To Segment 3.3	B-11
B-5	Distribution Of Reassigned Administration - Support Costs To Sub- Segments	B-12
B-6	Reassignment Of 6522 (Clocking In/Out) Costs - MODS Offices	B-12
B-7	Modified Attribution Of Administration - Support Costs	B-13

1 AUTOBIOGRAPHICAL SKETCH

2 My name is Halstein Stralberg. I am the manager of the Operations Research Division at
3 Universal Analytics, Inc. (UAI), a management consulting firm in Torrance, California.

4 My academic background is in mathematics, with a master's degree from the University of Oslo,
5 Norway in 1963. I received a bachelor's degree in mathematics, physics and astronomy at the
6 University of Oslo in 1961. Most of my professional experience is in the area of management
7 science and operations research. I have directed and performed over 20 years of postal related
8 studies as well as a number of management studies for other clients in government and private
9 industry, in such diverse fields as production scheduling and control, corporate planning and
10 finance, investment analysis, design and optimization of transportation systems, health care and
11 computer system design.

12 I have previously presented a total of 15 pieces of testimony before this Commission on a variety
13 of postal costing and rate design issues. Two were rebuttal testimonies on behalf of the Postal
14 Service in Docket R80-1. I presented four testimonies on behalf of Time Inc. in R87-1, four on
15 behalf of Time Warner Inc. in R90-1, one in MC91-3 two in R94-1 and two in MC95-1.

16 Since 1987 I have directed UAI's activities in support of Time Warner's participation in postal
17 rate cases. Besides the presentation of testimony, I have advised Time Warner on a variety of
18 postal issues and directed the development of computer models for analysis of postal costs and
19 rate design. One of these models is the Universal Mail Flow Model (TW-LR-6), which I used to
20 estimate second-class presort and palletization savings in my R90-1 testimony.

21 From 1973 until 1987, I directed UAI's efforts under several contracts with the U.S. Postal
22 Service. Some of my major activities on these contracts included:

- 23 • Design and development of the Mail Processing Cost Model (MPCM), a weekly staffing
24 and scheduling computer program for postal facilities, with an annualized extension
25 (AMPCM) that uses linear programming to fit long term staffing planning in a postal
26 facility to seasonal variations in volume and personnel absentee/attrition rates.
- 27 • An extensive data collection in 18 postal facilities designed to: (1) establish a Postal
28 Service data base on mail arrival rates and mail attributes affecting costs (subclass,
29 shape, indicia, presort, container method, etc.), and (2) develop the model input data
30 needed to apply MPCM for each facility.
- 31 • The "Study of Commercial Mailing Programs" --under the Long Range Classification

1 Study Program. This study involved a detailed cost and market evaluation of several
2 rates and classification concepts, including various presort concepts, destinating SCF
3 discounts for second class, plant loading and barcoding of preprinted envelopes.

- 4 • A BMC cost analysis which resulted in the establishment of the Inter/Intra-BMC parcel
5 post rate differential in R80-1.
- 6 • Numerous simulation studies requested by postal management using the MPCM.

7 My two rebuttal testimonies on behalf of the Postal Service in R80-1 addressed the Intra/Inter
8 BMC cost analysis and Dr. Merewitz's use of MPCM to analyze peak load costs.

9 I have conducted a number of classes and seminars on the use of MPCM both for Postal Service
10 employees and interested outside parties. I have made extensive visits to more than 30 USPS
11 mail processing facilities, including multiple repeat visits to some of them, the last in September,
12 1996. On these visits I observed all aspects of mail processing operations on all tours, as well as
13 methods of mail collection, acceptance and transportation. I estimate that in total I have spent
14 more than 2000 hours on site in these facilities. I have also observed various ongoing postal data
15 collection systems.

16 Besides my postal activities, I directed a study for the department of Health and Human Services
17 of the impact of alternative regulatory policies used by state Medicaid agencies. This study
18 included an extensive data gathering effort and multiple regression analysis to determine factors
19 influencing utilization and cost in the Medicaid program.

20 Before joining UAI I was an Operations Research Analyst at the Service Bureau Corporation
21 (IBM), where I performed several large-scale simulation studies. These included an analysis
22 during the design stage of the Dallas/Fort Worth Airport's people mover system and simulations
23 to improve design and response time in large interactive computer systems.

24 I was an Operations Research Analyst at Norsk Hydro, a Norwegian petrochemical company,
25 where my work included design, development and implementation of factory production
26 scheduling systems, studies of transportation and distribution systems and risk analysis of
27 investment decisions.

28 For three years I was an assistant Professor of Mathematics at the University of Oslo, Norway.

1 I. PURPOSE OF TESTIMONY

2 In this testimony I comment on the Postal Service's proposed method for distributing
3 Segment 3 costs among subclasses and special services. I identify a number of unstated,
4 unverified and in some cases clearly erroneous assumptions that underlie witness
5 Degen's distribution of mail processing costs based on a combination of MODS and
6 IOCS data.

7 Besides identifying various problems with Degen's method, I offer an alternative
8 approach that, while not fully satisfactory since the available data are wanting in many
9 respects, relies on fewer untested assumptions, is closer to the approach traditionally
10 used by the Commission, and makes use of much information that Degen has chosen to
11 ignore.

12 II. SUMMARY

13 In this docket the Postal Service has introduced two major changes in the treatment of
14 cost segment 3, consisting of clerk and mailhandler wage costs:

15 (1) USPS witness Bradley challenges the long held but untested assumption of 100%
16 variability in most mail processing costs and presents econometric estimates of
17 the volume variabilities for various mail processing operations.

18 (2) USPS witness Degen presents a method of distributing volume variable clerk
19 and mailhandler wage costs that differs significantly from the traditional
20 method.

21 I recommend that the Commission accept Bradley's estimates of volume variability in
22 mail processing as the most accurate available. While I have not analyzed the technical
23 merit of the details in Bradley's econometric method, I firmly believe that he at least is
24 correct in his main conclusion, i.e., that mail processing costs are substantially less than
25 100% volume variable. Besides being intuitively obvious, this is confirmed by the
26 considerable slack time in mail processing evidenced by the large and fast growing pool
27 of break time and other general overhead "not handling" costs identified in IOCS.

28 On the other hand, I have identified many severe problems with Degen's proposed
29 method for distributing mail processing and other segment 3 costs to subclasses and

1 special services, particularly his distribution of mixed mail and not handling costs.
2 Degen, despite claims to the contrary, has not addressed the many complaints about
3 bias in the IOCS raised by Periodicals and other mailers since Docket No. R90-1.
4 Instead, he presents a method that is worse than the traditional IOCS method and
5 requires reliance on numerous unstated, untested and sometimes demonstrably wrong
6 assumptions, while ignoring much useful information recorded by IOCS clerks about
7 the activities that clerks and mailhandlers engage in.

8 By insisting on distributing all mixed mail and not handling costs within a large
9 number of cost pools, Degen ignores all cross-pool cost relationships and introduces
10 significant distortions. His mixed mail method is basically the same method that both
11 the Commission and the Postal Service concluded should not be used in Docket R94-1.
12 Degen's extension of this elaborate but conceptually flawed approach by applying it
13 individually within a large number of MODS cost pools makes it worse, not better. He
14 introduces even more untested and erroneous assumptions by extending this already
15 flawed approach to empty items and containers, which, according to the IOCS data,
16 cost almost as much to handle when empty as when they contain mail.

17 "Not Handling" costs today represent over 42% of all accrued mail processing costs.
18 Degen does not address the reasons why these costs have increased so much, and his
19 approach ignores all distinctions between the 63 different types of not handling activity
20 or inactivity that IOCS clerks observed clerks and mailhandlers engaged in. By
21 distributing them strictly within the cost pools that observed employees happened to be
22 clocked into, Degen assigns an excessive portion of these costs to the highly presorted
23 and least automated mail, which receives a major portion of its handling at platforms
24 and opening units. Those are operations where productivity is not monitored and
25 where employees often are sent when there are no assignments for them elsewhere,
26 leading to very high proportions of not handling being recorded at those operations in
27 the IOCS.

28 The evidence Degen presents to link mixed mail and not handling costs to specific
29 subclasses and special services is so weak that I recommend the Commission consider
30 treating, at least in this docket, even some volume variable costs as institutional. In

1 particular, I have identified \$2,733 million in volume variable (\$3,727 million accrued)
 2 not handling costs, referred to in the following as general overhead costs, that showed a
 3 highly anomalous growth during the past ten years when the automation program was
 4 being implemented. Apart from the historical connection with the automation
 5 program, little is known about the true causes of these sharply increased costs. The
 6 Postal Service apparently has still not seriously analyzed these cost increases. I
 7 recommend that the Commission treat at least some of these costs as institutional, until
 8 the Postal Service produces firm evidence linking them to specific subclasses and
 9 services.

10 Additionally, I propose an alternative method of distributing mail processing and other
 11 segment 3 costs that I urge the Commission to apply to those volume variable costs that
 12 it decides should be attributed. My method uses the same IOCS data, the same accrued
 13 costs and the same volume variability factors that Degen uses, and it attributes the same
 14 proportion of total segment 3 costs. However, it differs from Degen's method in many
 15 important respects. Specifically, I propose that:

- 16 • Mixed mail and not handling costs that are related to specific shape categories
 17 should be distributed based on the direct subclass costs for the corresponding
 18 shapes. The distribution should be performed within facility type (MODS,
 19 BMC and NonMODS), CAG and basic function, but not within MODS cost
 20 pools.
- 21 • All other mixed mail costs should be distributed based on all direct subclass
 22 costs, again within facility type, CAG and basic function.
- 23 • Window service and administration/support related not handling costs that
 24 Degen misclassifies as mail processing costs should be distributed with the
 25 distribution keys traditionally applied to such costs.
- 26 • Not handling costs related to specific subclasses and special services (e.g.,
 27 Express Mail, Registry, P.O. Boxes) should be attributed to those subclasses and
 28 services.
- 29 • General overhead type not handling costs not linked to specific classes or
 30 activities should be distributed based on all direct and mixed mail costs, within
 31 facility type, CAG and, when available, basic function.

32 The method I propose for this docket relies on fewer untested or improbable
 33 assumptions than Degen and is closer to the traditional approach. Yet it is far from
 34 ideal, because much important information needed for accurate cost distribution simply

1 is not available. In order to make possible more accurate cost distributions in the
2 future, the Postal Service must first of all develop a better way to collect data on mixed
3 mail. Some suggested improvements to the current method are described later in this
4 testimony. Secondly, it must address seriously the complaints of anomalously rising
5 costs that Periodicals mailers have raised for a number of years, as well as the true
6 causes for the still ongoing increase in not handling costs. This will require identifying
7 the criteria applied by postal managers both in hiring decisions and in their decisions to
8 assign employees to specific tasks, including their assignment of employees during
9 slack periods when no work is available, and an analysis of the economic impact of such
10 decisions.

11 In Section III I review the background against which the Postal Service's proposal in
12 this docket must be seen, including issues frequently raised by Periodicals mailers that
13 the Postal Service has chosen to ignore. Sections IV, V and VI detail my critique of
14 Degen's approach and explain the differences between his approach and mine with
15 regard to (1) the use of MODS and PIRS cost pool data; (2) mixed mail cost distribution;
16 and (3) not handling cost distribution.

17 Exhibit 1 shows my proposed distribution of mail processing costs, for all postal
18 facilities and separately for MODS offices, BMC's and NonMODS offices. Exhibit 2
19 shows my proposed distribution of all segment 3 costs, as respectively mail processing,
20 window service and administration/support costs. Exhibit 3 compares my proposed
21 distribution of segment 3 costs with that proposed by the Postal Service. Several
22 additional exhibits are included to illustrate specific points in my criticism of Degen's
23 approach. Appendix A describes in detail my methodology and the data sources I
24 relied on. Appendix B describes my proposed method for distributing window service
25 and administration/support related not handling costs.

26 III BACKGROUND

27 In order to view the Postal Service's proposal in this docket in its proper context, one
28 needs to consider the historical developments in mail processing costs, particularly
29 during the past ten years when the Postal Service implemented automation of letter

1 sorting. During that period, Periodicals mailers have seen a highly anomalous increase
2 in the processing costs attributed to them. MPA witness Cohen and industry witnesses
3 Little and Crain present testimony in this docket that reviews these historical
4 developments in detail and expresses the dismay of Periodicals mailers, both about the
5 increasing costs and the Postal Service's continued unwillingness to address this
6 problem. In this section I focus on the historical facts most relevant to my current
7 testimony.

8 In both Dockets R90-1 and R94-1 I testified before this Commission about the sharp and
9 anomalous increases in the mail processing costs for Periodicals, as measured by the
10 IOCS, since FY86. I offered some possible explanations for this phenomenon, including
11 the one that today still appears the most likely: that some of the employees processing
12 Periodicals at manual and mechanized operations are essentially "automation
13 refugees," i.e. employees formerly used for letter sorting, either manually or on LSM's,
14 but no longer needed for those tasks, except, perhaps, during short surge periods before
15 some critical dispatches. The rest of the time, these employees must still be clocked into
16 some operation in order to get paid, and there is strong evidence in this docket that
17 platforms and opening units, as well as manual flats cases, are among the favored areas
18 for employees to spend time when not needed elsewhere. In other words, letter mail
19 automation has had the paradoxical, presumably unintended and unforeseen,
20 consequence that productivity has continually declined at the various manual
21 operations where Periodicals are mostly handled.

22 Between FY86 and FY96, Periodicals processing costs increased much faster than postal
23 wage rates and faster than the costs of all other major mail classes, despite both new
24 technology and increased mailer presorting, barcoding and palletization that should
25 have made the Postal Service's job easier. Closely related to these cost increases have
26 been an increase in "not handling" and other non-productive time and a corresponding
27 decline in productivity at the operations where Periodicals mail is mostly handled.

28 Despite testimony by myself and others in the last two rate cases, despite admonitions
29 by the Commission, despite numerous other attempts by the Periodicals industry to
30 draw management's attention to this very serious issue, there has been no meaningful

1 effort by USPS management to address the problem.

2 In R94-1 it was revealed that the Postal Service had made one major change in its IOCS
 3 procedures since Docket No. R90-1. It had replaced its previous method of collecting
 4 data on mixed mail with an elaborate scheme that required IOCS data collectors to do
 5 considerably more work than previously for each mixed mail tally. Unfortunately, this
 6 scheme was hopelessly flawed in its concept, as I pointed out in my R94-1 rebuttal
 7 testimony.¹ One major flaw is its complete failure to collect any class related
 8 information about mail in containers, which incur most of the mixed mail costs,
 9 apparently based on the belief that such information can be reliably inferred via a series
 10 of proxies. In R94-1 the Postal Service itself declined to use this information, due to
 11 questions about whether the data were really meaningful, and the Commission
 12 concurred that the data should not be used.² In this docket, the Postal Service appears
 13 to have forgotten all its previous reservations about this flawed scheme. As I show in
 14 Section V, implementing this already flawed approach within many cost pools requires
 15 even more unverified assumptions and causes even more biased results.

16 To its credit the Postal Service has in this docket challenged the long held but untested
 17 assumption of 100% volume variability in mail processing. But when it comes to the
 18 still rising Periodicals costs, the Postal Service's refusal to face the issue continues.
 19 Despite all claims to the contrary, Degen neither inquires into nor addresses the reasons
 20 for these rising costs. Instead his methodology not only unquestioningly accepts the
 21 already high Periodicals costs, but would raise them further.³

22 Periodicals mailers understand that in the long run large rate increases cannot be
 23 avoided if costs are allowed to remain out of control. They have been doing their part

¹ TW-RT-1, Rebuttal testimony of Halstein Stralberg on behalf of Time Warner Inc., Docket No R94-1, at 12-13 (Tr. 11851-52).

² Docket No. R94-1, Tr. 1166-71; PRC Op. R94-1 at III-22-23.

³ While the mail processing costs attributed by Degen to Periodicals are about the same as under the old methodology used in FY96, this must be seen against a background of much lower systemwide attribution levels. In other words, Degen has in reality increased Periodicals mail processing costs substantially.

1 to reduce their costs. The Postal Service, however, seems more concerned with its wish
2 to announce savings realized by automation. To support such claims, it proposes a new
3 cost distribution method that, unjustifiably and uncritically, shifts large amounts of
4 costs onto the mail that is still mostly sorted manually.

5 In fact, Degen has not addressed any of the major issues raised by Periodicals mailers.
6 "Not handling" costs are today larger than ever, and neither Degen nor the Postal
7 Service has made any serious effort to determine why they are so high or why they
8 keep rising. The best that can be said of Degen's approach is that it compiles data
9 showing which cost pools MODS employees are clocked into when they don't handle
10 mail. But Degen draws the wrong conclusion from this data. He ignores all available
11 information about what employees were actually doing while not handling mail,
12 assuming instead that the not handling costs within a cost pool are caused exclusively
13 by the direct and mixed mail processed within that same pool. Degen is not interested
14 in whether an employee was selling stamps, doing general administrative work,
15 monitoring an automated letter sorting machine or on break, relying instead on the
16 overriding assumption that not handling costs are causally related only within each cost
17 pool.

18 In trying to make better sense of the data presented by Degen in this docket, I have
19 come to conclude that there simply is no fully satisfactory way to distribute mail
20 processing costs based on the information available. Despite having spent millions of
21 dollars collecting mixed mail data, the Postal Service still does not know which
22 subclasses are within the containers that cause most mixed mail costs. Nor is it any
23 closer to explaining rising overhead and other not handling costs than when I first
24 raised the issue of automation refugees more than seven years ago.

25 In the rest of this testimony I present my criticism of Degen's methodology in more
26 detail, and explain the distribution method I believe is the best possible, given the
27 paucity of meaningful data.

28 IV. COST POOLS

29 Each clerk and mailhandler tally in the IOCS data base is associated with a dollar value,

1 where the sum of the costs for all tallies equals total accrued wage costs. Because IOCS
 2 sampling frequencies differ between CAG's, these tally costs are computed relative to
 3 the accrued costs within each combination of CAG and craft, as described in USPS-ST-
 4 47. In the traditional IOCS method, these tally costs determined the contribution each
 5 tally made to the distributed mail processing costs.

6 Degen's method assigns all tallies taken at MODS offices and BMC's to a number of cost
 7 pools. The assignment is based on MODS (PIRS) operation numbers recorded by IOCS
 8 clerks. Each pool is defined by its accrued costs, according to the Postal Service's pay
 9 data system, and by a volume variability factor determined by Bradley. Degen uses the
 10 IOCS tally costs through most of his program, but in the end, in order to be consistent
 11 with Bradley's variability analysis, he re-weights the tallies in each cost pool so that the
 12 sum of the tallies in each pool equals the accrued costs of that pool. Additionally, he
 13 applies the volume variability factors determined by Bradley for each pool. In
 14 mathematical terms, this is done as follows.

15 Let K be a given cost pool, I a tally assigned to that pool, and POOLCOST(K) the total
 16 accrued costs within that pool, according to MODS. Let TCP(K) be the sum of the tally
 17 costs (TC(L)) for all tallies L assigned to pool K. Under Degen's method, the volume
 18 variable cost associated with tally I is then:

$$19 \quad PC(I) = TC(I) * POOLCOST(K) * VV(K) / TCP(K)$$

20 where VV(K) is the volume variability factor for pool K, according to Bradley and TC(I)
 21 is the tally cost for tally I.⁴

22 I agree with Degen that the general approach outlined above is an appropriate method
 23 for applying Bradley's variability analysis to the IOCS data. However, I strongly
 24 disagree with Degen's further decision to distribute all mixed mail and not handling
 25 costs exclusively within their assigned pools. Doing so ignores all cross pool

⁴ See Tr.6528 where Degen describes how he converts tally costs to volume variable costs. USPS LR-H-304 contains, in spreadsheet Dma-13b.xls, the tally dollars and accrued costs for each pool used by Degen.

1 relationships and leads to severe distortions. Furthermore, consistency with Bradley's
2 analysis does not require confining cost distribution to within each pool.

3 In most cases I believe the best way to avoid the distortions introduced by Degen's
4 method, given the lack of more specific information, is to simply distribute the mixed
5 mail and not handling costs across all pools, though separately for MODS, BMC and
6 NonMODS facilities and, when possible, within CAG and basic function. On the other
7 hand, some not handling tallies are associated with specific information that allows a
8 more accurate distribution. The distributions I propose are equally consistent with
9 Bradley's variability analysis, since the cost I associate with each tally is given by the
10 above formula.

11 For example, assume that a tally describes an employee as selling stamps or setting
12 meters in a postal window, but that the tally is assigned by Degen to the FSM (flat
13 sorting machine) cost pool, because the observed employee was clocked into an FSM
14 related MODS code. Since Bradley's analysis of the FSM cost pool was based on all
15 wage costs for employees clocked into FSM MODS codes, regardless of what those
16 employees were actually doing, it may be necessary, for consistency, to apply the FSM
17 variability factor to all costs assigned to the FSM cost pool, i.e. to modify the tally costs
18 as described above. However, that does not mean that all not handling and mixed mail
19 costs within a given pool have to be distributed in the same way as the direct costs in
20 that pool. It still makes more sense to distribute not handling costs according to what
21 observed employees were actually doing. The appropriate way to distribute costs of
22 selling stamps or setting postal meters, for example, is based on the relative usage of
23 stamps and meters by the different subclasses, as in the traditional costing approach,
24 rather than distributing them within cost pools for totally unrelated functions.

25 In subsequent sections I offer several additional examples of the severe distortion
26 caused by Degen's pool-by-pool approach when, for example, mail that is treated as
27 mixed mail (e.g., loose letters or flats in a container) at one pool undergoes the piece
28 sorting that gives rise to most "direct" tally costs at other pools, and when employees
29 are frequently reassigned between pools, spending significant amounts of
30 nonproductive time at one pool in periods of low activity only to be really busy at

1 another pool during surge periods (e.g., before a critical dispatch).

2 These problems do not affect cost distribution within CAG's, which are separate groups
 3 of facilities. Employees cannot easily be reassigned from one CAG to another, whereas
 4 they easily can be, and frequently are, reassigned between cost pools. Nor do they
 5 appreciably affect cost distribution within "basic function." The major basic function
 6 categories are "outgoing" and "incoming." While there obviously is overlap, outgoing
 7 and incoming operations in postal facilities are mostly done on separate shifts, limiting
 8 the probability of frequent reassignments between basic functions.⁵

9 My alternative method distributes all mixed mail and most not handling costs across
 10 cost pools, but within CAG and basic function. Further details of my approach, and of
 11 the difference between my approach and Degen's, are given in Appendix A.

12 V. MIXED MAIL COSTS

13 In the IOCS, a direct tally occurs when an employee is observed handling an individual
 14 piece of mail, or an "item" or container that contains identical pieces.⁶ Additionally,
 15 two methods are used to create some direct tallies from mixed mail. One is the "top
 16 piece rule," normally applied when an employee is seen handling an individual bundle,
 17 letter tray or flat tray. The other is counting the mail in some items that do not contain
 18 identical mail and to which the top piece rule does not apply. In all other cases where
 19 employees are seen handling mail, mixed mail tallies occur.

20 The volume variable mixed mail costs that Degen distributes include \$66 million in
 21 uncounted mixed mail item costs and \$490 million in mixed container costs.

⁵ Outgoing mail is processed mostly on the Tour 3 (late afternoon and evening) shift and culminates with the dispatches of mail that came from collections that day. Then the Tour 1 (early morning) shift takes over and performs mostly incoming processing, which culminates with the dispatch of destinating mail to AO's, stations and branches. The Tour 2 (day) shift processes more incoming mail, mostly non-preferential, as well as transit mail.

⁶ The pieces in an item or container are considered "identical" only if they "have the same origin, mail class, subclass, shape, size, weight and postage. The pieces are the same except for their destinations." USPS LR-H-49 at 88.

1 Additionally, he includes in his definition of mixed mail \$229 million in empty item
2 costs and \$350 million in empty container costs. Altogether, he distributes \$1,136
3 million in volume variable "mixed mail" costs, versus \$4,873 million in "direct" costs,
4 including counted and top piece rule items, and \$4,050 million in "not handling" costs.

5 The mail most likely to produce direct item or container tallies, and correspondingly
6 less likely to produce mixed mail tallies, is highly presorted mail that travels through
7 the postal system in mailer prepared bundles, sacks, trays or pallets, such as Periodicals
8 and most Standard A mail. Sacks, pallets and bundles from Periodicals mailers, for
9 example, have identical mail pieces in them and therefore mostly give rise to direct
10 tallies in IOCS. They incur substantial handlings at platforms and in opening units
11 (bundle sorting) but mostly as what IOCS calls identical mail.

12 Mixed mail, on the other hand, consists of either collection mail or mail that has
13 undergone at least one sorting operation and has thereby been mixed with other mail in
14 postal facilities. Periodicals mail is likely to cause a larger portion of the direct
15 item/container costs than of the mixed mail costs. That would imply that its share of
16 mixed mail costs should be less than its share of direct costs. However, quite the
17 opposite occurs under Degen's method. In MODS offices, for example, regular rate
18 Periodicals (2RR) has 3.86% of the direct volume variable costs, but Degen assigns it
19 5.75% of all mixed mail costs.

20 Distributing mixed mail costs fairly to mail subclasses is a difficult task. Frankly, the
21 Postal Service's proposed scheme is not adequate to the task. It is essentially the same
22 flawed approach that the Postal Service cautioned against using, and the Commission
23 agreed should not be used, in Docket No. R94-1 (see Note 2, Supra). In order to
24 implement it within each cost pool, Degen adds many new and unsubstantiated
25 assumptions that make an already flawed approach even worse. He introduces even
26 more distortions by extending the approach to empty equipment costs that in the past
27 were simply treated as general overhead costs.

28 The evidence Degen presents to link mixed mail costs to specific subclasses is so weak
29 that it raises doubt whether there exists any basis for attributing these costs to

1 subclasses. If the Commission decides that these costs should nevertheless be
2 attributed, however, I recommend that it use the following approach:

- 3 (1) Mixed mail costs associated with specific shape categories (letters/cards, flats,
4 or IPP's/parcels) should be distributed over the direct costs associated with the
5 corresponding shapes, within CAG, basic function and facility type; and
- 6 (2) All other mixed mail costs, including empty item and container costs, should be
7 distributed over all direct mail costs, again within CAG, basic function and
8 facility type.

9 This is essentially the same approach as that which the Commission applied in previous
10 dockets.⁷ It is not an ideal solution. It is likely to attribute an excessive portion of the
11 mixed mail costs to the highly presorted subclasses, which provide most of the "direct"
12 items and containers handled by the Postal Service. It is, however, still a much better
13 approach than what the Postal Service proposes in this docket.

14 In order to be able to accurately distribute mixed mail costs in the future, what is
15 needed is nothing less than a complete rethinking and redesign of the current IOCS
16 approach to collecting data on mixed mail. The current approach, while elaborate and
17 costly, simply fails to produce information from which reliable inferences can be drawn
18 about the subclass content of mixed items and containers. The Commission should
19 send the Postal Service back to the drawing board to come up with a better approach
20 before the next rate case.

21 The following discussion explains in detail the particular problems with Degen's mixed
22 mail approach. I discuss mixed and empty item costs first, and then mixed and empty
23 container costs. Finally, I show how the Postal Service's mixed mail scheme has an
24 imbedded bias against palletized mail, by treating pallets differently from other entities
25 (containers) used to carry bundles, sacks and trays.

⁷ Appendix A explains in detail how I propose to implement this approach in the present docket.

1 **A. MIXED AND EMPTY ITEM COSTS**

2 **1. Mixed Item Costs**

3 IOCS clerks collect data on 16 different "item" types, including bundles, three types of
4 trays, ten types of sacks, pallets and "other" items. When they encounter bundles, letter
5 trays or flat trays that do not contain identical mail, they are supposed to apply the "top
6 piece rule" to determine the subclass. Ideally, according to IOCS handbook F-45 (USPS-
7 LR-H-49), all mixed mail items to which the top piece rule does not apply should be
8 counted.

9 In FY95 the Postal Service extended the top piece rule to apply to all letter and flat tray
10 tallies.⁸ Since non-top piece rule items are supposed to be counted, there should,
11 therefore, not be any mixed mail items in the IOCS data base. In reality, however, there
12 are \$66 million in volume variable (\$93.6 million accrued) uncounted mixed mail item
13 costs in the BY96 data. Of the \$66 million, \$26.2 million are for bundles and letter and
14 flat trays, to which the top piece rule should have been applied. According to Degen,
15 this failure to apply the top piece rule was either because of concern about delaying the
16 mail, or because of errors on some tallies. Tr. 6456-7.

17 According to the IOCS handbook, non-top piece rule items should be counted except
18 when it is "extremely difficult" to do so. USPS LR-H-49. Yet, in reality, only about half
19 of them were counted. When uncounted bundles and letter and flat trays are included,
20 IOCS clerks counted only about 38% of the mixed items to which the top piece rule was
21 not applied.⁹ This is illustrated in Exhibit 4, which shows, for each item type and
22 facility type, the volume variable costs of, respectively, direct, counted, mixed
23 uncounted and empty items.

⁸ According to witness Patelunas: "Prior to this change, there were a number of conditions under which the 'top-piece' rule did not apply. Under the new procedures, the data collector uses the 'top-piece' rule for all letter and flat tray tallies." MC97-2, USPS-T-5 at page 10.

⁹ Degen refers to concern about delaying the mail as another reason for not counting mixed items. That reason, however, is mentioned neither for top-piece-rule nor non-top-piece-rule items in the IOCS handbook. The handbook gives only two examples of "extremely difficult": (1) palletized, shrink-wrapped sacks; and (2) "a sealed registered pouch or CON-CON that cannot be unlocked." Handbook at 90-91. In reality, many much easier to count items also remained uncounted.

1 Degen distributes the costs of uncounted mixed items, empty items and items in
 2 containers with a distribution key based on subclass information for direct and counted
 3 items. He performs these distributions within cost pool and item type. This approach
 4 is seriously flawed. For the following reasons, neither the direct item data nor the
 5 counted item data, nor the combination of both, is suitable for the purpose of
 6 distributing the costs of uncounted mixed items.

7 The table below breaks down the costs of direct and counted mixed non-top piece rule
 8 items by major class category. Direct items, i.e. sacks and pallets with identical pieces,
 9 are generally prepared not by the Postal Service but by bulk mailers, mainly Periodicals
 10 and Standard A mailers. As the table shows, over 56% of these item costs are for
 11 Standard A, with another 26% for Periodicals. In MODS offices, Periodicals account for
 12 almost 31% of the direct sack and pallet costs (see Exhibit 5). Obviously, therefore, the
 13 data on these direct sacks and pallets are not at all suitable for determining the
 14 proportions by subclass of mail contained in mixed mail items, which can contain all
 15 kinds of mail, including collection sacks and sacks made up at USPS pouching units.

Direct & Counted Item Costs - All Offices (Volume Variable Costs - Non-Top Piece Rule Items)				
Subclass	Counted		Direct:	
	\$1,000's	Percent	\$1,000's	Percent
First	6,260	14.88%	3,014	5.52%
Periodicals	5,129	12.20%	14,130	25.87%
Standard A	8,519	20.26%	30,786	56.37%
Standard B	5,125	12.19%	2,680	4.91%
Priority	9,157	21.77%	1,592	2.91%
Express	2,220	5.28%	875	1.60%
Other	5,647	13.43%	1,541	2.82%
Total	42,057	100.00%	54,618	100.00%

16 Degen might have produced less distortion if, instead of using direct and counted item
 17 data to distribute uncounted mixed item costs, he had used only the counted item data.
 18 This approach would still not be correct, however, because it is evident that the mixed
 19 items IOCS data collectors count do not have the same characteristics as the mixed
 20 items they choose not to count.

1 One way to confirm that the selection of which mixed items to count was biased is to
2 compare the relative counted and uncounted costs for different item types in Exhibit 4.
3 For parcel trays (TRAY-P), 74.3% were counted, more than for any other item type.
4 Second in percent counted were brown sacks, with 70.4%. For most item types, the
5 percent counted was substantially less. This is hardly a coincidence. Brown sacks
6 mainly carry magazines. Because magazines are relatively large, there tend to be few of
7 them in each sack and they are therefore easy to count. Parcel trays carry parcels,
8 which are also large and are few in number and easy to count.

9 The Postal Service may believe that this bias in counting doesn't matter, as long as one
10 analyzes each item type separately. However, there is no reason to suppose that the
11 tendency to count items with a few large pieces, and not items with many small pieces,
12 does not extend to all item types. In fact, it is to be expected that IOCS clerks, pressed
13 for time to meet their quota of tallies, would tend not to count a collection sack with
14 hundreds of different pieces in it, but to count any item with just a few pieces.¹⁰

15 This is not a new issue. It was debated extensively in Docket No. R94-1, where both my
16 testimony and that of MPA witness Cohen demonstrated the strong probability of bias
17 in the selection of which items to count. At that time, both the Commission and the
18 Postal Service concluded that the counted item data could not be relied on to distribute
19 the costs of uncounted items and items in containers. The Commission should draw the
20 same conclusion in this docket.¹¹

¹⁰ On cross examination (Tr. 6706), Degen implied that the main reason mixed items were not counted was to avoid delaying the mail. But unless the item is encountered just before a critical dispatch, the sampled employee could continue to work on other items while the data collector counts the one sampled. If almost half of all mixed items are observed just before a critical dispatch, then the Postal Service must have a much worse peaking problem than anyone has imagined. And those uncounted items must all contain high priority mail, unlike the counted items which contain all kinds of mail and certainly unlike the direct items which are almost all Periodicals and Standard A. It is much more likely that the data collectors, in most cases, chose not to count because it would delay them, not because it would delay the mail.

¹¹ In R94-1 USPS witness Barker testified that the costs of counted items should not be viewed as sufficiently reliable to use for distribution purposes unless and until the Postal Service had performed a special study to determine why so many mixed mail items remained uncounted and whether there existed a rational basis for distributing their costs based on the counted items. Tr.

1 For bundles and letter/flat trays, to which the top piece rule normally applies, less
 2 distortion might be achieved by excluding the direct item costs and attributing mixed
 3 item costs based only on the costs of top piece rule items, which after all are also mixed
 4 mail. That improvement to Degen's approach, however, would still not guarantee a
 5 correct distribution, given Degen's explanation that these items were recorded as mixed
 6 in order not to delay the mail.¹²

7 An additional problem that arises if one tries to distribute item costs within each of
 8 Degen's cost pools is the extreme thinness of the data in individual cells. In Degen's
 9 MODS data, I found 233 combinations of cost pool and non-top-piece-rule item type
 10 where mixed items had been observed. In 72 of these cells not a single item had been
 11 counted, and in those 72 cells a distribution across all pools becomes necessary in any
 12 case.

13 2. Empty Item Costs

14 In both MODS and NonMODS offices the cost of handling most item types was almost
 15 as large when the items were empty as when there was mail in them, which makes one
 16 wonder how much of the time recorded as spent handling empty items is time well
 17 spent. As Exhibit 4 shows, some item types purportedly cost substantially more to
 18 handle when empty than when there is mail in them.¹³

19 Degen's approach to distributing the \$229 million in volume variable empty item costs
 20 is flawed for at least two reasons. First, as discussed above, his distribution key is
 21 biased by giving too much weight to mail in direct items and too little weight to mail in
 22 mixed items.

1157-58, R94-1. The Postal Service has presented no results from such a special study in this docket. Nor, to my knowledge, has it ever conducted or considered conducting such a study.

¹² If concerns about delaying the mail were so serious that the data collectors did not even have time to look at one piece in these items, the items must indeed have contained some high priority mail. These bundles and trays must in any case have contained mail different from that contained in the bundles and trays to which there was time to apply the top piece rule, again indicating a likely bias when one distributes one set based on the other.

¹³ At BMC's, most items not containing parcels are simply transferred without being opened. Even there, however, \$14 million were incurred in handling of empty items.

1 Second, Degen's approach rests on the assumption that each item type containing mail
 2 that is handled within a given pool is correspondingly handled as empty within the
 3 same pool. Degen provides no evidence that this is true and apparently has not even
 4 looked for such evidence. In fact, it is almost certainly false. Take for example a direct
 5 sack which may travel through several postal facilities, undergoing various loading,
 6 unloading, sorting and transfer operations before finally being emptied at its
 7 destinating facility (e.g. a delivery unit in the case of a carrier route sack). Whatever is
 8 subsequently done to the empty sack to cause it to incur, according to Degen's data,
 9 almost as many costs as when it carried mail, it is extremely unlikely that its path back
 10 to a mailer will pass through exactly the same operations.¹⁴ I found 238 combinations of
 11 item type and MODS cost pool where empty items had been observed. In 50 of those,
 12 items had been observed only when empty. In an additional 26, no direct or counted
 13 items were observed.

14 If costs of empty sacks and other items are to be attributed at all to specific subclasses,
 15 they should, given the complete lack of evidence supporting Degen's narrower
 16 distribution, be treated as general overhead costs, distributed upon all direct costs.

17 B. MIXED AND EMPTY CONTAINER COSTS

18 1. Mixed Container Costs

19 The Postal Service's current scheme for collecting data on mixed container costs in IOCS
 20 is fundamentally defective, due to its failure to collect any class-related information
 21 about these containers. Instead, it relies on a series of proxies to distribute these costs to
 22 subclasses. Degen did not invent this system, which both the Postal Service and the
 23 Commission rightly declined to place any reliance on in R94-1, but he not only adopts it
 24 (the first Postal Service witness to do so) but increases the impact of its deficiencies by
 25 applying it within a large number of individual cost pools. In the process he introduces
 26 a number of unstated, unproven, improbable and in some cases clearly erroneous

¹⁴ Some emptied items will be filled with other mail in the facility where they were emptied. Those items at least will not traverse as empty the path they followed when full.

1 assumptions.

2 Assume that an IOCS data collector sees an employee handling two flats bundles, one
3 containing copies of Time and the other copies of Newsweek (a quite possible scenario,
4 since these publications are handled similarly and generally at the same time of the
5 week). Although this would appear to be identical mail for all purposes relevant to the
6 distribution of mail processing costs, the IOCS defines it as not "identical" and the data
7 collector must refrain from capturing the readily available class information and instead
8 record a "multiple item container" with bundles in it. Tr. 6550-51 The same applies to
9 bundles of Standard A catalogs, First Class presorted letters (unless exactly equal in all
10 relevant and irrelevant respects), and so on. Degen then relies on the distributed costs
11 of bundle handling within each pool as a proxy to determine the costs of bundles
12 observed in various types of containers.

13 The absurdity of this approach is perhaps most obvious in Degen's treatment of loose
14 mail observed in containers. Containers with loose flats (and similar containers with
15 letters) appear mostly at platforms and opening units, whereas their contents, i.e. the
16 pieces and items carried in those containers, are mostly handled elsewhere. It is
17 therefore inappropriate to distribute the mixed container costs within each pool.

18 Yet Degen distributes the large costs of loose flats and letters observed in containers at
19 platforms and opening units on the basis of the relatively small portion of individual
20 letter and flat handlings recorded at those operations, instead of the much larger
21 portion performed at the operations dedicated to piece sorting.

22 Degen states the assumption underlying his approach: that "the subclass distribution of
23 direct tallies handling flat-shape pieces in the same cost pool is an unbiased estimate of
24 the unknown subclass distribution of loose flats in mixed-mail containers." Tr. 6528.
25 He provides no evidence to support this assumption, and refers to no study of its
26 accuracy. Moreover, application of his approach within each cost pool requires the
27 further (unstated) assumption that mail that appears in containers at a given pool also
28 appears as loose mail at the same cost pool. This latter assumption is clearly wrong, as
29 the table below illustrates.

Direct And Loose-In-Container Item Costs At MODS Platforms/Opening Units		
Item Type	Direct	Loose In Containers
Letters	6.97%	53.30%
Flats	9.38%	48.51%
Bundles	22.77%	64.28%
Flat Trays	32.63%	61.84%
Letter	29.00%	55.61%

1 The table shows, for five major item types, the percentages, respectively, of direct and
2 loose-in-container handling costs that occur at platforms and opening units in MODS
3 facilities. In the case of letters, for example, only 6.97% of direct handlings occur in
4 those cost pools, yet over 53% of the loose-letters-in-container costs occur there.
5 Degen's method, therefore, distributes over half the letters-in-containers costs based on
6 only a small and incidental part of the total letter handling costs. For flats, the
7 imbalance is almost as large: 48.51% of the loose-flats-in-container costs are distributed
8 based on only 9.38% of the direct flats costs.¹⁵

9 This imbalance is not limited to loose pieces in containers but extends to bundles and
10 other items (e.g., flat and letter trays) as well. For example, only 22.77% of direct
11 bundle handling in MODS offices occurs at platforms and opening units, while 64.28%
12 of bundles-in-container costs occur there. The pools with the largest percentages of
13 direct bundle handling are manual letters (18.59%) and BCS operations (13.87%), but
14 employees at those operations apparently do not move the containers that hold all those
15 bundles, since they only have 4.44% and 0.88% respectively of the bundles-in-container
16 costs. Exhibit 6 contains additional data on direct and loose-in-container item costs.

17 The result of Degen's pool-by-pool distribution is that mail classes that receive a large

¹⁵ Since in Degen's universe flats are sorted at letter operations, letters are sorted at flats operations and in fact both are sorted just about anywhere, one suspects that most of the letter and flat sorting that appears at opening units and platforms results from employees being clocked into one operation but working at another. Generally, individual letter and flat sorting is not performed at platforms or opening units. (Even if an employee were to remove a handful of letters or flats from a container in order, for example, to place them in a tray, he would be recorded in IOCS as handling a bundle rather than as handling letters or flats.)

1 portion of their total handling at platforms and opening units, such as Periodicals, will
2 be held responsible for a disproportionate share of container costs.

3 This particular problem can be partly ameliorated by distributing container costs across
4 all pools, rather than within pools. I strongly recommend this alternative if the Postal
5 Service's container data are to be used at all.

6 There is, however, another, more fundamental problem with Degen's loose-mail-in-
7 container data that I see no way of addressing short of discarding all the current mixed
8 container data, distributing all mixed costs upon all direct costs and urging the Postal
9 Service to come up with a better system in the future.

10 It is obvious that since Periodicals do undergo a lot of flat sorting they will, under any
11 variant of Degen's scheme, be held responsible for a large portion of the \$38 million
12 loose flats in container costs. But when, if ever, do Periodicals flats appear loose in
13 containers?

14 The only types of flats one would reasonably expect to appear loose in large containers
15 are non-presorted flats arriving through collections, or perhaps being brought to postal
16 platforms by certain types of First or Standard A mailers. Periodicals flats are packaged
17 by mailers and submitted as bundles on pallets or in sacks. When those pallets or sacks
18 do get opened, the bundles are sorted into containers, but as bundles, not as loose
19 pieces. Putting loose Periodicals (or Standard A) flats in containers would destroy their
20 presortation and possibly their facing as well.¹⁶

21 One can only speculate as to the correct interpretation of these loose-pieces-in-container
22 costs. Such speculation would not be necessary if the IOCS directly captured class

¹⁶ Some bundles, of course, are broken unintentionally as they move through the system. It is also possible that postal employees do occasionally break open flat and letter bundles and place them as loose pieces in hampers and other containers. But even if this is done in a way that does not require extra piece sorting, it still would be inefficient make-shift work, as a handling step could be saved by simply taking those bundles, after they have been sorted into hampers, etc., to the operations where they will be piece sorted and placing them directly on the ledge of the sorting cases or machines.

1 information for containerized mail.

2 2. Empty Container Costs

3 Containers, like items, cost almost as much to handle when empty as when there is mail
4 in them, if Degen's data are to be believed.

5 Degen distributes the empty container costs, for each container type and within each
6 cost pool, based on the costs he has distributed for mixed and direct containers of the
7 same type at the same cost pool. Consequently, all the highly questionable assumptions
8 Degen relies on to distribute mixed container costs are extended to the additional \$350
9 million in empty container costs. In addition, his distribution of empty container costs
10 relies on the further untested, unstated and most likely erroneous assumption that each
11 container type containing mail that is handled within a given pool is correspondingly
12 handled as empty within the same pool.

13 The reasons for rejecting Degen's distribution of empty container costs are therefore
14 even stronger than the reasons for rejecting his distribution of mixed container costs.
15 As with empty items, if empty container costs are to be attributed at all to subclasses,
16 they should be treated as general overhead costs and distributed based on all direct
17 subclass costs.

18 **C. PALLETS SHOULD BE TREATED AS CONTAINERS.**

19 Another ill-conceived aspect of the IOCS mixed mail scheme is that pallets are
20 considered items rather than containers. Most direct pallets contain mailer prepared
21 Periodicals or Standard A bundles. Most of the pallets that were counted (as items) also
22 appear to have contained Periodicals or Standard A bundles. But pallets are also used
23 to carry sacks or trays which, as Degen confirmed (Tr. 6539-40), are unlikely to be
24 counted because of the significant effort that would entail. Furthermore, because pallets
25 are defined as items rather than containers, there is no way for the data collectors to
26 record the fact that a pallet had sacks or trays rather than bundles on it. Tr. 6568. This
27 creates an inconsistency relative to how items in containers are recorded.

28 To illustrate this problem, consider a highly simplified example. Assume that a given

1 postal operation (e.g., opening unit) is dedicated exclusively to bundle sorting, that it
 2 handles only two classes of mail, and that class A's bundles arrive in APC's while class
 3 B's bundles arrive on pallets. Assume further that each class is found to incur \$1,000 in
 4 direct bundle handling costs, and that the operation additionally incurs \$500 in pallet
 5 handling and \$500 in APC handling costs, for a total cost of \$3,000. Obviously, since
 6 class A is the only class using APC's, class B the only class using pallets, and their
 7 bundle handling costs are equal, both are responsible for a total of \$1,500.

8 That, however, is not how the Postal Service's "improved" mixed mail system works.
 9 Since class B is the only class using pallets, and pallets are defined as "items," class B
 10 will be held responsible for all pallet handling costs. Since APC's are defined not as
 11 items but as containers, IOCS clerks are not allowed to report the fact that the bundles
 12 in APC's are all class A, only that they are bundles.¹⁷ And since class B has one half of
 13 the bundle handling costs, it will be held responsible for half of the APC costs as well.
 14 In other words, \$1,750 will be attributed to class B and only \$1,250 to class A.

15 Let us now consider how this affects Periodicals. Bundles of Periodicals are, to a large
 16 extent, carried on pallets through the postal system. If pallets were defined as
 17 containers, like all other entities that may contain bundles as well as sacks and trays,
 18 then an IOCS data collector who saw a pallet with Periodicals bundles would record it
 19 only as a pallet containing bundles, with no class information. The costs of that pallet
 20 would then be distributed based on the costs of all bundle handlings. Since regular rate
 21 periodicals (2RR) has about 6.8% of all bundle handling costs, it would be assigned
 22 about 6.8% of all costs of pallets with bundles on them. Instead, since pallets are
 23 defined as items, 2RR is assigned more than one third of all pallet costs, including the
 24 costs of pallets containing sacks or trays that are likely to belong to other classes. In
 25 addition, 2RR is held responsible for 6.8% of the costs of other containers with bundles
 26 in them.

¹⁷ Unless, of course, all the pieces in an APC are identical. But bundles in APC's are more likely to be bundles that already have been sorted at another post office, i.e. mixed with bundles from other mailers, even if they may all be of the same class.

1 This is yet another example of how Periodicals mail is certain to be overcharged under
 2 any possible use of the item/container data collected by the current IOCS. To correct
 3 this particular distortion, IOCS must be modified to (1) allow the fact that a pallet
 4 contains sacks, trays or parcels rather than bundles to be recorded; and more
 5 importantly, (2) record class related information for containers as well as items.

6 D. MIXED MAIL SUMMARY

7 The Postal Service's method of distributing mixed mail costs had fundamental problems
 8 even before Degen attempted to apply it separately within each of a large number of
 9 cost pools:

- 10 (1) it failed to recognize the fundamental difference between direct items (i.e.,
 11 items with identical mail pieces) that almost always originate from bulk mailers
 12 and mixed mail items that can contain all kinds of mail;
- 13 (2) it failed to address the inevitable bias introduced by letting IOCS data collectors
 14 count only items that are easy to count and will not delay the mail;
- 15 (3) it failed to recognize the difference between trays and bundles so time sensitive
 16 that trained data collectors did not even have time to examine one piece, and
 17 other trays and bundles;
- 18 (4) it created an inevitable bias against mail that travels through the system in
 19 palletized bundles, by treating pallets as items instead of as containers;
- 20 (5) it completely failed to record any direct class information about mail in mixed
 21 containers, even for containers that contain only one subclass but with non-
 22 identical pieces; and
- 23 (6) it relied on a number of unverified and unreasonable assumptions regarding
 24 the relationship between loose mail in containers and piece handlings, ignoring
 25 for example the fact that letters and flats that appear loose in containers usually
 26 have come through collections.

27 Degen compounds these already severe problems by applying the same unsound
 28 procedures, and relying on the same inadequate data, within individual cost pools.
 29 Besides the extreme thinness of the mixed mail data that he places his reliance on, he
 30 has to rely on assumptions that relationships hold true within individual pools that
 31 may not, and probably do not, hold even in the aggregate. One consequence, discussed
 32 above, is that he distributes the large costs of loose letters and flats in containers
 33 observed at opening units and platforms in proportion to the mostly incidental

1 handling of individual letters and flats that occurs at those operations.

2 I do not necessarily advocate going back to the system that existed some years ago,
3 when containers were characterized as "mixed First and third," "mixed fourth," etc.
4 That system had its own weaknesses. But under the current system, IOCS clerks are
5 being asked to do much more work than before for each mixed mail tally, yet the end
6 result is less useful information. With all the effort that now goes into producing item
7 and container tallies, there certainly must be a way to capture better information
8 relevant to cost distribution.

9 I therefore urge the Commission to decline to adopt Degen's deeply flawed approach to
10 distributing mixed mail costs and to send the Postal Service back to the drawing board,
11 insisting that it come up with a mixed mail system that makes sense. In the meantime,
12 the best solution available is to use the simpler and more traditional approach outlined
13 above and described in more detail in Appendix A, i.e., to distribute shape related
14 mixed mail costs based on the corresponding shape related direct costs and to distribute
15 other mixed mail costs based on all direct costs. That approach still produces some bias
16 against the types of mail that mostly travels through the postal system as identical (and
17 thereby direct) mail, but the distortion is much less than under Degen's approach.

18 VI. NOT HANDLING COSTS

19 The disastrous and highly anomalous increase in Periodicals costs over the past ten
20 years occurred at the same time as two other major changes. One was the automation
21 of letter sorting. The other was a sharp increase in costs referred to in this docket as
22 "not handling" costs. In this section I first discuss the increase in not handling costs:
23 how it is a natural consequence of increased automation and how, under the Postal
24 Service's costing methods (old and new), the least automated mail will inevitably be
25 held responsible for a portion of this cost increase, even though it did not cause the
26 increase.

27 Next I show that the distribution of not handling costs proposed by Degen compounds
28 the problem, first by ignoring important information available about some of the not
29 handling costs and second by wrongly assuming that not handling costs are causally

1 related only to direct and mixed mail costs within the same cost pool. Finally, I describe
2 a better way to distribute not handling costs, which uses much of the information
3 Degen ignored, while relying on fewer unverified assumptions. Unlike Degen's
4 approach, my approach uses distribution keys that correspond to the nature of each
5 type of not handling activity. I distribute these costs, not within MODS cost pools, but
6 within facility type, CAG and basic function.

7 **A. AUTOMATION HAS CAUSED A LARGE INCREASE IN NOT HANDLING**
8 **COSTS, MUCH OF WHICH THE LEAST AUTOMATED MAIL HAS WRONGLY**
9 **BEEN FORCED TO ABSORB.**

10 As late as Docket No. R90-1, the only type of "not handling" costs of which there was
11 general awareness outside the Postal Service itself was so-called overhead, consisting of
12 breaks/personal needs, clocking in and out, and handling empty equipment.
13 Testimony in that docket, by myself and others, questioned why overhead costs, as a
14 percentage of other mail processing costs, had grown from 20.8% in FY86 to 23% in
15 FY89. That increase, however, was small compared to what followed. In FY95 the
16 overhead percentage grew to 29.4%, and in FY96 it jumped to 31.5%.

17 The largest component of overhead costs is break/personal needs time. According to
18 Degen's data, an astonishing 15.4% of all working hours in mail processing facilities are
19 spent on breaks. That is an hour and 14 minutes in an average eight-hour work day,
20 not including lunch breaks.

21 However, as early as R90-1 my testimony postulated the existence of considerable
22 additional "not handling" time, in the form of "automation refugees," i.e. employees no
23 longer needed for manual letter sorting but still in the system, having been reassigned
24 to the manual operations, particularly opening units, where productivity is least
25 monitored in postal facilities. That seemed then, and still seems today, the only possible
26 way one can explain the large increases in Periodicals costs.

27 Another cost category, namely costs reported as "mixed mail" by the LIOCATT, also
28 grew dramatically after FY86. In Docket No. R94-1 witness Barker revealed that what
29 were called "mixed mail" costs, (i.e. costs with IOCS activity codes 5610-5750) included

1 not just mixed mail but also not handling, and that in fact most of the increase in those
 2 costs was in the not handling component. In FY96, according to Degen's data, these not
 3 handling costs were about as large as the break-time costs, representing another 15% of
 4 all time spent in mail processing facilities. That is not all. One of the more bizarre
 5 "facts" brought to light in this case is that about one third of the time spent on
 6 "handling empty equipment" is actually spent not handling empty equipment, or
 7 anything else. Tr.6532. The "not handling empty equipment" costs are 2.8% of all mail
 8 processing costs. Clocking in and out adds another 1.9%. Altogether, 35.1% of clerk
 9 and mailhandler mail processing costs, or almost three hours in an eight hour day, are
 10 spent on breaks/personal needs, clocking in/out, "not handling empty equipment" or
 11 "not handling" as defined by activity codes 5610-5750. In some cost pools, mainly
 12 operations where postal facilities do not measure productivity, these percentages are
 13 even much higher.¹⁸

14 In order to understand what all these non-handlings mean, it is necessary to realize one
 15 of the limitations of the IOCS. Apart from breaks, the IOCS has no way of indicating
 16 that an employee was observed doing nothing at all. If no specific category on the IOCS
 17 clerk's handheld computer fits, he must choose from categories such as "other work,"
 18 or indicate that the employee was on his way to get something, etc. There is no way to
 19 indicate complete non-activity. The Postal Service's position is, of course, that their
 20 employees are always kept busy. See, for example, Moden's response to TW/USPS-T4-
 21 9d at Tr. 5935-36 and Degen's response to TW/USPS-T12-23 at Tr. 6522-25.

22 Other than common sense, therefore, the only proof that all these not handling costs do
 23 not represent productive time is the simple historical fact that most of them did not
 24 exist before FY86. Attempting to justify the large increase in these costs in R94-1,
 25 witness Barker argued that with increasing automation employees spend more time
 26 monitoring machines and less time touching individual mail pieces. He said that this is
 27 not a problem as long as overall productivity is improving. Tr. 1237-39, R94-1.

¹⁸ The percentage is higher still when one removes the window service and administrative costs that Degen has incorrectly included in his definition of mail processing. The percentage is close to 50% at opening units and over 50% at platforms and sack sorting operations.

1 Barker's explanation would make sense if most of the new not handling costs occurred
 2 at the most automated operations. Instead, as can be seen from Degen's data, most of
 3 these costs occur at non-automated operations. That, essentially, is what I postulated in
 4 my R90-1 testimony, without the supporting evidence available today."¹⁹

5 In fact, it is not surprising that most non-handlings occur at opening units and
 6 platforms, given that those are the operations where productivity is not monitored.
 7 Even the USPS Inspection Service has concluded that facility managers have little
 8 incentive to worry about productivity at those operations.²⁰ Furthermore, postal
 9 employees have to clock in somewhere as soon as they arrive at work or get back from
 10 lunch, in order to get paid. The ten minutes per day spent clocking in and out of
 11 operations show that facilities have ample flexibility to send these employees where
 12 they are needed when they are needed, but why send them to an automated sorting
 13 operation before they are really needed there, when doing so would reduce the
 14 productivity achieved at that operation? Not surprisingly, it appears that employees
 15 often start their shift by checking into some opening unit and stay there until they are
 16 given specific assignments.²¹

17 Of course, excessive not handling time is not limited exclusively to platforms and
 18 opening units, as can be inferred from the sharply reduced productivity (pieces per

¹⁹ Strictly speaking, what I postulated in R90-1 was that over-staffing at some manual operations would reduce productivity at those operations and be reflected in IOCS as higher costs for the mail that receives most of its handlings at those operations. The sharp increase in not handling is one manifestation of this phenomenon that can be recognized in IOCS, assuming one is willing to compare data for different years. Another manifestation that IOCS cannot identify directly, but that is confirmed by declining productivity figures (Tr. 5565), is that employees at over-staffed operations simply work slower than if they were under real pressure to meet a deadline. Even Moden appears to agree that employees don't always work equally hard. Tr. 5990-91.

²⁰ See USPS LR-H-236, U.S. Postal Inspection Service, "National Coordination Audit: Allied Workhours" (December 1996), at 10,13.

²¹ Id. at 19. Even though they spend ten minutes a day on the average clocking in and out of operations, there is evidence that employees don't always bother to do so when they go from one operation to another. How else can one explain letters being sorted at flats cases and vice versa, window customers being served in areas where they are not admitted, etc.? Table 6-1 in Exhibit 6 shows how the handlings of different shape items are spread over MODS operations. See Tr. 6400-6413 for the spread of non-handlings with different activity codes over MODS operations.

1 manhour) at almost all letter and flat sorting operations from FY88 to FY96 that is
2 reflected in Bradley's MODS data. Time Warner XE-2 to witness Bradley, Tr. 5565²²

3 To summarize, letter mail automation has had two major effects. First, it has
4 dramatically reduced the direct costs involved in sorting letters, due to the order of
5 magnitude difference in productivity between automated and manual letter sorting.
6 Second, it has brought about a major increase in not handling costs, not only at
7 automated operations, where Barker said an increase should be expected, but in many
8 manual operations, as I postulated in R90-1. Overall, the savings in direct costs are no
9 doubt larger than the increases in not handling costs. The trouble is, however, that the
10 IOCS is not capable, and was never designed to, detect the connection between these
11 two phenomena so that the cost savings produced by the automation program would
12 be offset by the cost increases it also produces.

13 Nor does it appear that the Postal Service has made any serious attempt to study this
14 connection, although one might think that addressing this issue would provide valuable
15 clues as to how the postal work force can be managed more efficiently. Instead the
16 Postal Service has, over the past ten years, burdened the least automated mail with an
17 ever greater portion of not handling costs that were caused by automation, thereby
18 allowing it to make exaggerated claims about automation savings.²³

19 A simple example will illustrate why, even before Degen introduced further distortion

²² Of the productivity declines shown by that exhibit, perhaps the 18% decline in flat sorting machine (FSM) productivity is the most counterintuitive. Since FY88, FSM's have been changed from their original configuration to a more efficient 2+2 configuration that, according to Moden, was expected to increase productivity by 13%, based on engineering estimates. Moden response to TW/USPS-T4-14j at Tr. 5957, 5960. More importantly, they have all been equipped with barcode readers, and a large portion of non-carrier route flats today, at least Periodicals and Standard A flats, are pre-barcoded. Despite all that, and the improvements one might expect as postal employees became more familiar with these machines, productivity declined from 893 pieces per manhour to 734. (The decline was 21% before Bradley "scrubbed" his data.) Note that FSM is mislabeled FSB in the exhibit referred to.

²³ See General Accounting Office, "Automation is restraining but not reducing costs" (May 1992), at 28-29, 34-35; "Postal Service role in a competitive communications environment" (May 24, 1994) at 12-13.

1 in this docket, the Postal Service's distribution of "not handling" costs in proportion to
2 the "direct" costs has led to a bias against the least automated mail. Consider a postal
3 service that handles only two product lines (mail classes 1 and 2) and uses a system
4 similar to IOCS to distribute costs between them. At a certain point in time both classes
5 are handled manually. The costing system shows \$1,000 in "direct" costs for each class,
6 and another \$1,000 in "not handling" costs. In other words, total costs are \$3,000. Since
7 each class has the same direct costs and both are handled similarly, the not handling
8 costs are also split equally between them; i.e. a total of \$1,500 is attributed to each class.

9 This postal service then automates the processing of class 1, while class 2 continues to
10 be handled manually. After this change, the costing system shows that the direct costs
11 of class 1 have been cut in half, to only \$500, while the direct costs for class 2, still
12 handled manually, remain at \$1,000. However, the not handling costs have increased
13 by \$200, to a total of \$1,200. In other words, total costs are \$2,700, a saving of \$300.

14 It is reasonable in this case to give class 1 credit for the \$300 saved; i.e. its new costs
15 should be set at \$1,200, while the costs of class 2 should remain at \$1,500. That,
16 however, is not how the costing system works if it is like the real IOCS. It concludes
17 that since class 2 now incurs two thirds of the direct costs, it must also be responsible
18 for two thirds of the \$1,200 not handling costs. In other words, class 2 is charged with
19 \$1,000 in direct and \$800 in not handling costs, for a total of \$1,800. Its costs have
20 suddenly, according to this costing system, increased by \$300, or 20%, even though it is
21 handled no differently than before. Class 1, on the other hand, is charged with only
22 \$500 in direct and \$400 in indirect costs, for a total of \$900. It gets credit not only for the
23 \$300 real savings that resulted from automation but for another \$300 in bogus savings
24 produced by an outdated and no longer adequate costing system.

25 Real life is obviously more complex, and there are many classes of mail, all affected
26 somewhat differently. Nevertheless, this example does illustrate what has happened to
27 Periodicals costs over the past ten years. It also illustrates why the Postal Service,
28 unwilling to admit its failure to manage its workforce efficiently in an automated
29 environment, has never offered any meaningful explanation of the Periodicals cost
30 increase or been willing to undertake a serious inquiry into the matter.

1 B. DEGEN'S POOL-BY-POOL METHOD FURTHER DISTORTS THE
2 RELATIONSHIP BETWEEN DIRECT AND NOT HANDLING COSTS

3 The pool-by-pool approach to distribution of not handling costs that Degen proposes
4 causes two types of distortion. First, it inevitably leads to an even larger bias against
5 the least automated mail, which receives a large portion of its total handling at
6 platforms and opening units, the operations where employees most often are clocked in
7 when they don't handle mail. Second, it ignores all information (other than MODS
8 codes) that IOCS clerks recorded about different not handling activities. These issues
9 are discussed further in sections 1 and 2 below.

10 1. The Pool-By-Pool Approach Unfairly Attributes Excessive Not Handling Costs To
11 The Least Automated Mail.

12 As discussed above, the sharply increased not handling costs brought about by
13 automation are mostly concentrated at platforms and opening units, operations where
14 productivity is least monitored and therefore favored places to send people not needed
15 elsewhere. But those operations are also where mail that is highly presorted and
16 undergoes little automated sorting, such as Periodicals and most Standard A mail,
17 receives a large portion of its handlings. Such mail, particularly its carrier route
18 presorted component, requires mostly dock transfers and bundle sorts but little piece
19 sorting, whereas mail with little presortation spends a large proportion of its time at
20 piece sorting operations.

21 Ignoring the real reasons why so much not handling time is spent at platforms and
22 opening units, ignoring the historical relationship between the implementation of
23 automation and the rise in not handling costs, ignoring even all the information that
24 IOCS does provide about different types of not handling costs, Degen proposes simply
25 to distribute all not handling costs within each pool based only on the direct and mixed
26 mail costs within that same pool. One inevitable consequence is higher costs than ever
27 attributed to Periodicals, which receive a large portion of their handling at platforms
28 and opening units.

29 The Postal Service claims that this new methodology was intended to "address" the
30 concerns of Periodicals mailers and others about rising mail processing costs. Instead,

1 the method supports even more exaggerated claims of automation savings. The Postal
 2 Service apparently has given no serious consideration to questions raised by Periodicals
 3 mailers, who keep pointing out that their costs used to be much lower and that they
 4 have done a lot of work themselves to reduce those costs.

5 2. Degen Ignores All Information About The Nature Of Each Type Of Not Handling
 6 Activity.

7 The not handling costs that Degen distributes as mail processing costs are defined by 63
 8 different IOCS activity codes, each representing a unique type of activity or inactivity.
 9 These codes reflect what IOCS clerks saw sampled clerks and mailhandlers doing. They
 10 are used in the traditional costing approach, which applies a number of different
 11 distribution keys designed according to the nature of each activity. Degen, on the other
 12 hand, ignores all this information, insisting that all that matters is the MODS cost pools
 13 employees happened to be clocked into.

14 The following sections demonstrate the inadequacy of Degen's approach with regard to
 15 four general categories of not handling costs: (a) class and activity specific not handling
 16 costs; (b) shape specific not handling costs; (c) general overhead not handling costs; and
 17 (d) not handling costs related to special services.

18 a. Class And Activity Specific Not Handling Costs. Degen takes his reliance on pool-
 19 by-pool distribution to the point of absurdity when he applies it even to costs for which
 20 much more specific information is available. For example, almost \$30 million in volume
 21 variable costs with IOCS activity code 6231, representing not handling associated with
 22 Express Mail, were observed over a large number of mail processing cost pools. No
 23 reasonable person would argue that these costs should be attributed to anything but
 24 Express Mail. Yet Degen, insisting that the only thing that matters is what cost pools
 25 people were logged into, attributes these Express Mail specific costs over all mail
 26 classes.²⁴ He does the same with costs in activity codes 6220 (special delivery) and 6230

²⁴ In MODS offices, \$22.6 million of these costs were spread over almost all the pools, again indicating that employees were logged into one operation while working at another. Only about half of the \$22.6 million were incurred in the EXPRESS cost pool, where, by the way, many classes other than Express Mail appear to be handled. See Tr. 6401-03, 6405, 6407, 6409.

1 (Registry).

2 Degen does the same with all window service and administration/support activities
3 where people performing those activities were incorrectly clocked into a MODS mail
4 processing operation. As explained in Appendix B, I identified \$498.317 million of such
5 volume variable not handling costs related to window service and
6 administration/support (\$819.866 million accrued). Degen simply distributes these
7 costs within whatever mail processing cost pool employees were clocked into, ignoring
8 the much more accurate distribution keys available to the Postal Service and the
9 Commission for distributing such costs.

10 As I explained above in Section IV, consistency with Bradley's volume variability
11 analysis may require use of pool relationships to determine the volume variability
12 factor associated with each tally. It does not, however, require ignoring all information
13 recorded by IOCS clerks about what observed employees were actually doing, when
14 use of such information would produce more meaningful cost distribution. In my
15 alternative approach I apply the distribution keys appropriate for each class and
16 activity indicated by the IOCS activity codes.

17 b. Shape Specific Not Handling Costs. Degen also ignores the shape related
18 characteristics of some not handling costs. In Docket No. R94-1, USPS witness Barker,
19 discussing the rapid increase in mail processing not handling costs, indicated that one
20 thing the Postal Service had done to improve distribution of not handling costs was to
21 isolate those directly associated with processing of, respectively, letters/cards, flats, and
22 parcels/IPP's. Activity code 5610 was used for not handling at operations dedicated to
23 letters and cards, code 5620 was similarly used for operations dedicated to flats, and
24 code 5700 for parcels/IPP's.

25 These codes are still in Degen's data base. Total volume variable not handling costs
26 were \$505.781 million for code 5610, \$172.679 million for code 5620, and \$71.331 million
27 for code 5700.²⁵ Degen ignores this information and treats 5610-5700 costs like all other

²⁵ Of course, in MODS offices none of these costs are limited to the pools where one would expect to

1 not handling costs, e.g. distributing 5610 costs over many costs unrelated to letter
 2 sorting, etc., thus further distorting the true cost relationships in mail processing.
 3 Rather than addressing the problem of rising not handling costs, Degen throws out
 4 what little progress the Postal Service had made towards a somewhat fairer distribution
 5 of these costs. The appropriate distribution keys for 5610, 5620 and 5700 not handling
 6 costs are, in my opinion, the direct letters and cards costs, the direct flats costs, and the
 7 direct parcel/IPP costs.

8 c. General Overhead Not Handling Costs. Degen also distributes costs that are
 9 general overhead in nature, such as breaks, clocking in/out, not handling empty
 10 equipment and the mixed all shapes (code 5750) costs, within each pool. Yet he has
 11 conducted no study of whether these costs are causally related only to the direct and
 12 mixed costs within the same pool, and I doubt that such a study would have confirmed
 13 his assumptions.

14 Consider break time. An employee on break might as well be on break from any
 15 operation. The fact that while on break he is logged into a given MODS operation does
 16 not mean that he is needed for the mail being handled at that operation, but rather that
 17 he is not needed there at that particular time. The one hour and fourteen minutes in an
 18 average eight hour day spent on breaks/personal needs is far more than Moden could
 19 explain in terms of need for "wash up time" or on any other basis, and can only mean
 20 that there are significant blocks of time in an average processing day when facilities do
 21 not need all their available employees. The employees must still be clocked in
 22 somewhere, however, in order to get paid. USPS response to TW/USPS-T-4-23,
 23 redirected from witness Moden.

24 This category of general overhead not handling costs represents \$3,728 million in
 25 accrued costs, or 28.3% of all accrued mail processing costs (see Table A-2 in Appendix
 26 A for a breakdown of these costs). The existence of such large and still growing not

find them, as can be seen from Table A-4 in Appendix A. All three codes can be found in most MODS cost pools, reflecting again the fact that employees are not always clocked into the operations where they are working.

1 handling costs unrelated to specific productive activities is a clear evidence of
2 considerable slack time in the postal system, reflecting an inability of USPS managers to
3 manage their workforce efficiently in the automated environment. It also constitutes an
4 independent verification of Bradley's conclusion that mail processing costs cannot be
5 100% volume variable, since a significant volume increase would (or at least should)
6 provide the Postal Service with an opportunity to get more work out of its existing
7 workforce, rather than just hiring more employees.

8 Since the Postal Service has produced no meaningful study of how facility managers
9 really plan the use of their employees' time and where people are sent when not
10 needed, little is known about the true causes for the sharp increases in these costs. For
11 this reason, the Commission should seriously consider treating even the volume
12 variable portion of these costs as institutional, until such time as the Postal Service
13 produces convincing evidence linking them to specific subclasses and special services
14 and explaining satisfactorily why these costs have grown so much in the past ten years.

15 If, however, the Commission decides that the volume variable portion of these
16 overhead costs must be attributed even in this docket, the best approach to distributing
17 them, though far from perfect, is to do what the Postal Service used to do, namely to
18 treat them as systemwide costs and distribute them proportionately over all other costs.

19 d. Not Handling Costs Related To Special Services. Another inexplicable aspect of
20 Degen's method is that, except for the Function 4 cost pools (stations and branches), he
21 distributes no not handling costs at all to special services in MODS offices. This makes
22 no sense, since his data show direct costs related to special services being incurred by
23 employees clocked into almost all cost pools. An employee performing special services
24 while for example clocked into an opening unit presumably also spends time on
25 breaks/personal needs, clocking in/out, etc.

26 The question of how to distribute not handling costs should be decided based on the
27 nature of each type of not handling activity, not by the MODS pool employees happen
28 to be clocked into while performing the activity. Some of the not handling costs that
29 Degen apparently believes should not be distributed to special services are in fact

1 specifically related to special services and should therefore be distributed only to those
 2 services. Examples include activity codes 5020 and 6020 (P.O. Boxes), 5080 and 6080
 3 (money orders), 6220 (special delivery) and 6230 (Registry). Additionally, as I show in
 4 Appendix A, certain not handling activities, e.g. those with activity code 6580 (postage
 5 due), have major components related to special services.

6 On the other hand, some not handling activities are not at all related to special services
 7 and therefore should not be distributed to them. For example, shape related not
 8 handling costs clearly are not related to special services, since the latter have no shapes
 9 associated with them.

10 All these considerations are ignored by Degen, due to his total reliance on the pool-by-
 11 pool approach to distributing not handling costs.

12 C. A BETTER WAY TO DISTRIBUTE NOT HANDLING COSTS

13 This section outlines the method I propose for distributing not handling costs. The
 14 details are described in Appendix A. My method does not resolve every outstanding
 15 uncertainty about the correct distribution of these costs. Not could it do so, given the
 16 continuing lack of any in-depth study, which only the Postal Service itself could
 17 perform, of the factors that drive these costs and have caused them to rise so much in
 18 the past decade.

19 However, my method is far better than that proposed by Degen, in that I pay attention
 20 to the characteristics of each type of not handling, as defined by IOCS activity codes,
 21 and select the distribution key most appropriate for each type.

22 The key features of my approach are as follows:

- 23 (1) All not handling costs with activity codes linked to specific subclasses or special
 24 services are distributed to those subclasses and services. Examples include not
 25 handling costs specifically linked to Express Mail, Registry, Special Delivery,
 26 P.O. Boxes and Money Orders.
- 27 (2) All not handling costs related to window service and administration/support
 28 activities are distributed the way such costs have traditionally been distributed
 29 within cost segments 3.2 and 3.3. While I reassign these costs from mail
 30 processing to segments 3.2 and 3.3, the important issue is not which segment the

1 costs are listed under but how they are distributed.

2 (3) In order to avoid the severe distortions caused by Degen's pool-by-pool
3 approach, I distribute most remaining not handling costs within facility type,
4 CAG and basic function, with the exception that for some categories (e.g. breaks)
5 basic function is not available.

6 (4) I develop shape specific distribution keys to distribute the shape specific not
7 handling costs (i.e., those with activity codes 5610-5700).

8 (5) Not handling costs are distributed to special services as well as subclasses, with
9 the exception of costs related to specific shapes or empty equipment.

10 (6) I use only volume variable costs to perform all distributions.

11 Exhibit 1 shows my resulting distribution of mail processing costs. Appendix B
12 describes my proposed distribution of the window service and administration/support
13 costs that Degen misclassifies as mail processing costs.

14 VII. CONCLUSIONS

15 The Postal Service deserves credit for addressing the question of volume variability in
16 mail processing and challenging the long held but not credible assumption of 100%
17 variability. It also deserves credit for making available MODS data that, despite many
18 flaws, at least offer the potential for better insight in the factors that drive mail
19 processing costs.

20 However, as I have demonstrated, the Postal Service has severely misinterpreted these
21 data in its attempt to use them for cost distribution. Witness Degen's cost distribution
22 approach is based on unverified, unreasonable and in some cases clearly erroneous
23 assumptions. The many serious flaws in his methodology include:

24 (1) his implementation of a poorly designed and fundamentally biased scheme for
25 capturing mixed mail costs, which both the Commission and the Postal Service
26 itself refused, for good reasons, to rely on in Docket No. R94-1 and which Degen
27 makes worse still by applying it within individual pools;

28 (2) his insistence on distributing costs within pools, without regard to evident cost
29 relationships that exist across pools; and

30 (3) his ignoring all information, much of it relevant and important, that is available
31 in IOCS regarding the characteristics of different types of not handling costs.

32 Degen has not examined the causes of rising not handling costs. On the contrary, he

1 has taken a step backward by ignoring what little relevant information is available
2 about these costs. Nor has he addressed any of the questions raised by Periodicals
3 mailers who have seen their costs rise much faster than postal wages despite all their
4 efforts to help reduce those costs. Instead, his method uncritically assumes the
5 legitimacy of past large cost increases and then proposes to raise Periodicals costs even
6 further.

7 If the Postal Service, at long last, would take Periodicals mailers' concerns about rising
8 costs seriously and launch a real investigation into why those costs have risen so much,
9 the results might benefit more than just Periodicals mailers, by revealing the large
10 inefficiencies in today's postal system and suggesting ways to use postal employees'
11 time more efficiently. Instead, the Postal Service has chosen an approach that loads
12 even more costs onto the least automated mail, thereby avoiding unpleasant questions
13 about the efficiency of its management of its workforce and supporting its exaggerated
14 claims of automation savings.

15 In addition to pointing out the failings in Degen's methodology, I have outlined a
16 different approach to mail processing cost distribution, which is described in further
17 detail in Appendices A and B. The alternative I propose is not ideal. A completely
18 satisfactory method would require much more and better information about why postal
19 managers assign people to different positions at different times, and about the true
20 composition of mixed mail, information which only the Postal Service is in a position to
21 collect. My proposed method is far better than Degen's, however, because I have
22 avoided reliance on unverified assumptions and at the same time made use of
23 important information that Degen simply ignored.

24 As I have demonstrated, the evidence provided by the Postal Service to link most mixed
25 mail and not handling costs to specific subclasses and services in this docket is so weak
26 that it raises serious doubts whether any basis exists for attributing even the volume
27 variable portion of these costs. In particular, little is known about what really causes
28 the \$3,727 million accrued (\$2,733 million volume variable) costs referred to above as
29 general overhead not handling costs. All that can be said with certainty about these
30 costs is that they grew anomalously during the past ten years when the automation

1 program was being implemented. The Commission should seriously consider treating
2 these costs as institutional until the Postal Service provides more reliable information
3 about what causes them.

4 If, however, it decides that all volume variable mail processing costs should be
5 attributed, then I urge the Commission to use my alternative approach to attribute
6 Segment 3 costs.

EXHIBITS 1-6

1 **ALTERNATIVE ATTRIBUTION OF MAIL PROCESSING COSTS**

2 Table 1-1 on the following page shows the attribution of mail processing costs that I
3 propose to replace Degen's method. The tables on subsequent pages show my
4 attribution, compared with Degen's, for costs incurred respectively in MODS offices,
5 NonMODS offices and BMC's. Total attribution is less than Degen's because I propose
6 to classify some costs as window service and administration/support costs (Segments
7 3.2 and 3.3). My proposed attribution of window service and administration/support
8 costs is described in Appendix B.

Exhibit 1, P. 2 of 5
Revised 2/20/98

Table 1-1: Attributed Mail Processing Costs - All Offices (\$1,000's)			
Subclass	Degen	Stralberg	Difference
First-Class:			
Letters and Parcels	4,651,743	4,702,082	50,339
Presort Letters and Parcels	1,063,109	1,003,779	(59,330)
Postal Cards	3,214	3,111	(103)
Private Mailing Cards	136,725	150,506	13,781
Presort Cards	36,425	45,593	9,168
Total First Class	5,891,215	5,905,071	13,856
Priority Mail	477,897	319,010	(158,887)
Express Mail	84,168	53,669	(30,499)
Mailgrams	74	108	34
Periodicals:			
Within County	15,159	13,576	(1,583)
Regular Rate Publications	461,712	367,827	(93,885)
Nonprofit Publications	80,740	67,674	(13,066)
Classroom Publications	5,684	3,728	(1,956)
Total Periodicals	563,295	452,806	(110,490)
Standard A:			
Single Piece Rate	78,662	76,513	(2,149)
Regular Enhanced Car. Rte.	266,254	215,442	(50,812)
Regular Other	1,545,319	1,417,689	(127,630)
Total Bulk Regular	1,811,573	1,633,131	(178,442)
Nonprofit Enhanced Car. Rte.	28,946	22,319	(6,627)
Nonprofit Other	367,511	352,266	(15,245)
Total Bulk Nonprofit	396,457	374,585	(21,872)
Total Standard A	2,286,692	2,084,229	(202,463)
Standard B:			
Parcels Zone Rate	159,880	126,110	(33,770)
Bound Printed Matter	74,506	65,535	(8,971)
Special Standard	68,491	69,576	1,085
Library Mail	16,350	15,487	(862)
Total Standard B	319,227	276,709	(42,518)
Penalty - U. S.P.S.	77,658	79,290	1,631
Free Mail	10,100	8,563	(1,536)
International Mail	209,017	197,784	(11,233)
Total All Mail	9,919,344	9,377,239	(542,105)
Special Services:			
Registry	42,163	66,952	24,789
Certified	18,473	22,932	4,459
Insurance	771	925	154
COD	1,815	2,378	563
Special Delivery	243	1,847	1,605
Special Handling	200	274	75
Other	76,063	88,212	12,149
Total Special Services	139,728	183,521	43,793
Total Volume Variable	10,059,072	9,560,760	(498,312)

Table 1-2: Attributed Mail Processing Costs - MODS (\$1,000's)			
Subclass	Degen	Stralberg	Difference
First-Class:			
Letters and Parcels	3,853,315	3,890,026	36,711
Presort Letters and Parcels	847,751	787,825	(59,926)
Postal Cards	2,279	2,177	(101)
Private Mailing Cards	111,759	124,063	12,304
Presort Cards	28,718	37,292	8,574
Total First Class	4,843,822	4,841,384	(2,438)
Priority Mail	410,462	255,199	(155,263)
Express Mail	63,591	40,391	(23,200)
Mailgrams	74	108	34
Periodicals:			
Within County	10,018	8,492	(1,526)
Regular Rate Publications	354,199	272,147	(82,052)
Nonprofit Publications	62,875	50,460	(12,415)
Classroom Publications	3,459	2,092	(1,367)
Total Periodicals	430,551	333,191	(97,360)
Standard A:			
Single Piece Rate	54,294	52,031	(2,263)
Regular Enhanced Car. Rte.	169,041	133,672	(35,369)
Regular Other	1,106,751	983,411	(123,340)
Total Bulk Regular	1,275,792	1,117,084	(158,708)
Nonprofit Enhanced Car. Rte.	19,716	15,464	(4,252)
Nonprofit Other	287,179	269,902	(17,277)
Total Bulk Nonprofit	306,895	285,366	(21,529)
Total Standard A	1,636,981	1,454,481	(182,500)
Standard B:			
Parcels Zone Rate	64,010	36,783	(27,227)
Bound Printed Matter	28,846	18,998	(9,848)
Special Standard	21,379	15,488	(5,891)
Library Mail	6,157	4,280	(1,877)
Total Standard B	120,392	75,550	(44,842)
Penalty - U. S.P.S.	56,303	58,562	2,259
Free Mail	7,400	5,520	(1,880)
International Mail	173,427	162,633	(10,794)
Total All Mail	7,743,003	7,227,019	(515,984)
Special Services:			
Registry	27,011	39,174	12,163
Certified	5,684	7,149	1,464
Insurance	133	298	165
COD	508	726	219
Special Delivery	243	1,304	1,061
Special Handling	85	122	37
Other	47,113	57,094	9,981
Total Special Services	80,776	105,867	25,091
Total Volume Variable	7,823,779	7,332,885	(490,894)

Table 1-3: Attributed Mail Processing Costs - NonMODS (\$1,000's)			
Subclass	Degen	Stralberg	Difference
First-Class:			
Letters and Parcels	794,125	805,942	11,817
Presort Letters and Parcels	214,435	214,812	377
Postal Cards	935	933	(2)
Private Mailing Cards	24,847	26,289	1,442
Presort Cards	7,707	8,255	548
Total First Class	1,042,049	1,056,231	14,182
Priority Mail	65,920	61,803	(4,117)
Express Mail	20,558	13,098	(7,460)
Mailgrams	0	0	0
Periodicals:			
Within County	5,045	4,990	(55)
Regular Rate Publications	91,108	83,403	(7,705)
Nonprofit Publications	14,266	14,349	83
Classroom Publications	1,311	1,148	(163)
Total Periodicals	111,730	103,889	(7,841)
Standard A:			
Single Piece Rate	12,912	12,573	(339)
Regular Enhanced Car. Rte.	80,272	67,274	(12,998)
Regular Other	299,550	298,162	(1,388)
Total Bulk Regular	379,822	365,436	(14,386)
Nonprofit Enhanced Car. Rte.	7,710	5,567	(2,143)
Nonprofit Other	60,700	62,992	2,292
Total Bulk Nonprofit	68,410	68,559	149
Total Standard A	461,144	446,568	(14,576)
Standard B:			
Parcels Zone Rate	19,634	16,215	(3,419)
Bound Printed Matter	12,908	11,209	(1,699)
Special Standard	8,471	8,496	25
Library Mail	1,758	1,571	(187)
Total Standard B	42,771	37,491	(5,280)
Penalty - U. S.P.S.	17,070	16,861	(209)
Free Mail	726	768	42
International Mail	6,461	6,221	(240)
Total All Mail	1,768,429	1,742,930	(25,499)
Special Services:			
Registry	14,973	27,212	12,239
Certified	12,789	15,752	2,963
Insurance	630	605	(25)
COD	1,307	1,650	343
Special Delivery	0	537	537
Special Handling	115	152	37
Other	28,806	30,826	2,020
Total Special Services	58,620	76,734	18,114
Total Volume Variable	1,827,049	1,819,664	(7,385)

Table 1-4: Attributed Mail Processing Costs - BMC's (\$1,000's)			
Subclass	Degen	Stralberg	Difference
First-Class:			
Letters and Parcels	4,303	6,114	1,811
Presort Letters and Parcels	923	1,142	219
Postal Cards	0	0	0
Private Mailing Cards	119	154	35
Presort Cards	0	46	46
Total First Class	5,344	7,456	2,112
Priority Mail	1,515	2,009	493
Express Mail	19	180	161
Mailgrams	0	0	0
Periodicals:			
Within County	96	95	(1)
Regular Rate Publications	16,405	12,277	(4,128)
Nonprofit Publications	3,599	2,865	(734)
Classroom Publications	914	489	(426)
Total Periodicals	21,015	15,726	(5,289)
Standard A:			
Single Piece Rate	11,456	11,909	453
Regular Enhanced Car. Rte.	16,941	14,496	(2,445)
Regular Other	139,018	136,115	(2,903)
Total Bulk Regular	155,959	150,611	(5,348)
Nonprofit Enhanced Car. Rte.	1,520	1,288	(233)
Nonprofit Other	19,632	19,372	(260)
Total Bulk Nonprofit	21,152	20,660	(492)
Total Standard A	188,567	183,180	(5,387)
Standard B:			
Parcels Zone Rate	76,236	73,112	(3,124)
Bound Printed Matter	32,752	35,327	2,575
Special Standard	38,641	45,592	6,951
Library Mail	8,435	9,636	1,201
Total Standard B	156,064	163,668	7,604
Penalty - U. S.P.S.	4,285	3,866	(419)
Free Mail	1,973	2,275	302
International Mail	29,129	28,930	(199)
Total All Mail	407,912	407,290	(622)
Special Services:			
Registry	179	566	387
Certified	0	32	32
Insurance	9	23	14
COD	0	1	1
Special Delivery	0	6	6
Special Handling	0	1	1
Other	144	292	148
Total Special Services	332	921	589
Total Volume Variable	408,244	408,211	(33)

Exhibit 2, P. 1 of 1
Revised 2/20/98

Table 2-1: Modified Attribution Of BY96 Segment 3 Costs (\$1,000's) ¹				
	3.1 Mail Processing	3.2 Window Service	3.3 Admin./ Support	Total Segment 3
First-Class:				
Letters & Parcels	4,821.288	515.633	482.312	5,819.232
Presort Letters & Parcels	1,021.182	22.798	143.563	1,187.543
Single Piece Cards	157.708	33.190	19.011	209.909
Presort Cards	47.331	792	5.361	53.484
Total First Class	6,047.509	572.412	650.247	7,270.168
Priority Mail	317.269	42.667	29.499	389.435
Express Mail	53.623	23.797	52.807	130.227
Mailgrams	114	0	17	130
Periodicals:				
Within County	13.623	473	2.746	16.842
Regular Rate Publications	373.446	2.260	41.116	416.821
Nonprofit Publications	68.988	243	10.201	79.432
Classroom Publications	3.798	0	386	4.184
Total Periodicals	459.855	2.975	54.449	517.280
Standard A:				
Single Piece Rate	73.912	2.481	6.590	82.983
Regular Enhanced Car. Rte.	206.289	5.953	67.042	279.284
Regular Other	1,363.549	23.106	151.282	1,537.937
Total Bulk Regular	1,569.838	29.059	218.324	1,817.221
Nonprofit Enhanced Car. Rte.	21.312	980	5.248	27.540
Nonprofit Other	339.015	8.409	37.612	385.035
Total Bulk Nonprofit	360.327	9.389	42.860	412.576
Total Standard A	2,004.077	40.930	267.774	2,312.780
Standard B:				
Parcels Zone Rate	122.366	7.746	12.224	142.337
Bound Printed Matter	63.601	641	7.328	71.571
Special Standard	68.170	3.296	6.083	77.549
Library Mail	15.096	102	1.170	16.367
Total Standard B	269.234	11.786	26.805	307.825
Penalty - U. S.P.S.	103.620	14.202	10.156	127.977
Free Mail	8.926	187	744	9.857
International Mail	209.994	24.648	21.895	256.537
Total All Mail	9,474.221	733.603	1,114.392	11,322.216
Special Services:				
Registry	31.606	12.087	4.903	48.596
Certified	23.209	39.092	11.452	73.754
Insurance	937	11.938	851	13.725
COD	2.406	3.669	878	6.953
Special Delivery	49	153	110	312
Money Orders	0	82.983	4.139	87.123
Stamped Envelopes	0	1,361	67	1,428
Special Handling	277	548	41	867
Post office box	0	69.153	7.163	76.317
Other	88.878	10.208	10.265	109.351
Total Special Services	147.362	231.193	39.870	418.425
Total Volume Variable	9,621.584	964.796	1,154.262	11,740.642
Other	2,805.963	1,059.160	850.338	4,715.462
Total Costs	12,427.547	2,023.956	2,004.601	16,456.103

¹ Sources: Seg. 3.1: Table A-9. Seg 3.2: Table B-3. Seg. 3.3: Table B-7.

Table 3-1: Attributed BY96 Clerk & Mailhandler Wage Costs (\$1,000's)			
	USPS Proposal	Stralberg	Difference
First-Class:			
Letters & Parcels	5,566.303	5,819.232	252.929
Presort Letters & Parcels	1,194.689	1,187.543	(7.146)
Single Piece Cards	183.379	209.909	26.530
Presort Cards	41.349	53.484	12.135
Total First Class	6,985.720	7,270.168	284.448
Priority Mail	540.853	389.435	(151.418)
Express Mail	112.436	130.227	17.791
Mailgrams	88	130	42
Periodicals:			
Within County	17.388	16.842	(546)
Regular Rate Publications	496.960	416.821	(80.139)
Nonprofit Publications	88.934	79.432	(9.502)
Classroom Publications	6.005	4.184	(1.821)
Total Periodicals	609.287	517.280	(92.007)
Standard A:			
Single Piece Rate	82.069	82.983	914
Regular Enhanced Car. Rte.	305.921	279.284	(26.637)
Regular Other	1,605.824	1,537.937	(67.887)
Total Bulk Regular	1,911.745	1,817.221	(94.524)
Nonprofit Enhanced Car. Rte.	32.442	27.540	(4.902)
Nonprofit Other	385.597	385.035	(562)
Total Bulk Nonprofit	418.039	412.576	(5.463)
Total Standard A	2,411.853	2,312.780	(99.073)
Standard B:			
Parcels Zone Rate	168.661	142.337	(26.324)
Bound Printed Matter	76.322	71.571	(4.751)
Special Standard	72.257	77.549	5.292
Library Mail	16.453	16.367	(86)
Total Standard B	333.693	307.825	(25.868)
Penalty - U. S.P.S.	112.772	127.977	15.205
Free Mail	11.042	9.857	(1.185)
International Mail	252.743	256.537	3.794
Total All Mail	11,370.487	11,322.216	(48.271)
Special Services:			
Registry	31.718	48.596	16.878
Certified	63.305	73.754	10.449
Insurance	12.818	13.725	907
COD	5.968	6.953	985
Special Delivery	216	312	96
Money Orders	82.277	87.123	4.846
Stamped Envelopes	1.341	1.428	87
Special Handling	754	867	113
Post office box	65.299	76.317	11.018
Other	89.524	109.351	19.827
Total Special Services	353.220	418.425	65.205
Total Volume Variable	11,723.707	11,740.642	16.935
Other	4,732.392	4,715.462	(16.930)
Total Costs	16,456.099	16,456.103	4

1 DIRECT, COUNTED, UNCOUNTED AND EMPTY ITEM COSTS

2 Table 4-1 shows the volume variable BY96 costs associated with respectively direct
 3 (identical), counted mixed, uncounted mixed and empty items, for each item type.
 4 Tables 4-2 through 4-4 on the subsequent pages show the corresponding information
 5 for, respectively, MODS offices, NonMODS offices and BMC's. The tables separate top-
 6 piece-rule and non-top-piece-rule items. The direct costs shown for top-piece-rule items
 7 include all top-piece-rule tallies. None of these items were counted. In total, there were
 8 \$41.537 million in counted item costs and \$66.012 million in uncounted mixed item
 9 costs, i.e. 38.6% of eligible items were counted.

10 The estimates of counted item costs are from datasets TW28emdr, TW28enmr and
 11 TW28ebmr, provided by Degen in USPS LR-H-296. Other estimates are from the data
 12 sources described in Appendix A.

Table 4-1: Volume Variable Item Costs - All Offices (\$1,000's)					
Item Type	Direct	Mixed		Total	Empty
		Counted	Uncounted	Non-Empty	
Top Piece Rule:					
BUNDLE	587,930	N.A.	5,308	593,238	N.A.
TRAY-FT	93,243	N.A.	6,399	99,642	50,510
TRAY-LT	295,238	N.A.	14,446	309,684	91,861
Total Top Piece Rule:	976,410	N.A.	26,154	1,002,564	142,371
Non-Top Piece Rule					
CON-CON	407	209	1,292	1,926	5,061
TRAY-P.	1,017	1,317	456	2,929	2,813
PALLET	8,746	1,926	4,374	15,099	8,120
OTHITEM	1,776	1,063	3,081	5,941	8,011
SCK-BL&O	1,112	2,569	2,706	6,389	2,061
SCK-GREN	539	2,688	2,933	6,192	5,798
SCK-OR&Y	996	8,390	5,846	15,278	7,586
SCK-BRWN	8,853	3,643	1,535	14,098	7,668
SCK-WH#1	5,153	6,472	3,260	14,911	12,639
SCK-WH#2	6,732	5,529	5,687	18,100	14,429
SCK-WH#3	17,393	3,070	2,879	23,492	8,472
SCK-OTHR	2,058	1,415	2,784	6,275	3,382
SCK-INTL	356	3,244	3,027	6,628	943
Total Non-Top Piece Rule	55,139	41,537	39,859	137,256	86,985
Total All Items	1,031,549	41,537	66,012	1,139,820	229,356

Table 4-2: Volume Variable Item Costs - MODS (\$1,000's)					
Item Type	Direct	Mixed		Total	Empty
		Counted	Uncounted	Non-Empty	
Top Piece Rule:					
BUNDLE	445,969	N.A.	3,619	449,588	N.A.
TRAY-FT	79,928	N.A.	5,621	85,549	43,093
TRAY-LT	264,595	N.A.	13,245	277,840	78,968
Total Top Piece Rule	790,493	N.A.	22,484	812,977	122,061
Non-Top Piece Rule:					
CON-CON	339	133	1,143	1,633	4,150
TRAY-P.	862	1,203	368	2,573	2,589
PALLET	4,835	1,021	3,469	9,377	4,725
OTHITEM	867	542	1,686	3,116	6,071
SCK-BL&O	745	2,079	2,706	5,531	1,973
SCK-GREN	466	2,357	2,602	5,457	4,537
SCK-OR&Y	755	7,391	5,565	13,756	6,964
SCK-BRWN	5,959	3,182	1,261	10,468	6,072
SCK-WH#1	2,539	2,232	1,557	6,354	5,527
SCK-WH#2	3,257	3,181	2,965	9,554	10,069
SCK-WH#3	7,208	1,620	1,896	10,873	4,972
SCK-OTHR	674	615	1,553	2,859	2,289
SCK-INTL	133	2,518	3,027	5,680	930
Total Non-Top Piece Rule	28,639	28,074	29,797	87,232	60,868
Total All Items	819,132	28,074	52,281	900,209	182,929

Table 4-3: Volume Variable Item Costs - NonMODS (\$1,000's)					
Item Type	Direct	Mixed		Total	Empty
		Counted	Uncounted	Non-Empty	
Top Piece Rule:					
BUNDLE	128,635	N.A.	653	129,287	N.A.
TRAY-FT	12,033	N.A.	430	12,463	6,752
TRAY-LT	25,341	N.A.	854	26,195	12,459
Total Top Piece Rule	166,009	N.A.	1,936	167,945	19,211
Non-Top Piece Rule:					
CON-CON	68	76	88	232	911
TRAY-P.	44	88	0	132	105
PALLET	823	194	71	1,087	855
OTHITEM	802	403	1,109	2,315	1,420
SCK-BL&O	367	490	0	857	88
SCK-GREN	38	274	269	580	1,261
SCK-OR&Y	233	905	280	1,419	590
SCK-BRWN	1,368	275	0	1,643	1,224
SCK-WH#1	329	497	427	1,253	1,580
SCK-WH#2	292	905	985	2,181	2,034
SCK-WH#3	1,780	397	105	2,283	2,171
SCK-OTHR	241	0	269	509	949
SCK-INTL	0	0	0	0	0
Total Non-Top Piece Rule	6,384	4,504	3,603	14,491	13,188
Total All Items	172,393	4,504	5,540	182,436	32,399

Table 4-4: Volume Variable Item Costs - BMC's (\$1,000's)					
Item Type	Direct	Mixed		Total Non-Empty	Empty
		Counted	Uncounted		
Top Piece Rule:					
BUNDLE	13,326	N.A.	1,037	14,363	N.A.
TRAY-FT	1,281	N.A.	349	1,630	666
TRAY-LT	5,302	N.A.	347	5,649	433
Total Top Piece Rule	19,909	N.A.	1,733	21,642	1,099
Non-Top Piece Rule:					
CON-CON	0	0	61	61	0
TRAY-P.	111	26	87	224	120
PALLET	3,088	711	835	4,634	2,540
OTHITEM	107	118	286	510	520
SCK-BL&O	0	0	0	0	0
SCK-GREN	35	57	62	154	0
SCK-OR&Y	8	95	0	103	32
SCK-BRWN	1,527	186	274	1,987	372
SCK-WH#1	2,285	3,743	1,276	7,304	5,533
SCK-WH#2	3,184	1,444	1,737	6,365	2,326
SCK-WH#3	8,404	1,053	878	10,336	1,329
SCK-OTHR	1,143	800	963	2,907	145
SCK-INTL	223	726	0	949	12
Total Non-Top Piece Rule	20,115	8,959	6,458	35,533	12,929
Total All Items	40,024	8,959	8,191	57,175	14,028

1 **DIRECT & COUNTED ITEM COSTS BY MAJOR CLASS**

2 Tables 5-1 through 5-3 show the volume variable BY96 costs associated with,
 3 respectively, direct (identical) and counted mixed non-top-piece-rule item costs broken
 4 down by major class category. The estimates of counted item costs are from datasets
 5 TW28emdr, TW28enmr and TW28ebmr, provided by Degen in USPS LR-H-296. There
 6 is a small discrepancy in the estimated relative amounts of direct and counted item
 7 costs between the tables below and those shown in Exhibit 4, due to a discrepancy in the
 8 counted item data provided by Degen.¹ However, this discrepancy does not affect the
 9 method I propose for distributing mixed mail costs in this docket.

Table 5-1: Direct & Counted Item Costs In MODS Offices (Volume Variable Costs - Non-Top Piece Rule Items)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	5,347	18.70%	2,661	9.46%
Periodicals	3,744	13.09%	8,638	30.72%
Standard A	4,849	16.96%	14,317	50.91%
Standard B	1,213	4.24%	714	2.54%
Priority	7,946	27.79%	1,242	4.42%
Express	1,856	6.49%	584	2.08%
Other	3,638	12.72%	(36)	-0.13%
Total	28,594	100.00%	28,119	100.00%

¹ This discrepancy has the following history. Degen originally, in response to TW/USPS-12-28e, provided counted item costs by cost pool, item type and subclass. Time Warner asked, in TW/USPS-5, why it appeared that the international sacks counted in MODS offices contained no international mail. Degen responded by saying that there was a mistake in his original counted item response, that in fact many more international sacks had been counted, and that the corrected information would be filed in USPS LR-H-296. Data sets TW28emdr, TW28ebmr and TW28enmr from that library reference give estimates of total counted item costs by cost pool and item type, and a further breakdown of the counted item costs for each pool and item type by subclass. The two do not match completely, particularly for international sacks. Subtracting the counted item costs given by subclass from the corresponding combined direct and counted item data in the IOCS data base gives a small negative direct cost for international mail, indicating that Degen's revised response must have overstated the counting of international sacks.

Table 5-2: Direct & Counted Item Costs NonMODS Offices (Volume Variable Costs - Non-Top Piece Rule Items)				
Subclass	Counted		Direct:	
	\$1,000's	Percent	\$1,000's	Percent
First	867	19.25%	284	4.45%
Periodicals:	680	15.11%	1,578	24.71%
Standard A:	926	20.56%	3,882	60.80%
Standard B:	451	10.02%	(0)	-0.00%
Priority	1,211	26.89%	350	5.48%
Express	364	8.07%	291	4.56%
Other	5	0.10%	0	0.00%
Total	4,504	100.00%	6,384	100.00%

Table 5-3: Direct & Counted Item Costs In BMC's (Volume Variable Costs - Non-Top Piece Rule Items)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	46	0.51%	69	0.34%
Periodicals	704	7.86%	3,915	19.46%
Standard A	2,745	30.63%	12,588	62.58%
Standard B	3,460	38.62%	1,966	9.77%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	2,004	22.37%	1,577	7.84%
Total	8,960	100.00%	20,115	100.00%

**COSTS OF LOOSE ITEMS AND ITEMS IN CONTAINERS AT MODS COST
POOLS**

Tables 6-1 and 6-2 on the following pages show how the direct costs of loose items and the costs of items-in-containers, respectively, are spread over MODS cost pools for different item types. Comparison of the two tables show clearly that loose items are mostly handled at operations different from those that predominantly handle containers with the same types of items in them. It is therefore inappropriate to distribute items-in-container costs based on direct item costs within cost pools.

Each table summarizes at the bottom the total handling costs per item type and the portion of those costs that are incurred at platforms and opening units, defined to include MODS cost pools Bulk PR, CancMPP, OpBulk, OpPref, Platfrm, Pouching, Sacks_H and Sacks_M. For each item type, the proportion of items-in-container costs incurred at platforms or opening units is significantly larger than the corresponding proportion for direct item costs. The last column in each table represents "other items," which here means all non-top-piece-rule items (sacks, pallets, parcel trays, etc.).

Exhibit 6, P. 2 of 3

Table 6-1: Direct Volume Variable Item Costs Per MODS Cost Pool & Item Type (\$1,000's)									
Cost Pool	Cards	Letters	Flats	IPP's	Parcels	Bundles	Flat Trays	Letter Trays	Other Items
Bcs/	4,021	209,359	823	174	19	61,535	5,020	66,569	268
Express	28	360	6,962	231	1,432	310	0	97	1,000
Fsm/	158	8,360	334,521	1,309	1,704	28,501	23,929	664	358
Lsm/	20,747	374,633	2,556	369	171	36,527	1,338	22,184	260
Manf	252	10,886	204,992	1,547	3,651	26,280	7,228	637	711
Manl	27,992	523,223	20,554	2,096	2,346	82,899	2,758	24,021	471
Manp	23	576	1,430	1,258	4,624	640	63	264	362
Mecparc	55	235	348	160	1,890	387	0	0	215
Ocr/	1,207	58,324	675	92	100	17,693	1,423	18,282	93
Priority	28	1,067	12,737	2,621	20,249	509	70	325	2,448
Spbs Oth	91	1,173	4,075	6,243	3,405	13,944	519	256	1,843
Spbsprio	0	68	4,273	3,310	6,509	1,442	204	104	893
Busreply	389	3,248	630	104	215	1,381	116	167	49
Intl	747	16,961	5,045	1,183	4,419	2,887	602	1,656	2,288
Ld15	5,673	124,721	1,426	0	0	28,565	1,763	34,268	0
Ld41	0	4,764	28	0	0	1,183	39	710	31
Ld42	19	308	450	0	24	75	14	60	0
Ld43	2,229	72,130	41,874	6,421	20,342	24,099	5,840	7,770	1,855
Ld44	736	37,851	11,759	733	1,321	5,806	481	873	170
Ld48 Exp	0	16	226	2	23	0	0	0	0
Ld48 Oth	123	2,003	533	76	324	554	180	201	59
Ld48_Ssv	53	1,409	741	99	213	361	53	80	0
Ld49	9,156	69,095	28,505	1,059	2,187	2,736	950	2,418	41
Ld79	291	3,268	797	44	330	3,645	201	2,209	1,861
Mailgram	0	0	0	0	0	0	0	0	41
Registry	44	405	203	32	79	158	0	30	159
Rewrap	109	2,184	361	3	462	57	0	169	0
IBulk Pr	25	636	106	0	123	558	28	821	33
ICanempp	1,723	50,499	12,705	2,249	2,259	8,385	3,027	5,795	551
IEeqmt	0	216	170	0	62	259	56	0	60
IMisc	137	4,469	1,421	207	803	1,225	376	1,439	283
IOpbulk	338	10,661	10,392	2,431	2,282	31,589	2,968	8,965	3,790
IOppref	524	31,811	26,630	16,478	12,879	34,113	6,523	26,660	7,417
IPlatfrm	79	6,462	6,040	1,407	8,288	6,830	4,844	7,407	13,562
IPouchng	785	13,955	13,754	10,269	7,254	16,419	7,510	23,845	5,299
ISacks_H	38	905	1,193	414	2,485	3,281	708	2,341	4,375
ISacks_M	0	64	544	61	1,002	365	475	910	4,253
IScan	0	593	754	369	2,710	112	595	2,045	1,561
ISupport	138	2,684	516	87	230	661	29	312	53
Ld48_Adm	0	0	0	0	0	0	0	0	0
Support Oth.	0	206	0	0	0	0	0	42	0
Total	77,957	1,649,789	760,750	63,138	116,415	445,969	79,928	264,595	56,713
Platforms/ Open. Units	3,512	114,993	71,364	33,310	36,572	101,540	26,083	76,744	39,281
Percent	4.51%	6.97%	9.38%	52.76%	31.42%	22.77%	32.63%	29.00%	69.26%

Table 6-2: Volume Variable Item-In-Container Costs At MODS Cost Pools (\$1,000's)									
Cost Pool	Cards	Letters	Flats	IPP's	Parcels	Bundles	Flat Trays	Letter Trays	Other Items
Bcs/	0	3,243	66	0	0	171	367	16,389	169
Express	0	21	116	42	69	0	28	61	501
Fsm/	0	138	4,015	170	180	925	9,183	179	382
Lsm/	265	1,448	149	66	0	336	196	3,807	147
Manf	1	123	5,339	239	168	1,314	5,318	503	340
Manl	22	1,357	520	65	8	864	1,394	7,740	454
Manp	1	22	66	252	592	74	93	111	278
Mecparc	0	55	0	52	55	55	0	0	231
Ocr/	106	874	0	45	0	90	222	3,399	98
Priority	40	114	281	413	2,168	69	114	188	1,475
Spbs Oth	27	119	487	672	752	1,358	66	106	758
Spbsprio	0	3	204	748	1,177	168	150	105	927
Busreply	0	25	88	129	76	54	56	110	8
Intl	4	58	249	297	741	127	368	548	2,309
Ld15	0	1,881	0	0	0	0	0	15,211	0
Ld41	0	34	0	0	0	0	0	404	0
Ld42	0	0	10	0	0	10	0	38	0
Ld43	81	1,596	1,363	624	2,291	717	2,689	5,111	1,047
Ld44	6	48	110	81	28	0	187	305	2
Ld48 Exp	0	0	0	0	0	0	1	0	0
Ld48 Oth	1	34	19	4	49	23	162	222	6
Ld48_Ssv	2	29	16	0	17	6	31	20	14
Ld49	0	293	280	0	0	43	348	1,030	0
Ld79	0	52	0	0	0	0	0	537	285
Mailgram	0	0	0	0	0	0	0	0	0
Registry	0	4	7	32	84	9	9	58	342
Rewrap	43	0	68	95	19	55	63	55	0
1Bulk Pr	0	0	8	0	0	34	60	381	18
1Cancmpp	212	4,625	1,244	612	270	83	1,055	2,455	614
1Eqgmt	0	5	56	121	68	0	165	266	865
1Misc	63	269	251	108	32	413	577	1,387	125
1Opbulk	23	868	2,355	756	966	1,770	2,836	5,461	1,933
1Oppref	90	2,500	3,186	1,841	2,157	3,122	6,338	18,284	5,083
1Platfrm	215	3,736	3,650	3,263	13,307	5,446	17,261	27,143	22,013
1Pouchng	5	1,635	2,156	1,075	1,137	1,317	7,117	18,136	3,339
1Sacks_H	0	292	400	259	1,615	560	1,507	2,605	3,618
1Sacks_M	0	169	122	63	255	189	389	825	899
1Scan	0	196	60	177	435	56	647	1,964	1,129
1Support	0	71	107	38	81	20	128	248	57
Ld48_Adm	0	0	0	0	0	0	0	0	0
Support Oth.	0	0	0	0	0	0	0	0	0
Total	1,206	25,938	27,050	12,339	28,796	19,481	59,124	135,391	49,464
Platforms/ Open. Units	544	13,825	13,122	7,868	19,706	12,521	36,563	75,291	37,517
Percent	45.11%	53.30%	48.51%	63.77%	68.43%	64.28%	61.84%	55.61%	75.85%

APPENDIX A: DATA SOURCES AND METHODOLOGY

This appendix explains in detail the methodology used to develop the alternative mail processing cost distribution presented in Exhibit 1. Section 1 explains how I extracted from the IOCS data base the information needed to develop an alternative distribution method, as well as various exhibits presented with this testimony. Section 2 describes various spreadsheets used to perform my calculations. Section 3 describes how IOCS tally costs are translated to corresponding volume variable costs in my methodology. Section 4 describes my use of CAG and basic function to disaggregate mail processing costs. Section 5 describes the methodology I propose be used in this docket for distributing mixed mail and not handling mail processing costs. Section 6 describes some further adjustments I applied to the distributed mail processing costs, similar to the adjustments in witness Alexandrovich's workpapers. My proposed treatment of not handling costs associated with window service and administration/support activities is described in Appendix B.

1. SAS Programs Used To Access The IOCS Data Base

I started with a series of SAS runs, documented in MPA LR-H-1. The library reference contains the SAS program listings, LOG files and resulting ASCII output for each program. There are a total of 15 programs and 15 output files, five for each of the three facility types. They are named xCAGBFy, where x is either B, M or N, representing BMC's, MODS offices and NonMODS offices respectively, and y is one of the letters D, M, E, P or N, denoting respectively (1) direct tallies; (2) mixed mail and empty item tallies; (3) empty item tallies only; (4) unidentified container tallies; and (5) not handling tallies. The contents of each file type are described below. Each file consists of lines representing all encountered combinations of the relevant variables along with the IOCS tally costs for each such combination.

Direct Costs. Files xCAGBFD.txt contain entries representing all direct costs classified as mail processing costs by Degen, including costs of top piece rule items and counted items. Each line represents a unique combination of the following variables: (1) CAG; (2) basic function; (3) cost pool; (4) subclass or special service; and (5) Type, where Type can be any of the following:

(1) unspecified;

- 1 (2) a specific shape (card, letter, flat, IPP or parcel);
- 2 (3) an item type as defined in USPS LR-H-49 (bundle, one of three tray types, one of
- 3 ten sack types, pallet, or other item); or
- 4 (4) a container type as defined at page 91 in USPS LR-H-49.

5 The subclass codes include mixed mail codes 5300-5345, resulting from some counted
6 items.

7 Mixed Mail Costs. Files xCAGBFM.txt include costs of all mixed uncounted items,
8 empty items, and identified mixed mail containers. Each line represents a combination
9 of: (1) CAG; (2) basic function; (3) cost pool; (4) activity code; (5) Handling; and (6)
10 Type, where the variable Type is always either a shape or item type and Handling is a
11 container type for mixed mail container entries and equivalent to Type for items not in
12 containers.

13 Empty Item Costs. Files xCAGBFE.txt are subsets of the corresponding xCAGBFM.txt
14 files, containing only entries representing empty item costs.

15 Unidentified Container Costs. Files xCAGBFP.txt contain the costs of unidentified
16 containers. Each line is a unique combination of: (1) CAG; (2) basic function; (3) cost
17 pool; (4) activity code; and (5) container type.

18 Not Handling Costs. Files xCAGBFN.txt contain all costs defined by Degen as
19 mail processing not handling costs, including some costs traditionally classified as
20 window service and administrative costs. Each line is a unique combination of: (1)
21 CAG; (2) basic function; (3) cost pool; and (4) activity code.

22 2. Spreadsheets

23 Data from the SAS outputs described above were imported into spreadsheets in order
24 to be able to perform operations on individual entries. The following five spreadsheets
25 were used to develop the alternative distribution of Segment 3 costs described in
26 Exhibits 1-3:

- 27 (1) MODS computes the direct costs per subclass and distributes mixed mail and
- 28 not handling costs for MODS offices.
- 29 (2) MODSMX computes and tabulates mixed mail costs in MODS offices.
- 30 (3) MODSNH computes all not handling costs in MODS offices and tabulates those

1 that will be distributed as mail processing, window service and administrative
 2 costs respectively. It also performs my proposed distribution of sub-segments
 3 3.2 and 3.3 as well as total Segment 3 costs.

4 (4) NonMODS performs all necessary computations for NonMODS offices.

5 (5) BMC performs all necessary computations for BMC's.

6 Additionally, spreadsheet COUNTED was used to develop the information relating to
 7 counted items in Exhibits 4 and 5.

8 My spreadsheets are included in Library Reference TW LR-H-1. My analysis was
 9 performed using Quattro for Windows version 5 spreadsheets. To facilitate their use,
 10 the library reference also includes Excel versions of each spreadsheet.

11 3. IOCS Tally Costs And Volume Variable Costs

12 My calculations start by computing, for each cost combination produced by the SAS
 13 programs described above, the volume variable costs corresponding to the tally costs
 14 for the given combination. Volume variable costs are computed by multiplying the
 15 tally costs with the ratio of accrued costs to tally costs for the given cost pool and then
 16 applying the variability factors determined by witness Bradley for each pool. I use
 17 volume variable costs in all subsequent calculations.¹

18 I distribute volume variable mixed mail and not handling costs across cost pools, rather
 19 than within costs pools, for reasons explained earlier in this testimony. It should be
 20 understood that even Degen distributes some costs across pools.² However, his
 21 method uses IOCS tally dollars until the end and only then, after distributing all mixed
 22 mail and not handling costs, does he re-weight to cost pool dollars and apply volume
 23 variability factors. This approach appears to be inappropriate, for the following
 24 reasons.

¹ In the case of NonMODS facilities, conversion to volume variable costs from tally costs requires only multiplication with a single factor, since Bradley did not analyze individual cost pools in those offices. For those offices I therefore use tally costs through most of my calculations, converting to volume variable costs only in the final step.

² Degen distributes across pools whenever a distributing dataset contains no data in a given cell, which occurs often in the case of mixed mail. Additionally, he always distributes certain cost pools (e.g. MISC, EEQMT) across all pools, and he distributes mixed mail costs at platforms across a set of pools that includes opening units. LR-H-146, part II.B.

1 First, Bradley's variability factors differ substantially among pools. Distribution across
2 pools, before applying these factors, implies a distribution over costs that are assumed
3 to be partly fixed, whereas in other parts of the Postal Service's costing methodology
4 volume variable costs are generally distributed upon other volume variable costs.

5 Second, tally costs differ substantially from accrued costs in many pools.³ If the accrued
6 costs are the "true" pool costs, then the tally costs are not the true costs, and a
7 distribution based on them will necessarily cause distortions of the true cost
8 relationships. To avoid these problems, I use only volume variable costs, as defined by
9 Bradley's variability factors applied to the accrued costs (according to MODS and PIRS)
10 within each pool.

11 4. Use Of CAG And Basic Function

12 As explained earlier in this testimony, I conclude that distributing mixed mail and not
13 handling costs within each of Degen's numerous cost pools causes severe distortions by
14 ignoring many relevant cross-pool cost relationships. For this reason, I distribute all
15 mixed mail and most not handling costs within CAG and basic function, rather than
16 within pool. Application of this approach to the three facility types is explained below.

17 a. Distribution Within CAG.

18 The MODS IOCS data show costs belonging to CAG's A, B, C and D. However, over
19 90% of the costs are classified as CAG A, with most of the rest being CAG B. Due to the
20 limited amount of CAG C and D costs in these facilities, I combine the data for CAG's B,
21 C and D into one group.

22 BMC's constitute a separate CAG, and the BMC data therefore cannot be further broken
23 down by CAG.

24 I found CAG's B through H represented in the NonMODS data and used all of them in
25 my distribution of mixed and not handling costs.⁴

³ See Degen's response to DMA/USPS-T12-13b and Dma13b.xlsx in USPS LR-H-304.

⁴ I expected to find CAG's I and J data as well in NonMODS offices, but since the tally costs I used add up to the same number as that indicated by Degen, I must have used all the data he used. If CAG's I and J

1 Table A-3 illustrates the importance of distributing costs within CAG. Part a of the
 2 table breaks down the direct, mixed and not handling costs in MODS facilities by CAG.
 3 While 90.3% of the direct MODS mail processing costs are in CAG A, almost 95% of the
 4 mixed mail costs and over 95% of certain not handling costs are in CAG A. The not
 5 handling costs most concentrated in large facilities (CAG A) are those associated with
 6 activity codes 5610-5750, and these are the not handling costs that have grown the most
 7 since the Postal Service introduced letter mail automation. Of the MODS CAG A
 8 volume variable costs that I distribute as mail processing costs (segment 3.1), only
 9 48.49% are from direct mail tallies. If one includes the additional not handling costs
 10 that Degen misclassified as mail processing, then only 45.69% are from direct tallies.

11 That excessive not handling time is predominantly a problem in very large postal
 12 facilities is confirmed by part b of Table A-3, which breaks down direct, mixed and not
 13 handling costs in NonMODS offices by CAG B through H. As one goes to smaller and
 14 smaller facilities, the percent of direct costs increases and the time spent not handling
 15 decreases, to only 12.4% of total employee time in CAG H facilities.⁵

16 b. Distribution Within Basic Function

17 The basic function categories used in IOCS are: (1) outgoing; (2) incoming; (3) transit;
 18 and (4) other. According to Handbook F-45, one of the first three categories should be
 19 used when an employee is handling mail and for most not handling activities as well,
 20 while the "other" category is to be used "when the employee is working in a section or
 21 operation that does not involve mail and the Basic Functions Outgoing, Incoming, and
 22 Transit do not apply." USPS LR-H-49 at 136-38 and Appendix B.

23 Yet the "other" category appears, though as a small percentage of the total, also for
 24 direct mail and mixed mail tallies. Since this appears to mean simply that the IOCS
 25 clerks could not determine the correct basic function, I eliminate "other" as a separate
 26 category prior to distributing mixed mail and not handling costs. This is done by
 27 allocating the "other" costs proportionately over the three other categories in both the

data ever existed, they must have been combined with CAG H data in an earlier stage of processing the IOCS data.

⁵ In CAG H facilities, employees spend an average of only 16 minutes in an eight hour day on "breaks/personal needs," almost one hour less than the system average for clerks and mailhandlers.

1 distributing and distributed data sets.⁶

2 I do not use distribution by basic function for not handling costs that are given totally or
3 predominantly as "other." For example, almost all "break/personal needs" costs
4 appear with basic function "other" in the IOCS data, reflecting the obvious fact that
5 basic function is meaningless for an employee who is on break.⁷

6 5. Distribution Of Mixed Mail And Not Handling Costs

7 Described below are the distribution keys I developed for mixed mail and the various
8 types of not handling costs. All distributions are performed separately within each of
9 the three facility types, i.e. MODS, NonMODS, and BMC's. The first "page" in
10 spreadsheets MODS, NonMODS, and BMC shows the process that starts with the direct
11 costs for each facility type and ends with the inclusion of all mixed mail and not
12 handling costs, except the not handling costs that are reassigned to cost segments 3.2
13 and 3.3. Tables A-5 through A-7 show my attribution of direct, mixed mail and not
14 handling costs to subclasses and special services in, respectively, MODS, NonMODS
15 and BMC facilities.

16 The discussion below is organized as follows:

- 17 (1) mixed mail costs;
- 18 (2) window service and administration/support related not handling costs;
- 19 (3) specific class or service related not handling costs;
- 20 (4) shape-related not handling costs;
- 21 (5) mixed shapes not handling and overhead costs; and
- 22 (6) other not handling costs.

23 a. Mixed Mail Costs

24 With a few exceptions, the mixed mail tallies in Degen's IOCS mail processing data base
25 have one of the following five activity codes:

⁶ If, for example, the basic functions in a given data set are 40% outgoing, 40% incoming, 10% transit and 10% other, this is transformed to 44.444% outgoing, 44.444% incoming and 11.111% transit.

⁷ While this is recognized in IOCS, Degen goes to the other extreme, assuming that all break time costs must be distributed to mail handled in the pool that the idle employee is clocked into while on break.

- 1 (1) 5610 - mixed letters and cards;
- 2 (2) 5620 - mixed flats;
- 3 (3) 5700 - mixed IPP's and parcels;
- 4 (4) 5750 - mixed all shapes; and
- 5 (5) 6523 - empty items and containers.

6 I distribute the mixed mail costs with activity code 5610 based on the corresponding
 7 direct costs associated with letters and cards. The distribution is performed within
 8 facility type, CAG and basic function. Similarly, I distribute the 5620 mixed mail costs
 9 based on direct costs associated with flats and the 5700 mixed mail costs based on direct
 10 costs associated with IPP's and parcels. For the last two categories, which represent by
 11 far the largest portion of mixed mail costs, I use a distribution key based on all direct
 12 costs for subclasses. This distribution is also performed within facility type, CAG and
 13 basic function. I distribute no mixed mail costs to special services. The distributed
 14 mixed mail costs are added to the direct costs, forming another distribution key used
 15 for some of the not handling costs described below.*

16 b. Window Service and Administration/Support Costs

17 Appendix B identifies the window service and administration/support related not
 18 handling costs that Degen has classified as mail processing costs, and describes how
 19 such costs should be distributed. As discussed earlier in this testimony, once the volume
 20 variable portion of these costs has been determined, there is no reason not to distribute
 21 them according to what the observed employees were actually doing. I reassign them
 22 back to cost segments 3.2 and 3.3 in order to apply a more appropriate distribution
 23 method.

24 c. Specific Class Or Service Related Costs

25 Costs with not handling codes 6220, 6230 and 6231 appear in all three facility types.
 26 There is no need to "distribute" these costs since they are in fact associated specifically

* The exceptions referred to above occur for MODS facilities only. They include a small amount of costs (0.521 million volume variable) with activity code 5461, representing mixed international mail, which I attribute directly to international mail. Additionally, there are a total of \$3.225 million volume variable costs with activity codes 6480, 6516, 6519, 6620 and 6630, all of which should ideally be considered part of segment 3.3 (administration and support). Since the amount is relatively small, I kept them as a part of segment 3.1 costs and distributed them in the same way as the 5750 and 6523 mixed mail costs.

1 with special delivery, Registry and Express Mail. Table A-1 summarizes the volume
2 variable costs, tally costs and accrued costs for these activity codes.

3 Traditionally, 6231 costs have been treated as "specific fixed" costs associated with
4 Express Mail in cost segment 3.3. In the Postal Service's filing, those 6231 costs that
5 Degen did not transfer to mail processing are still treated, in cost segment 3.3, as
6 specific fixed costs that become part of the incremental Express Mail costs. For
7 consistency I reallocate all 6231 costs back to segment 3.3, as explained further in
8 Appendix B.

Table A-1: Class/Service Specific Not Handling Costs - All Offices (\$1,000's)				
Class/ Service	Activity Code	Volume Variable	Accrued Costs	Tally Costs
Spec. Delivery	6220	1,517	4,137	4,051
Registry	6230	30,605	80,389	85,367
Express Mail	6231	29,863	54,195	57,209
Total		61,985	138,721	146,628

9 d. Shape Related Not Handling Costs.

10 These are the not handling components of activity codes 5610, 5620 and 5700. I
11 distribute them based on direct costs for, respectively, letters and cards, flats and
12 IPP's/parcels. These distributions are performed separately within each combination of
13 CAG, basic function, and facility type, but across MODS (PIRS) cost pools. Separate
14 pages in spreadsheets MODS, BMC, and NonMODS contain each shape based
15 distribution key.

16 One would expect to find 5610 costs at operations dedicated to letters, 5620 at those
17 dedicated to flats, and 5700 at those dedicated to parcels. However, although
18 concentrated mostly at those operations, each type of cost also occurs, in Degen's data
19 base, at many operations where one would not expect to find them. At the same time,
20 one finds handlings of individual letters, flats, or parcels at operations one would not
21 expect. This is illustrated in Table A-4. Presumably, this is due to employees being
22 clocked into one operation while working at another. As with the mixed shapes and
23 general overhead costs discussed below, I conclude that these costs should not be
24 distributed separately within individual MODS cost pools.

1 e. Mixed Shapes And Overhead Costs

2 These are costs with activity codes 5750 (mixed shapes), 6521 (breaks/personal needs),
 3 6522 (clocking in/out), and 6523 (not handling empty equipment). Table A-2 shows the
 4 magnitude of these costs, which represent \$3.6 billion in IOCS tally costs, \$3.73 billion in
 5 accrued costs according to Degen, and \$2.73 billion in volume variable costs according
 6 to Degen/Bradley. What is known about these costs is that they have grown a great
 7 deal during the implementation of letter mail automation, but it is not known precisely
 8 why they have grown and continue to grow so much. Distributing these costs within
 9 individual MODS or PIRS pools when so little is known about their true causality
 10 makes little sense. I distribute them across all MODS (PIRS) cost pools, but within CAG
 11 and basic function, with the exception that basic function is not known for the 6521 and
 12 6522 costs. I distribute the 6523 costs over direct and mixed costs for all mail and the
 13 others over direct and mixed costs for all mail and special services.

Table A-2: Mixed & Overhead Not Handling Mail Processing Costs (\$1,000s)				
	IOCS Code	Volume Variable Costs	Accrued Costs	Tally Costs
Mixed All Shapes	5750	782,792	1,073,136	1,028,702
Breaks/Personal Needs	6521	1,478,103	2,032,392	1,966,503
Clocking In/Out	6522	194,309	252,614	245,861
Empty Equip. Not Handling	6523	277,939	369,353	360,580
Total		2,733,142	3,727,494	3,601,646

14 Tallies with activity code 6522 are not included in the IOCS data for BMC's and
 15 NonMODS offices presented in this docket. Instead they are distributed by
 16 Alexandrovich (WP-B, W.S.3.1.1) after Degen finishes his distribution of all other mail
 17 processing costs. Section 6 below describes this and several other adjustments required
 18 for a complete distribution of all mail processing costs.

19 In the BMC IOCS data, the 6521 costs appear as belonging to a separate cost pool
 20 (Zbreaks) that is not included among the BMC cost pools Degen lists in his testimony
 21 and various interrogatory responses. Instead, Degen has included a distribution of the
 22 6521 costs in the accrued costs he gives for the six other BMC cost pools. Using Degen's
 23 accrued pool costs, it therefore is not necessary to explicitly consider the 6521 costs in
 24 the analysis of BMC costs.

1 As explained earlier in this testimony, the evidence available to link these costs to
 2 specific subclasses and special services is so weak that I seriously doubt whether any
 3 rational basis exists for attributing even their volume variable portion. For this reason,
 4 the Commission should consider treating some or all of the not handling costs with
 5 activity codes 5750 and 6521-23 (\$3.6 billion in IOCS costs) as institutional costs, at least
 6 until the Postal Service provides a credible explanation of what has caused these costs
 7 to increase so much during the past ten years. If, however, the Commission decides
 8 that these costs must be attributed, then it should, given that so little is known about
 9 their true causes, treat them as general overhead costs and distribute them in the
 10 manner explained above.

11 f. Other Not Handling Costs

12 There remain the following categories of not handling costs not discussed above:

- 13 • platform acceptance costs (6210);
- 14 • nixie costs (6240);
- 15 • central markup costs (6570);
- 16 • postage due costs (6580); and
- 17 • carrier related costs (6420, 6430).

18 As with other categories of non-overhead not handling costs, Degen ignores the ready
 19 availability of distribution keys suited to not handling costs with activity codes 6210,
 20 6240, 6570 and 6580. For example, the LIOCATT program treats the platform
 21 acceptance not handling costs (code 6210) as part of uniform operation code 07, which is
 22 defined as "accepting mail from patron on platform." Similarly, Nixie costs have
 23 uniform operation code 06, and postage due and central markup costs have operation
 24 codes 00 and 14.⁹

25 The ideal way to distribute these not handling costs, in a manner consistent with
 26 Bradley's volume variability estimates, is therefore as follows. For each facility type,
 27 isolate the volume variable direct costs associated with uniform operation codes 00, 06,
 28 07 and 14 respectively and use each set as a distribution key for the corresponding not

⁹ See Table B-5 in USPS LR-H-1 and FY96 CRA Workpaper C-2: Fiscal Year 1996 LIOCATT for clerks and mailhandlers by operation code.

1 handling costs. These distributions can then be performed separately within facility
2 type, CAG and basic function.

3 I have used a slightly simpler approach, due to shortness of time and resources. Rather
4 than constructing distribution keys for not handling costs 6210, 6240, 6570 and 6580
5 separately from the IOCS data for each facility type, I simply used the distribution keys
6 available from the FY96 LIOCAT, i.e. the distributed costs for the four uniform
7 operation codes listed above. Table A-8 summarizes these distribution keys. This
8 approach requires use of the same distribution key for each facility type, but the
9 inaccuracy that might result is negligible compared to the major distortion caused by
10 Degen's method, which simply ignores all information about the nature of each not
11 handling activity. For example, as can be seen from Table A-8, more than half of all
12 postage due costs are linked to special services. That is also true for the direct costs in
13 Degen's "Business Reply" cost pool. But most of the not handling postage due costs
14 (code 6580) are spread over a variety of other Degen cost pools that sampled employees
15 happened to be clocked into. The consequence is that under Degen's scheme a
16 disproportionate share of the 6580 costs are distributed to mail classes, including classes
17 that do not incur any direct postage due costs.

18 In the case of 6210 (platform acceptance) not handling costs, I do not use basic function
19 since it appears that doing so would make little sense.¹⁰

20 The last category listed above (6420 and 6430) is costs that it would appear should not
21 even be in cost segment 3. I have treated these as system overhead costs and
22 distributed them in the same manner as the other overhead costs described in the
23 preceding section.

¹⁰ As can be seen from the LIOCAT development of the distribution for uniform operation code 07, almost all these costs with the exception of the 6210 costs are given as outgoing, with the residual portion having basic function "other." The 6210 costs, on the other hand, have a substantial component of incoming and transit. I don't know the reason for this apparent discrepancy. It would appear that mail being accepted from a postal patron is at that point always outgoing mail, since no postal employee has made any decision yet about where to send it.

1 **6. Further Mail Processing Cost Adjustments**

2 In his workpapers A2 and B3 witness Alexandrovich makes several adjustments to the
3 mail processing costs distributed by Degen. Table A-9 shows corresponding
4 adjustments applied to the alternative distribution described above. These adjustments
5 are:

- 6 (1) distribution of BMC and NonMods clocking in and out costs (activity code
7 6522);
- 8 (2) special delivery adjustment;
- 9 (3) registry adjustment;
- 10 (4) lump sum distribution; and
- 11 (5) premium pay adjustment.

12 The first four of these adjustments are carried out in W.S. 3.1.1 of Alexandrovich's B3
13 workpaper (LR-H-201). I have carried out the corresponding adjustments, based on my
14 revised distribution of mixed mail and not handling costs. The first adjustment
15 distributes a total of \$47.111 million in accrued clocking in and out costs at BMC's and
16 NonMODS offices (\$34.635 million volume variable), based on all other mail processing
17 costs distributed for these facility types. The second adjustment distributes special
18 delivery mail processing costs to subclasses based on Segment 9 mail handling costs.
19 The third adjustment distributes Registry costs to certain mail categories and the last
20 adjustment distributes a total of \$33.826 million in lump sum costs that are not included
21 in the IOCS data base.

22 The premium pay adjustment is shown at the beginning of Alexandrovich's workpaper
23 A2. It is based on keys for nightshift and Sunday processing that should be recalculated
24 to be consistent with my revised mail processing cost distribution. I have not, however,
25 attempted to update these keys. Instead, I simply redistributed the same total costs that
26 Alexandrovich redistributes in performing this adjustment.

27 Page WKPA_B in spreadsheet MODSNH shows the details of the adjustments
28 described above. I used the resulting mail processing costs distribution, shown in Table
29 A-9, in performing the redistribution of certain administration/support costs, as
30 described in Appendix B. Under my method, total BY96 mail processing costs are
31 \$12,427.547 million, of which \$9,621.583 million are volume variable.

Table A-3a: MODS Direct, Mixed & Not Handling Costs By CAG (\$1,000's)			
	CAG A	CAG's BCD	Total
Direct	3,244,655 90.34%	346,965 9.66%	3,591,620 100.00%
Mixed	858,261 94.54%	49,551 5.46%	907,811 100.00%
Not Handling:			
5610-5750 Costs	1,153,581 95.20%	58,177 4.80%	1,211,758
6521-6523 Costs	1,309,359 92.25%	110,039 7.75%	1,419,398 100.00%
Other Mail Processing Not Handling	125,355 61.97%	76,943 38.03%	202,298 100.00%
Total Segment 3.1 Not Handling (Stralberg)	2,588,296 91.35%	245,158 8.65%	2,833,454 100.00%
Total Segment 3.1 (Stralberg)	6,691,211 91.25%	641,674 8.75%	7,332,885 100.00%
Not Handling Transferred To 3.2 & 3.3	410,570 83.64%	80,324 16.36%	490,895 100.00%
Percent Direct:			
Relative To Stralberg Total	48.49%	54.07%	48.98%
Relative To Degen Total	45.69%	48.06%	45.91%

Table A-3b: NonMODS Direct, Mixed & Not handling Costs By CAG (\$1,000's)								
	B	C	D	E	F	G	H	Total
Direct	104,104 9.17%	252,268 22.22%	213,427 18.80%	235,190 20.72%	144,443 12.73%	92,420 8.14%	93,262 8.22%	1,135,114 100.00%
Mixed	14,510 9.44%	41,104 26.74%	27,455 17.86%	41,083 26.72%	18,112 11.78%	6,835 4.45%	4,644 3.02%	153,742 100.00%
Not Handling	67,937 12.62%	178,179 33.11%	95,947 17.83%	99,638 18.51%	48,986 9.10%	33,707 6.26%	13,800 2.56%	538,194 100.00%
Total	186,551 10.21%	471,551 25.81%	336,828 18.44%	375,910 20.57%	211,541 11.58%	132,963 7.28%	111,706 6.11%	1,827,050 100.00%
Percent Direct	55.80%	53.50%	63.36%	62.57%	68.28%	69.51%	83.49%	62.13%
Percent Mixed	7.78%	8.72%	8.15%	10.93%	8.56%	5.14%	4.16%	8.41%
Percent Not Handling	36.42%	37.79%	28.49%	26.51%	23.16%	25.35%	12.35%	29.46%

Table A-4: Shape Related Direct & Not Handling Costs in MODS Cost Pools (\$1,000's)						
Cost Pool:	Direct Handling			Shape Related Not Handling		
	Letters & Cards	Flats	IPP's & Parcels	Letters & Cards	Flats	IPP's & Parcels
BCS/	213,380	823	193	103,202	111	137
EXPRESS	388	6,962	1,663	92	105	186
FSM/	8,519	334,521	3,013	4,066	72,872	165
LSM/	395,380	2,556	540	57,419	659	209
MANF	11,138	204,992	5,199	3,495	42,024	204
MANL	551,215	20,554	4,442	90,205	3,201	499
MANP	599	1,430	5,882	206	106	1,758
MECPARC	290	348	2,050	41	0	1,036
OCR/	59,532	675	192	24,923	90	0
PRIORITY	1,095	12,737	22,870	471	330	5,328
SPBS OTH	1,265	4,075	9,648	127	108	1,543
SPBSPRIO	68	4,273	9,819	153	220	1,201
BUSREPLY	3,637	630	319	427	0	108
INTL	17,708	5,045	5,602	2,145	819	1,230
LD15	130,393	1,426	0	42,430	0	0
LD41	4,764	28	0	5,301	32	0
LD42	327	450	24	107	63	0
LD43	74,359	41,874	26,762	20,666	6,075	5,342
LD44	38,587	11,759	2,054	5,806	411	192
LD48 EXP	16	226	25	0	0	0
LD48 OTH	2,126	533	400	308	71	49
LD48_SSV	1,462	741	312	198	34	18
LD49	78,251	28,505	3,247	650	53	0
LD79	3,558	797	373	211	0	69
MAILGRAM	0	0	0	0	0	0
REGISTRY	449	203	111	70	28	7
REWRAP	2,293	361	465	377	0	302
1BULK PR	662	106	123	137	0	71
1CANCMPP	52,222	12,705	4,509	11,305	1,669	182
1EEQMT	216	170	62	0	59	122
1MISC	4,606	1,421	1,010	5,165	1,678	296
1OPBULK	10,999	10,392	4,713	7,673	4,114	1,533
1OPREF	32,335	26,630	29,357	22,401	6,069	4,250
1PLATFRM	6,541	6,040	9,695	5,686	2,471	3,705
1POUCHNG	14,740	13,754	17,522	19,921	6,980	1,657
1SACKS_H	942	1,193	2,900	687	592	881
1SACKS_M	64	544	1,063	139	0	749
1SCAN	593	754	3,079	373	195	171
1SUPPORT	2,822	516	316	887	187	40
LD48_ADM	0	0	0	0	0	0
Total	1,727,540	760,750	179,553	437,470	151,426	33,244

Table A-5: Distribution Of MODS Direct, Mixed And Not Handling Costs (\$1,000's)					
	Direct Costs	Mixed Mail Costs	Not Handling Costs	Distribute 5301-5345 Costs	Total
First-Class:					
Letters and Parcels	1,897,032	496,676	1,494,403	1,916	3,890,026
Presort Letters and Parcels	388,342	94,308	304,788	388	787,825
Postal Cards	1,048	285	844	1	2,177
Private Mailing Cards	59,994	15,487	48,521	61	124,063
Presort Cards	17,661	4,629	14,984	18	37,292
Priority Mail	121,421	34,574	99,204		255,199
Express Mail	17,159	5,662	17,570		40,391
Mailgrams	49	15	44		108
Periodicals:					
Within County	4,194	925	3,356	17	8,492
Regular Rate Publications	137,930	33,129	100,533	556	272,147
Nonprofit Publications	25,222	5,955	19,180	103	50,460
Classroom Publications	1,073	266	748	4	2,092
Standard A:					
Single Piece Rate	24,650	5,988	20,941	452	52,031
Regular Enh. Car. Rte.	67,185	14,933	50,392	1,162	133,672
Regular Other	486,785	119,034	369,041	8,550	983,411
Nonprofit Enh. Car. Rte.	7,872	1,704	5,755	134	15,464
Nonprofit Other	131,636	31,915	104,004	2,347	269,902
Standard B:					
Parcels Zone Rate	17,140	4,747	14,652	245	36,783
Bound Printed Matter	9,310	2,208	7,354	126	18,998
Special Standard	7,287	1,976	6,123	103	15,488
Library Mail	2,143	549	1,560	28	4,280
Penalty - U. S.P.S.	28,087	6,491	23,984		58,562
Free Mail	2,644	742	2,134		5,520
International Mail	73,833	23,695	65,105		162,633
Special Services:					
Registry	14,130	0	25,045		39,174
Certified	3,733	0	3,416		7,149
Insurance	124	0	174		298
COD	432	0	294		726
Special Delivery	135	0	1,168		1,304
Special Handling	79	0	42		122
Other Special Services	34,037	0	23,057		57,094
Mixed First Class (5301)	1,281	315	789	(2,385)	0
Mixed Periodicals (5331)	389	81	211	(680)	0
Mixed Third Class (5340)	6,586	1,321	3,502	(11,409)	0
Mixed Standard A (5341)	710	145	382	(1,237)	0
Mixed Standard B (5345)	290	58	154	(502)	0
Total	3,591,620	907,811	2,833,454	0	7,332,885

Table A-6: Distribution Of NonMODS Direct, Mixed And Not Handling Costs (\$1,000's)						
	Direct Costs	Mixed Mail Costs	Not Handling Costs	5301- 5345 Costs	Total Tally Costs	Volume Variable Costs
First-Class:						
Letters and Parcels	618,647	88,023	269,551	424	976,646	805,942
Presort Letters and Parcels	167,535	21,344	71,319	113	260,311	214,812
Postal Cards	693	132	306	0	1,131	933
Private Mailing Cards	19,984	2,819	9,040	14	31,857	26,289
Presort Cards	6,089	930	2,979	4	10,003	8,255
Priority Mail	45,114	6,924	22,856		74,893	61,803
Express Mail	8,578	1,448	5,846		15,872	13,098
Mailgrams	0	0	0		0	0
Periodicals:						
Within County	3,991	520	1,523	12	6,046	4,990
Regular Rate Publications	65,433	8,918	26,516	200	101,068	83,403
Nonprofit Publications	11,052	1,461	4,840	34	17,388	14,349
Classroom Publications	893	128	367	3	1,391	1,148
Standard A:						
Single Piece Rate	8,898	1,445	4,750	143	15,236	12,573
Regular Enh. Car. Rte.	53,202	6,176	21,381	765	81,523	67,274
Regular Other	227,279	31,065	99,582	3,389	361,315	298,162
Nonprofit Enh. Car. Rte.	4,153	542	1,988	63	6,746	5,567
Nonprofit Other	45,632	6,480	23,506	716	76,334	62,992
Standard B:						
Parcels Zone Rate	11,336	2,004	6,264	46	19,649	16,215
Bound Printed Matter	8,401	1,306	3,845	32	13,583	11,209
Special Standard	5,933	1,039	3,300	24	10,295	8,496
Library Mail	1,096	268	535	4	1,904	1,571
Penalty - U. S.P.S.	11,401	2,014	7,018		20,433	16,861
Free Mail	588	86	258		931	768
International Mail	4,151	738	2,650		7,538	6,221
Special Services:						
Registry	7,022	0	25,953		32,975	27,212
Certified	12,518	0	6,570		19,088	15,752
Insurance	481	0	252		733	605
COD	1,409	0	591		1,999	1,650
Special Delivery	0	0	651		651	537
Special Handling	124	0	60		184	152
Other Special Services	19,762	0	17,593		37,355	30,826
Mixed First Class (5301)	348	72	135	(555)	0	0
Mixed Periodicals (5331)	150	33	66	(249)	0	0
Mixed Third Class (5340)	3,390	359	1,036	(4,785)	0	0
Mixed Standard A (5341)	187	24	80	(291)	0	0
Mixed Standard B (5345)	68	9	29	(106)	0	0
Total	1,375,539	186,306	643,236	0	2,205,081	1,819,664

Revised 2/20/98

Table A-7: Distribution Of BMC Direct, Mixed And Not Handling Costs (\$1,000's)					
	Direct Costs	Mixed Mail Costs	Not Handling Costs	Distribute 5301-5345 Costs	Total
First-Class:					
Letters and Parcels	2,082	1,172	2,786	74	6,114
Presort Letters and Parcels	232	119	776	14	1,142
Postal Cards	0	0	0	0	0
Private Mailing Cards	40	22	91	2	154
Presort Cards	0	0	45	1	46
Priority Mail	693	380	936		2,009
Express Mail	8	3	169		180
Mailgrams	0	0	0		0
Periodicals:					
Within County	30	14	50	1	95
Regular Rate Publications	5,741	2,795	3,570	171	12,277
Nonprofit Publications	1,350	646	829	40	2,865
Classroom Publications	255	110	117	7	489
Standard A:					
Single Piece Rate	5,222	2,661	3,912	114	11,909
Regular Enh. Car. Rte.	6,546	3,258	4,553	139	14,496
Regular Other	61,278	30,504	43,031	1,301	136,115
Nonprofit Enh. Car. Rte.	590	288	398	12	1,288
Nonprofit Other	8,701	4,365	6,121	185	19,372
Standard B:					
Parcels Zone Rate	31,528	16,155	25,241	188	73,112
Bound Printed Matter	15,484	7,811	11,941	91	35,327
Special Standard	20,115	10,077	15,282	117	45,592
Library Mail	4,070	2,128	3,414	25	9,636
Penalty - U. S.P.S.	1,545	840	1,482		3,866
Free Mail	915	511	849		2,275
International Mail	12,012	6,575	10,343		28,930
Special Services:					
Registry	145	0	421		566
Certified	0	0	32		32
Insurance	11	0	12		23
COD	0	0	1		1
Special Delivery	0	0	6		6
Special Handling	0	0	1		1
Other Special Services	179	0	113		292
Mixed First Class (5301)	40	22	29	(90)	0
Mixed Periodicals (5331)	118	51	50	(219)	0
Mixed Third Class (5340)	425	182	179	(787)	0
Mixed Standard A (5341)	459	226	279	(964)	0
Mixed Standard B (5345)	197	100	124	(421)	0
Total	180,010	91,015	137,186	0	408,211

Table A-8: LIOCATT Based Distribution Keys For Certain Not Handling Costs				
	Platform Accept	Nixie	Central Markup	Postage Due Due
Not Handling Code	6210	6240	6570	6580
IOCS Operation Code	07	06	14	00
First-Class:				
Letters and Parcels	7,086,660	52,139,636	69,869,862	17,205,321
Presort Letters and Parcels	5,557,860	14,424,783	47,314,507	2,250,290
Postal Cards	0	320,350	0	0
Private Mailing Cards	516,789	1,830,085	4,609,543	572,542
Presort Cards	411,086	569,251	1,623,596	204,066
Priority Mail	2,717,705	2,229,056	1,499,294	788,831
Express Mail	496,231	28,052,533	225,177	728,798
Mailgrams	0	0	0	0
Periodicals:				
Within County	325,354	0	428,948	0
Regular Rate Publications	1,557,034	3,199,526	14,351,969	0
Nonprofit Publications	494,467	434,390	4,425,371	0
Classroom Publications	399	0	0	0
Standard A:				
Single Piece Rate	380,319	1,137,129	7,000,123	969,118
Regular Enh. Car. Rte.	4,096,682	736,784	1,678,872	182,131
Regular Other	13,424,292	6,064,397	7,387,738	1,154,887
Nonprofit Enh. Car. Rte.	423,389	82,505	269,550	0
Nonprofit Other	6,419,477	1,590,259	1,159,387	345,016
Standard B:				
Parcels Zone Rate	899,106	389,628	591,262	220,967
Bound Printed Matter	334,873	292,641	1,553,663	118,594
Special Standard	249,253	443,927	372,198	523,877
Library Mail	0	0	51,579	0
Penalty - U. S.P.S.	900,408	4,630,326	9,479,484	1,074,087
Free Mail	0	0	273,562	0
International Mail	176,690	10,583,168	525,311	902,985
Special Services:				
Registry	63,342	60,864,964	70,239	361,974
Certified	144,955	23,240,271	0	3,406,832
Insurance	53,142	533,070	0	82,234
COD	0	2,316,941	0	137,489
Special Delivery	60,859	0	0	0
Special Handling	6,472	0	0	0
Other Special Services	119,672	10,883,053	8,704,344	31,292,750
Total	46,916,516	226,988,673	183,465,579	62,522,789

Revised 2/20/98

Table A-9: Adjustments To Redistributed Mail Processing Costs (\$1,000's)							
	MP Costs From Exhibit 1.	BMC/ N.MODS 6522 Costs	Special Delivery Adjust.	Registrv Adjust.	Lump Sum Dist.	Premium Pay Adjust.	Adjusted MP Costs
First-Class:							
Letters & Parcels	4,702.082	11.045	14	0	12.86	95.283	4,821.288
Presort Letters & Parcels	1,003.779	2.932	10	0	2.748	11.714	1,021.182
Postal cards	3.111	13	0	0	9	0	3,132
Single Piece Cards	150.506	359	1	0	412	3,298	154.576
Presort Cards	45.593	113	1	0	125	1,500	47.331
Total First Class	5,905.071	14.461	26	0	16.15	111.79	6,047.509
Priority Mail	319.010	885	32	0	873	(3,531)	317.269
Express Mail	53.669	181	1,476	0	151	(1,855)	53.623
Mailgrams	108	0	2	0	0	4	114
Periodicals:							
Within County	13.576	70	0	0	37	(60)	13.623
Regular Rate Publications	367.827	1,429	1	0	1,008	3,181	373.446
Nonprofit Publications	67.674	264	0	0	185	864	68.988
Classroom Publications	3.728	28	0	0	10	32	3.798
Total Periodicals	452.806	1,791	1	0	1,241	4,017	459.855
Standard A:							
Single Piece Rate	76.513	463	0	0	210	(3,274)	73.912
Regular Enh. Car. Rte.	215.442	1,266	0	0	591	(11,011)	206.289
Regular Other	1,417.689	7,377	0	0	3,889	(65,406)	1,363.549
Total Bulk Regular	1,633.131	8,643	0	0	4,481	(76,417)	1,569.838
Nonprofit Enh. Car. Rte.	22.319	107	0	0	61	(1,175)	21.312
Nonprofit Other	352.266	1,328	0	0	965	(15,544)	339.015
Total Bulk Nonprofit	374.585	1,435	0	0	1,026	(16,719)	360.327
Total Standard A	2,084.229	10,541	0	0	5,717	(96,410)	2,004.077
Standard B:							
Parcels Zone Rate	126.110	2,017	1	0	350	(6,112)	122.366
Bound Printed Matter	65.535	1,020	0	0	182	(3,135)	63.601
Special Standard	69.576	1,236	0	0	193	(2,835)	68.170
Library Mail	15.487	258	0	0	43	(693)	15.096
Total Standard B	276.709	4,531	2	0	768	(12,775)	269.234
Penalty - U. S.P.S.	79.290	323	0	24.655	285	(933)	103.620
Free Mail	8.563	66	0	0	24	273	8.926
International Mail	197.785	795	267	11,159	573	(585)	209.994
Total All Mail	9,377.239	33,575	1,806	35,814	25.78	0	9,474.221
Special Services:							
Registry	66.952	382	0	(35,814)	86	0	31.606
Certified	22.932	214	0	0	63	0	23.209
Insurance	925	9	0	0	3	0	937
COD	2,378	22	0	0	7	0	2,406
Special Delivery	1,847	7	(1,806)	0	0	0	49
Special Handling	274	2	0	0	1	0	277
Other	88.212	424	0	0	242	0	88.878
Total Special Services	183.521	1,060	(1,806)	(35,814)	401	0	147.362
Total Volume Variable	9,560.760	34,635	0	0	26.18	0	9,621.584
Other	2,785.850	12,476	0	0	7,637	0	2,805.963
Total Costs	12,346.610	47,111	0	0	33.82	0	12,427.547

1 **APPENDIX B: WINDOW SERVICE AND ADMINISTRATIVE COSTS**

2 This appendix identifies the not handling costs that Degen proposes to treat as mail
3 processing costs that should instead be treated as parts of cost segments 3.2 (window
4 service) and 3.3 (administration and support). It also explains how I propose to
5 attribute these reassigned costs to subclasses and special services.

6 Table B-1 summarizes the volume variable portion of these costs, as well as the
7 corresponding IOCS tally costs and accrued costs. Degen attributes these costs to mail
8 processing because employees incurring them happened to be (erroneously) clocked
9 into mail processing operations when observed by IOCS clerks. However, as explained
10 earlier in this testimony, once the volume variable portion of these costs has been
11 determined, there is no reason not to distribute them according to what the observed
12 employees were actually doing, i.e. window service and administrative work.

Table B-1: Not Handling Costs That Should Be Returned To Segments 3.2 & 3.3 (\$1,000's)			
Cost Category	Volume Variable	Accrued Costs	Tally Costs
Window Service:			
Codes 5020-5195, 6000-6200	41,444	99,395	105,705
Breaks (6521)	5,469	9,802	10,224
Clocking In/Out (6522)	3,496	8,138	8,640
Total Window Service	50,409	117,335	124,569
Administration - Support:			
Express Mail (Code 6231)	29,863	54,195	57,209
Codes 6320-30, 6460-6519, 6610-60	284,363	468,345	495,253
Breaks (6521)	121,934	161,506	161,961
Clocking In/Out (6522)	11,748	18,485	19,330
Total Administration - Support	447,909	702,531	733,754
Total Transferred From Mail Processing	498,317	819,866	858,322

13 The volume variable costs in Table B-1 include:

- 14 (1) \$41.444 million with activity codes 5020-5195 and 6000-6200, which represent
15 various types of window related activities;
16 (2) \$29.863 million in administrative costs specifically related to Express Mail;
17 (3) \$284.363 million with activity codes 6320-6330, 6460-6519 and 6610-6660, which
18 represent various types of administrative and support activities; and
19 (4) \$142.647 million in overhead (breaks and clocking in/out) costs.

20 In the following I explain first how the costs in Table B-1 should be distributed to

1 subclasses and special services within cost segments 3.2 and 3.3. I then explain my
2 calculation of the overhead portion of these costs.

3 1. Window Service Costs

4 Table B-2 breaks down the reallocated window service costs by IOCS activity code. It
5 includes a description of the type of activity indicated by each code, according to
6 Appendix B in USPS LR-H-1. I reassign all costs with codes 5020-5180 and 6000-6200
7 found in the MODS mail processing part of Degen's IOCS data. Degen's answer to
8 MPA/USPS-T12-8d (see accompanying spreadsheet in USPS LR-H-277) confirms that
9 all these costs, as well as the corresponding break time costs, would traditionally have
10 been treated as window service costs. My calculation of the reallocated clocking in and
11 out costs is explained in Section 3 below.

12 Table B-3 shows how I propose to attribute these costs to subclasses and special
13 services. In the Postal Service's filing, the final attribution of window service costs is
14 developed in worksheet W.S.3.2.1 in witness Alexandrovich's workpaper B. My
15 calculations start with the results of that worksheet and apply a similar methodology to
16 the additional window service costs.

17 For example, W.S.3.2.1 attributes costs with activity codes 5040 and 6040, which
18 represent selling stamps to customers, based on RPW estimates of the number of
19 stamps used by each subclass. I do the same with the additional 5040 and 6040 costs
20 that Degen misclassified as mail processing costs. The only difference is that while
21 W.S.3.2.1 applies an assumed volume variability factor for these costs, I use the volume
22 variable portion of the additional 5040 and 6040 costs that is already given in Table B-2.
23 I use a similar approach for codes 5070, 6070, and 6073, which relate to the setting of
24 meters. Consistent with W.S.3.2.1, I attribute the costs of codes 5050 and 6050 (selling
25 cards) to the private post card subclass.

26 Additionally, many of the codes in Table B-2 correspond to specific categories of special
27 services and can be attributed directly to those services. Codes 5020 and 6020 relate to
28 P.O. boxes. Codes 5080 and 6080 relate to money orders. I attribute them to these
29 services. Similarly, I attribute costs with codes 5060 and 5090 to stamped envelopes and
30 codes 5120, 6030, 6120 and 6200 to other services.

1 Finally, I add the costs attributed as described above to the total costs for each subclass
 2 and service given in W.S.3.2.1 and use those combined costs as a key for attributing all
 3 remaining window service costs shown in Table B-2.

4 Total window service costs under this approach become \$2,023.956 million, about \$10
 5 million more than in the FY96 CRA cost report. There appear to be two reasons for this
 6 discrepancy. First, with the re-weighting of IOCS tallies that Degen performs in order
 7 to be consistent with Bradley's volume variability analysis, the IOCS tallies indicating
 8 window service cannot be expected to produce exactly the same costs as under the
 9 traditional IOCS approach. Second, Degen indicated in his responses to MPA/USPS-
 10 T12-8 and TW/USPS-T12-41 that some direct costs have been transferred by his
 11 method, both from window service to mail processing and vice versa. Since these are
 12 direct costs whose subclass is already known, and the main objective is to attribute costs
 13 to subclasses, I did not attempt to reclassify them between mail processing and window
 14 service.

15 2. Administrative And Support Costs

16 Table B-4 breaks down the reallocated administrative and support costs by IOCS
 17 activity code and describes the type of activity indicated by each code, according to
 18 Appendix B in USPS LR-H-1.¹ In the following I explain how the volume variable
 19 portion of these costs should be attributed to subclasses and special services.

20 Costs with activity codes 6320-6330, 6460-6519 and 6610-6660 are used in W.S.3.0.4 of
 21 Alexandrovich's workpaper B to develop different categories of administrative and
 22 support costs. Those costs are then distributed in worksheets W.S.3.3.1 and 3.3.2 and
 23 workpapers A1 and A2, using various distribution keys. For example, costs with code
 24 6630, by far the largest component in Table B-4, are part of general office and clerical
 25 costs and are distributed based on all other salaries in cost segments 2 through 12.

¹ My analysis of administration-related not handling costs matches that indicated by Degen in his response to MPA/USPS-T12-8, except that Degen's answer did not include \$12.7 million related to LD15, representing remote encoding facilities. For consistency, I have included the LD15 administration-related costs in the above table. Since the remote encoding facilities are physically separate from other mail processing facilities, another approach might be to treat them completely apart from MODS facilities. I have not, however, attempted to carry out this approach.

1 In Table B-5 the reassigned volume variable and accrued costs in Table B-4 are grouped
2 into the cost categories used in W.S.3.0.4. The first two columns show the non-overhead
3 portion of these costs, while the last two columns include the reassigned overhead costs,
4 distributed in the same proportion as the reassigned non-overhead costs.

5 For each category in Table B-5, the volume variable portion should be distributed to
6 subclasses based on the distribution keys used for the corresponding category in the
7 Alexandrovich workpapers. The difference between accrued and volume variable costs
8 should be added to the fixed costs for each category.² However, as a result of my
9 redistribution of mail processing and window service costs, some of the distribution
10 keys used by Alexandrovich will also change. His distribution keys include salary costs
11 in cost segments 2-12. My redistribution of mail processing and window service costs
12 will affect the distribution of segment 2 (supervisors) costs as well as segment 11
13 (custodial and maintenance) costs.

14 Table B-7 presents a redistribution of the costs already distributed by Alexandrovich
15 within segment 3.3, as well as a distribution of the reassigned administration/support
16 costs listed in Table B-5.

17 Due to limited time and resources I did not recalculate all elements of Alexandrovich's
18 distribution keys. Specifically, I did not attempt to recalculate the distribution of
19 segment 11 costs. Within segment 2, I redistributed the costs of supervision of mail
20 processing and window service activities, using my revised distributions of the
21 corresponding segment 3 costs. Additionally, I replaced the distribution key for
22 supervision of central mail markup with the same LIOCATT distribution key that I
23 used to distribute activity code 6570 not handling costs, as explained in Appendix A. I
24 did not attempt to redistribute other sub-segments of segment 2. The following
25 describes exactly how I performed the distribution shown in Table B-7, for each cost
26 category in Table B-5. Further details can be found on page WKPA_B of my MODSNH
27 spreadsheet.

² The costs already in W.S.3.0.4 are distributed by Alexandrovich using volume variabilities corresponding to his various distributing sets. Notes on page 38.1 of workpaper A-2. The difference in distributing the reassigned costs is that their volume variability is already known from Table B-4.

1 For the Express Mail related (6231) costs in Table B-5, I attribute the volume variable
 2 portion directly to Express Mail, while including the difference between accrued and
 3 volume variable costs as "specific fixed," so that all accrued 6231 costs become part of
 4 the "incremental" Express Mail costs. With this approach, total 6231 costs associated
 5 with Express Mail become \$83.505 million, close to the \$82.089 million in the FY96 CRA
 6 report.

7 I distribute the reassigned data collection and processing costs based on FY96 piece
 8 volume data, consistent with Alexandrovich's method. For general office and clerical
 9 costs, I use a distribution key based on all segment 2-12 salaries, excluding segment 3.3
 10 and the supervision of administration/support activities part of segment 2. I use this
 11 key to redistribute the \$329.228 million in volume variable general office and clerical
 12 costs already distributed by Alexandrovich, as well as to distribute the reassigned
 13 \$302.865 million. I apply the same distribution key to time and attendance costs.

14 For quality control costs I use a distribution key based on mail processing and segment
 15 6 salaries, to distribute both the quality control costs in Table B-5 and those already in
 16 segment 3.3. For the last five categories in Table B-5 (scheme examination, parcel
 17 training, non-parcel training, other training and "other administration") I simply use
 18 the distribution keys already in Alexandrovich's A2 workpaper to distribute the
 19 reassigned costs. Ideally, however, most of these distribution keys should be
 20 recalculated to be consistent with my revised distribution of mail processing costs.

21 Exhibit 2 summarizes my proposed attribution of the mail processing, window service
 22 and administration/support portions of Segment 3 costs. Exhibit 3 compares my
 23 distribution of Segment 3 costs with the distribution in Alexandrovich's testimony.³

24 As with window service costs, this treatment of administration/support not handling
 25 costs assures that the costs of each activity are distributed in a manner consistent with
 26 the nature of the activity itself. This is a far more accurate method for attributing these

³ Since Degen filed a change to his testimony, resulting in the attribution of an additional \$17 million in mail processing costs, I presume that Alexandrovich's Segment 3 cost distribution should change accordingly. However, since I am not aware of any corresponding change being filed by Alexandrovich, I show the original numbers from his testimony in Exhibit 3. For this reason, it may appear, but it is not the case, that I am attributing about \$17 million more Segment 3 costs than the Postal Service has proposed.

1 costs to the mail and services that cause them than Degen's method of distributing them
2 within whatever mail processing related cost pools employees doing administrative
3 work were erroneously clocked into.

4 For example, most of the 6231 costs correctly attributed to Express Mail by my method
5 as well as by the traditional IOCS method are distributed by Degen as general not
6 handling costs, causing all classes of mail to bear a part of the burden of these costs.
7 Another example is the \$464.134 million (\$302.865 million volume variable) in general
8 office and clerical costs (see Table B-5) that Degen distributes within mail processing but
9 that I reassign to administration/support. Since the corresponding \$555.181 million
10 (\$329.228 million volume variable) that Degen left in cost segment 3.3 are distributed
11 (Alexandrovich workpaper A-2) over all salaries in cost segments 2 through 12, the
12 effect of his approach is that mail processing carries all of the \$464.134 million plus its
13 proportionate share of the remaining \$555.181 million. Because different subclasses do
14 not use all cost segments in the same proportion, the effect is to overburden those
15 subclasses that use a higher than average portion of mail processing costs.

16 As shown in Table B-7, total segment 3.3 costs with my method are \$2,004.601 million,
17 versus \$1,987.493 million in the FY96 CRA, a difference of \$17.108 million. However,
18 there is one further adjustment that I have not attempted to make, which if carried out
19 would leave cost segment 3.3 with fewer costs than in the FY96 data.

20 In W.S.3.0.4, the "other admin." category includes \$70.101 million in volume variable
21 direct & mixed mail costs, imported from part IV of USPS LR-H-146 (see note in
22 W.S.3.3.1), that have migrated from mail processing to segment 3.3. It might be more
23 accurate to transfer these costs back to the mail processing segment, where they would
24 carry their part of the greater burden of overhead and other general not handling costs
25 in mail processing. This adjustment, along with the others described above, would
26 leave segment 3.3 with considerably fewer costs than in the FY96 CRA. This indicates
27 that there still are additional not handling costs, which I have not been able to identify,
28 that should be transferred to segment 3.3.

29 3. Reallocated Overhead Costs

30 Employees engaged in window service and administration/support activities obviously

1 also spend some time on breaks and in clocking in or out of operations.

2 I relied on Degen's answer to MPA/USPS-T12-8d to determine the break time (6521)
3 costs that correspond to the non-overhead costs in Tables B-2 and B-4. In that response
4 Degen also indicated that \$153.607 million in clocking in/out (6522) costs traditionally
5 classified as administrative have been reclassified by him as mail processing costs.
6 However, Degen appears to have compared his program with the LIOCATT, which
7 calls all 6522 costs administrative. In the past these costs were then distributed, by what
8 used to be called Barker's (now Alexandrovich's) workpapers, among mail processing,
9 window service and administration. I use the approach described below to determine
10 the portion of clocking in and out costs that should be returned to segments 3.2 and 3.3.

11 Traditionally, 6522 costs were distributed among mail processing, window service and
12 administration/support in W.S.3.0.1, by apportioning them based on total non-
13 overhead costs. Alexandrovich, in this docket, uses essentially the same approach for
14 BMC's and Non-MODS offices, where 6522 tally costs do not appear explicitly in the
15 IOCS data base. In fact, he does the same for MODS offices, except that in those offices
16 he excludes mail processing, apparently assuming that the mail processing portion of
17 6522 costs in MODS offices already has been correctly allocated by Degen.

18 Table B-6 presents a similar method of distributing all 6522 costs for MODS offices,
19 including mail processing. The table operates on accrued costs. From the MODS costs
20 assigned by Degen to mail processing (\$10,225.601 million) I subtract the 6522 portion
21 as well as the other costs that I reassign back to window service and administration.
22 The adjusted non-6522 MODS costs are used to distribute the 6522 MODS costs. From
23 the 6522 costs distributed in this manner I subtract the 6522 costs attributed to each
24 category by Degen/Alexandrovich to determine the portion that should be reallocated.
25 To determine the volume variable portion of these costs I use the ratio of volume
26 variable to accrued costs for all other costs reassigned to window service and
27 administration/support respectively. The results of this method indicate that \$3.496
28 million (volume variable) in 6522 costs should be reallocated to window service and
29 \$11.748 million should be reallocated to administration and support.

30 The assumption underlying this method is that, since clerks and mailhandlers appear to
31 move relatively frequently, not only between mail processing activities but also

1 between mail processing, window service and administrative functions, it makes most
2 sense to consider the costs directly involved in moving from one assignment to another
3 as systemwide costs that should be shared in proportion to all other costs. While one
4 could perhaps use alternative assumptions, I believe it is best to rely on this assumption
5 until the Postal Service produces a well-founded study that clearly identifies the specific
6 causes behind the increase in 6522 and other overhead costs.

Table B-2: Window Service Costs Returned To Segment 3.2 (\$1,000's)

Type Of Activity	Code	Volume Variable	Accrued Costs	Tally Costs
Serving A Window Customer:				
P.O. Box	5020	335	758	787
Selling Stamps	5040	9,274	18,480	20,062
Selling Cards	5050	177	362	398
Selling Envelopes Plain	5060	8	50	49
Setting Meters	5070	266	750	807
Selling Money Orders	5080	837	1,473	1,570
Selling Envelopes Printed	5090	8	105	107
Change Of Address	5110	192	382	411
Passport Application	5120	8	377	408
Retail Products	5130	123	208	234
All Other Work	5170	1,358	2,195	2,319
Permit Applications/ Deposits	5180	89	123	129
Customer Inquiry	6000	1,705	4,270	4,480
Waiting For Window Customer	6010	6,737	13,693	14,564
Window Related Activities:				
P.O. Box	6020	3,712	6,698	6,961
Caller Service	6030	2,382	4,574	4,810
Selling Stamps	6040	890	1,925	2,139
SSPC Work	6045	268	876	907
Selling Cards	6050	63	231	239
Setting Meters	6070	431	1,138	1,242
Off Site Setting Meters	6073	120	647	672
Money Orders	6080	138	464	507
Change Of Address	6110	274	538	562
Passport Application	6120	237	1,004	1,099
Retail Products	6130	101	368	379
Migratory Bird Stamp	6140	7	49	48
All Other Work	6170	10,695	34,857	36,901
Permit Applications/ Deposits	6180	248	667	666
Genral Delivery, etc.	6200	760	2,134	2,250
Overhead:				
Breaks	6521	5,469	9,802	10,224
Clocking In/Out	6522	3,496	8,138	8,640
Total Transferred To Window Service		50,409	117,335	124,569

Table B-3: Modified Attribution Of Window Service Costs (\$1,000's)

Subclass	WS 3.2.1	Stamps	Meters	Cards	Spec. Serv.	Overhead & Other	Revised Total
Letters & Parcels	489,789	8,735	362			16,747	515,633
Presort Letters & Parcels	21,505	204	348			740	22,798
Postal cards	0	0	0			0	0
Single Piece Cards	31,460	406	7	240		1,078	33,190
Presort Cards	755	10	1			26	792
Total First Class	543,508	9,355	718	240		18,591	572,412
Priority Mail	41,227	45	9			1,386	42,667
Express Mail	23,023	0	1			773	23,797
Mailgrams	0	0	0			0	0
In-County publications	457					15	473
Regular rate publications	2,186					73	2,260
Nonprofit publications	235					8	243
Classroom publications	0					0	0
Total Periodicals	2,879					97	2,975
Single Piece Rate	2,391	9	1			81	2,481
Regular Enh. Car. Rte.	5,677	72	11			193	5,953
Regular Other	22,021	287	48			750	23,106
Nonprofit Enh. Car. Rte.	930	15	3			32	980
Nonprofit Other	7,998	118	19			273	8,409
Total Standard A	39,017	502	82			1,329	40,930
Parcels Zone Rate	7,491	3	1			252	7,746
Bound Printed Matter	619	1	0			21	641
Special Standard	3,186	2	0			107	3,296
Library Mail	98	0	0			3	102
Total Standard B	11,395	6	2			383	11,786
Penalty - U. S.P.S.	13,740					461	14,202
Free Mail	181					6	187
International Mail	23,585	256	6			801	24,648
Total all mail	698,556	10,164	817			23,826	733,363
Special services:							
Registry	11,695					393	12,087
Certified	37,822					1,270	39,092
Insured	11,550					388	11,938
C.O.D.	3,549					119	3,669
Special delivery	148					5	153
Money orders	79,884				404	2,695	82,983
Stamped envelopes	1,302				16	44	1,361
Special handling	530					18	548
Post Office Box	62,861				4,047	2,246	69,153
Other	6,490				3,387	332	10,208
Total special services	215,831				7,853	7,509	231,193
Total Volume Variable	914,387	10,164	817	240	7,853	31,334	964,796
Total Other Costs	992,234	10,241	1,718	353	9,062	45,552	1,059,610
Total Window Service	1,906,621	20,405	2,535	593	16,915	76,886	2,023,956

Table B-4: Administration - Support Costs Returned To Segment 3.3 (\$1,000's)				
Cost Category	Activity Code	Volume Variable	Accrued Costs	Tally Costs
Mail Related:				
Express Mail	6231	29,863	54,195	57,209
Supplies and Equipment (MODS)	6320	3,653	9,068	9,477
Supplies and Equipment (NonMODS)	6320	106	135	129
Claims and Inquiry	6330	4,247	9,112	9,565
Vehicle Service Clerical Work	6460	1,226	2,093	2,148
Qual. Control/Rev. Protection (MODS)	6480	5,991	8,250	8,324
Qual. Control/Rev. Protection (NonMODS)	6480	66	84	80
Headquarters/Area Test	6495	2,041	3,000	2,986
Conducting and Taking Scheme Exams	6500	1,534	2,036	2,277
Training - Letter Shape	6511	3,854	4,015	1,149
Training - Flat Shape	6512	455	520	501
Training - Parcel Shape	6514	63	81	70
Training - Mixed All Shapes	6516	3,665	4,236	2,201
Training - Other Training	6519	10,387	14,540	15,033
General Services:				
Personnel and E&LR Work	6610	13,193	19,427	21,556
Accounting Or Auditing	6620	10,942	21,749	21,189
General Administrative Services	6630	213,934	344,174	370,456
Time and Attendance at Non-PSDS Office	6640	1,253	3,130	3,534
PSDS/MODS Time and Attendance	6650	4,789	17,717	19,139
PSDS/MODS - All Other	6660	2,965	4,977	5,439
Overhead:				
Breaks/Personal Needs	6521	121,934	161,506	161,961
Clocking In/Out	6522	11,748	18,485	19,330
Total		447,909	702,531	733,754

Table B-5: Distribution Of Reassigned Administration - Support Costs To Sub-Segments (\$1,000's)

	Excluding Overhead		With Overhead	
	Volume Variable	Accrued	Volume Variable	Accrued
Express Mail	29,863	54,195	43,728	72,863
Data Collection & Processing	5,005	7,978	7,046	10,726
General Office & Clerical	214,547	345,221	302,865	464,134
Time & Attendance	19,234	40,274	29,537	54,146
Miscellaneous Work	6,057	8,334	8,189	11,204
Scheme Examination	1,534	2,036	2,055	2,738
Parcel Training	116	155	156	208
Non-Parcel Training	7,922	8,698	10,147	11,694
Other Training	10,387	14,540	14,106	19,548
Other Admin	19,561	41,111	30,078	55,272
Total Reassigned	314,226	522,540	447,909	702,531

Table B-6: Reassignment Of 6522 (Clocking In/Out) Costs - MODS Offices (\$1,000's Based On W/S 3.0.1, page 2)

	Mail Processing	Claims/ Inquiry	Window Service	Admin./ Support	Total
Total (Degen)	10,225,601	22,691	684,142	670,637	11,603,071
6522 (Degen)	205,525	674	7,091	7,427	220,717
Excluding 6522 costs	10,020,076	22,017	677,051	663,210	11,382,354
Reassigned Not Handling Costs	(783,785)		109,197	674,589	0
Adjusted Non-6522 Costs	9,236,291	22,017	786,248	1,337,799	11,382,354
Distribute 6522 Costs	178,901	674	15,229	25,912	220,717
New Total	9,415,192	22,691	801,477	1,363,711	11,603,071
Reassigned 6522	(26,623)	0	8,138	18,485	(0)
Volume Variable	(15,245)		3,496	11,748	0

Revised 2/20/98

Table B-7: Modified Attribution Of Administration - Support Costs (\$1,000's)				
	USPS	Stralberg		
		Redistributed	From Sec. 3.1	New Total
First-Class:				
Letters & Parcels	302,027	306,549	175,763	482,312
Presort Letters & Parcels	92,320	92,197	51,366	143,563
Single Piece Cards	11,583	12,159	6,852	19,011
Presort Cards	3,137	3,428	1,933	5,361
Total First Class	409,067	414,333	235,914	650,247
Priority Mail	21,927	18,408	11,091	29,499
Express Mail	6,211	5,651	47,156	52,807
Mailgrams	9	10	7	17
Periodicals:				
Within County	1,721	1,726	1,020	2,746
Regular Rate Publications	27,573	25,769	15,348	41,116
Nonprofit Publications	6,729	6,513	3,688	10,201
Classroom Publications	285	242	144	386
Total Periodicals	36,308	34,250	20,200	54,449
Standard A:				
Single Piece Rate	4,114	4,136	2,454	6,590
Regular Enhanced Car. Rte.	43,303	43,061	23,981	67,042
Regular Other	97,685	96,088	55,194	151,282
Total Bulk Regular	140,988	139,149	79,175	218,324
Nonprofit Enhanced Car. Rte.	3,578	3,478	1,771	5,248
Nonprofit Other	24,178	24,122	13,490	37,612
Total Bulk Nonprofit	27,756	27,599	15,261	42,860
Total Standard A	172,858	170,884	96,889	267,774
Standard B:				
Parcels Zone Rate	8,089	7,566	4,658	12,224
Bound Printed Matter	4,456	4,435	2,893	7,328
Special Standard	3,585	3,757	2,325	6,083
Library Mail	707	711	459	1,170
Total Standard B	16,837	16,470	10,335	26,805
Penalty - U. S.P.S.	6,324	6,619	3,537	10,156
Free Mail	483	458	286	744
International Mail	14,351	14,252	7,643	21,895
Total All Mail	684,375	681,334	433,058	1,114,392
Special Services:				
Registry	2,775	3,212	1,691	4,903
Certified	6,778	7,048	4,404	11,452
Insurance	487	510	341	851
COD	579	602	276	878
Special Delivery	59	64	46	110
Money Orders	2,393	2,511	1,629	4,139
Stamped Envelopes	39	40	26	67
Special Handling	22	25	16	41
Post office box	2,438	4,219	2,944	7,163
Other	6,412	6,790	3,475	10,265
Total Special Services	21,982	25,021	14,849	39,870
Total Volume Variable	706,357	706,355	447,907	1,154,262
Other	595,711	595,712	254,626	850,338
Total Costs	1,302,068	1,302,068	702,533	2,004,601

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document on all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.


Timothy L. Keegan

December 30, 1997

1 CHAIRMAN GLEIMAN: Mr. Stralberg, have you had an
2 opportunity to examine the packet of designated written
3 cross-examination that was made available earlier today?

4 THE WITNESS: Yes, I have.

5 CHAIRMAN GLEIMAN: And if those questions were
6 asked of you today, would the answers be the same as those
7 you previously provided in writing?

8 THE WITNESS: Yes. I should point out there is
9 one correction that should be made. It is a minor typing
10 error and it is in the answer to my -- answer to the Postal
11 Service's fourth question. The page heading said page 1 of
12 2 and it is page 1 of 1.

13 In addition to that, the copy already includes a
14 correction to a table that I provided as part of my answer
15 the Postal Service's Question Number 25. That was -- the
16 Postal Service asked me to provide a new version of my Table
17 A-7, except using tally costs instead of volume variable
18 costs. I named that table A-7-T, and since I changed my
19 Table A-7 I am also changing that, but that is already in
20 the copy.

21 CHAIRMAN GLEIMAN: Do you know if that first
22 correction, the typo, was made in the packets?

23 THE WITNESS: No, it was -- I was alerted to it a
24 few, about half an hour ago.

25 CHAIRMAN GLEIMAN: Counsel indicates that they

1 were able to get the correction into the package.

2 THE WITNESS: Oh, it was?

3 MR. BURZIO: The correction was --

4 CHAIRMAN GLEIMAN: That's okay.

5 THE WITNESS: Okay.

6 CHAIRMAN GLEIMAN: That's why it is good to have
7 good counsel.

8 THE WITNESS: Yes.

9 CHAIRMAN GLEIMAN: With the corrections I am going
10 to provide two copies of the designated written
11 cross-examination of the witness to the reporter and direct
12 that it be accepted into evidence and transcribed into the
13 record at this point.

14 [Designation of Written
15 Cross-Examination of Halstein
16 Stralberg, TW-T-1, was received
17 into evidence and transcribed into
18 the record.]

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

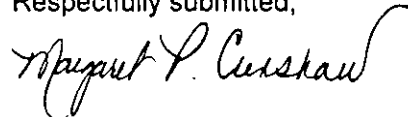
Postal Rate and Fee Changes, 1997

Docket No. R97-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF TIME WARNER INC.
WITNESS HALSTEIN STRALBERG
(TW-T1)

<u>Party</u>	<u>Interrogatories</u>
Newspaper Association of America	NAA/TW-T1-1-5
Office of the Consumer Advocate	NAA/TW-T1-1-5 USPS/TW-T1-1-30
United Parcel Service	USPS/TW-T1-1-20
United States Postal Service	NAA/TW-T1-1-5 USPS/TW-T1-1-30

Respectfully submitted,



Margaret P. Crenshaw
Secretary

Designating Parties:

NAA, OCA, USPS

NAA, OCA, USPS

NAA, OCA, USPS

NAA, OCA, USPS

NAA, OCA, USPS

OCA, UPS, USPS

OCA, UPS, USPS

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Designating Parties:

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**RESPONSE OF WITNESS HALSTEIN STRÄLBERG TO INTERROGATORY OF
NEWSPAPER ASSOCIATION OF AMERICA**

NAA/TW-T1-1. Please refer to your direct testimony at page 3, lines 25-27. You state that Professor Bradley's conclusion that mail processing costs are less than 100 percent volume variable is "...confirmed by the considerable slack time in mail processing evidenced by the large and fast growing pool of break time and other general overhead "not handling" costs identified in IOCS." Please explain how this "slack time" related to the growth in break time and not handling costs supports the argument that mail processing costs are less than 100 percent volume variable.

NAA/TW-T1-1. The existence of considerable slack time means that if postal volume were to increase significantly the Postal Service would have an opportunity to get more work out of its existing workforce, rather than just hiring more employees. In other words, mail processing costs should not increase as much as volume. Conversely, given the Postal Service's apparent inability to reduce its workforce to take full advantage of automation, it is unlikely that, given a volume decline, the Postal Service would be able to reduce its mail processing costs accordingly.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
NEWSPAPER ASSOCIATION OF AMERICA**

NAA/TW-T1-2. Please refer to your direct testimony at page 4, lines 28-30, and page 5, lines 1-9. You discuss the treatment of volume variable mixed mail and not handling costs.

- (a) Please confirm that your sole justification for arguing that the Commission should consider treating mixed mail volume variable costs as institutional costs is that the Postal Service has not shown a sufficient causal link between mixed mail costs and specific subclasses of mail. Please explain if you cannot confirm.
- (b) Please provide an estimate of the amount of volume variable mixed mail costs you believe should be treated as institutional costs and provide the method and calculations you use to derive this estimate. If you cannot provide an estimate, please explain why not.
- (c) If the "highly anomalous" growth in not-handling costs that you identify were well understood and were accurately linked (in your estimation) to the delivery of specific subclasses of mail, would attribution be justified? Please explain.

NAA/TW-T1-2.

- a. Confirmed.
- b. I have not developed an estimate of the amount of volume variable mixed mail costs that should be treated as institutional costs in this docket. My testimony simply urges the Commission to seriously consider whether sufficient evidence exists in this docket to link mixed mail and not handling costs to subclasses. My testimony, in the part you cite, expresses particular concern about certain not handling costs (those with activity codes 5750, 6521, 6522 and 6523) for which I consider the lack of established causal connections to specific subclasses to be even more serious than for the mixed mail.

With regard to mixed mail, the lack of established causal connections to subclasses is in my opinion worst for empty containers and mixed mail containers, for which the Postal Service collects no subclass data. Empty and other unidentified container costs are \$400.174 million volume variable. The corresponding accrued costs are \$537.895 million. Mixed mail container costs are \$440.066 million volume variable or \$594.734 accrued.

- c. Yes with regard to the volume variable portion of these not handling costs.

**RESPONSE OF WITNESS HALSTEIN STRÄLBERG TO INTERROGATORY OF
NEWSPAPER ASSOCIATION OF AMERICA**

NAA/TW-T1-3. In your direct testimony, you discuss an alternative cost distribution for clerk and mailhandler costs. Would your distribution methodology yield the same cost distribution as the methodology used by the Commission in Docket No. R94-1. If no, please describe and quantify any differences by class and subclass of mail.

NAA/TW-T1-3. The methodology I propose for distributing clerk and mailhandler costs is much closer to the Commission's R94-1 methodology than the approach advocated by witness Degen. Yet there are some differences between my method and the R94-1 method. These differences include:

- My method is applied to the FY96 IOCS data rather than to the FY93 data. Between FY93 and FY96 the Postal Service made some changes in the method of collecting IOCS data.
- Whereas the Commission's R94-1 method distributed IOCS tally costs, my method distributes the accrued pool costs associated with each tally, modified by the pool-specific volume variability factors developed by witness Bradley.
- Whereas my method generally leads to lower attribution levels, due to Bradley's variability factors, it also partially attributes some costs that previously were considered fully institutional.
- My method superimposes a segregation of costs by office type (MODS, NonMODS and BMC) on top of the traditional segregation by CAG.
- In the R94-1 methodology, costs associated with breaks/personal needs, clocking in/out and handling empty equipment were treated as overhead costs distributed in proportion to the distribution of all other processing costs to subclasses and special services. My method distributes breaks/personal needs and clocking in/out costs separately within office type and CAG. It distributes the "handling" portion of "empty equipment" costs differently from the "not handling" portion. Neither portion is distributed to special services. Both are distributed within office type, CAG and basic function, but the "handling" portion is distributed similarly to the mixed mail costs.

As to the difference in impact on classes and subclasses between my distribution method and the Commission's R94-1 method, an approximation can be seen by comparing Exhibit 2 in my testimony with the segment 3 cost distribution given in the Cost Segments and Components report for FY96 in USPS LR-H-2.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
NEWSPAPER ASSOCIATION OF AMERICA**

NAA/TW-T1-4. In Docket No. R94-1, you presented arguments for treating certain mail processing overhead costs as institutional costs and alternative options for distributing these costs across mail classes and subclasses. These arguments are similar to those you are presenting in the current proceeding. In Docket No. R94-1, the Commission did not accept the suggestion to exclude mixed-mail data from the distribution of mail processing costs, concluding that, "Using the counted mixed-mail tallies as part of the direct tally base for distributing uncounted mixed-mail costs is the preferable approach." [p. 3072]

- a. Please describe any differences in the arguments you are putting forward in this proceeding compared to your testimony in Docket No. R94-1.
- b. Do you believe that the Commission's decision was incorrect in Docket No. R94-1?
- c. What circumstances, if any, have changed to suggest that the Commission should reverse its previous decision in the current proceeding? Please explain.

NAA/TW-T1-4.

- a. The focus of my arguments in the present docket is to point out the numerous fallacies in the approach to mail processing costs distribution proposed by witness Degen. Additionally, I present an alternative distribution method, that attributes the same costs as those attributed by Degen, but is closer to the traditional approach and avoids Degen's reliance on numerous unverified and sometimes demonstrably erroneous assumptions. My testimony also shows that, due to the paucity of information about the true cost relationships in mail processing, there simply is no accurate and reliable way to distribute these costs to subclasses and special services.

I presented two testimonies in R94-1. My direct testimony demonstrated the unreasonableness of the sharp increases in mail processing costs charged to certain subclasses, including Periodicals, since FY86, and urged the Commission to take this into account when setting rates. My rebuttal testimony: (1) pointed out fallacies in the mail processing cost distribution approach that had been proposed by UPS witness Blaydon; (2) proposed a realignment of the cost distribution produced by IOCS based on an analysis of trends in subclass costs between FY86 and FY93; and (3) argued for increases in certain worksharing discounts.

- b. The Commission's treatment of counted mixed mail item tallies in R94-1, when it included such tallies with the direct tallies before distributing uncounted mixed mail costs, is the same method that I propose in my current testimony.

As to whether the Commission's R94-1 decision on this subject was correct or incorrect, I can only reiterate the conclusion expressed in my current testimony, namely that there simply is no fully satisfactory way to distribute mail processing costs based on the information currently available, but that the method adopted by

the Commission in R94-1 and proposed in my testimony in this docket is more reasonable than that proposed by witness Degen, in light of such information as is available.

- c. The mixed mail distribution method that I recommend in this docket is essentially the same method that the Commission chose to use in R94-1. I do not believe current circumstances warrant the changes to that method suggested by Degen.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
NEWSPAPER ASSOCIATION OF AMERICA**

NAA/TW-T1-5. Please refer to your direct testimony at page 34, lines 6-9. You state that
"Degen simply distributes these costs within whatever mail processing cost pool employees
were clocked into, ignoring the much more accurate distribution keys available to the Postal
Service and the Commission for distributing such costs."

Also please refer to your direct testimony at page 11, lines 14-16:

"Since Bradley's analysis of the FSM cost pool was based on all wage costs for employees
clocked into FSM MODS codes, regardless of what those employees were actually
doing....." (emphasis added)

- a. If employees are clocked into FSM MODS codes but were doing other work, please
explain the effect of this "misclocking" on Bradley's variability estimates for the FSM
MODS pools.
- b. Please explain why you find these "misclocking" errors to be important in the distribution
of the costs to subclasses of mail but you do not find these same errors to be problematic
when Bradley performs his variability analysis.

NAA/TW-T1-5.

a-b. It should have no effect. Bradley performed an econometric analysis of certain
cost pools defined by groups of MODS numbers, including the FSM cost pool, and
reached certain conclusions regarding the variability of the costs in those pools with
regard to volume. For purpose of variability analysis (as opposed to cost distribution),
the relevant factor is what cost pool employees were clocked into, not what precise
activity they were doing. Bradley's analysis must be judged by the soundness of his
mathematical approach, his choice of independent variables and other technical factors,
not on what employees incurring costs in the various pools were actually doing.

On the other hand, when it comes to distributing these costs to subclasses and special
services, the question of precisely which activities the costs represent becomes crucial,
because all classes of mail do not require the same type of work to be performed. The
example I use at page 11 in my testimony is when an employee was actually selling
stamps or setting meters in a postal window. In that particular example, it should be
obvious that responsibility for these costs must be distributed according to how much
different classes make use of stamps and meters. The problem is not with the
"misclocking" of employees at the FSM or any other cost pool, only with Degen's
failure to take this misclocking into account when distributing mixed mail and not
handling costs.

There is no conflict between the two cited parts of my testimony.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-1. Please explain how you purport to produce a more accurate distribution of volume variable costs in, for example, the BCS cost pool, by employing IOCS tally information associated with non-BCS mail processing operations, including non-letter operations.

USPS/TW-T1-1. I believe it is fallacious to think that mixed mail and not handling mail processing costs can be accurately distributed simply by isolating them in many individual cost pools, while ignoring all interconnections between costs incurred at different pools. The reasons I reached this conclusion are described in my testimony. Some of the most important reasons are summarized below. Please see also my answers to various other questions in this set of interrogatories, particularly my answers to USPS/TW-T1-2.

Besides operations dedicated to particular methods of sorting mail pieces, such as the BCS pool you refer to, mail processing facilities perform many "allied" activities, mostly at platforms and opening/pouching units, that are necessary support activities for the piece distribution functions. As witness Bradley concludes: "Allied activities exist to support the direct piece sorting of mail and it is in this sense that they are 'allied' with the direct activities". Bradley in fact uses volume measures at direct piece sorting activities also as "cost drivers" for his analysis of the volume variability of "allied" cost pools. USPS-T-14 at 18-19.

These allied cost pools account for a very major portion of all mixed mail and not handling costs. Mixed mail is mostly handled in the allied cost pools. Furthermore, besides the not handling functions that naturally belong in the allied cost pools, extra not handling costs are added because: (1) employees arriving at work or returning from lunch often clock into an opening unit to assure that they will get paid while waiting for specific assignments; and (2) since productivity generally is monitored at piece sorting operations but not at allied operations, a strong incentive exists for managers and supervisors to have employees momentarily not needed elsewhere clock into an allied cost pool. While allied operations generally have a low level of automation compared with the highly sophisticated automated letter sorting operations, they account for most of the sharp increase in not handling costs that has occurred since the start of letter mail automation.

In view of the above, an important step in the quest for more accurate mail processing cost distribution should be to closely analyze the relationship between costs at the various piece sorting operations and at the allied labor operations. Little appears to be known, for example, regarding which portion of the mixed mail and not handling costs at a given allied operation (e.g. preferential opening units) are related to each of the various piece sorting operations served by the allied operation.

These are not easy questions, but it is time the Postal Service at least starts to address them in earnest. The main problem with Degen's approach is that he simply ignores these issues completely. Instead of addressing seriously the cost relationships described above, Degen simply distributes the large mixed mail and not handling costs at allied operations based only on the relatively few direct costs at those operations, while ignoring all connections to the direct costs at the piece sorting operations served by the allied operations.

For this reason I concluded that, lacking more helpful information about the true relationship between allied and the various direct operations, and about the true reasons for the sharply increased not handling costs, it is after all better to use an approach that cuts across the cost pools and uses all direct costs to distribute all mixed and not handling costs (within CAG and basic function), rather than the pool by pool approach whose effect is to distribute most of the mixed and not handling costs upon only a small part of the direct costs, and to ignore all cross-pool cost relationships.

If it were only a matter of distributing mixed mail and not handling costs at letter and flat piece sorting operations, then maybe it would be acceptable to treat operations such as BCS, OCR, LSM, FSM etc. as completely separate entities. But it is the presence of the very large mixed and not handling costs at allied operations that themselves have relatively few direct costs and whose precise relationship to the piece sorting operations is poorly understood, that causes the major distortion in Degen's approach. In fact, as pointed out in my testimony, the effect of his approach is a strong bias leading to exaggerated costs being attributed to the least automated and the most presorted mail, whose time in postal facilities is spent mostly in the allied labor areas.

The main reason why the least automated and the most presorted mail is inevitably victimized by the pool-by-pool approach is as follows. While allied operations mostly serve letter and flat piece sorting operations, some mail is handled only at the allied operations. Parcels are often handled individually at platforms and opening units. IPP's are sorted, along with bundles of letters and flats, at opening and pouching units. And presorted bundles, sacks and trays of letters and flats, which give rise to direct IOCS tallies because they have identical mail pieces, are often handled only at the allied operations, thus bypassing piece sorting in many facilities. These types of mail give rise to a large portion of the direct costs incurred at allied operations. Under Degen's approach they are therefore also held responsible for the large mixed mail and not handling costs at allied operations, which exist to support piece sorting operations. While bypassing piece sorting, due to preparation by mailers, the highly presorted mail is nevertheless forced to absorb some of the allied mixed and not handling costs related to piece sorting operations.

Another separate reason the pool-by-pool approach will not work is that employees are not always clocked into the MODS operations where they actually are working. For this reason, there are no "pure" cost pools in Degen's data. Even the BCS and OCR

pools include tallies of employees handling flats or parcels. In fact, every MODS cost pool except the Mailgram pool has tallies of employees handling letters as well as tallies of employees handling flats. Most of them also have tallies of employees handling parcels and IPP's. Consequently, it is not even possible to determine the true costs incurred in BCS sorting, OCR sorting, etc. based on Degen's data, much less to distribute those costs to subclasses.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-2. Please refer to program ALB105C5, USPS-LR-H-21.

- (a) Please confirm that the shape-related mixed mail codes (5610, 5620, 5700) are assigned based on the mail processing operation recorded in IOCS question 19. If you do not confirm, please explain.
- (b) Please confirm that witness Degen's distribution cost pools (BCS, LSM, Manual Flats, etc.) are MODS-based analogues to IOCS question 19 operations. If you do not confirm, please explain.
- (c) Please confirm that the assignment of the shape-related mixed mail codes in program ALB105C5 does not take into account whether the mail processing operation is a manual, mechanized, or automated operation. If you do not confirm, please explain.
- (d) Is it your testimony that you should obtain more accurate mixed-mail distributions by employing mixed-mail activity codes that ignore whether the tally was taken in a manual, mechanized, or automated operation? Please explain fully.

USPS/TW-T1-2.

- a. Since I am not an expert Cobol programmer I cannot testify with authority as to what exactly the many programs in USPS-LR-H-21 do. However, I accept your representation that program ALB105C5 assigns shape-related mixed mail codes based on answers to IOCS question 19.
- b. The analogy you refer to may look good in theory, but hardly in practice, for reasons explained below.

First, Degen's method provides nothing even resembling the use of shape specific mixed mail codes for NonMODS offices, which after all do incur a significant portion of all mail processing costs, and many of which do have shape specific operations that give rise to activity codes 5610, 5620 and 5700.

In MODS offices, the Degen cost pools are based on the MODS numbers IOCS clerks believed sampled employees were clocked into, whether or not they were actually working at the operations that those MODS numbers indicate. On the other hand, the question 19 answers used to assign shape-related mixed mail codes indicate where the IOCS clerks actually saw sampled employees working. As Table USPS-2 attached to this answer illustrates, the two concepts lead to very different results.

The table shows the volume variable mixed mail costs, at each MODS cost pool, that have been assigned activity codes 5610, 5620, 5700 and 5750 respectively. It does not include the not handling costs with corresponding activity codes, but the comments below apply equally well to shape related not handling costs. As the table shows, employees that IOCS clerks saw working at shape related operations must have

been clocked into many operations not related to those shapes. In other words, MODS employees do not always work at the operations they are clocked into.

For example, observations by IOCS clerks of employees handling mixed mail at letter specific operations correspond to \$107.147 million in volume variable costs. There are five letter specific cost pools in Degen's MODS data: BCS, LSM, OCR, LD15 (remote coding) and MANL (manual letters). Those pools, however, account for only \$63.108 million, or 58.9%, of the mixed mail 5610 costs. The remaining 41.1% were recorded while employees were clocked into a variety of operations not related specifically to letter mail processing.¹

Altogether, 5610 mixed mail costs were recorded while employees were clocked into 34 different MODS cost pools. 31.35% of these costs were recorded while employees were clocked into platform or opening unit cost pools. As I understand the use of Question 19 answers, if an employee actually were seen working at an opening unit or on the platform, a 5610 activity code would not result. In other words, these employees must have been clocked into opening unit or platform operations while actually working at manual, mechanized or automated letter mail operations.

Similar conclusions apply for flats. The MODS cost pools include two (FSM and MANF) that are flat specific. But those cost pools account for only 61.71% of the 5620 mixed mail costs. Altogether, employees observed at flat specific operations handling mixed mail were clocked into 25 different MODS cost pools, most of which are not flat specific. Regarding parcels/IPP's, the MANP and MecParc pools are presumably for parcels only, and the Priority, Spbs Other and SpbsPrio pools can probably be considered mostly parcel and IPP related. But these pools together account for only 27.06% of the mixed mail costs with activity code 5700. Degen's pool by pool approach is therefore totally unsuitable for isolating the mixed mail costs that are parcel/IPP specific.

The table also shows that employees sometimes were clocked into letter or flat specific operations while actually working elsewhere. For example, \$1.427 million mixed mail costs with activity code 5750 (mixed all shapes) appear in the FSM cost pool. This presumably represents employees whom the IOCS clerks thought were

¹ It is possible that the \$2.618 million in 5610 mixed mail costs at the 1CancMPP cost pool were recorded at letter specific canceling operations. But since this cost pool also includes cancellation of flats and parcels, Degen's approach leaves no room for distinguishing mixed mail or not handling costs on the basis of shape. The same applies to the \$6.256 million in 5610 mixed mail costs recorded at the LD41, LD42 and LD43 cost pools which represent automated, mechanized and manual sorting at stations and branches of MODS offices. These operations may have separate components handling respectively letters, flats and IPP's/parcels, but Degen's approach does not allow use of these distinctions.

clocked into an FSM operation. But if those employees actually were working at FSM operations, then mixed mail code 5620 should have resulted, rather than 5750.

While Table USPS-2 focuses on volume variable costs, the picture is even worse if one considers accrued costs. Only 54.53% of accrued 5610 mixed mail costs were recorded while employees were clocked into letter specific operations, even though the 5610 code indicates that all of these observed employees actually were working at letter specific operations.

Finally, while I have focused on shape specific mixed mail costs, discrepancies of the type described above have even graver consequences with regard to shape specific not handling costs. The not handling costs with activity codes 5610, 5620 and 5700 respectively are tabulated by MODS cost pool in the last three columns of Table A-4 in Appendix A of my testimony. For example, while mixed mail related 5610 (letter specific) costs are "only" \$107.147 million, the corresponding not handling costs are \$437.47 million. And of the latter, only 72.7% were recorded while the observed employees were clocked into letter specific cost pools.

- c. Confirmed, subject to the same caveats as in part a.
- d. While it is conceivable that the answers to question 19 could be utilized more efficiently than with the approach described in my testimony, Degen's pool by pool approach is not the answer.

As shown in my answer to part b above, the notion that one can accurately distinguish mixed mail and not handling costs specific to letters, flats and parcels/IPP's by means of Degen's pool by pool approach is an illusion which the Postal Service should put aside, the sooner the better. Distinguishing between cost pools does not enable one to isolate, for example, the mixed mail costs at letter operations from other mixed mail costs, simply because employees often work at cost pools other than those they are clocked into. I see no reason to believe that attempts at an even finer differentiation between types of mixed mail costs via the pool by pool approach would be any less misleading.

Furthermore, let us assume that the problems I have described in part b above were somehow resolved. In other words, assume that (1) employees in MODS offices were always clocked into the operations they actually work at; and (2) Degen's cost pools scheme really did allow a separation of mixed mail and not handling costs that are respectively letter specific, flat specific and parcel/IPP specific. Even in this very hypothetical situation, it is not obvious that any gain in cost distribution accuracy would be achieved by separate distributions of mixed mail and not handling costs incurred at automated, mechanized and manual operations.

Take flats as an example. A separate distribution of mixed mail and not handling costs at the FSM and MANF (manual flats) cost pools would make sense if the two pools were totally separate, i.e. if costs incurred in one pool were not related to costs incurred in the other. In reality, the two are highly interrelated. Most flats can be processed at either FSM or MANF operations. Decisions as to where they really will be sorted are made by facility managers based on considerations such as equipment availability, scheduling needs, etc. As explained by witness Moden at page 21 of his testimony, staffing of these operations is also highly interrelated. According to Moden:

"Manual cases become the method-of-last-resort, especially late in the evening as rejects from automated operations appear in quantity. To meet service commitments, manual cases must be staffed to handle these late surges."

Moden's comments may apply even more to letters than to flats. In any event, they indicate that staffing of manual sorting operations must also take into account the needs of the mail that normally is processed in automated or mechanized operations. In other words, costs at manual, mechanized and automated operations are interrelated. In order to move towards a more accurate costing system, the Postal Service should conduct an in-depth analysis of this dynamic interaction between automated, mechanized and manual sorting operations and how facility managers actually schedule employees at these operations. A costing system based on the results of such an analysis would certainly be far more reliable than one based on Degen's numerous unverified and sometimes clearly erroneous assumptions.

Finally, even if one could somehow achieve a perfectly accurate distribution of all shape specific mixed mail costs, most mixed mail costs are of the "mixed all shapes" variety and have activity code 5750. These costs are incurred mostly at allied operations, i.e. platforms and opening units. As discussed in my answer to USPS/TW-T1-1, allied operations essentially serve the shape specific sorting operations by performing various preparatory steps prior to sorting and steps such as pouching and dispatching the mail after it has been sorted.

Given these interrelationships, an accurate costing system would need to determine which portion of the allied operation costs are spent serving each type of shape specific sorting operation. In other words, one would need to address questions such as: which portion of the costs at an allied operation is spent preparing mail for BCS sorting, FSM sorting, etc.? It would also require a full study of the cost consequences when, for example, employees clock into an opening unit while waiting for a specific assignment elsewhere, or are sent back to an allied operation during a temporary lull in activity, etc.

Degen's approach essentially denies the existence of all these issues. Rather than analyze the interrelationships between allied operation costs and sorting operation costs he simply assumes that all mixed mail and not handling costs at allied operations (including most 5750 costs) are causally related only to the direct costs at the same operations (cost pools). He does so even though most of the direct costs at these allied operations appear to be there only because employees frequently are clocked into one operation while working elsewhere.

This in fact may be the most important difference between Degen's approach and mine. Degen assumes away all interrelationships between costs at allied operations and those at the various sorting operations, by treating each cost pool as a completely independent entity unrelated to other cost pools. My approach recognizes both that these cost interrelationships exist and that woefully little is really known about them, due to the lack of any meaningful USPS study of these issues. I have therefore chosen a conservative approach that simply assumes, given the lack of more specific information, that the 5750 costs are incurred proportionately to all other mail processing costs.

Table USPS-2: MODS Volume Variable Mixed Mail Costs Per Shape Code And Cost Pool (\$1,000's)				
Cost Pool:	5610	5620	5700	5750
Bcs/	21,600	0	0	1,535
Express	21	25	29	1,351
Fsm/	713	14,840	237	1,427
Lsm/	8,006	73	66	472
Manf	481	13,238	0	1,486
Manl	13,075	1,128	91	2,887
Manp	0	47	773	821
Mecparc	0	0	303	240
Ocr/	5,412	0	0	490
Priority	75	4	1,595	5,189
Spbs Oth	61	46	395	4,944
Spbsprio	111	43	435	3,138
Busreply	49	0	0	620
Intl	866	381	618	4,888
LD15	15,016	0	0	7,638
LD41	437	0	0	39
LD42	26	37	0	50
LD43	5,793	2,256	1,793	10,851
LD44	223	74	79	592
LD48 Exp	0	0	0	43
LD48 Oth	90	47	28	505
LD48_Ssv	9	19	8	119
LD49	44	0	0	2,259
LD79	0	0	0	1,082
Mailgram	0	0	0	0
Registry	0	0	9	1,117
Rewrap	113	0	0	401
1Bulk Pr	63	0	35	671
1Cancmpp	2,618	432	35	9,984
1Eqmt	60	0	130	1,480
1Misc	919	379	0	3,372
1Opbulk	3,715	2,403	621	13,189
1Oppref	10,212	3,298	1,289	35,470
1Platfrm	4,364	2,540	2,265	101,996
1Pouchng	12,000	3,887	803	29,810
1Sacks_H	496	218	559	12,608
1Sacks_M	119	0	555	5,573
1Scan	155	5	148	8,421
1Support	205	83	39	699
LD48_Adm	0	0	0	0
Total	107,147	45,503	12,939	277,458
At Shape Specific				
Pool:	63,108	28,078	3,502	N.A.
Percent:	58.90%	61.71%	27.06%	N.A.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-3. Do you believe that all mixed-mail in an operation is likely to have the same subclass distribution regardless of the item or container information recorded in IOCS question 21? If so, please reconcile your answer with witness Cohen's Table 4 (MPA-T-2, p. 24). If not, why do you propose ignoring the question 21 data in your testimony?

USPS/TW-T1-3. No.

Pages 12-25 of my testimony explain why I concluded that the elaborate and costly mixed mail scheme the Postal Service introduced some years ago simply will not work. Its perhaps most serious flaw is the complete failure to collect any subclass information for mixed mail containers, which represent the largest portion of mixed mail costs. I also show, in that part of my testimony, why implementing this approach within a large number of individual pools actually increases its inherent unreliability by ignoring many important cross-pool cost relationships.

Given the problems inherent in the current approach, use of it within many different pools only creates an illusion of accuracy, when in fact there are not enough data available to distribute mixed mail and not handling costs to subclasses reliably. In this situation, it is better to use a more conservative approach that relies on fewer unwarranted assumptions and is closer to the traditional method. That, after all, is what both the Postal Service and the Commission concluded in R94-1, when the same type of item/container data was already available.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-4. On page 11 of your testimony, you claim that there are "severe distortions" involved in distributing not-handling costs as a group, by cost pool. As an example, you offer the example of not handling costs migrated from window service to FSM.

- a. Please refer to spreadsheet TW-19.xls, USPS-LR-H-260. Please confirm that tallies with window service activity codes are 0.23% of costs in the FSM pool. If you do not confirm, please explain.
- b. Is it your testimony that distributing 0.23% of FSM cost pool costs per witness Degen's methodology will lead to "severe distortions" of the cost distribution? Please explain.

USPS/TW-T1-4.

a. Confirmed.

b. The window service related not handling costs misclassified as FSM costs under Degen's approach are \$1.552 million, volume variable. Distributing these costs within the FSM cost pool to mail subclasses that generally do not use window services, rather than treating them as window service costs, is already a distortion of the true cost relationships. Furthermore, it is a totally unnecessary distortion, since the Postal Service already has at its disposal more accurate methods for distributing various types of window service costs.

Whether this by itself is a severe distortion obviously depends on one's perspective. In any case, my testimony shows that distributing all not handling costs, which now are over 40% of all clerk and mailhandler costs, with no consideration of the nature of the different types of not handling, relying instead exclusively on the cost pools that employees happened to be clocked into, does add up to a very severe distortion of the true cost relationships within segment 3.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-5. Please refer to Table 4-1, Exhibit 4, TW-T-1.

- a. Please confirm that Table 4-1 indicates that IOCS data collectors obtained a top piece for $976,410/1,002,564 = 97.4\%$ of non-empty items subject to the Top Piece Rule (weighed by cost). If you do not confirm, please explain.
- b. Is it your testimony that the 97.4% of eligible items to which the Top Piece Rule was successfully applied are not representative of all items subject to the Top Piece Rule in any significant way? Please explain fully.

USPS/TW-T1-5.

- a. Confirmed, although it should be noted that the \$976.410 million direct costs for bundles, letter trays and flat trays consist both of costs of direct items with identical pieces, and of mixed mail items where the subclass was determined by application of the top piece rule. It is not known which portion of the \$976.410 million falls into each category, though it is possible that this could be determined from the IOCS data.
- b. Obviously, since 97.4% is much more than the remaining 2.6%, a profile of all top-piece-rule items would be more like the 97.4% than the 2.6%. That, however, does not mean that the 2.6% (or \$26.154 million, volume variable) are similar to the 97.4%. In my testimony I have given some reasons why they may in fact be rather different from the 97.4%.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-6. Please see Table 4-1, Exhibit 4, TW-T-1.

- a. Please confirm that Table 4-1 indicates that IOCS data collectors were able to obtain subclass information for the contents of $(55,139+41,537)/137,256 = 70.4\%$ of non-empty items not subject to the top piece rule (weighted by cost). If you do not confirm, please explain.
- b. Please confirm that Table 4-1 indicates that IOCS data collectors were able to obtain subclass information for $(1,031,549+41,537)/1,139,820 = 94.1\%$ of all non-empty single items (weighted by cost). If you do not confirm, please explain.

USPS/TW-T1-6.

- a. Confirmed.
- b. Confirmed.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-7. Please see Exhibit 5, TW-T-1. Please disaggregate Tables 5-1, 5-2 and 5-3 by item type, and please also provide the resulting tables in electronic spreadsheet format.

USPS/TW-T1-7. Tables similar to Tables 5-1, 5-2 and 5-3 in my testimony, but representing individual non-top-piece rule item types, are shown on the following pages. Tables 5a through 5m represent individual item types in all offices. Tables 5-1a through 5-1m represent similar information for MODS offices, Tables 5-2a through 5-2m represent NonMODS offices and Tables 5-3a through 5-3m represent BMC's.

TW-LR-H-3, being filed today, includes a Quattro spreadsheet named items.wb1 and a corresponding Excel spreadsheet named items.xls. The spreadsheets contain pages named MODS, NonMODS and BMC. Each page contains the tables for its corresponding facility group.

USPS/TW-T1-7
Page 2 of 8

Table 5a: Direct & Counted Item Costs In All Offices (Volume Variable Costs - Con-Con's)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	76	36.38%	52	12.71%
Periodicals	0	0.00%	114	27.90%
Standard A	56	26.97%	242	59.38%
Standard B	76	36.23%	(0)	-0.00%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	1	0.42%	(0)	-0.00%
Total	209	100.00%	407	100.00%

Table 5b: Direct & Counted Item Costs In All Offices (Volume Variable Costs - Parcel Trays)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	627	47.60%	373	36.70%
Periodicals	39	2.99%	0	0.00%
Standard A	197	14.93%	397	39.06%
Standard B	206	15.65%	95	9.29%
Priority	131	9.92%	40	3.95%
Express	0	0.00%	0	0.00%
Other	117	8.91%	112	10.99%
Total	1,317	100.00%	1,017	100.00%

Table 5c: Direct & Counted Item Costs In All Offices (Volume Variable Costs - Pallets)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	64	3.34%	522	5.97%
Periodicals	581	30.15%	2,730	31.21%
Standard A	449	23.33%	4,598	52.57%
Standard B	730	37.91%	643	7.35%
Priority	72	3.76%	146	1.66%
Express	0	0.00%	0	0.00%
Other	29	1.50%	107	1.23%
Total	1,926	100.00%	8,746	100.00%

Table 5d: Direct & Counted Item Costs In All Offices (Volume Variable Costs - Other Items)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	305	28.70%	391	22.00%
Periodicals	4	0.38%	191	10.76%
Standard A	260	24.48%	922	51.93%
Standard B	89	8.42%	109	6.12%
Priority	269	25.28%	160	8.99%
Express	76	7.15%	(0)	-0.02%
Other	59	5.60%	4	0.21%
Total	1,063	100.00%	1,776	100.00%

Table 5e: Direct & Counted Item Costs In All Offices (Volume Variable Costs - SCK-BL&O)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	0.00%	55	4.95%
Periodicals	0	0.00%	0	0.00%
Standard A	0	0.00%	0	0.00%
Standard B	55	2.16%	(0)	-0.00%
Priority	707	27.53%	142	12.78%
Express	1,787	69.59%	851	76.49%
Other	18	0.72%	64	5.78%
Total	2,569	100.00%	1,112	100.00%

Table 5f: Direct & Counted Item Costs In All Offices (Volume Variable Costs - Green Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	1,923	71.47%	466	86.86%
Periodicals	192	7.12%	28	5.15%
Standard A	227	8.43%	4	0.75%
Standard B	120	4.46%	4	0.68%
Priority	190	7.06%	38	7.03%
Express	0	0.00%	0	0.00%
Other	39	1.46%	(2)	-0.46%
Total	2,691	100.00%	537	100.00%

Table 5g: Direct & Counted Item Costs In All Offices (Volume Variable Costs - Or. & Yellow Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	447	5.31%	57	5.93%
Periodicals	86	1.02%	(0)	-0.00%
Standard A	97	1.16%	84	8.70%
Standard B	81	0.96%	5	0.56%
Priority	7,352	87.34%	818	84.35%
Express	96	1.14%	0	0.00%
Other	259	3.08%	4	0.45%
Total	8,417	100.00%	969	100.00%

Table 5h: Direct & Counted Item Costs In All Offices (Volume Variable Costs - Brown Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	344	9.43%	149	1.68%
Periodicals	2,570	70.55%	6,381	72.08%
Standard A	611	16.76%	1,985	22.42%
Standard B	67	1.83%	144	1.62%
Priority	51	1.40%	0	0.00%
Express	0	0.00%	0	0.00%
Other	1	0.02%	194	2.19%
Total	3,643	100.00%	8,853	100.00%

Table 5i: Direct & Counted Item Costs In All Offices (Volume Variable Costs - White #1 Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	755	11.65%	343	6.67%
Periodicals	98	1.51%	1,083	21.04%
Standard A	1,882	29.05%	3,070	59.62%
Standard B	2,985	46.09%	349	6.77%
Priority	93	1.44%	83	1.61%
Express	53	0.82%	(0)	-0.00%
Other	610	9.43%	221	4.29%
Total	6,476	100.00%	5,150	100.00%

Table 5j: Direct & Counted Item Costs In All Offices (Volume Variable Costs - White #2 Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	809	14.63%	331	4.92%
Periodicals	861	15.58%	1,067	15.85%
Standard A	2,590	46.84%	4,641	68.95%
Standard B	570	10.30%	341	5.06%
Priority	237	4.30%	(0)	-0.00%
Express	0	0.00%	0	0.00%
Other	462	8.36%	352	5.23%
Total	5,529	100.00%	6,732	100.00%

Table 5k: Direct & Counted Item Costs In All Offices (Volume Variable Costs - White #3 Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	403	13.12%	320	1.84%
Periodicals	423	13.78%	2,459	14.14%
Standard A	1,870	60.90%	13,607	78.23%
Standard B	161	5.24%	466	2.68%
Priority	0	0.00%	44	0.25%
Express	0	0.00%	0	0.00%
Other	213	6.95%	496	2.85%
Total	3,070	100.00%	17,393	100.00%

Table 5l: Direct & Counted Item Costs In All Offices (Volume Variable Costs - Other Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	193	13.64%	86	4.17%
Periodicals	235	16.63%	355	17.25%
Standard A	306	21.65%	952	46.25%
Standard B	505	35.66%	397	19.31%
Priority	47	3.29%	122	5.94%
Express	60	4.27%	25	1.22%
Other	69	4.87%	120	5.86%
Total	1,415	100.00%	2,058	100.00%

Table 5m: Direct & Counted Item Costs In All Offices (Volume Variable Costs - International Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	26	0.70%	(0)	0.00%
Periodicals	70	1.89%	0	-0.00%
Standard A	0	0.00%	0	0.00%
Standard B	2	0.07%	0	-0.00%
Priority	9	0.23%	0	-0.00%
Express	147	3.93%	(0)	0.01%
Other	3,477	93.18%	(132)	100.00%
Total	3,732	100.00%	(132)	100.00%

USPS/TW-T1-7
Page 4 of 8

Table 5-1a: MODS Direct & Counted Item Costs (Volume Variable Costs - Con-Con's)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	76	57.05%	52	15.25%
Periodicals	0	0.00%	114	33.48%
Standard A	56	42.29%	174	51.26%
Standard B	0	0.00%	0	0.00%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	1	0.65%	(0)	-0.00%
Total	133	100.00%	339	100.00%

Table 5-1b: MODS Direct & Counted Item Costs (Volume Variable Costs - Parcel Trays)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	627	52.10%	373	43.29%
Periodicals	39	3.28%	0	0.00%
Standard A	197	16.34%	321	37.24%
Standard B	92	7.67%	59	6.80%
Priority	131	10.86%	40	4.66%
Express	0	0.00%	0	0.00%
Other	117	9.75%	69	8.01%
Total	1,203	100.00%	862	100.00%

Table 5-1c: MODS Direct & Counted Item Costs (Volume Variable Costs - Pallets)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	64	6.31%	522	10.80%
Periodicals	374	36.62%	1,842	38.11%
Standard A	225	22.01%	2,135	44.16%
Standard B	286	27.97%	190	3.92%
Priority	72	7.10%	146	3.01%
Express	0	0.00%	0	0.00%
Other	0	0.00%	0	0.00%
Total	1,021	100.00%	4,835	100.00%

Table 5-1d: MODS Direct & Counted Item Costs (Volume Variable Costs - Other Items)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	146	26.99%	210	24.16%
Periodicals	4	0.75%	91	10.51%
Standard A	203	37.51%	419	48.36%
Standard B	49	9.03%	108	12.47%
Priority	32	5.87%	35	4.03%
Express	76	14.02%	(0)	-0.04%
Other	32	5.83%	5	0.52%
Total	542	100.00%	867	100.00%

Table 5-1e: MODS Direct & Counted Item Costs (Volume Variable Costs - SCK-BL&O)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	0.00%	55	7.39%
Periodicals	0	0.00%	0	0.00%
Standard A	0	0.00%	0	0.00%
Standard B	55	2.67%	(0)	-0.00%
Priority	581	27.94%	66	8.90%
Express	1,424	68.50%	559	75.08%
Other	18	0.89%	64	8.63%
Total	2,079	100.00%	745	100.00%

Table 5-1f: MODS Direct & Counted Item Costs (Volume Variable Costs - Green Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	1,842	78.07%	429	92.44%
Periodicals	192	8.12%	0	0.00%
Standard A	161	6.81%	(0)	-0.04%
Standard B	24	1.01%	(0)	-0.00%
Priority	102	4.34%	38	8.13%
Express	0	0.00%	0	0.00%
Other	39	1.66%	(2)	-0.54%
Total	2,360	100.00%	464	100.00%

Table 5-1g: MODS Direct & Counted Item Costs (Volume Variable Costs - Or. & Yellow Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	360	4.85%	57	7.90%
Periodicals	0	0.00%	0	0.00%
Standard A	97	1.31%	0	0.01%
Standard B	37	0.50%	0	0.00%
Priority	6,620	89.24%	668	91.82%
Express	96	1.29%	0	0.00%
Other	207	2.80%	2	0.27%
Total	7,418	100.00%	728	100.00%

Table 5-1h: MODS Direct & Counted Item Costs (Volume Variable Costs - Brown Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	344	10.80%	70	1.17%
Periodicals	2,109	66.28%	4,488	75.33%
Standard A	611	19.19%	1,245	20.89%
Standard B	67	2.10%	93	1.56%
Priority	51	1.60%	0	0.00%
Express	0	0.00%	0	0.00%
Other	1	0.03%	63	1.05%
Total	3,182	100.00%	5,959	100.00%

Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	644	28.78%	300	11.82%
Periodicals	0	0.00%	421	16.61%
Standard A	747	33.41%	1,646	64.92%
Standard B	648	28.98%	87	3.43%
Priority	83	3.71%	83	3.26%
Express	53	2.38%	(0)	-0.00%
Other	61	2.73%	(1)	-0.04%
Total	2,236	100.00%	2,536	100.00%

Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	756	23.78%	311	9.54%
Periodicals	591	18.58%	484	14.87%
Standard A	1,392	43.75%	2,322	71.29%
Standard B	132	4.15%	75	2.31%
Priority	220	6.91%	(0)	-0.01%
Express	0	0.00%	0	0.00%
Other	90	2.83%	65	2.00%
Total	3,181	100.00%	3,257	100.00%

Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	304	18.79%	234	3.25%
Periodicals	309	19.07%	1,148	15.92%
Standard A	968	59.75%	5,680	78.80%
Standard B	35	2.17%	102	1.42%
Priority	0	0.00%	44	0.61%
Express	0	0.00%	0	0.00%
Other	4	0.22%	0	0.00%
Total	1,620	100.00%	7,208	100.00%

Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	157	25.51%	49	7.26%
Periodicals	56	9.10%	49	7.23%
Standard A	193	31.38%	375	55.62%
Standard B	76	12.35%	(0)	-0.00%
Priority	47	7.57%	122	18.14%
Express	60	9.83%	25	3.74%
Other	26	4.26%	54	8.02%
Total	615	100.00%	674	100.00%

Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	26	0.88%	(0)	0.00%
Periodicals	70	2.34%	0	-0.00%
Standard A	0	0.00%	0	0.00%
Standard B	2	0.08%	0	-0.00%
Priority	9	0.29%	0	-0.00%
Express	147	4.88%	(0)	0.00%
Other	2,751	91.54%	(354)	100.00%
Total	3,006	100.00%	(354)	100.00%

Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	0.00%	0	0.00%
Periodicals	0	0.00%	0	0.00%
Standard A	0	0.00%	68	100.00%
Standard B	76	100.00%	(0)	-0.00%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	0	0.00%	0	0.00%
Total	76	100.00%	68	100.00%

Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	0.00%	0	0.00%
Periodicals	0	0.00%	0	0.00%
Standard A	0	0.00%	44	100.01%
Standard B	88	100.00%	(0)	-0.01%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	0	0.00%	0	0.00%
Total	88	100.00%	44	100.00%

Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	0.00%	0	0.00%
Periodicals	153	79.10%	193	23.48%
Standard A	0	0.00%	630	76.52%
Standard B	40	20.90%	0	0.00%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	0	0.00%	0	0.00%
Total	194	100.00%	823	100.00%

Table 5-2d: NonMODS Direct & Counted Item Costs (Volume Variable Costs - Other Items)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	159	39.37%	181	22.60%
Periodicals	0	0.00%	0	0.00%
Standard A	4	0.96%	496	61.84%
Standard B	2	0.48%	(0)	-0.00%
Priority	237	58.72%	125	15.55%
Express	0	0.00%	0	0.00%
Other	2	0.48%	(0)	-0.00%
Total	403	100.00%	802	100.00%

Table 5-2e: NonMODS Direct & Counted Item Costs (Volume Variable Costs - SCK-BL&O)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	0.00%	0	0.00%
Periodicals	0	0.00%	0	0.00%
Standard A	0	0.00%	0	0.00%
Standard B	0	0.00%	0	0.00%
Priority	126	25.79%	76	20.65%
Express	364	74.21%	291	79.35%
Other	0	0.00%	0	0.00%
Total	490	100.00%	367	100.00%

Table 5-2f: NonMODS Direct & Counted Item Costs (Volume Variable Costs - Green Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	81	29.62%	38	100.02%
Periodicals	0	0.00%	0	0.00%
Standard A	38	13.83%	(0)	-0.01%
Standard B	67	24.50%	(0)	-0.01%
Priority	88	32.05%	(0)	-0.00%
Express	0	0.00%	0	0.00%
Other	0	0.00%	0	0.00%
Total	274	100.00%	38	100.00%

Table 5-2g: NonMODS Direct & Counted Item Costs (Volume Variable Costs - Or. & Yellow Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	87	9.62%	(0)	-0.00%
Periodicals	86	9.48%	(0)	-0.00%
Standard A	0	0.00%	84	36.12%
Standard B	0	0.00%	0	0.00%
Priority	732	80.90%	149	63.88%
Express	0	0.00%	0	0.00%
Other	0	0.00%	0	0.00%
Total	905	100.00%	233	100.00%

Table 5-2h: NonMODS Direct & Counted Item Costs (Volume Variable Costs - Brown Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	0.00%	79	5.76%
Periodicals	275	100.00%	1,032	75.44%
Standard A	0	0.00%	257	18.80%
Standard B	0	0.00%	0	0.00%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	0	0.00%	0	0.00%
Total	275	100.00%	1,368	100.00%

Table 5-2i: NonMODS Direct & Counted Item Costs (Volume Variable Costs - White #1 Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	111	22.34%	(0)	-0.00%
Periodicals	5	1.03%	192	58.46%
Standard A	106	21.37%	137	41.55%
Standard B	265	53.19%	(0)	-0.00%
Priority	10	2.07%	0	0.00%
Express	0	0.00%	0	0.00%
Other	0	0.00%	(0)	-0.00%
Total	497	100.00%	329	100.00%

Table 5-2j: NonMODS Direct & Counted Item Costs (Volume Variable Costs - White #2 Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	53	5.83%	0	0.00%
Periodicals	192	21.27%	(0)	-0.00%
Standard A	563	62.29%	292	100.00%
Standard B	76	8.38%	(0)	-0.00%
Priority	18	1.95%	(0)	-0.00%
Express	0	0.00%	0	0.00%
Other	3	0.29%	0	0.00%
Total	905	100.00%	292	100.00%

Table 5-2k: NonMODS Direct & Counted Item Costs (Volume Variable Costs - White #3 Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	89	22.33%	(0)	-0.00%
Periodicals	0	0.00%	73	4.11%
Standard A	240	60.36%	1,707	95.89%
Standard B	69	17.31%	0	0.00%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	0	0.00%	0	0.00%
Total	397	100.00%	1,780	100.00%

Table 5-2i: NonMODS Direct & Counted Item Costs (Volume Variable Costs - Other Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	N.A.	65	27.02%
Periodicals	0	N.A.	87	36.11%
Standard A	0	N.A.	89	36.86%
Standard B	0	N.A.	0	0.00%
Priority	0	N.A.	0	0.00%
Express	0	N.A.	0	0.00%
Other	0	N.A.	0	0.00%
Total	0	N.A.	241	100.00%

Table 5-3b: BMC Direct & Counted Item Costs (Volume Variable Costs - Parcel Trays)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	0.00%	0	0.00%
Periodicals	0	0.00%	0	0.00%
Standard A	0	0.00%	33	29.32%
Standard B	26	100.00%	36	32.25%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	0	0.00%	43	38.43%
Total	26	100.00%	111	100.00%

Table 5-3c: BMC Direct & Counted Item Costs (Volume Variable Costs - Pallets)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	0.00%	0	0.00%
Periodicals	54	7.53%	694	22.48%
Standard A	225	31.59%	1,833	59.37%
Standard B	404	56.80%	453	14.68%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	29	4.07%	107	3.48%
Total	711	100.00%	3,088	100.00%

Table 5-3d: BMC Direct & Counted Item Costs (Volume Variable Costs - Other Items)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	0.00%	0	0.00%
Periodicals	0	0.00%	100	93.59%
Standard A	53	45.11%	7	6.54%
Standard B	39	32.80%	1	0.56%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	26	22.09%	(1)	-0.68%
Total	118	100.00%	107	100.00%

Table 5-3f: BMC Direct & Counted Item Costs (Volume Variable Costs - Green Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	0.00%	0	0.00%
Periodicals	0	0.00%	28	77.87%
Standard A	28	49.53%	4	11.82%
Standard B	29	50.47%	4	10.31%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	0	0.00%	0	0.00%
Total	57	100.00%	35	100.00%

Table 5-3g: BMC Direct & Counted Item Costs (Volume Variable Costs - Or. & Yellow Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	0.00%	0	0.00%
Periodicals	0	0.00%	0	0.00%
Standard A	0	0.00%	0	0.00%
Standard B	43	45.39%	5	69.48%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	52	54.61%	2	30.52%
Total	95	100.00%	8	100.00%

Table 5-3h: BMC Direct & Counted Item Costs (Volume Variable Costs - Brown Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	0.00%	0	0.00%
Periodicals	186	100.00%	861	56.38%
Standard A	0	0.00%	483	31.66%
Standard B	0	0.00%	51	3.34%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	0	0.00%	132	8.62%
Total	186	100.00%	1,527	100.00%

Table 5-3i: BMC Direct & Counted Item Costs (Volume Variable Costs - White #1 Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	0.00%	44	1.91%
Periodicals	93	2.48%	470	20.57%
Standard A	1,028	27.47%	1,288	56.35%
Standard B	2,072	55.37%	262	11.46%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	549	14.68%	222	9.71%
Total	3,743	100.00%	2,285	100.00%

Table 5-3j: BMC Direct & Counted Item Costs (Volume Variable Costs - White #2 Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	0.00%	21	0.65%
Periodicals	78	5.40%	582	18.30%
Standard A	635	43.96%	2,028	63.70%
Standard B	362	25.06%	265	8.34%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	369	25.59%	287	9.02%
Total	1,444	100.00%	3,184	100.00%

Table 5-3k: BMC Direct & Counted Item Costs (Volume Variable Costs - White #3 Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	10	0.92%	86	1.03%
Periodicals	114	10.86%	1,238	14.73%
Standard A	662	62.88%	6,220	74.01%
Standard B	57	5.42%	364	4.33%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	210	19.94%	496	5.90%
Total	1,053	100.00%	8,404	100.00%

Table 5-3l: BMC Direct & Counted Item Costs (Volume Variable Costs - Other Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	36	4.52%	(28)	-2.45%
Periodicals	179	22.41%	219	19.18%
Standard A	113	14.17%	488	42.70%
Standard B	429	53.56%	397	34.76%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	43	5.34%	66	5.81%
Total	800	100.00%	1,143	100.00%

Table 5-3m: BMC Direct & Counted Item Costs (Volume Variable Costs - International Sacks)				
Subclass	Counted		Direct	
	\$1,000's	Percent	\$1,000's	Percent
First	0	0.00%	0	0.00%
Periodicals	0	0.00%	0	0.00%
Standard A	0	0.00%	0	0.00%
Standard B	0	0.00%	0	0.00%
Priority	0	0.00%	0	0.00%
Express	0	0.00%	0	0.00%
Other	726	100.00%	223	100.00%
Total	726	100.00%	223	100.00%

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-8. In your testimony you state, "application of [witness Degen's] approach within each cost pool requires the further (unstated) assumption that mail that appears in containers at a given pool also appears as loose mail at the same cost pool" (TW-T-1, page 20, lines 26-28). Please provide a formal demonstration that this is necessary for the assumption stated by witness Degen, quoted at TW-T-1, page 20, lines 22-24. Please discuss any mathematical arguments you employ in this process.

USPS/TW-T1-8. Maybe it will become clearer if I quote a little more of Degen's interrogatory response to TW/USPS-T12-24, at Tr. 6528. The part of his response already quoted in my testimony stated that the assumption underlying his approach: to distribution of loose-flats-in-container costs was that: "the subclass distribution of direct tallies handling flat-shape pieces in the same cost pool is an unbiased estimate of the unknown subclass distribution of loose flats in mixed-mail containers." Degen's response at Tr. 6528 then continued:

"The idea is that if the IOCS sample were hypothetically re-drawn, that some mail that we observe as directs would instead be 'observed' as part of mixed-mail (say, because a piece was observed in a container instead of in the hand of an employee sorting it into a case), and vice-versa. The direct mail distributions from the hypothetical two samples should differ only by random sampling error."

In other words, Degen appears to assume that any two pieces with equal probability of being observed as mixed mail also have equal probability of being observed, in a hypothetical re-drawn sample, as directs (i.e., in this context, as loose individually handled pieces). But at a given cost pool this clearly cannot hold if some pieces that appear as mixed mail have zero probability of being observed as loose pieces at that cost pool. Consequently, it is necessary, for Degen's assumption to hold, that mail that appears in containers (i.e. mixed) at a cost pool also appears as loose mail at the same cost pool, as I already stated in my testimony.

These somewhat abstract arguments should in any case not be allowed to obscure the very simple and basic problem that my testimony identifies with Degen's distribution of loose-mail-in-container costs. Handling of individual letters and flats generally occurs at operations dedicated to letter and flat processing respectively and does not occur at allied operations (opening units and platforms), which handle containers, bundles and other items but not individual pieces. But as the table at page 21 of my testimony shows, a very major portion of container handlings occurs at those allied operations. One example of the effect of Degen's approach is that he distributes the 53.3% of all loose-letters-in-container costs that occur at allied operations based upon only 6.97% of the direct letter handling costs. An accurate approach would have to

USPS/TW-T1-8
Page 2 of 2

identify the operations where the loose-letters-in-containers observed at allied operations are subsequently handled as individual pieces, and distribute the container handling costs based on the letter handling costs at those operations. This is just one example of the numerous cross-pool cost relationships that Degen's pool-by-pool approach ignores.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-9. Please refer to your testimony at page 31.

- a. Please confirm that your hypothetical assumes that not-handling costs in the manual operation do not vary with the volume of mail processed manually. If you do not confirm, please explain.
- b. What cost distribution would result in your hypothetical if not-handling costs in the manual operation were 80% volume variable? Please explain.

USPS/TW-T1-9.

- a. The only assumptions in my hypothetical are: (1) that not handling costs are distributed in proportion to direct costs; and (2) that after automation of the handling of one class, total not handling costs increased. My hypothetical makes no reference to not handling costs in "the manual operation." Nor does it assume that there is only one manual operation. However, to make my example a little closer to real life, perhaps I should have postulated that the increase in not handling costs after implementation of automation occurred mostly in certain "allied" operations common to both classes of mail.
- b. My testimony offers this simple example as an illustration of what appears to have happened to Periodicals costs over the last ten years, under the traditional costing system which assumed 100% volume variability of all mail processing costs. Of course, according to Bradley's analysis, both not handling and other costs are considerably less than 100% volume variable. In any case, precisely what to make of the 80% not handling variability you postulate would appear to depend on additional assumptions not made in my example and not spelled out in your question.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-10. Please refer to your testimony at page 33, lines 7-17. What percentage of the costs for the 63 IOCS activity codes would be distributed in proportion to all mail processing costs in an office group under your proposed methodology? Please provide any supporting calculations in electronic spreadsheet format.

USPS/TW-T1-10. The answer to your question depends on how you define "office group". I distribute 6521 (breaks/personal needs) costs within CAG, so that if you define "office group" as consisting of a combination of CAG and MODS/NonMODS, or of the BMC's, then it can be said that I distribute 6521 costs proportionally to all "handling" mail processing costs within those office groups. I do the same with 6522 (clocking in/out) costs in MODS offices. The 6522 costs in BMC's and NonMODS offices are distributed proportionately to all other mail processing costs in those offices, similar to what witness Alexandrovich does in his workpapers.

For all other not handling costs, I either use distribution within basic function, or distribution keys different from "all mail processing costs," or both. A further description of the methods I use to distribute different types of not handling costs can be found at pages A-7 through A-11 in Appendix A of my testimony.

In summary, only 6521 and 6522 costs are distributed in direct proportion to all "handling" mail processing costs. Even those costs are distributed separately within CAG, except the 6522 costs at BMC's and NonMODS offices. The magnitude of these costs, relative to all other not handling costs, can be inferred from the spreadsheets already provided with my testimony, in TW-LR-H-1.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-11. Please refer to your testimony at page 33, line 26 to page 34, line 1. Please confirm that the FY1996 Postal Service methodology classifies costs for activity codes 6220 and 6230 as fully institutional. If you do not confirm, please explain.

USPS/TW-T1-11. It is my understanding that under the Postal Service's traditional costing approach not handling costs with activity codes 6220 (Special Delivery) and 6230 (Registry) were not attributed. It is also my understanding that those costs exist only in order to facilitate the provision of these special services and that they could therefore, if not attributed, be seen as "specific fixed" costs that form part of the total "incremental" costs of these services.

Under the Bradley/Degen approach, the average volume variability factors for 6220 and 6230 costs are, respectively, 36.67% and 38.07%, as can be inferred from Table A-1 in Appendix A of my testimony. My testimony provides an alternative way to distribute the costs identified as volume variable by Bradley and Degen. I concluded, and still believe, that as long as these costs are attributed at all they should be attributed to the services that cause them.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-12. Please refer to your testimony at page 39, lines 19-21, and USPS-LR-H-146, pages II-11 to II-12.

- a. Please confirm that witness Degen's method distributes not-handling costs to special services in several "Function 1" cost pools. If you do not confirm, please explain.
- b. Please explain fully how your response to subpart (a) affects your testimony.

USPS/TW-T1-12.

- a. I assume that the intended reference is to page 36, rather than page 39, in my testimony. Confirmed with regard to cost pools 1EEQMT, 1MISC and 1SUPPORT.
- b. My testimony regarding distribution of not handling costs remains that such costs should be distributed in accordance with the nature of each not handling activity, rather than according to the cost pool observed employees happened to be clocked into. In particular, not handling costs clearly related to special services should be attributed to those services regardless of cost pool.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-13. Please refer to your testimony at page 25, lines 1-2, where you claim that "Periodicals mail is certain to be overcharged under any possible use of the item/container data collected by the current IOCS."

- a. Is it your testimony that it is impossible for Periodicals to be "undercharged" with mixed-mail costs under some possible uses of the item and container data collected in IOCS? Please explain.
- b. Consider a pallet consisting of shrink-wrapped brown sacks which is sampled in IOCS and results in a mixed-mail tally. Is it likely that such a pallet would have resulted in a direct Periodicals tally if its contents had been counted? Please explain.
- c. Please confirm that Periodicals would receive a smaller share of the costs associated with this tally, and thus be "undercharged," under the mixed-mail distribution approach proposed by witness Degen, as compared with the situation described in subpart (b) in which the contents are counted and the tally is recorded as a direct Periodicals tally. If you cannot confirm, please explain fully.

USPS/TW-T1-13.

- a. My testimony is that the use of IOCS item and container data proposed by witness Degen does unfairly overcharge Periodicals mail. Furthermore, because the bias of the current scheme for collecting mixed mail data is to over-represent Periodicals, I see no rational way to use this data that would "undercharge" Periodicals.
- b. The likelihood that a pallet with shrink-wrapped brown sacks would contain Periodicals is probably about 72%, which is the percentage of direct brown sacks that contain Periodicals. As to the likelihood of a pallet containing shrink-wrapped sacks, and the likelihood of such sacks being brown, these questions cannot be addressed with the current IOCS data collection scheme, which effectively makes it impossible to record any information about sacks or trays on pallets.

The likelihood of a pallet with shrink-wrapped sacks being counted by an IOCS data collector is extremely small, given that palletized shrink-wrapped sacks are one of only two examples of "extremely difficult to count" given in the IOCS manual.

- c. It is meaningless to refer to an individual tally as over- or under-charging a particular class of mail.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-14. Please refer to your testimony at page 24, lines 16-20, where you claim that the costs associated with bundles on pallets would "be distributed based on the costs of all bundle handlings" if pallets were treated as containers. Please confirm that under the scenario you describe, witness Degen's methodology actually would distribute the costs associated with bundles on pallets based on the costs of bundle handlings in the same cost pool, except for the MODS 1Platform and BMC Platform cost pools. If you do not confirm, please explain fully. If you do confirm, please state how this affects your testimony.

USPS/TW-T1-14. Confirmed that your question conforms with my understanding of how Degen distributes bundles-in-container costs. There is no effect on my testimony.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-15. Please consider an identified container with loose flats that is sampled in the MODS platform (IPlatform) cost pool. You claim that the flats "are mostly handled elsewhere." Is it reasonable to assume that the loose flats would either be sent to a cancellation, meter mail prep, or opening unit operation to be canceled and/or trayed prior to distribution or other handling? If your answer is negative, please explain how you would expect this mail to be handled.

USPS/TW-T1-15. Before answering your question, let me point out that it appears from this question and from USPS/TW-T-16b that the Postal Service agrees that flat mail (and I presume letter mail) appearing loose in containers at platforms and opening units is mail needing cancellation/meter prep and/or traying, in other words unsorted mail. It follows that this mail cannot be Periodicals mail, which is presorted as packages in sacks or on pallets by mailers and does not appear loose in containers. Consequently, it is incorrect to attribute the costs of handling these containers to Periodicals and other presorted subclasses, as I argued in my R94-1 rebuttal testimony and again in my testimony in this docket.¹

It does appear reasonable to assume that loose pieces in a container at a platform will be handled in one of the ways you suggest. On the other hand, it apparently does not always happen that way. As can be seen from Table 6-2 in my testimony, letters and flats do sometimes appear loose in containers at various piece sorting operations. For example, \$10.4 million in volume variable loose-letters-in-container costs in MODS offices, 40% of the total, appear at the BCS, MANL, OCR, LSM, LD15 and LD41-43 letter sorting operations. Since it is difficult to envision those operations placing loose letters in containers, the containers must have gotten there via platforms and opening units. The same applies to flats. It is not difficult to envision a facility supervisor concluding, for example, that it would be faster to take a hamper of loose flats (assuming they don't need cancellation) directly to a piece sorting operation, bypassing the extra step of traying at an opening unit or meter prep operation.

¹ See Docket No. R94-1, PRC's Opinion, paragraphs 3048 & 3068 and TW-RT-1 at 11-12 (Tr. 25/11850-51).

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-16. Please consider an identified container with loose mailpieces that is sampled in a MODS opening unit cost pool (1OpBulk or 1OpPref). You claim that the loose mail is "mostly handled elsewhere."

- (a) Please refer to the description of MODS operations 110C and 180C, in USPS-LR-H-48, Appendix A. Please confirm that an opening unit function is "traying letters and flats for case distribution."
- (b) Is it reasonable to assume that loose mail in containers found in opening units is there to be trayed for subsequent processing? Please explain any negative response.

USPS/TW-T1-16.

- a. Confirmed.
- b. Please see my answer to USPS/TW-T1-15.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-17. Please refer to your testimony at page 21-22, and to USPS-LR-H-49, page 88.

- (a) Please confirm that the IOCS definition of a "bundle" includes both "packages" of mailpieces assembled and secured together, and multiple pieces of mail not secured together that are handled as a unit.
- (b) Please confirm that "bundles" observed at platforms and opening units are likely to be "packages" of mailpieces. If you do not confirm, please explain.
- (c) Please confirm that "bundles" observed at piece distribution operations are likely to be multiple pieces of mail not secured together that are handled as a unit. If you do not confirm, please explain.
- (d) Please confirm that "packages" of mailpieces are likely to consist of presorted mail. If you do not confirm, please explain.

USPS/TW-T1-17.

- a. Confirmed. The fact that a "bundle" can mean one or the other, and that it can be a bundle of letters, of flats or of something else, is one of the weaknesses of the current IOCS scheme.
- b. Bundles observed at platforms and opening units may correspond to either definition. An employee at a canceling operation may take a handful of letters and enter it in the canceling machine's feeder or remove it from an output stack in order to put it in a tray. At a meter mail prep or opening unit, employees may take handfuls of letters or flats in order to insert them in trays. In each case, employees would be recorded in IOCS as handling bundles, and in neither case are those bundles secured together.

At operations dedicated exclusively to bundle sorting or pouching, the bundles are obviously likely to be secured together. But at other allied operations, such as those mentioned above, they may not be.

- c. Bundles observed at piece distribution operations may correspond to either definition. What probably can be stated with some confidence is that bundles observed in containers are secured bundles, since if they were not secured they would be seen as loose mail. And since there are containers with bundles observed at various piece distribution operations (though less frequently than they are observed at allied operations) there obviously are secured bundles (packages) at piece sorting operations. Table 6-2 in my testimony shows, for example, that manual letter and flat distribution operations in MODS offices (including LD43 operations performed at stations and branches) account for 15% of all bundles-in-

container costs. Secured bundles may also arrive at a piece distribution in sacks. When removed from the sack (or container) such a bundle is still a secured bundle. Then when whatever holds the bundle together is removed, it becomes an unsecured bundle.

When an employee is sweeping a distribution case (or machine) he will remove a handful of letters or flats from the case (unsecured bundle). If he then puts a rubber band around it, it becomes a secured bundle which may later, for example, be distributed at a pouching unit.

- d. The term "package," as used for example in the DMM, generally refers to a bundle that has been presorted by a mailer subject to certain prescribed standards. However, in the context of the preceding questions in this interrogatory, it appears that you are using the term to represent any secured bundle. Secured bundles may result from a piece distribution operation in which an employee puts a rubber band around letters or flats sorted to a given sorting bin. A label may then be put on this bundle and it may be sent to, for example, a pouching unit for further processing. Since a bundle of this type requires several handling steps, i.e., first securing it, then applying a label, then sorting the bundle, its probability of being observed by an IOCS clerk may be larger than that of a mailer-prepared bundle.

Secured bundles may also be found in the collection mailstream. A postal patron mailing a handful of letters or flats or both will sometimes put a rubber band or tie a string around them. This rubber band (string) may cause extra work as it has to be removed, by a carrier, culling operator or other postal employee, in order to allow processing of the individual pieces.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-18. Suppose the costs for bundles in identified containers at platform and opening units were distributed across all cost pools (TW-T-1, page 22, lines 3-4).

- a. Please confirm that the mixed-mail costs to be distributed would consist primarily of packages of presorted mail. If you do not confirm, please reconcile your answer with your testimony at page 22, lines 16-19.
- b. Please confirm that the tallies used to distribute the mixed-mail costs would consist primarily of handlings of multiple pieces of mail at distribution operations. If you do not confirm, please explain the meaning of the 22.77% figure you report at page 21, line 10 of your testimony.
- c. Please confirm that your alternative identified container distribution would assign a disproportionately large share of costs to relatively less presorted subclasses of mail. If you do not confirm, please explain how your method purports to avoid such a result.

USPS/TW-T1-18.

- a. As explained in my answer to USPS/TW-T-17d, secured bundles found in containers may either be prepared by presort mailers, or be the result of previous USPS piece sorting, or they may be just bundles of unsorted pieces entered by postal patrons through the collection mailstream. This is not inconsistent with the cited part of my testimony, which simply points out that when pallets or sacks of Periodicals bundles do get opened, the bundles in them are sorted into various types of containers. That does not imply that other types of bundles are not also being transported in containers.¹
- b. The 22.77% figure is the percent of bundle handling (in volume variable costs) performed at platforms and opening units in MODS offices. However, as explained in my answer to USPS/TW-T1-17c, not all bundle handlings at other operations represent handling of unsecured bundles.

If your claim were true, then the distribution key in your hypothetical, consisting of all direct bundle handling costs in MODS offices, should be roughly similar to the distribution of direct piece handling costs. In fact, it is rather different. Table USPS-18, attached to this answer, shows what the key (given in percentages) would actually be like and compares it with the distribution of all other (non-bundle) direct costs and with the direct piece handling costs in MODS offices.

¹ Note that the most presorted bundles, i.e. those with carrier route presort, are mostly transported on pallets (not considered containers in IOCS jargon), or in sacks, often directly to the delivery units, and therefore have relatively little probability of being sampled by IOCS clerks in MODS offices.

As the table shows, the hypothetical distribution key would assign to the Periodicals subclasses a percentage of bundles-in-container costs roughly twice their percentage of other direct costs and piece handling costs. Standard A carrier route mail, probably the most highly presorted category, would be assigned a percentage more than four times its share of other direct costs. Most non-presorted categories, on the other hand, would be assigned percentages substantially less than their share of piece handling costs and other direct costs. See also my answer to part c below.

- c. This question appears to reflect a fundamental misunderstanding of what my proposed mixed mail cost distribution method consists of. I do not propose to distribute the costs of bundles observed in containers on the basis of costs of bundles outside containers, either within pools (as Degen does) or across pools. Distributing bundle-in-container costs upon bundle-out-of-container costs is inappropriate for several reasons, including the fact that a bundle can mean many different things. It can be a mailer prepared package of letters or flats, a secured bundle of letters or flats created in a postal piece sorting operation, or any handful of letters and flats that an employee is seen holding in his hand, among other things.

The mixed mail method I do propose is to distribute all shape-related mixed mail costs based on the corresponding shape-related direct costs, within CAG and basic function, and to distribute all other mixed mail costs based on all direct costs, again within CAG and basic function.

As to your assertion that the hypothetical method would "assign a disproportionately large share of costs to relatively less presorted subclasses of mail," I can neither confirm nor disprove it. As Table USPS-18 shows, the hypothetical method would in fact assign to the presorted subclasses percentages of the bundles-in-container costs that far exceed their percentages of the direct costs. So would Degen's pool-by-pool method. Whether the percentages in Table USPS-18 match the true cost distribution by subclass for bundles in containers is impossible to determine, due to the Postal Service's decision to collect no subclass-related data for mixed mail containers.

In any event, it makes little sense to strive for a perfect distribution of one small subset of the mixed mail costs if one cannot also provide a fair distribution of the remaining costs. As can be seen from Table 6-2 in my testimony, the volume variable bundles-in-container costs in MODS offices are \$19.481 million. But the corresponding costs are \$27.144 million for loose letters and cards in containers and \$27.050 million for loose flats in containers. As the Postal Service appears to be confirming in USPS/TW-T1-15 and USPS/TW-T1-16, these larger cost categories represent unsorted mail and it follows that they should not be attributed at all to the presorted subclasses. Yet Degen's method assigns a substantial portion of those costs to presorted mail, including Periodicals. Unfortunately, there appears to be no reliable way to determine how exactly those costs should be assigned, due again to

the Postal Service's decision to not collect any subclass data on mixed mail in containers.

I pointed out the irrationality of distributing the costs of loose pieces in containers to presorted subclasses in my R94-1 testimony and again in my testimony in this docket. The apparent impossibility of producing a reasonable way to distribute these fairly large cost categories, along with the asymmetrical treatment of pallets relative to other containers, were the main reasons why I concluded that it would be preferable to return to a traditional method of distributing mixed mail costs, until the Postal Service either devises an entirely new scheme for collecting mixed mail cost data, or fixes the several deficiencies in the current scheme.

Table USPS-18: MODS Direct Bundle Costs And Other Direct Costs			
Subclass	Direct Bundles	Direct Non-Bundles	Direct Piece Handling
1-1C LP	39.19%	54.75%	56.65%
2-1C PR	12.21%	10.61%	10.18%
3-PSTLC	0.03%	0.03%	0.03%
4-PVTC	1.53%	1.69%	1.75%
5-PRSTC	0.59%	0.48%	0.52%
6-PRIOR	0.41%	3.80%	4.01%
7-EXPRS	0.08%	0.53%	0.54%
8-MGRAM	0.00%	0.00%	0.00%
9-2C211	0.21%	0.10%	0.10%
9-2C212	6.84%	3.42%	3.39%
9-2C213	1.18%	0.63%	0.64%
9-2C214	0.02%	0.03%	0.03%
10-3COZ	0.49%	0.71%	0.78%
11-3CRGP	5.59%	1.34%	1.19%
12-3CRGO	21.12%	12.48%	12.56%
13-3CNPP	0.62%	0.16%	0.14%
14-3CNPO	6.71%	3.23%	3.21%
15-4CPCL	0.09%	0.53%	0.57%
16-4CPRN	0.24%	0.26%	0.28%
17-4CSPC	0.03%	0.23%	0.25%
18-4CLIB	0.03%	0.06%	0.07%
19-USPS	0.38%	0.84%	0.85%
20-FREE	0.03%	0.08%	0.08%
21-INTL	1.42%	2.15%	2.19%
22-REGIS	0.06%	0.44%	0.00%
23-CERT.	0.07%	0.11%	0.00%
24-INS.	0.00%	0.00%	0.00%
25-COD	0.00%	0.01%	0.00%
26-SP DL	0.00%	0.00%	0.00%
27-SP HD	0.00%	0.00%	0.00%
28-OTHSV	0.59%	1.00%	0.00%
5345	0.00%	0.01%	0.00%
5340	0.24%	0.17%	0.00%
5301	0.00%	0.04%	0.00%
5331	0.00%	0.01%	0.00%
5341	0.00%	0.02%	0.00%
Total	100.00%	100.00%	100.00%

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-19. Please consider an employee who is loading a barcode sorter (BCS). The employee is sampled while holding several mailpieces that were removed from a letter tray and are about to be placed in the feeder mechanism.

- a. Please confirm that the employee should be recorded in IOCS as handling a bundle. If you do not confirm, please explain.
- b. Please confirm that the mail the employee is observed handling would probably have been moved to the BCS in the tray. Please also confirm that the tray would likely have been placed in a rolling container to be moved. If you do not confirm, please explain.
- c. Is it necessary that mail handled as bundles in a BCS operation be moved to the operation in bundle form? If not, what is the relevance of the statement at TW-T-1, page 21, lines 12-16?

USPS/TW-T1-19.

- a. Confirmed.
- b. Trays are most likely, although it appears from the MODS/IOCS data, somewhat counter-intuitively, that a fairly substantial portion also arrives as loose letters in containers. See Table 6-2 in my testimony. Trays may arrive in rolling containers or via conveyor belts.
- c. No. I agree that the statement you refer to is misleading in that it implies that all bundles arrive in containers.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-20. Please refer to your testimony at page 23.

- a. Do you think it is likely that an empty container being moved by an employee working a BCS (or other distribution) operation would either (i) have contained mail destined for BCS sortation or (ii) be filled with mail that had been sorted on the BCS? Please explain.
- b. Do you think that mail distribution operations are commonly used as general empty equipment staging areas? Please explain any answer other than "no".
- c. Please provide all reasons of which you are aware that might explain why empty equipment costs related to particular distribution operations should be treated as general overhead costs.

USPS/TW-T1-20.

- a. I believe employees at BCS operations are more likely to move containers used at their own operation than they are to be moving containers used at other distribution operations.
- b. I am not aware of any instructions regarding which areas should be used as staging areas for empty equipment. However, it is my impression that the staging areas used depend on where the equipment is emptied, where it is going to be used again, and on available space, which may vary between facilities. In the case of letter trays, letter distribution operations would obviously be logical staging areas. For sacks and pallets, opening units may be more likely. Containers on wheels take up a great deal of space, whether full or empty, making considerations of available space paramount.
- c. The ideal way to attribute empty equipment costs would be for the Postal Service to develop a model, supported by live data, of how empty items and containers are really handled in the postal system, that allowed one to reliably associate costs of handling empty equipment with specific subclasses. Such a model does not exist. The question then becomes whether the method of attributing these costs in the way proposed by witness Degen in this docket is an acceptable substitute for an accurate model. My testimony presents several reasons for concluding that Degen's proposed method is not an acceptable alternative, and proposes instead that these costs, for the time being, be treated in a manner similar to that used by the Commission in the past. Some of my reasons for reaching this conclusion are repeated below.

In the case of empty containers, one reason to reject Degen's approach is that it almost doubles the effect of the distortion caused by his distribution of mixed mail container costs, since empty containers cost almost as much to handle as containers

with mail. For example, as I have pointed out several times, it is inappropriate to attribute costs of containers with loose flats to Periodicals, since Periodicals generally do not appear as loose flats in containers. To also attribute to Periodicals the cost of those containers when they are empty makes matters worse.

Additionally, contrary to what you appear to suggest in parts a and b of this interrogatory, empty containers are not handled only by employees assigned to operations where the containers are filled or emptied. For example, mail processing facilities often receive from their delivery units truckloads of empty containers that are being returned after the early morning delivery run. These containers are unloaded by platform employees, who may store them temporarily at the platform or take them to an opening unit, or wherever space is available. Later, an opening unit employee may for example take such an empty container to a distribution operation (e.g. a BCS) where it will be filled with sorted mail. The BCS employees may never move the empty container, at least not before it has been filled with trays of mail and therefore is no longer empty. Eventually, the container may be moved to the platform again and sent back to the delivery unit, repeating the cycle.

In this example it obviously would be most correct to attribute the cost of handling this container, both when full and when empty, to the mail being handled at the BCS. But there would be no way to ascertain from Degen's data, even if IOCS samples were taken of this container being handled while empty, that it was being used for the BCS mail. Instead, the effect of Degen's approach would be to distribute its costs based on whatever mail is being handled individually at opening units or platforms, which may have a quite different subclass breakdown.

Similar considerations apply to empty items, which may be handled at several operations besides the operations where they are emptied or filled.

In order to resolve this dilemma, what is needed is more information about how empty items and containers really are handled in postal facilities. I recommend that the Postal Service undertake a study, which could have the dual purpose of: (1) determining the reasons for today's historically very high costs of handling empty equipment and finding way to reduce those costs; and (2) establishing a better basis for mail processing cost attribution. Questions that might be useful to address include: (1) how much of the empty container costs are spent moving containers back and forth simply in order to make space available for different operations; (2) how much is spent setting up opening units prior to distribution; (3) how much is spent recycling empty containers from delivery units back to the distribution operations where they will be filled again; and (4) which employees (assigned to which operations) normally perform these tasks? Of course, as mentioned several times in my testimony, it would also be very helpful to have subclass-specific data on full containers, indicating, for example, whether all those containers full of loose

letters and flats really contain collection mail, and if not what kind of mail they contain.

These and other pertinent questions simply cannot be answered within the confines of today's IOCS, and some other scheme (or a revamped IOCS) is necessary to address them. In the meantime, I recommend that empty equipment costs be attributed in the manner proposed in my testimony.

RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF UNITED STATES POSTAL SERVICE

USPS/TW-T1-21. Please refer to your testimony at pages 26-27.

- a. Is it your testimony that "not handling costs" are not causally related to mail handlings in the same cost pool? If not, please explain your testimony.
- b. Is it your testimony that witness Degen's not-handling distribution is incorrect primarily because you believe that "not handling costs" are not causally related to mail handlings in the same cost pool? If not, please explain your testimony.
- c. Suppose it is correct to assume that "not handling costs" are causally related to mail handlings in the same cost pool. Would it then be appropriate to distribute the "not handling costs" within the same cost pool? Please explain fully.

USPS/TW-T1-21. This series of questions appears to be based on the assumption that not handling costs can never be causally related to the mail handlings within more than one pool. This very confining assumption is unlikely to lead to any real understanding of the cost relationships within mail processing.

Consider an example with only three cost pools and let MH_i be the costs of mail handling and NH_i the not handling costs in pool i , where $i=1, 2$ or 3 . Assume that it has somehow been established that not handling costs are related to mail handling costs by formulas of type:

$$NH_i = C_{i,1} * MH_1 + C_{i,2} * MH_2 + C_{i,3} * MH_3^1$$

In this example, not handling costs are related to the mail handling costs within the same pool as well as to the mail handling costs in other pools, and it is therefore inappropriate to distribute them based only on the mail handling costs within the same pool. In reality, of course, the functional relationships between handling and not handling costs depend on the nature of the not handling costs. Furthermore, these relationships are not known and it appears that the Postal Service has made no attempt to study them, even though such a study is essential in order to come to grips with the true reasons for the ever increasing not handling cost component.

- a. No. While some not handling costs may be totally unrelated to the mail handling costs within a pool (e.g. employees doing window service or administrative work while clocked into a pool for piece distribution), other types of not handling may be

¹ This particular form may, for example, represent an employee whose base assignment is to a particular pool, but who during the day is called upon to help out during critical periods at other pools. As soon as his assignment in one of the other pools is finished, he returns to his base pool, where his not handling time (e.g. breaks) will therefore be recorded.

related both to the pool into which an employee is clocked and other pools. Assume for example that an employee is clocked into an opening unit but is told to take a half hour break after which he is supposed to clock into and go to a manual letter sorting operation, which it is expected will at that time have work for him. Degen's approach essentially assumes that the cost of that employee while on break is causally related only to the operation where he was, but is no longer needed, i.e., the opening unit. One could just as well argue that those costs belong to the operation the employee is going to. Resolving this issue would require an in-depth analysis of the factors that facility managers and supervisors consider when they make staffing decisions.

- b. No. There are two main problems with Degen's approach to distribution of not handling costs. He ignores the fact that there are many types of not handling activity and he ignores (or assumes out of existence) all cross-pool cost relationships.
- c. Distributing the not handling costs in a pool based only on the mail handling costs within the same pool would be appropriate only if it could be demonstrated that there is no causal relationship to any costs incurred outside the given pool.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-22. Please refer to your testimony at page 29, lines 1-4.

- a. You state that "Barker's explanation would make sense if most of the new not handling costs occurred in the most automated operations." Please confirm that evaluating this statement requires examining changes in not-handling costs over time. If you do not confirm, please explain fully.
- b. You then state that "as can be seen from Degen's data, most of these costs occur at non-automated operations." Please confirm that witness Degen's data is specific to a single point in time.
- c. Please explain in detail how you purport to evaluate the statement in part (a) using data for a single point in time. Please state clearly and justify all assumptions you would need to employ for this purpose.

USPS/TW-T1-22.

a-c. The not handling costs discussed in the part of my testimony that you refer to are those assigned activity codes 5610, 5620, 5700 and 5750 in the IOCS. They are distinct from the not handling costs traditionally referred to as "overhead" (i.e. costs of breaks/personal needs, clocking in/out and moving empty equipment), which also have grown a great deal. They are also distinct from the not handling costs associated with various window service and administrative functions, and from costs associated directly with specific subclasses. In the following I refer to not handling costs with activity codes 5610-5700 as "general not handling" costs.

Although the available historical data regarding these costs are limited, and Degen's data are available only for FY96, there is still sufficient information to confirm the statement in my testimony that you refer to. The reason is that in FY86, before the large-scale deployment of letter mail automation, these costs were only a small fraction of what they are today. That fact effectively allows comparison of two points in time, not one as your interrogatory suggests.

Mail processing costs with activity codes 5610 (letters/cards), 5620 (flats), 5700 (IPP's/parcels) and 5750 (mixed all shapes) can be extracted from the LIOCATT report for each fiscal year. A complicating factor is that these activity codes represent, not only not handling costs but also some mixed mail costs. In this docket it has become possible to separate the portion of these costs that represents not handling from the portion that represents mixed mail.

Another complication arises from the fact that around FY92 the Postal Service changed the instructions to IOCS clerks for collecting data on mixed mail. Prior to that time, class related information was collected on most mixed mail, resulting in a long range of activity codes representing for example "mixed First Class," "mixed second," "mixed

third," "mixed First and Priority," "mixed second and third," "mixed foreign mail" and many more similar combinations. Under the new data collection scheme, however, most of this information ceased to be recorded, and many of the previous mixed mail activity codes ceased to be used. Instead, most mixed mail costs are represented with codes 5610-5750, the ones also representing not handling costs, since FY92.

Table USPS-22a summarizes the mixed mail/general not handling costs according to LIOCAT report ALA85OP5 for FY86, FY96 and selected years in between. In FY86 total 5610-5750 costs were \$303 million, while class specific mixed mail costs with various other activity codes were \$637 million, for a total of \$940 million. I don't know which portion of the \$303 million 5610-5750 costs was for mixed mail and which portion was for not handling. Let us, however, make the most conservative assumption possible, namely that all \$303 million were not handling costs.

Table USPS-22a: Mixed Mail & General Not Handling Costs Per LIOCAT (\$1,000's)						
	FY86	FY89	FY92	FY93	FY95	FY96
Misc. Mixed	637,135	797,500	108,599	30,925	18,741	24,590
5610	7,572	810	607,022	688,090	761,663	709,128
5620	4,998	449	223,445	242,072	273,124	262,455
5700	0	16	29,620	33,831	40,307	122,960
5750	290,337	652,179	1,501,159	1,650,207	1,727,488	1,545,091
Total	940,042	1,450,954	2,469,846	2,645,126	2,821,323	2,664,224

Table USPS-18b tabulates the general not handling costs (excluding mixed mail costs) in FY96, extracted from Degen's MODS/IOCS data for MODS offices, NonMODS offices and BMC's. The table uses tally costs, rather than accrued or volume variable costs, in order to facilitate comparison with the FY86 data.

As the table shows, the FY96 not handling portion of the 5610-5700 costs was \$1,883 million, with the 5750 (mixed all shapes) portion equal to \$1,029 million. In other words, the 5610-5750 not handling costs increased from no more than \$303 million in FY86 to \$1,883 million, at least a six-fold increase, during the period when letter mail automation was being deployed in postal facilities. Even allowing for wage inflation (roughly 43% in the period) and some volume increase, there can be little doubt that most of today's very high not handling costs are related to the changes in mail processing over the last ten years.¹ I find it hard to believe that the Postal Service can simply ignore this historical fact and claim that the problem with high not handling

¹ Additionally, it is very unlikely that none of the \$303 million represented mixed mail, since an IOCS clerk in FY86 who saw an employee handle a container with all kinds of classes and shapes in it would have recorded information leading to activity code 5750. If a significant portion of the \$303 million in FY86 were for mixed mail, then the increase in not handling costs is more than six-fold during the period.

costs has been "addressed" by attributing most of these costs to the least automated mail.

Table USPS-22b: FY96 General Not Handling Tally Costs (\$1,000's)					
	5610	5620	5700	5750	Total
MODS	481,419	170,449	51,316	781,888	1,485,072
NonMODS	81,403	24,952	13,115	124,875	244,344
BMC	1,530	904	29,284	121,939	153,657
Grand Total:	564,352	196,305	93,714	1,028,702	1,883,074

The part of my testimony that you question states that most of these costs occur at non-automated operations. The correctness of that statement can be seen simply from the fact that over half of these costs in FY96 (as in FY86) had activity code 5750 (mixed all shapes), indicating that they were incurred at the generally non-automated allied operations rather than at piece sorting operations, some of which are automated. Additionally, my statement implies that most of the new not handling costs do not occur at the most automated operations. That too can easily be proven based on the FY86 and FY96 data.

As the two tables above demonstrate, not handling costs with activity code 5610-5750 increased by at least \$1,580 million (\$1,883-\$303) during the period. To prove the second point, it is only necessary to show that at least half of these additional costs were added at non-automated operations. In other words, that at least $\$303 + 0.5 * \$1,580 = \$1,093$ million of the FY96 general not handling costs occurred at non-automated operations. Since neither operations that give rise to 5750 not handling costs, nor flats operations, which give rise to the 5620 costs, are automated, and the combined 5620 and 5750 costs are \$1,225 million, my point is already demonstrated.²

Furthermore, even the 5610 (letter specific) not handling costs occur more frequently at non-automated than at automated operations. That can be seen from Table USPS-22c, which breaks down the 5610-5750 not handling tally costs in MODS facilities by cost pool and activity code. As the table shows, some (letter specific) 5610 costs occur at many cost pools not related to letter sorting, although they are concentrated at the letter pools.³ Let us focus on those that are shown at letter pools. The 5610 not handling tally

² Even the FSM sortation that reads mailer provided barcodes is not an automated operation, since flats still have to be hand-fed one at a time.

³ 5610 costs may occur at non-letter cost pools because employees are clocked into the wrong operations, or because some other operations have letter specific sub-operations (e.g. the cancellation/meter prep operation), or because an employee at for example an opening unit brings mail to a letter operation and then waits around before returning to his own operation. In either case, it is most appropriate that these costs be attributed to letter mail, as is done with my proposed method.

costs at the OCR, BCS, LD15 and LD41 automated operations add up to \$155.913 million in MODS offices. But at manual and mechanized letter operations, i.e., the MANL, LSM, LD42 and LD43, they are \$198.833 million. Since the 5610 costs in FY86 were practically zero, it follows that even the letter-specific portion of not handling costs has grown more at the non-automated than at the automated operations.⁴

Going back to Table USPS-22a, the 5750 costs more than doubled between FY86 and FY89, while the various mixed mail codes increased only moderately. From FY92 on, comparison becomes difficult because due to the new data collection scheme most mixed mail costs are also recorded with codes 5610-5750. Note, however, witness Barker's R94-1 testimony that almost all the increase in mixed mail costs had been in the not handling category.

I tend to believe that the Postal Service, were it willing to do so, could provide tabulations showing the annual increases in each type of not handling cost since at least FY86, using IOCS tapes from each year.⁵ I recommend that the Postal Service attempt to extract this information in order possibly to gain a better understanding of exactly how not handling costs have grown over the past ten years and why they have grown so much.⁶

⁴ This comparison between automated and non-automated letter operations might be more evenly balanced if one could include the (unknown) not handling costs at remote encoding centers (REC's). Use of tally costs allows consideration only of the portion of the LD15 cost pool that is incurred at general processing facilities, since no tallies are taken at the REC's. On the other hand, the above comparison excludes NonMODS offices, which generally are much less automated than MODS offices and where the percentage of 5610 costs incurred at non-automated operations is therefore likely to be larger.

⁵ The ability to separate the mixed mail and not handling portions of the 5610-5750 costs does not depend on MODS data but on the use of previously unused IOCS data fields.

⁶ Between FY95 and FY96, there appears to have been a drop in total mixed mail and general not handling costs. I assume this reduction, which occurred mainly in the categories 5610 (mixed letters) and 5750 (mixed all shapes), is at least partly related to the change in IOCS instructions that expanded the use of the top piece rule. I am not aware of any explanation for the sharp increase in 5700 (mixed parcels) costs that appears to have occurred between FY95 and FY96.

Table USPS-22c: MODS General Not Handling Tally Costs Per Cost Pool (\$1,000's)					
Cost Pool	5610	5620	5700	5750	Total
BCS/	112,850	122	150	3,505	116,627
EXPRESS	230	261	466	4,904	5,861
FSM/	4,018	72,012	163	4,673	80,866
LSM/	54,859	630	199	2,034	57,722
MANF	4,131	49,671	241	4,308	58,352
MANL	115,004	4,081	636	14,783	134,504
MANP	580	298	4,951	6,116	11,945
MECPARC	54	0	1,356	949	2,359
OCR/	33,761	122	0	1,020	34,903
PRIORITY	853	598	9,654	21,664	32,769
SPBS OTH	291	247	3,537	31,876	35,951
SPBSPRIO	181	261	1,422	8,951	10,815
BUSREPLY	555	0	140	909	1,604
INTL	3,306	1,262	1,895	10,739	17,202
LD15	1,430	0	0	996	2,426
LD41	7,872	48	0	714	8,634
LD42	548	321	0	76	945
LD43	28,422	8,355	7,347	33,081	77,205
LD44	7,451	527	247	7,724	15,949
LD48 EXP	0	0	0	0	0
LD48 OTH	1,978	456	315	5,690	8,440
LD48_SSV	1,207	209	108	2,674	4,197
LD49	758	62	0	2,644	3,463
LD79	305	0	100	3,441	3,847
MAILGRAM	0	0	0	139	139
REGISTRY	522	206	51	3,016	3,795
REWRAP	436	0	349	2,087	2,872
1BULK PR	264	0	137	2,115	2,516
1CANCMPP	19,001	2,804	306	33,584	55,696
1EEQMT	0	63	130	4,209	4,403
1MISC	5,702	1,853	327	15,725	23,606
1OPBULK	8,970	4,810	1,793	38,952	54,524
1OPPREF	29,477	7,986	5,593	102,622	145,678
1PLATFRM	7,816	3,397	5,093	263,932	280,239
1POUCHNG	23,453	8,218	1,950	66,397	100,018
1SACKS_H	1,161	1,001	1,489	36,222	39,873
1SACKS_M	145	0	779	13,223	14,147
1SCAN	479	250	220	15,412	16,361
1SUPPORT	1,514	319	68	6,989	8,890
LD48_ADM	1,834	0	99	3,796	5,730
MODS Total	481,419	170,449	51,316	781,888	1,485,072

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-23. Please refer to TW-T-1, footnote 21, and to the table provided as Attachment 1 to this interrogatory.

- a. Is it your testimony that the only explanation for "letters being sorted at flats cases" is that employees are clocked into MODS operations other than what they are working (i.e., "misclocking")? If not, please explain your testimony.
- b. Please confirm that the table provided as Attachment 1 to this interrogatory provides a breakdown of IOCS clerk/mailhandler tallies by shape and the employee's sampled (as opposed to clocked-in) operation, recorded in IOCS question 19. If you do not confirm, please provide the breakdown you believe to be correct, and a detailed description of the procedures you used to develop this alternative breakdown.
- c. Please confirm that the data in Attachment 1 show that some employees who are sampled at flats cases were observed handling letter-shape mailpieces (and vice-versa). If you do not confirm, please explain your interpretation of the data.
- d. Please confirm that there must be explanations other than misclocking for letters being handled at flats cases. If you do not confirm, please explain how misclocking affects recording of the employees' sampled operation.
- e. Is a possible explanation for "letters being sorted at flats cases" (and vice-versa) that the letter and flat mailstreams are not "pure" (i.e., pieces of one type appear within other mailstream), since the dimensions of pieces are not individually measured when the letter and flat mailstreams are separated? Please explain fully.

USPS/TW-T1-23.

- a. I cannot testify as to why all shapes appear to be handled almost everywhere in the postal system, according to the IOCS/MODS data, only that that is what the data appear to show. Note that the word "misclocking" does not appear in my testimony.
- b. I do not possess the resources necessary to replicate the table in your Attachment 1. For the purpose of answering the remaining questions in this interrogatory I will assume that the table is correct.
- c. Confirmed.
- d. Confirmed that "misclocking" apparently is not the only reason. In order to get a rough idea of whether "misclocking" might nevertheless be a contributing factor to the presence of letters at flats cases, etc., in the Degen data, I have performed a simple comparison summarized in the table below. I made the comparison for the four letter and two flat sorting operations that can be identified both in Attachment 1 and in Table A-4 of my testimony, which shows the direct volume variable costs of handling letters/cards, flats and IPP/parcels at each MODS cost pool.

For each of these operations, I calculated the percentage of unexpected shapes, both in Attachment 1 representing the IOCS Question 19 data and in my Table A-4 which is based on the MODS/IOCS data. For example, at letter cases in Attachment 1 there are a total of 21,898 tallies with identified shape. Of those, 503 tallies, or 2.3%, indicate flats, IPP's or parcels. In the MODS IOCS data, however, 4.34% of the shapes at manual letter cases are non-letters.

Unexpected Shapes At Sorting Operations		
Piece Distribution	Percent Wrong Shape	
	MODS/IOCS	IOCS Q19
Letter Case	4.34%	2.30%
OCR	1.44%	0.65%
BCS	0.47%	0.70%
LSM	0.78%	1.71%
Flats Case	7.38%	3.46%
FSM	3.33%	2.16%

Besides manual letter cases, the largest differences between the two sets of data are at manual flats cases and at FSM's. At manual flats cases, the IOCS Question 19 data indicate 3.46% of the shapes as non-flats. That percentage more than doubles, to 7.34%, in the MODS/IOCS data. Note also that most non-flat tallies at flat cases in the Question 19 data are parcels, which may well have been parcels resembling flats and capable of being sorted at flat cases. In the MODS/IOCS data, however, most of the additional non-flats are letters. The percentage of letters at flats cases is 1.34% according to the Question 19 data, but 5.03%, almost four times as much, in the MODS/IOCS data.

From this admittedly somewhat unscientific comparison it appears that while "misclocking" is not the only factor causing letters and flats to appear at operations where one would not expect to find them, it nevertheless is a major contributing factor, especially at manual flats cases, manual letter cases and FSM's.

There are at least two other reasons why the additional effect of "misclocking" may be larger than the above comparison indicates. Some MODS tallies did not allow MODS numbers to be determined and for those tallies Degen's program assigns the cost pool one would expect based on other data. Additionally, it is reasonable to assume that in cases where IOCS clerks did not know the MODS numbers employees were clocked into, they would have tended to assume the numbers where employee were working, even if they were actually clocked somewhere else. I know of no way to quantify the possible impact of these factors.

In any case, the Attachment 1 data do not explain why in Degen's data so many employees appear at mail processing operations while engaged in window service

or administrative work. Nor do they make any less likely the tendency for employees in many facilities to be clocked into allied operations while in fact working elsewhere, as described by the USPS Inspection Service's audit team in USPS LR-H-236.

- e. I assume that by separation of the letter and flat mailstreams you refer to the culling process applied to collection mail. I agree that that process may allow some mail pieces to be entered into the wrong mailstream. This is one possible explanation for the phenomenon illustrated in Attachment 1.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T-24. Please refer to MPA-T-2, page 7. Witness Cohen states that in Docket No. R94-1, it was your testimony that IOCS, and in particular the LIOCATT cost distribution system, was "inadequate to distribute mail processing costs in the radically different operating environment of the 1990s."

- (a) Is witness Cohen's statement an accurate summary of your Docket No. R94-1 testimony, as it pertained to IOCS/LIOCATT? If not, please explain.
- (b) Please confirm that the mixed-mail distribution method you propose is identical to the LIOCATT method, except that you propose to implement witness Bradley's variability analysis via the formula provided at page 10 (line 19) of your testimony, and that you propose to carry out the distributions by office group (BMC's, MODS 1&2 and non-MODS) in addition to the IOCS CAG stratum and basic function. If you do not confirm, please explain. If you believe there are additional differences, please provide a complete description of each additional difference.

USPS/TW-T-24.

- a. I have looked in vain through the part of witness Cohen's testimony that you refer to for any mention of the word LIOCATT. The question therefore presents an inaccurate and misleading description of Cohen's current testimony, besides being inadequate as a summary of what I said about the IOCS in R94-1.

The fundamental problem that I identified with use of IOCS in today's environment is not one that can be fixed by replacing the LIOCATT with some other tally manipulation program. Rather, it is the inherent inability of the IOCS sampling approach to determine the true reasons for the large increases that have occurred in not handling costs. Any method of tabulating IOCS tallies and their associated costs will, when compared with similar tabulations taken ten years earlier, show a tremendous growth in not handling time spent at various operations, as well as in time spent on breaks, on empty equipment, etc. But no manner of manipulating these data can, without some additional intelligence, explain why these costs have increased so much or show the correct way to distribute responsibility for these costs among subclasses.

IOCS may record employees being at certain operations not handling mail at certain times. But it cannot explain why a clerk or mailhandler is at a certain place at a certain time, because the true reason is often simply that he was told to be there. What is really needed, therefore, is an in-depth analysis of how hiring, staffing and scheduling decisions are made by facility managers and their supervisors, including the types of criteria used in making such decisions. If, for example, such an analysis were to show that managers tend to load up some manual operations with extra staff in order to serve as backup for overflows or rejects of high priority automated

mail, then that would not only help explain the continuing decline in productivity at manual operations but would have fundamental implications for the attribution of cost responsibility at those manual operations. So too if it were demonstrated, as indicated by the Inspection Service, that employees are sometimes told to clock into opening units until given some other assignments, or when no longer needed at piece distribution operations.

The IOCS itself cannot provide this kind of information, which is needed in order to properly interpret IOCS data. Unfortunately, other than some efforts by teams of postal inspectors, there has been no serious attempt by the Postal Service to even begin to address these issues.

In my R94-1 testimony I also criticized the Postal Service's FY92-93 changes to the IOCS method of collecting mixed mail data, including its abandonment of all attempts at collecting class related data on mixed mail in containers, in favor of the same elaborate but flawed approach promoted by witness Degen in this docket. See TW-RT-1 at 12-13 (Tr. 25/11851-52) in R94-1. I believed then, and still believe today, that as long as there is no better information available with which to analyze mixed mail costs, it is after all safer, and likely to cause less distortion relative to the true costs, to use the more traditional approach for distributing these costs.

- b. The main difference, besides the ones you mention, is that the costs defined as "mixed mail" in LIOCATT are not the same as the costs called "mixed mail" in my testimony. The LIOCATT distribution of mixed mail costs is applied to tallies with activity codes 5300-5750, including tallies that in reality represent not handling. My mixed mail method is not applied to the not handling portion of the costs with activity codes 5610, 5620, 5700 and 5750. On the other hand, it does include the tallies that represent handling of empty items and containers. The latter costs are traditionally attributed outside of the LIOCATT program, without regard to distinctions based on CAG or basic function.

Stated differently, I define mixed mail costs in the same way as they are defined in witness Degen's program, although my approach to distributing them is similar to that used in the LIOCATT. I distribute the mixed mail costs with activity codes 5610, 5620 and 5700 to subclasses based on the distribution of direct costs of respectively letters/cards, flats and IPP's/parcels. I distribute the remaining mixed mail costs based on all direct costs.

As I said in my testimony, I do not believe that this approach is ideal, but it is the best practical approach at this time, until the Postal Service provides more meaningful data that could lead to a more accurate distribution of the mixed mail costs.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T-25. Please refer to TW-T-1, Exhibit 1, page 2.

- (a) Please break down the "Stralberg" column of Table 1-1 into "direct mail," "mixed mail," and "not handling mail" components. Please also provide your response, and any supporting calculations, in electronic spreadsheet format.
- (b) Please isolate the effect of your proposed changes in mixed-mail distribution methodology by providing the cost distribution, broken down as in part (a) of this interrogatory, that would obtain if you distributed the IOCS tally costs "TC(I)" (TW-T-1, page 10) instead of the associated volume variable costs "PC(I)."

USPS/TW-T-25.

- a. Please see Tables A-5, A-6 and A-7 in Appendix A of my testimony, which provide the information requested, separately for MODS offices, NonMODS offices and BMC's. These tables can also be found, in electronic format, in TW LR-H-1.¹
- b. Since it is not clear to me what exactly you mean by "isolate the effect of your proposed changes in mixed-mail distribution," I will comply with your request in the most straightforward manner possible, i.e. by replacing volume variable costs with tally costs in my calculations. Table A-6 referred to above already gives the direct, mixed and not handling tally costs attributed to each subclass in NonMODS offices by my method. Attached to this answer are Tables A-5T and A-7T which provide the corresponding information for MODS offices and BMC's.

If your purpose is to compare my method with the FY96 attribution of mail processing costs, then several factors must be considered. First, since my method is based on accrued costs and Bradley's volume variability factors, it includes the costs at remote encoding centers (REC's) as part of cost pool LD15, by extrapolating the LD15 tallies taken in mail processing facilities to include also costs as REC's, where no tallies are taken. In a distribution based on tally costs it would be necessary to add the REC costs separately, but it obviously is not known which portion of the REC costs are "not handling", "mixed mail" or "direct" costs, nor is it clear whether those terms even have meaning when applied to the REC's, which handle transmitted images rather than actual mail pieces.

¹ The first sheet in spreadsheet MODS contains Table A-5 in cells BN4..BS49. The first sheet in spreadsheet NonMODS contains Table A-6 in cells AM3..AS48. The first sheet in spreadsheet BMC contains Table A-7 in cells AN3..AS48. In Table A-6, the direct, mixed and not handling costs shown are tally costs, which to get the corresponding volume variable costs must be multiplied by the 0.786 volume variability factor and with the ratio of NonMODS accrued costs to tally costs.

Second, replacing volume variable costs with tally costs, with no other changes, has the effect of attributing certain costs that in the traditional approach, as described in section 3.1 of USPS LR-H-1, are considered institutional. These costs would have to be moved from attributed to institutional in order to allow comparison with FY96 costs.

Third, as discussed in sections 1 and 2 of Appendix B in my testimony, certain "direct" costs traditionally shown as mail processing costs were transferred to cost segments 3.2 and 3.3 by Degen's method and I did not attempt to move those costs back to segment 3.1.

Finally, please note that "mixed mail" in my method defines a different set of costs than does the term when used in the traditional costing approach, and that my method also treats not handling costs differently.

Table A-5T: Distribution Of MODS Direct, Mixed And Not Handling Tally Costs (\$1,000's)					
	Direct Costs	Mixed Mail Costs	Not Handling Costs	Distribute 5301-5345 Costs	Total
First-Class:					
Letters and Parcels	2,077,425	606,367	1,787,082	2,648	4,473,523
Presort Letters and Parcels	420,229	114,046	367,342	534	902,152
Postal Cards	1,221	362	1,040	2	2,626
Private Mailing Cards	65,598	18,950	58,621	85	143,254
Presort Cards	16,399	4,578	15,046	21	36,045
Priority Mail	177,517	56,977	158,251		392,745
Express Mail	34,918	12,687	36,355		83,960
Mailgrams	62	21	59		143
Periodicals:					
Within County	4,956	1,242	4,510	27	10,735
Regular Rate Publications	164,538	44,599	132,449	846	342,433
Nonprofit Publications	29,902	7,989	25,217	156	63,265
Classroom Publications	1,272	351	948	6	2,577
Standard A:					
Single Piece Rate	29,281	8,262	28,480	610	66,633
Regular Enh. Car. Rte.	75,833	18,742	63,797	1,464	159,837
Regular Other	556,673	151,129	461,910	10,815	1,180,526
Nonprofit Enh. Car. Rte.	9,726	2,416	8,048	187	20,377
Nonprofit Other	150,050	40,440	131,016	2,972	324,479
Standard B:					
Parcels Zone Rate	23,964	7,625	23,047	358	54,994
Bound Printed Matter	11,713	3,278	10,801	169	25,962
Special Standard	9,758	3,034	9,258	145	22,195
Library Mail	2,817	839	2,329	39	6,025
Penalty - U. S.P.S.	32,704	9,089	33,259		75,052
Free Mail	3,504	1,093	3,089		7,686
International Mail	94,221	34,152	89,463		217,836
Special Services:					
Registry	55,597	0	47,589		103,186
Certified	7,301	0	6,662		13,964
Insurance	201	0	293		494
COD	518	0	470		987
Special Delivery	341	0	1,302		1,643
Special Handling	117	0	65		183
Other Special Services	43,041	0	36,120		79,161
Mixed First Class (5301)	1,689	467	1,133	(3,290)	0
Mixed Periodicals (5331)	568	132	335	(1,035)	0
Mixed Third Class (5340)	7,780	1,789	4,701	(14,270)	0
Mixed Standard A (5341)	971	227	581	(1,779)	0
Mixed Standard B (5345)	391	89	231	(711)	0
Total	4,112,798	1,150,975	3,550,901	(0)	8,814,674

USPS/TW-T1-25

Page 4 of 4

Revised 2-25-98

Table A-7T: Distribution Of BMC Direct, Mixed And Not Handling Tally Costs (\$1,000's)					
	Direct Costs	Mixed Mail Costs	Not Handling Costs	Distribute 5301-5345 Costs	Total
First-Class:					
Letters and Parcels	2,434	1,768	4,675	111	8,989
Presort Letters and Parcels	260	157	1,180	20	1,617
Postal Cards	0	0	0	0	0
Private Mailing Cards	54	35	143	3	234
Presort Cards	0	0	71	1	72
Priority Mail	796	487	1,086		2,369
Express Mail	12	6	238		256
Mailgrams	0	0	0		0
Periodicals:					
Within County	36	20	76	2	134
Regular Rate Publications	6,388	3,746	5,024	194	15,351
Nonprofit Publications	1,607	911	1,163	47	3,728
Classroom Publications	319	164	179	8	671
Standard A:					
Single Piece Rate	5,941	3,977	7,475	177	17,570
Regular Enh. Car. Rte.	7,746	4,612	6,472	191	19,021
Regular Other	67,996	42,343	66,980	1,803	179,122
Nonprofit Enh. Car. Rte.	726	415	570	17	1,729
Nonprofit Other	10,181	6,412	10,400	274	27,267
Standard B:					
Parcels Zone Rate	36,632	21,050	24,946	304	82,931
Bound Printed Matter	16,604	9,384	10,802	135	36,925
Special Standard	20,550	12,332	17,947	187	51,017
Library Mail	4,434	2,747	4,178	42	11,400
Penalty - U. S.P.S.	1,839	1,162	1,796		4,797
Free Mail	969	614	803		2,387
International Mail	13,420	8,347	11,792		33,559
Special Services:					
Registry	194	0	573		768
Certified	0	0	46		46
Insurance	14	0	18		32
COD	0	0	2		2
Special Delivery	0	0	10		10
Special Handling	0	0	1		1
Other Special Services	216	0	155		370
Mixed First Class (5301)	54	35	47	(135)	0
Mixed Periodicals (5331)	123	64	64	(251)	0
Mixed Third Class (5340)	492	258	259	(1,008)	0
Mixed Standard A (5341)	629	368	458	(1,456)	0
Mixed Standard B (5345)	281	171	215	(667)	0
Total	200,947	121,585	179,842	0	502,374

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T-26. Please refer to TW-T-1 at page 34, and to USPS-LR-H-1, section 3.3 (especially 3.3.3 and 3.3.4.) You state that the Postal Service proposes to ignore "much more accurate distribution keys available to the Postal Service for distributing such costs [i.e., costs "migrated" from cost segment 3.3]."

- a. Please confirm that the distribution keys to which you refer in the above quote are the distribution keys that implement the methodology described in USPS-LR-H-1, section 3.3.4. If you do not confirm, please explain fully.
- b. Please confirm that your proposed distribution method for Cost Segment 3.3 would not alter the cost methodology described in USPS LR-H-1, section 3.3. If you do not confirm, please explain fully. As necessary, please provide a detailed description of each difference between your proposed methodology and that described in USPS LR-H-1, section 3.3, along with references to corresponding computer code and/or calculations in TW-LR-1.

USPS/TW-T-26.

a-b. The quote from page 34 of my testimony refers to window service as well as administrative costs. Attribution of window service costs is discussed in section 3.2 of LR-H-1, while administrative costs are discussed in section 3.3. Those sections describe which window service and administrative costs are to be considered respectively attributable, fixed and specific fixed in the traditional costing approach.

The method described in my testimony attributes the costs determined to be volume variable by the Bradley/Degen analysis of volume variability. The Bradley/Degen findings of volume variability are not consistent with the guidelines given in section 3 of LR-H-1. For example, section 3.3.3 specifies that costs of Express Mail personnel not handling mail (IOCS activity code 6231) should be treated as specific fixed. Degen, however, attributes a major portion of these costs in segment 3.1. Furthermore, he attributes them to many classes of mail, not only Express Mail. I attribute the same portion of the 6231 costs, but to Express Mail only, and in segment 3.3 rather than segment 3.1. Therefore, neither Degen's method nor mine follows the LR-H-1 guidelines for cost attribution. However, it is still far more accurate to attribute Express Mail costs to Express Mail than to spread them over all classes of mail.

As explained in Appendix B of my testimony, the distribution keys I use for the volume variable portion of the window service and administrative costs that Degen had misclassified as mail processing costs are the distribution keys used in the applicable sections of witness Alexandrovich's A and B workpapers. I presume that those distribution keys are consistent with sections 3.2 and 3.3 of LR-H-1. Spreadsheet MODSNH in TW LR-H-1 contains the calculations I used to redistribute window service and administrative not handling costs.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-27. Please refer to TW-T-1 at page B-7. You state that "6522 tally costs do not appear explicitly in the IOCS data base" for BMCs and Non-MODS offices.

- a. Please confirm that activity code 6522 tallies are assigned uniform operation code 10, which corresponds to the administrative component (Cost Segment 3.3) in the IOCS-based separation of clerk and mailhandler costs.
- b. Please confirm that activity code 6522 tallies (and the associated tally costs) do appear "explicitly" as part of the administrative tally sets for BMCs and Non-MODS offices. If you do not confirm, please explain.

USPS/TW-T1-27.

- a. Confirmed.
- b. Confirmed. Please note that this has no effect on the conclusions or the alternative cost distribution methodology presented in my testimony.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-28. Please refer to TW-T-1, Table B-6.

- a. Does the distribution of activity code 6522 costs you present in Table B-6 allocate the activity 6522 costs among components approximately in proportion to the "Adjusted Non-6522 Costs"? If your answer is negative, please provide a table comparing your proposed activity code 6522 cost allocation to that which would result from a proportional allocation.
- b. Assuming clerks and mailhandlers working in mail processing operations clock into and out of particular activities more frequently than their counterparts in window service and/or administrative activities, would it be reasonable to assign a larger portion of the 6522 costs to the mail processing component than would result from the proportional allocation? Please explain.

USPS/TW-T1-28.

- a. Yes.
- b. What you suggest might make sense if mail processing, window service and administrative activities were performed by three distinct workforces, and it could be demonstrated that the mail processing workforce did clock in and out more frequently than the other two. However, what has become clear in this case is that a substantial portion of window service and in particular administrative activities are being performed by employees who are clocked into mail processing MODS codes. Were that not the case, the issue of migrated window service and administrative costs would not exist. Furthermore, it is unlikely that these employees would be clocked into mail processing MODS codes if they did not, at other times, really perform mail processing activities. In other words, there must be many clerks that go back and forth between segments 3.1, 3.2 and 3.3. Degen's data show this effect for those employees who for whatever reason did not clock out of their mail processing related MODS numbers before engaging in window service or administrative activities. It is not known how many other employees go back and forth but do appropriately clock in and out before moving from one type of work to another.

Assume, for example, that a clerk in a small office works most of the day manually sorting letters, but that he is asked to temporarily fill in for a window clerk in order to be able to serve waiting patrons.¹ He clocks out of his current distribution

¹ Most of the window related not handling costs that appear in Degen's data under mail processing are clocked into the cost pools related to work at stations and branches, where distribution cases and windows are often in close proximity.

USPS/TW-T1-28
Page 2 of 2

operation, goes to work at the window and returns a half hour later when he clocks back into his letter sorting operation. I don't know if this is typical of the situations leading to the mixing of window service and mail processing in Degen's data (except that Degen's data show it when the employee forgets to clock in and out), but if it is, then one could argue that at least in this situation, the ratio of clocking in/out time to work time is greater for the window service activity.

As with so many other issues relating to clerk and mailhandler costs, the real problem is the absence of facts to replace arbitrary assumptions. Until these facts have been established, I believe that it is better for the Commission to stay close to the traditional method of cost attribution, i.e., in this case to distribute 6522 costs among segment 3 components in proportion to non-6522 costs.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-29. Please refer to TW-T-1, pages 27 and 29.

- a. Please confirm that you hypothesize that clerks who are "no longer needed for manual [or mechanized] letter sorting but still in the system" are commonly assigned to platform and opening unit operations, and that they clock into these operations in order to get paid. If you do not confirm, please explain.
- b. If you confirm part (a), does your hypothesis imply that the proportion of clerk costs in those operations should have increased over time? Please explain any negative response fully.
- c. If you confirm part (a), does your hypothesis imply that the proportion of not-handling costs in those operations should have increased faster than average? Please explain any negative response fully.

USPS/TW-T1-29.

a-c. Page 27 in my testimony refers to a hypothesis I formulated in Docket R90-1, as a possible explanation for the excessive increase in the costs attributed to Periodicals and some other subclasses. Page 29 discusses several recent facts that support the hypothesis. The hypothesis described refers to "manual operations, particularly opening units." I do not hypothesize that clerks are commonly assigned to platforms, which generally are the domain of mailhandlers, though not exclusively so.

Nor do I assume that all of the enormous increase in not handling costs between FY86 and FY96 took place at opening units and platforms. Such an assumption would make little sense, since the facts show that there have been orders of magnitude increases in not handling costs at letter, flat and parcel operations as well as allied operations. See my response to USPS/TW-T1-22, particularly tables USPS-22a and USPS-22b. There I show that not handling costs assigned activity code 5610, i.e. those associated with letter operations, grew from no more than \$7.6 million in FY86 to \$564 million in FY96. Similarly, 5620 not handling costs (flats operations) grew from no more than \$5 million to \$196 million, and 5750 (mixed all shapes) not handling costs, incurred at allied operations, grew from a maximum of \$290 million to \$1,098 million. In absolute terms, therefore, not handling costs have grown most at allied operations, but in percentage terms they have grown most at distribution operations.¹

¹ Allied operations do, however, have a much higher ratio of not handling to handling costs. That is why Degen's proposal to assign all responsibility for the high not handling costs at allied operations to the mail receiving direct handling at those operations is particularly devastating to the highly presorted mail that bypasses most piece distributions and therefore incurs a large portion of its total handling at the allied operations.

One predictable effect of these large increases has been a decline in productivity at all types of piece sorting operations except parcel operations, as demonstrated by the exhibit at Tr. 5565. The Postal Service has nevertheless realized an overall gain in productivity, because most letters today are handled at BCS's and OCR's, which are an order of magnitude faster than the LSM and manual sorting methods they replaced. That, however, is small consolation to Periodicals and other mailers who are stuck with the less automated processing methods, whose productivities have declined sharply.

These are not my hypotheses, they are facts. It is also a fact, not my hypothesis, that Periodicals processing costs have grown much faster than postal wage rates, despite considerable advances in mailer presorting, pre-barcoding, palletization and dropshipping as well as processing technology, all of which should have made Periodicals less costly for the Postal Service to handle. And it is a fact, not my hypothesis, that all of this occurred in the period that the Postal Service implemented letter mail automation, and that the Postal workforce today is larger than ever, despite all of the manual letter sorting avoided by automation.

It remains my hypothesis, however, that there must be some connection between these phenomena. That hypothesis is strengthened by the Postal Service's continued inability to produce any meaningful explanation for the large increases in Periodicals mail processing costs.

As I also show in my response to USPS/TW-T1-22, it appears that somewhat less than half of today's large 5610 (letter specific) not handling costs are incurred at the automated letter operations (BCS, OCR). The rest are incurred at manual letter cases and LSM operations, which in the past seem to have worked fine without such large not handling costs. I find USPS witness Barker's R94-1 explanation for the large not handling costs at highly automated letter operations credible, i.e. that they are incurred because employees are now watching machines rather than handling mail pieces. But no credible explanation has been offered by the Postal Service for the much larger pool of new not handling costs at manual letter and flat cases and allied operations. Until the Postal Service offers some credible explanation for why these costs, as well as break time and empty equipment costs, have grown so much, it is difficult to avoid the conclusion that these costs represent large inefficiencies in the postal system.

Regarding the tendency to send distribution employees to allied operations when they are not needed for piece distribution, thereby boosting the reported MODS productivity rates, I believe this practice already existed before automation. But the consequences under automation are much graver. In the late 1970's, when I was helping the Postal Service to collect mail characteristics data and develop mail flow models, I had the opportunity to spend a considerable time in various mail processing facilities, on all tours, and to talk to numerous industrial engineers, managers and clerks/mailhandlers. At that time, the LSM was the Postal Service's most advanced machine and showing high productivity on the LSM's a prime concern. It was widely recognized by facility

employees that once an LSM ran out of mail, its operators would quickly be sent to clock in at some "lower" operation.

Based on this experience, I do not find it surprising that in FY86 there were already considerable not handling costs at allied operations (though little compared to today) but hardly any at letter- and flat-specific operations. Nor is it surprising that this effect, still not acknowledged by USPS headquarters, grew by leaps and bounds after the Postal Service started to deploy letter automation on a large scale while at the same time increasing its workforce.

**RESPONSE OF WITNESS HALSTEIN STRALBERG TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/TW-T1-30. Please refer to your response to USPS/TW-T1-7, and spreadsheet Items.xls, TW-LR-H-3.

- a. Please confirm that the "counted" data in the tables provided at pages 2 to 8 of USPS/TW-T1-7 were obtained from datasets TW28emdr, TW28enmr, and TW28ebmr, USPS-LR-H-296. If you do not confirm, please explain fully.
- b. Please confirm that there are several negative numbers entered in the "direct" columns of the tables provided at pages 2 to 8 of USPS/TW-T1-7, e.g., -\$354,000 for the "Other" subclass category in Table 5-1m. If you do not confirm, please explain fully.
- c. Please confirm that if you had computed the "direct" volume variable costs using the formula at page 10, line 19 of your testimony, you should not have obtained negative "direct" costs, since "TC(I)," "POOLCOST(K)," "W(K)" and "TCP(K)" are all positive numbers for every tally and cost pool. If you do not confirm, please explain fully.
- d. If you confirm part c, please explain in detail how you obtained negative "direct" cost estimates. Please provide electronic spreadsheet calculations, SAS code, and or any other supporting documentation as necessary.

USPS/TW-T1-30. The source of the anomalies that you refer to is explained in footnote 1 at page 1 of Exhibit 5 in my testimony. In response to a Time Warner interrogatory (TW/USPS-5), questioning Degen's original estimates of counted item costs per subclass and item type, Degen filed revised estimates contained in USPS LR-H-296 and claimed that his original answers had excluded some counted international sacks. However, the sum of the subclass costs associated with counted international sacks indicated in Degen's revised answer exceeds the sum of "direct plus counted" item costs for international sacks in the IOCS data. Subtracting the "counted" international sack costs indicated by Degen in USPS LR-H-296 from the "direct plus counted" international sack costs in the IOCS data therefore led to a negative estimate of the "direct only" costs. Since this discrepancy does not affect my proposed distribution methodology, and the deadline for interrogatories to USPS witnesses had already passed when the discrepancy was discovered, I made no further attempts to resolve it.

- a. Confirmed.
- b. Confirmed.
- c. Not confirmed. Since the "counted" data have been converted into "direct" tallies in the IOCS data base, and since the purpose of the tables referred to is to show the difference between the subclass distributions for the true "direct" costs (i.e., costs related to items with identical mail, normally provided only by bulk presort mailers) versus the costs that arise from counted items, the "direct" columns in these tables represent the costs extracted from the "direct" portion of the IOCS tallies minus the

counted costs as extracted from the datasets in USPS-LR-H-296. Negative numbers will therefore occur whenever the "counted" costs from USPS-LR-H-296 are larger than the total "direct plus counted" costs obtained from the IOCS tallies. That, of course, should not occur if the "counted" data in USPS-LR-H-296 are correct, since the "counted" costs alone cannot exceed the "direct plus counted" costs.

- d. Please see footnote 1 at page 1 of Exhibit 5 in my testimony.

Part of the problem described in that footnote can be traced to the following example. Dataset TW28emdr includes, for each non-top-piece-rule item type, a breakdown by MODS cost pool and subclass of the volume variable costs that resulted from counting items of that type. In the case of international sacks, the total counted costs indicated, summed over cost pool and subclass, are \$3.0055 million, including \$2.6658 million for international mail. But my tabulation, from Degen's MODS data, of all direct plus counted item costs (all shown as "direct" tallies) for international sacks, gave only \$2.6512 million, of which \$2.3115 million was for international mail. When I subtracted the \$2.6658 million in "counted" international mail costs from the corresponding \$2.3115 million in "direct plus counted" costs, the inevitable result was a negative number.

1 CHAIRMAN GLEIMAN: Does any participant have
2 additional written cross for the witness?

3 [No response.]

4 CHAIRMAN GLEIMAN: If not, then we will move on to
5 oral cross-examination.

6 Three parties have requested oral
7 cross-examination: The Newspaper Association of America;
8 United Parcel Service; and the United States Postal Service.

9 Does any other party wish to cross-examine this
10 witness?

11 [No response.]

12 CHAIRMAN GLEIMAN: If not, then we will begin with
13 the Newspaper Association of America. Mr. Yourshaw?

14 MR. YOURSHAW: We have determined we have no
15 questions for this witness.

16 CHAIRMAN GLEIMAN: Thank you, sir.

17 United Parcel Service?

18 MR. MCKEEVER: We also have no questions, Mr.
19 Chairman.

20 CHAIRMAN GLEIMAN: I bet you we can't make it
21 three in a row.

22 [Laughter.]

23 CHAIRMAN GLEIMAN: Ms. Duchek?

24 MS. DUCHEK: I am afraid to disappoint you, Mr.
25 Chairman. I wish we could make it three in a row but we

1 can't.

2 CHAIRMAN GLEIMAN: All right. Actually, if you
3 were going to disappoint me, after what I said you would be
4 saying that you didn't have any cross either, but I
5 guess we'll just have to proceed when you are ready then.

6 MS. DUCHEK: I am.

7 CROSS-EXAMINATION

8 BY MS. DUCHEK:

9 Q Good morning, Mr. Stralberg.

10 A Good morning.

11 Q Would you turn, please, to your response to U.S.
12 Postal Service Interrogatory T-1-1 --

13 A T-1 -- yes?

14 Q T-1-1, number 1 from the Postal Service.

15 A Yes, I have it.

16 Q And specifically would you look at the paragraph
17 beginning at the very bottom of page 2 and carrying on to
18 page 3.

19 A Yes.

20 Q As I read that paragraph, you are stating that it
21 is not possible for example to determine the true costs
22 incurred in BCS sorting and others because the MODS cost
23 pools are impure.

24 Is that a fair characterization of what you have
25 said there?

1 A That is one issue, yes.

2 Q Okay. Now doesn't your proposed method among
3 other things use basic function in lieu of cost pools to
4 distribute mixed mail costs?

5 A Yes. I use that instead.

6 Q Can we know the true costs of a basic function?

7 A What do you mean by the true costs of a basic
8 function?

9 Q The same as you meant when you talked about how we
10 could not know the true costs incurred in BCS sorting.

11 A Well, all that you can really know in either case
12 is the true costs of those tallies that the IOCS data
13 collectors recorded as originating incoming and so on. So
14 one has to assume that those are correct.

15 Q Well, since basic function is a ~~conceptive~~ *concept of*
16 activity in IOCS, won't estimates of total cost for a basic
17 function or for costs for the activities within that basic
18 function be subject to sampling error?

19 A Everything in IOCS is subject to sampling error.

20 Q Okay. I understand, Mr. Stralberg, that you have
21 U.S. Postal Service Library Reference H-49 with you that's
22 otherwise known as the IOCS Field Operating Manual or
23 Handbook F-45.

24 A Yes, I do have it.

25 Q And I've also furnished a copy to your counsel

1 this morning.

2 Are you aware that the F-45 contains a bit more
3 than two full pages of rules on the coding of basic
4 function, specifically its question 26, and that begins on
5 page 135 at the bottom, carries over through a little bit
6 onto the top of 138?

7 A To answer that question, yes, I'm aware of that.

8 Q Okay. Is it your understanding that these rules
9 on the coding of basic function among other things resolve
10 some situations in which the basic function is ambiguous?
11 For example, an operation which simultaneously processes
12 outgoing and incoming mail?

13 A Could you refer me to the --

14 Q Yes, I could.

15 A Instruction that you're talking about?

16 Q I believe it is on page --

17 A 136.

18 Q 136, the section 17-10, subpart C. I can read
19 that, if you'd like. "If the employee is working in an
20 operation in which both incoming and outgoing mail is being
21 processed, enter the basic function of the predominant
22 operation being performed at the time of the reading."

23 A Yes. That is true.

24 Q Okay. So that instruction tells the data
25 collectors to code the predominant basic function when both

1 ^{outgoing}
incoming and ~~outcoming~~ are being processed in the same
2 operation; correct?

3 A Yes. I believe in most cases originating mail is
4 processed at one time and the incoming at another time. I
5 agree that there are some overlaps when one may be
6 predominant.

7 Q But won't -- doesn't -- strike that.

8 Doesn't such a rule mean that there will be some
9 incoming mail in the outgoing basic function and vice versa?

10 A There is no question that basic function is not a
11 perfect way to characterize mail processing operations.

12 Q So one could say that basic functions are impure
13 in a sense in the same way as the MODS-based cost pools are
14 impure?

15 A I agree they are impure; sure.

16 Q Okay. Could the impurity, so to speak, of the
17 basic function costs adversely affect the reliability of
18 mixed mail distribution methods based upon basic function?

19 A Well, I think striving for purity is not
20 necessarily a goal. The advantage of breaking costs down in
21 certain ways -- there are certain advantages or
22 disadvantages. Whichever way you classify the IOCS tallies
23 into groups there are certain -- there might be certain
24 statistical advantages if all -- if the tallies in one group
25 have certain characteristics that are clearly distinct from

1 the other group, and furthermore there is not a whole lot of
2 interaction between the two.

3 The main problem I have with the cost pools is
4 that treating them as separate compartments ignores the
5 interaction between these cost pools. I think breaking
6 things down by CAG is a very pure way because facilities are
7 clearly separate. You don't reassign people, for example,
8 between CAGs. With basic function I agree it's not pure,
9 although one could generally say that in the facility in the
10 evening they work outgoing mail, in the early morning they
11 work incoming mail. So there is some separation.

12 Q Would you turn now to your Response No. 2 from
13 Interrogatory No. 2 from the Postal Service, please?

14 A Okay.

15 Q Specifically subpart (a).

16 A (a), yes. I'm sorry, I'm in (a) at this point.
17 Okay.

18 Q No, Postal Service No. 2, subpart (a).

19 A Yes. I'm sorry. Okay.

20 Q As I read your response to subpart (a), you state
21 that you accept the representation that program ALB105C5
22 assigns shape-related, mixed mail codes based on answers to
23 IOCS question 19, correct?

24 A Yes, that's how I understand the code.

25 Q Now, the activity codes we are talking about^{are} 5610,

1 which is mixed letters and cards; 5620, mixed flats, 5700,
2 mixed IPPs and parcels; and 5750, mixed, all shapes,
3 correct?

4 A Correct.

5 Q If you see a mixed mail tally with activity code
6 5610, isn't it correct that what that is telling you is that
7 the data collector observed an employee working at one of
8 several related mail processing -- several letter-related
9 mail processing operations, correct?

10 A Yes. An operation where they handle letters only.

11 Q Okay. But it doesn't necessarily mean that the
12 data collector observed the employee handling mixed letters,
13 does it?

14 A It could be handling. In 5610, most of those
15 costs are not handling costs. So, in fact, most of the time
16 it means they did not handle any particular mail.

17 Q But the employee would be working at one of
18 several letter-related mail processing operations, correct?

19 A Working or not working, he was there.

20 Q And is it the case that activity codes 5620 and
21 5700 have similar meanings, that is the employee was
22 observed working at a flat or parcel-related mail processing
23 operation?

24 A That is how I understand the interpretation of
25 them.

1 Q And, finally, if the employee was not observed
2 working at one of the shape-related operations, the tally
3 gets activity code 5750, correct?

4 A That is how I understand it, yes.

5 Q Now, in your response to No. 2, specifically, page
6 2 -- well, page 2, the first full paragraph, you note that
7 quite a bit of the 5610 tally costs are in apparently
8 non-letter-shaped MODs costs pools, is that correct?

9 A They are in cost pools that are not specific to
10 letter mail.

11 Q Okay. Now, if you would turn to the table on page
12 6 of your response to No. 2.

13 A Yes.

14 Q Would it be correct to say that you identify
15 111.165 million in volume variable mixed mail costs for
16 those, the four activity codes, 5610, 5620, 5700 and 5750 in
17 the MODs 1 platform operation? And what I have done there
18 is just go across the row for one platform which is near the
19 bottom. Do you see that?

20 A Yes. Yes.

21 Q And I have added --

22 A I did not add them up so I can't verify your sum.

23 Q Well, would you accept, subject to check, it is
24 111.165 million?

25 A One-one -- yeah, it sounds reasonable.

1 Q And 101.996 million, which is in the 5750 column,
2 represents just under 92 percent of the total number that I
3 gave you, the 111.165, would you accept that subject to
4 check?

5 A You are saying at the platform, it was mostly not
6 shape specific? What you are asking me to confirm is that
7 most of the --

8 Q I'm sorry. Let me restate that. I am looking at
9 the column for 5750 under one platform, 101.996.

10 A Uh-huh.

11 Q And I am asking you to confirm that that
12 represents approximately 92 percent, actually just a little
13 less, I think, than -- of 92 percent than 111.165 million,
14 the total.

15 A In other words, that most of the time at the
16 platform, when people were recorded at the platform, they
17 were not recorded as being at the letter or flat operation?

18 Q Right. They -- well, they received a 5750
19 activity code?

20 A Right. Yes. Yes.

21 Q Okay. So does that mean that about 8 percent of
22 the time, the remainder of the time, employees clocked in to
23 MOD operations 210 to 234, which are platform, are observed
24 at letter, flat or parcel distribution operations?

25 A That is how one would interpret it, yes.

1 Q Okay. And the other 92 -- approximately 92
2 percent of the time, the employee is observed at an
3 operation that the IOCS edit programs do not recognize as
4 shape-related?

5 A Correct. mostly the platform, I assume.

6 Q Would you expect mail handlers -- oh, I'm sorry --
7 would you look back now at your response to Time Warner No.
8 1 from the Postal Service on page 2, fourth paragraph?

9 A Yes.

10 Q And as I read your response, you're basically
11 saying there are two components to allied labor workload,
12 work in support of piece distribution operations and
13 processing of presorted mail that does not necessarily
14 require piece distribution. Is that a fair
15 characterization?

16 A That's mostly what the allied labor does. Some of
17 the mail goes from the allied operation to the piece
18 distributions.

19 Q Would you expect mail handlers assigned to allied
20 labor operations to perform the work of actually moving the
21 mail to and from distribution operations as well as from one
22 allied labor operation to another?

23 A It's quite possible that that could happen.

24 Q Now if you'd go back to your response to Postal
25 Service No. 2, page 2, you state that your understanding of

1 the use of the question 19 answers -- and I'm paraphrasing
2 here -- is that a 5750 activity code will result if the
3 employee is actually seen working at an opening unit or on
4 the platform; correct?

5 A That's how I understand it; yes.

6 Q Okay. In other words, in that situation, an
7 employee actually seen working at an opening unit or a
8 platform, for example, a 5610 activity code will not result.

9 A If he is working in an opening unit it should not
10 result.

11 Q Okay. Isn't it the case, though, that if the
12 employee is recorded performing an allied labor function in
13 IOCS question 18 and the data collector can identify a
14 distribution operation being supported, isn't the data
15 collector supposed to enter that operation in question 19?

16 A Well, let me see if I understand what you're
17 saying. An opening unit clerk is moving mail say to an OCR,
18 for example, and he is observed at the OCR either moving
19 that mail or not handing mail. It would -- and he is
20 clocked into an opening unit, say. So this is not --
21 clearly not a case of misclocking. He is clocked into the
22 operation he should be.

23 However, he is working on letter mail at that
24 point. He is handling letter mail. The fact that he is
25 handling letter mail is information that will be used if one

1 distributes part of the activity codes 5610, 5620, et
2 cetera. It will not be utilized if one simply records the
3 fact that this employee is clocked into an opening unit.

4 Q Can't you get that data from IOCS question 21 as
5 well?

6 A You mean in terms of the type of mail he is
7 handling?

8 Q Yes.

9 A Yes, in many cases you can, if he is handling
10 mail. However, most of the 5610 tallies are not handling.

11 Q Since the 5610 activity code is based on question
12 19 and not question 18, isn't it the case that the activity
13 code would be applied to mixed mail observations in both the
14 distribution activity and the related allied labor
15 activities?

16 A Could you say that again?

17 Q Yes. Since the 5610 activity code is based on
18 question 19 and not question 18, isn't it the case that that
19 activity code, the 5610, would be applied to mixed mail
20 observations in both the distribution activity and the
21 related allied labor activities?

22 A The 5610 code as I understand is used in the
23 LIOCATT. It's also used in my distribution. It's not used
24 in Mr. Degen's program. So are you referring to it in my
25 application of the 5610, or are you referring to LIOCATT or

1 what?

2 Q In yours.

3 A In yours. Yes, when something is either mixed
4 mail or not handling tally is given a 5610 activity code, I
5 do use that to distribute over letter mail.

6 Q And just so the record's clear, when I said "in
7 yours," you said "in yours." I want to make sure that the
8 record reflects we're talking about you, Mr. Stralberg's
9 methodology.

10 A Testimony TW-T-1.

11 Q Yes. Thank you.

12 So would it be fair to say that this really leads
13 to an issue of how you classify things? Do we treat these
14 costs as part of the letter distribution operations or as
15 part of separate allied labor cost pools about which
16 reasonable people might disagree? But isn't it the case
17 that the data in your table really do not show that
18 employees are inaccurately clocked?

19 A Are you referring to the table on page 6 now?

20 Q Yes.

21 A Well, what it does show is all of these activity
22 codes appear at almost all of the cost pools. That could
23 have many reasons. There are other indications if one
24 examines the IOCS data base that indicate that some people
25 are indeed clocked into the wrong pool, especially those

1 that do window service and administrative functions. In
2 that case it becomes very clear. If they are in -- whether
3 someone clocked into a certain mail processing pool really
4 should have been there or not cannot be positively
5 ascertained from a tally. Those who do window service and
6 administrative functions who are clocked into a mail
7 processing cost pool, it's pretty obvious that there is
8 something out of balance there, but when they're in one mail
9 processing cost pool rather than another, one can never
10 determine for sure, although one might suspect that there is
11 some imbalance.

12 Q Going back to the examples we were just talking
13 about, we would expect to see some labor in support of
14 specific distribution operations in the LDC-17 cost pools,
15 would we not?

16 A Yes. I think one of the things that one would
17 wish to know is to which extent does the labor in that cost
18 pool support or how much of their time is spent supporting
19 letter operations, how much of their time is spent
20 supporting flats operations, how much time is spent
21 supporting parcels operations? One can get some indications
22 of that by using these activity codes. Simply noting the
23 fact that they were in the allied labor cost pool or in an
24 opening unit, for example, is much more limited information.

25 Q Would you turn to page 5 of your response -- on

1 No. 2 from the Postal Service?

2 A Okay. Are we going all the way to 30 or --

3 Q The very end of your response on page 5 you state
4 that you assume, quote, given the lack of more specific
5 information, the 5750 costs are incurred proportionately to
6 all other mail processing costs, period, end quote.

7 A Yes.

8 Q Do you mean mail processing costs in the same CAG
9 and basic function?

10 A In the case of the 5750 costs, yes.

11 Q If there were more specific information which
12 could tell you that some of the mail with activity code 5750
13 were actually mixed letters, you would want to use that
14 information; correct?

15 A Well, that depends on a number of things. I
16 realize you are going back to the Postal Service's current
17 way of recording mixed mail. I've had some problems with,
18 for example, things like containers full of loose letters or
19 loose flats because knowing the fact that there is a
20 container full of loose letters, it seems to me that -- that
21 to me is what I normally would expect to associate with
22 collection mail. This is what one often sees mail coming
23 from a station or a branch or an associate office, and there
24 is a container full of them. Now knowing the fact that this
25 is letters and distributing those costs over all costs the

1 platform or over all direct costs at an opening unit or a
2 platform implies an assumption that the mail in this
3 container, which may no even be handled at that operation,
4 is similar to the mail that's being handled as individual
5 pieces at that operation. And therefore I have certain
6 problems with -- it's very nice to -- the fact that you have
7 recorded information about some of the mixed mail, but there
8 are a number of questions that remain exactly how to
9 interpret that.

10 Q But doesn't Witness Degen's proposed method
11 distribute a container of mixed letters to other letter
12 tallies?

13 A To other letter tallies handled at that operation.
14 It would be much better if you distribute it I think to all
15 letters. Even then there would remain the question of
16 whether loose letters in a container really occur for all
17 classes of mail or whether they only occur for collection
18 mail, and whether it's in the same proportion.

19 Q But wouldn't making use of this type of
20 information help you avoid distributing costs, for example,
21 for mixed collection letters to nonpresorted letters? Or to
22 presorted nonletters, I'm sorry.

23 A Say this again?

24 Q Wouldn't using this type of information which
25 comes from IOCS question 21 actually help you avoid

1 distributing, as an example, costs for mixed collection
2 letters to presorted nonletters?

3 A It would help you to avoid distributing it to
4 nonletters. But there are many types of letters. There are
5 many types of flats.

6 Q I'd like to ask you now some questions about
7 tallies that migrate between the IOCS-based and MODS-based
8 cost segment 3 components.

9 A You mean 3.3?

10 Q Between all three.

11 A All three. Okay.

12 Q Is it correct that your proposed methodology,
13 TWT1, would generally assign those tallies and the costs
14 associated with them to the cost component they would have
15 been assigned to under the previous IOCS-based methodology?

16 A Well, I basically propose to move all of the
17 non-handling costs associated with window service and
18 administration back to those cost pools.

19 Q And under your proposed methodology, what is the
20 treatment for the handling proportion?

21 A The handling proportion, and I think -- I believe
22 I explained that somewhere in my testimony in Appendix B. I
23 was under a certain time pressure to finish. The way I saw
24 it, the handling portion is, after all, mostly direct
25 tallies, you know, where it is mail that already had a

1 subclass designation. And so whether you list those under
2 Segment 3.1, 3.2 or 3.3 is not that important. Ideally, I
3 think should have moved those, too.

4 Q Under the prior IOCS-based cost methodology, were
5 the cost components defined in terms of groups of IOCS
6 operation codes?

7 A That is how I understand it, yes.

8 Q And is it your further understanding that the IOCS
9 operation codes are assigned in such a way that that IOCS
10 operation code essentially summarizes the question 18
11 response?

12 A I never saw those that way, but okay.

13 Q Would you accept that that is correct?

14 A Yes. The activity codes are assigned based on
15 question 18.

16 Q So if the employee's activity is classified under
17 the platform subpart of question 18, it gets the platform OP
18 code, correct?

19 A I believe so, yes.

20 Q And if the employee's activity is classified under
21 the window service subpart, it gets a window service OP
22 code, correct?

23 A Yes.

24 Q And if it is classified under the administrative
25 and other activities question, under No. 18, it gets an

1 administrative operation code, correct?

2 A I believe that is true.

3 Q Okay. Some operation codes correspond to mail
4 processing, some to window service, and some to
5 administration, correct?

6 A Yes.

7 Q And are these groups of IOCS operation codes what
8 define the functional components in the old LIOCATT
9 terminology?

10 A The functional components, I believe so, yes.

11 Q Hasn't it been the case that, even under the prior
12 IOCS-based traditional method, certain costs have been
13 reallocated among components?

14 A Yes, some of them, including the clocking in and
15 out costs and the empty equipment costs. It was assumed
16 that empty equipment only occurred in mail processing, which
17 is not totally true. But that was the assumption. And also
18 the clocking in and out costs were initially recorded as
19 administrative costs and then they were distributed. There
20 may be other examples, but I am not aware of them.

21 Q Let's talk about the one that you just gave for
22 clocking in and out. They were initially assigned
23 administrative but then they got switched because the
24 employee might have been clocking in to or out of a window
25 service or mail processing operation, correct?

1 A Yes.

2 Q Okay. And so would it be fair to say that the
3 rationale for these adjustments is that the IOCS operation
4 code sometimes misrepresents the real nature of the
5 employee's activity?

6 A That might be. As I understand it -- you may be
7 right. As I understand it, the fact is one doesn't really
8 know exactly how to distribute these costs and, therefore,
9 they are distributed proportionately.

10 Q So is it fair to say that the residual categories
11 for work that cannot otherwise be classified by the data
12 collector fall under question, I think it is 18(g), the
13 administrative other activities subpart?

14 A I don't remember 18(g), but, yes.

15 Q And doesn't this mean that hard to classify work
16 activities will tend to be assigned an administrative
17 operation code even if they are actually related to mail
18 processing or window service?

19 A Well, in following the -- I have looked through
20 the various tables on question 18, which really, as I
21 understand it, are menu choices being presented to the data
22 collectors, and they have really a wide range of choices.
23 Almost any conceivable activity, they can indicate.

24 If they don't find anything else, they can end up
25 as administrative. Under administrative, they can indicate

1 other, or they can indicate general administrative services
2 or whatever. There is a catch-all categories for activities
3 that no one can -- that they cannot possibly classify in any
4 other way, which seems to me like a way of hiding automation
5 refugees, but -- or hiding people who are not doing
6 anything.

7 There is an inconsistency between Library
8 Reference H-1, which says that general administrative
9 services are performed by typists and receptionists, and the
10 way is recorded in IOCS, which is a catch-all category for
11 people whose activity cannot possibly be classified.

12 So, in any case, people whose activity cannot
13 possibly be classified, as I see it, are essentially
14 overhead activities. Now, you can list those under Segment
15 3.3 or under Segment 3.1, I don't think it makes that much
16 of a difference. But they are essentially not associated
17 with any activity that you can say it belongs to this cost
18 pool or that cost pool.

19 Q Well, let me give you an example. Suppose an
20 employee is clocked into LDC 43, an LDC 43 MODs operation.
21 Now, LDC 43 includes manual distribution and related work at
22 stations and branches.

23 A At stations and branches, yes.

24 Q The employee is sent to the window to pick up mail
25 that has been deposited by customers. Let's assume that the

1 employee is not taking anything to the window, the employee
2 is just going to pick up mail there, so the employee
3 literally is not handling mail on the trip to the window and
4 is handling an item or container of mail on the return trip.
5 Are you with me so far?

6 A Yes, I follow you.

7 Q As a first general question, is it reasonable to
8 classify this activity as part of mail processing?

9 A Well, you can classify it as one or the other.
10 Okay. It is in between. The fact is, however, that this
11 particular employee at that particular time is handling the
12 type of mail that is received through a window, which is
13 certain classes of mail, as opposed to other classes of
14 mail. And so classifying him as window service would mean
15 that you are distributing his costs upon the type of mail
16 that is handled at windows. Classifying him as part of a
17 mail processing cost pool, that may handle many other
18 classes of mail, could be misleading.

19 Q Well, you talked a minute ago about Library
20 Reference H-1, and isn't it true that the hypothetical
21 example I have just described would have been classified
22 under Library Reference H-1 as collection and preparation of
23 mail and that traditionally has been considered part of mail
24 ~~process?~~ *processing?*

25 A I can't really answer that. You may be correct.

1 The fact is the costs I am proposing to move are those that
2 involve things like selling stamps, setting meters, waiting
3 for a customer at the window. In fact, if you look almost
4 all of the activity codes, the non-handling codes that I
5 propose to reclassify, none of them describe what you were
6 talking about. They describe things like having to do with
7 P.O. Boxes, very special services. At least the vast
8 majority of those costs do not fall in the category we just
9 discussed.

10 But if, in fact, someone is picking up mail from
11 window, then that is information that maybe should be used
12 to distribute those costs.

13 Q Again in the example I have posited, and I
14 understand your concerns with that example, that it doesn't
15 represent the bulk of things, but let's stay with that
16 example.

17 If the activity were classified under IOCS
18 Question 18(c) as the collection and preparation of mail, is
19 it your understanding that the tally would get a mail
20 processing operation code?

21 A I believe you are correct.

22 Q Okay. But if the employee is sampled at IOCS
23 while at the window without mail in hand, isn't it also
24 conceivable that the employee's activity could be classified
25 under Question 18(f)?

1 A Maybe. I think we'd have to go to Question 18(f)
2 to see, okay, what kind -- you may be correct on that.

3 There are a number of different categories. I am
4 already at 18(c), so I am getting close.

5 Q 18(c) begins on page 59 --

6 A Yes.

7 Q -- and 18(f) --

8 A Okay. Window service, part one.

9 Q Right, and 18(f) begins on page 70, correct?

10 A Yes -- okay. 18(f), part one, there's four
11 choices -- serving a customer, window related office
12 activity at window, window-related office activity away from
13 window, or at window waiting for a customer.

14 I am not sure which of those represents dealing
15 with collections.

16 Then there is a Part (b) of that which gives a
17 wide variety of choices, and I have looked at those before.

18 I can't really associate either -- any of those
19 either with someone picking up mail from the window.

20 Q Well, just assume that it was classified under
21 18(f). They would get a window service op code then,
22 correct?

23 A Yes. That's how I understand it.

24 Q Now would the three-digit MODS operation number,
25 assuming it is correctly recorded on the tally, indicate

1 throughout my hypothetical example that the employee was
2 engaged in a mail processing activity?

3 A In your hypothetical you assume that he had which
4 MODS code?

5 Could you say that again?

6 Q It would be any of the three-digit MODS operation
7 numbers under LDC 43, which is manual distribution.

8 A I remember, yes.

9 Q And related work at stations and branches.

10 A Right. Okay. So you are assuming that he did not
11 clock in or out. Again you are referring to someone who
12 went to pick up mail at the window?

13 Q Correct.

14 A From mail processing.

15 Q Correct.

16 A In other words, you are not really referring to
17 any of the categories in Section 18(f). Okay.

18 Q But the MODS operation code under LDC 43 would
19 indicate that the employee was engaged in mail processing.

20 A For the person who came from mail processing, yes.
21 It is a little harder to understand why someone who
22 primarily is working at the window has the same code.

23 Q Do you think that there are some activities that
24 may be difficult to classify as part of one or another cost
25 component? For instance, couldn't some activities which

1 are performed in support of mail processing operations
2 conceivably be classified under either mail processing or
3 administration?

4 A Could you give me an example maybe?

5 Q Well, some of the examples we just --

6 A We talked about window service so far.

7 Q Training on mail processing equipment.

8 A Yes, that is one of the minor categories that I am
9 proposing to reclassify.

10 By far the largest category, by the way,
11 two-thirds, is general administrative services, about which
12 nothing seems to be known what those people really do.

13 Another 10 percent is Express Mail costs, and what
14 you have mentioned is a very small category, but yes, sure,
15 if they are training on the mail processing scheme then,
16 sure, you could consider that part of mail processing.

17 Q Okay. In these sort of gray areas, if you will,
18 if cost components are defined essentially on the Question
19 18 response, it really means that how these costs are
20 treated or classified will depend on the judgment of the
21 individual data collector, correct?

22 A Well, it will depend on which -- number one, on
23 the particular choices that he makes in the series of menu
24 choices that are given to him, and number two, on how this
25 old COBOL program interprets his answers. There is a COBOL

1 program that interprets all of these, and one problem I
2 understand is nobody knows COBOL anymore.

3 Q Is it your understanding that most of the
4 migration of costs between mail processing and window
5 service involves Function 4 operations -- that is,
6 operations at stations and branches?

7 A I looked. I don't remember exactly. I believe a
8 fair amount of them do, yes.

9 Q Okay.

10 A Some but not all. In fact, the general
11 administrative services category, which is the largest, as
12 far as I can tell, stretch across all cost pools.

13 Q Well, do you recall Witness Degen's -- the
14 analysis he presented in response to POIR Number 3, Question
15 28?

16 A No, I don't. You are going to have to refresh my
17 memory.

18 Q Would you accept subject to check that that
19 response showed that almost half of the migration of costs
20 between mail processing and administration involved LDCs 18
21 and 48 -- LDC 18 is mail processing indirect related, LDC 48
22 is customer service administrative miscellaneous.

23 A It may have been about half or a little less, I
24 think.

25 Q Are you recommending in this case that the

1 Commission employ the traditional cost classification
2 allocation and distribution methods for the administrative
3 and window service components?

4 A Well, you asked me an interrogatory about that,
5 and you are referring to the traditional approach, which
6 makes certain assumptions about the percentage attributed.

7 I essentially propose to use the level of volume
8 variability that is indicated in the IOCS data in the
9 particular cost pools a particular cost is found because
10 that is what is consistent with the volume variability
11 analysis that was done.

12 So there is a distinction here between attribution
13 and distribution and I propose that the distribution be done
14 based on what the activity code indicates, and so for the
15 administrative services what I did was basically I used the
16 same methodology indicated in the work papers of Witness
17 Alexandrovich which distribute similar costs, except those
18 costs that were not migrated.

19 Q Well, does the prior IOCS based methodology assume
20 that there is a causal relationship between certain mail
21 processing and administrative activities?

22 A Are you referring to Library Reference H-1?

23 Yes, there are a series of -- Section 3.1 through
24 3.3 basically give -- state certain assumptions that now
25 have been proven wrong about mail processing cost

1 variability, and about the variability of window service and
2 administrative costs.

3 For example, it recommends that certain costs be
4 treated as specific fixed and some as partly variable and so
5 on.

6 Q But is there a corresponding distribution
7 assumption?

8 A Well, there's also some -- there are also
9 specifications there for how those costs should be
10 distributed.

11 In the case of general administrative services
12 they are distributed over all other salaries, which to me
13 seems quite appropriate. These are general overhead costs,
14 and so they should be distributed on top of everything else.

15 Q Well, if some of these administrative costs
16 including the general administrative under the old method
17 actually are related to mail processing support activities,
18 is it valid to classify those costs as part of mail
19 processing instead of administration?

20 A Well, again, I don't think the important issue is
21 which segment you list them under. The important issue is
22 how you distribute them. Now if we take another of the
23 relatively small categories like data collection, well, what
24 is data collection? It includes the MODS clerks who weigh
25 mail. Okay? It includes the IOCS clerks, and so on.

1 Now a MODS clerk who weighs mail very likely would
2 be weighed into an opening unit, because mail is weighed out
3 of the opening units. But really the function he is
4 performing is a general overhead function that really in my
5 opinion should be distributed on top of mail processing and
6 not within the particular pool. So whether you call it part
7 of mail processing or administration is not really the
8 issue, it's how you distribute those costs.

9 Q Well, that's correct, isn't it? If some mail
10 processing support activities were known to support
11 particular mail processing operations or functions, it is
12 appropriate to use that information in the cost distribution
13 process, is it not?

14 A Well, I've -- there's a few examples of activity
15 costs where I indicated that they were related. For
16 example, the Express Mail and registry and so on. And in
17 that case I agree. And again, whether you distribute
18 Express Mail costs to Express Mail within segments 3.1 or
19 3.3 is not the issue.

20 Q Believe ^{it} or not, we're done with No. 2 and we're
21 skipping ahead all the way to your response to Postal
22 Service No. 15.

23 A Okay. Let me get back to that.

24 Q If I'm characterizing your response correctly,
25 first paragraph in particular, you state that the question

1 itself seems to assume that loose mail in containers is
2 unsorted mail and simply cannot be periodicals mail; is that
3 correct?

4 A Well, that's what I -- that question seems to
5 indicate.

6 Q Okay. Is it your understanding that some secured
7 bundles of mail including mailer-prepared packages of first,
8 periodicals, Standard A, presort mail, break during bundle
9 distribution operations?

10 A Bundle breakage does occur.

11 Q Okay. Even --

12 A It's not -- it is not a major issue, because it
13 doesn't occur very frequently.

14 Q And bundle breakage would occur even for
15 periodicals mailers.

16 A It does occur even for periodicals mailers.

17 Q Couldn't bundles that break by accident be an
18 additional source of loose mail including flats observed in
19 containers in allied operations?

20 A They could; yes.

21 Q Okay.

22 A But again I don't think you can explain \$38
23 million dollars' worth of loose flats by broken bundles.

24 Q But there would be some quantity of loose
25 periodicals mail appearing as loose flats in allied

1 operations as a result of breakage -- from the breakage.

2 A That's conceivable.

3 Q Okay. Would you turn to Exhibit 5 of your
4 testimony, please.

5 A Okay.

6 Q If you'll bear with me, I'm not there yet.

7 Page 1 of Exhibit 5, footnote 1.

8 A Yes.

9 Q You indicate there that there is a discrepancy in
10 some data supplied by Witness Degen which explains why you
11 report negative direct costs for some mail classes and item
12 types both in your Exhibit 5 and your response to Postal
13 Service No. 7. Is that correct?

14 A Yes, there was a later interrogatory in which I
15 explained that.

16 Q Okay.

17 A Referring to this footnote.

18 Q And you note that you obtained the counted item
19 data from data sets provided by Witness Degen in Postal
20 Service Library Reference H-296; correct?

21 A Correct.

22 Q However, you do not indicate in that footnote
23 precisely how you obtained the combined direct and counted
24 item data. Can you provide us with an explicit citation
25 either to data provided by Witness Degen or to a SAS program

1 you employed and filed with the library reference for the
2 derivation of ~~there~~^{the} combined direct and counted item data?

3 A Yes. I did not obtain that data from Mr. Degen.
4 And I do explain this in Appendix A of my testimony. I
5 essentially am not a SAS programmer. I did not use SAS
6 directly. I had other people use SAS to extract data for me
7 which I put in spreadsheets that are filed with my
8 testimony -- I believe it's Library Reference TW-LR-1 --
9 which allowed me to determine what I believe are all the
10 relevant categories of -- or all the relevant
11 characteristics of the IOCS tallies for the purpose of
12 distributing costs.

13 Q Mr. Stralberg, and perhaps your counsel can
14 comment on this too, if we could get sometime in the near
15 future a copy of the SAS program perhaps. I don't
16 believe --

17 A I believe they were filed as an MPA library
18 reference.

19 Q I'm sorry, a reference to which SAS program was
20 specifically used to derive this?

21 A Okay.

22 Q Okay?

23 A Okay. Like I say, there is an MPA library
24 reference which I believe already gives that information.

25 Q Okay.

1 A I believe it already spells that out, but I am not
2 positive, since I didn't prepare it.

3 Q We're not positive, either.

4 A Okay.

5 Q If you could look at that and --

6 A Okay. Sure.

7 Q Point us to the source, even if it's clearly
8 spelled out in there. We haven't been able to decipher that
9 yet. We'd appreciate it.

10 A Um-hum.

11 MR. BURZIO: Perhaps Witness Cohen when she
12 appears could provide that citation.

13 MS. DUCHEK: If so, that would be fine, either
14 Witness Stralberg or Witness Cohen, and we'd be happy to
15 talk to Witness Cohen's counsel and reiterate our specific
16 question if that's at all helpful.

17 CHAIRMAN GLEIMAN: If the question is not answered
18 by Witness Cohen, then Mr. Stralberg -- Witness Stralberg
19 will provide the reference.

20 BY MS. DUCHEK:

21 Q Mr. Stralberg, would you now please turn to your
22 response to Interrogatory 30 from the Postal Service?

23 A Yes.

24 Q And I am going to have you look specifically at
25 subpart (c), and I am going to ask you some questions --

1 maybe I should say I am going to attempt to ask you some
2 questions about the formula.

3 A Which formula?

4 Q It refers to the formula on page 10. Your answer
5 to 30(c) refers to the formula on page 10 of your testimony,
6 of your direct testimony.

7 A My answer does not refer to it, your question
8 refers to it. Okay.

9 Q Well, let me start again. Your answer to 30(c),
10 30, subpart (c), from the Postal Service asks you to confirm
11 that the formula on page 10 --

12 A Yes.

13 Q -- of your direct testimony should not have
14 resulted in negative direct costs if you had calculated
15 those costs using the formula.

16 A Yes.

17 Q And you state not confirmed.

18 A The question reflects a misunderstanding. Okay.
19 The application on the formula on page 10 of my testimony
20 should be not result in a negative number. However, in the
21 tables that are referring to, I had a column called "Direct"
22 and a column called "Counted."

23 Now, of course, direct here really has two
24 interpretations. In the IOCS data base, the counted item
25 data were classified as -- they were merged with the direct

1 data, in other words, it all appears as direct tallies.
2 What I did was to separate out the counted tallies, so that
3 what would be left, and which I then called "Direct" is the
4 pure direct or, in other words, the mail with -- the items
5 with identical pieces in them.

6 So, in other words, that involved a subtraction
7 and it would -- that subtraction could end in a negative
8 number if the counted item costs, as estimated by Mr. Degen,
9 exceed the total direct costs, which, of course, they
10 shouldn't, but that appears to be what has happened.

11 Q Mr. Stralberg, are you aware that there is an IOCS
12 variable F9253B, and that is documented in Postal Service
13 Library Reference H-23, which you can use to identify
14 whether the subclass information in a direct tally came from
15 IOCS question 24, that is that the item was counted?

16 A I found that out too late.

17 Q When a pallet is cross-docked on the platform, how
18 would the data collection technician record a tally if the
19 employee is sampled during the return trip?

20 A What do you mean the return trip?

21 Q They have taken a pallet across to the truck and
22 are driving the forklift back.

23 A Okay. In other words, the forklift is not -- the
24 forklift driver is not handling mail at that time, so it is
25 a not handling tally.

1 Q A 57 --

2 A It's a not handling tally, I would presume.

3 Q Okay. You have characterized these costs, that
4 would be not handling 6521, as overhead. In this case,
5 isn't the return trip directly related to cross-docking the
6 pallet?

7 A Excuse me. I didn't quite follow you. What is
8 the reference to 6521? That refers to an employee on break.

9 Q I'm sorry. You said a minute ago the cost would
10 be not handling, correct?

11 A Well, I would assume so, yes.

12 Q Okay. And you have characterized not handling
13 costs as overhead, is that correct?

14 A Yes.

15 Q In the particular case I have posited, though,
16 isn't the return trip, the employee driving the forklift
17 back, directly related to cross-docking of that pallet?

18 A Yes, and, of course, we don't know that. But at
19 the time he is driving back, we don't know where he came
20 from, presumably. Generally, -- obviously, there are some
21 not handling costs that can be associated with specific
22 activities.

23 The main problem with not handling costs is there
24 are so many more of them than there used to be. They used
25 to be a small fraction of what they are today. So maybe

1 they are not really overhead, maybe they are related to
2 automation in some way. But as long as we don't really know
3 that, I believe the best way is to treat them as general
4 overhead costs.

5 Q Well, would there be return trips involved, for
6 example, in feeding an OCR?

7 A Yes, there are always return trips. They
8 shouldn't take that much time.

9 MS. DUCHEK: I have no further questions for now.

10 CHAIRMAN GLEIMAN: Is there any follow-up?
11 Questions from the bench?

12 [No response.]

13 CHAIRMAN GLEIMAN: Mr. Burzio, would you like a
14 few minutes with your witness?

15 MR. BURZIO: Yes, Mr. Chairman.

16 [Recess.]

17 CHAIRMAN GLEIMAN: Redirect, Mr. Burzio?

18 MR. BURZIO: We have no redirect, Mr. Chairman.

19 CHAIRMAN GLEIMAN: If that is the case, Mr.
20 Stralberg, I want to thank you. We appreciate your
21 appearance here today and your contributions to our record.
22 And if there is nothing further, you are excused.

23 THE WITNESS: Thank you.

24 [Witness excused.]

25 CHAIRMAN GLEIMAN: Before we begin with the MPA

1 witness, I think we will take our 10 minute break now. Come
2 back at 10 of the hour and pick up with Witness Cohen.

3 [Recess.]

4 CHAIRMAN GLEIMAN: Mr. Cregan, would you identify
5 your witness?

6 MR. CREGAN: My name is Jim Cregan, representing
7 MPA. For the record, I am accompanied by Steve Gold, also
8 representing MPA.

9 I would like to call MPA Witness Rita D. Cohen.
10 Whereupon,

11 RITA D. COHEN,
12 a witness, was called for examination by counsel for
13 Magazine Publishers of America and, having been first duly
14 sworn, was examined and testified as follows:

15 CHAIRMAN GLEIMAN: Please be seated. Counsel, if
16 you could introduce her testimony.

17 MR. CREGAN: Thank you.

18 DIRECT EXAMINATION

19 BY MR. CREGAN:

20 Q Ms. Cohen, do you have in front of you a document
21 designated MPA-T-2, Direct Testimony of Rita D. Cohen on
22 behalf of Magazine Publishers of America?

23 A I have the revisions.

24 Q It is in your book.

25 A It is in my book, okay. Well, I do have that,

1 yes.

2 Q Good. So far, so good.

3 You have never done this before, have you?

4 [Laughter.]

5 THE WITNESS: Well, I thought you meant for me to
6 have a copy to give you to hand them, and it's my only copy.

7 BY MR. CREGAN:

8 Q Was this document prepared by you or under your
9 supervision?

10 A Yes.

11 Q Does this document reflect revisions you filed on
12 February 11th and February 23rd of this year?

13 A Yes, it does.

14 Q Would you please summarize briefly for the record
15 these two sets of revisions?

16 A On February 11th I made some changes on one page
17 of my testimony and some exhibits to reflect changes made by
18 MPA Witness Glick with regard to rural carrier costs, and on
19 the 23rd I made a change to page 40 and some exhibits, again
20 to reflect changes made by Witness Stralberg to his
21 testimony, Time-Warner-1.

22 Q With those revisions as reflected in this
23 document, if you were testifying orally today, would your
24 testimony be the same?

25 A Yes, it would.

1 MR. CREGAN: Mr. Chairman, I will ask that Ms.
2 Cohen's testimony, MPA-T-2, as revised, be admitted into
3 evidence, and I will hand two copies to the reporter.

4 CHAIRMAN GLEIMAN: Are there any objections?

5 Hearing none, Ms. Cohen's testimony and exhibits
6 are received into evidence and I direct that they be
7 transcribed into the record at this point.

8 [Direct Testimony and Exhibits of
9 Rita D. Cohen, MPA-T-2, was
10 received into evidence and
11 transcribed into the record.]
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MPA-T-2

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

POSTAL RATE AND FEE CHANGES, 1997

DOCKET NO. R97-1

**DIRECT TESTIMONY
OF
RITA D. COHEN
ON BEHALF OF
MAGAZINE PUBLISHERS OF AMERICA**

TABLE OF CONTENTS

I.	AUTOBIOGRAPHICAL SKETCH	1
II.	PURPOSE AND SCOPE OF TESTIMONY AND SUMMARY OF CONCLUSIONS	2
III.	UNEXPLAINED AND EXCESSIVE INCREASES IN MAIL PROCESSING COSTS FOR PERIODICALS	5
	A. Mail Processing Cost Trends for Periodicals from 1986-1997	5
	B. Docket No. R90-1	6
	C. Docket No. RM92-2	6
	D. Docket No. R94-1	7
	E. Concerns of Others	9
	F. Efforts to Focus USPS on the Problem	11
	G. The Continuing Periodicals Cost Problem	12
IV.	THE POSTAL SERVICE'S PROPOSAL SIMULTANEOUSLY INCREASES CONFIDENCE IN ATTRIBUTION AND DECREASES CONFIDENCE IN DISTRIBUTION	15
	A. Witness Degen's new mail processing cost distribution	18
	1. Degen's mixed-mail distribution	20
	2. Degen's not-handling costs distribution	21
	B. Fundamental flaws in witness Degen's distribution methodology assumption	22
	1. Subclass proxy assumptions	23
	2. Distribution within cost pools	26
	C. Statistical Deficiencies in Witness Degen's Distribution Methodology .	28
V.	AN IMPROVED MAIL PROCESSING COST DISTRIBUTION TWO ALTERNATIVES	29
	A. A More Reasonable and Equitable Distribution	30
	B. Treat a Portion of Volume-Variable Mixed-Mail and Not-Handling Costs as Institutional	33
VI.	THE NEED FOR CONTINUED ANALYSIS AND MODERATION IN RATE INCREASES	38
	A. The Need for Additional Information	38
	B. Periodicals Cost Coverage and Rate Increases	40

EXHIBITS:

- Exh. MPA-2A:** USPS Current and Proposed Methods for Distributing Mail Processing Costs to Subclass/Special Service
- Exh. MPA-2B:** Stralberg-Cohen Distribution Method for Mail Processing Costs
- Exh. MPA-2C:** Modified Attribution of BY96 Segment 3 Costs
- Exh. MPA-2D:** Attributed BY96 Clerk & Mailhandler Wage Costs (\$000s)
- Exh. MPA-2E:** Calculation of Volume-Variable Cost Based Upon Base Productivity
- Exh. MPA-2F:** Test Year Attributable Cost by Subclass with Stralberg-Cohen Clerks and Mailhandlers Methodology and MPA Rural Carriers Methodology
- Exh. MPA-2G:** Test Year Attributable Cost by Subclass with Stralberg-Cohen Clerks and Mailhandlers (Treating Inefficient Mixed and Not Handling Costs as Institutional) Methodology and MPA Rural Carriers Methodology

1 I. AUTOBIOGRAPHICAL SKETCH

2 My name is Rita Dershowitz Cohen. I am Vice President for Economic and
3 Legislative Analysis at the Magazine Publishers of America (MPA). I am
4 responsible for postal, tax, environment, state, and consumer protection issues.
5 As part of my postal responsibilities, I am MPA's association executive for the
6 Mailers Technical Advisory Committee (MTAC) and participate in several MTAC
7 working groups, a member of the Postal Service's Periodicals Advisory Group, a
8 postal advisor to MPA's Smaller Magazine Advisory Council, and a frequent
9 speaker on postal topics.

10 I attended the University of Pennsylvania, receiving a bachelor's degree in
11 statistics and a master's degree in business and applied economics. I received
12 the J. Parker Burst prize for outstanding achievement in statistics.

13 Following my formal education, I worked as a statistician at the Postal Rate
14 Commission (PRC) for two years, testifying in Docket No. R74-1 on the issue of
15 second-class costing methodology. In 1975, I joined the Postal Service (USPS)
16 as a cost analyst in the Revenue and Cost Analysis Division. I was employed by
17 the Postal Service for ten years, including four years as an operations research
18 analyst in the Mail Classification Research Division and four years as a principal
19 operations research analyst in the Office of Rates. I conducted analyses of postal
20 costs in various cost segments and worked on classification and rate issues in
21 various postal rate and classification cases during that period. I testified on the
22 roll-forward model used to project costs in Docket No. R77-1.

23 In 1985, I left the Postal Service to join Buc & Associates, Inc., which in
24 1986 became part of ICF, Incorporated, a consulting firm based in Fairfax,
25 Virginia. I worked at ICF until 1995, becoming a Vice President in 1993. I
26 directed and performed economic and policy analyses for both governmental and
27 private clients, including MPA, McGraw-Hill, and the National Newspaper
28 Association (NNA). In Docket No. R87-1, I testified on carrier street time for MPA

1 and second-class presort discounts for NNA. Continuing my representation of
2 MPA, I proposed a rate design for second-class regular rate and nonprofit in
3 Docket No. R90-1 and testified on cost savings likely from introduction of the
4 barcode discount for flats in Docket No. MC 91-1. In Docket No. R94-1, I testified
5 on the In-Office Cost System and the Postal Service's distribution of mail
6 processing costs to classes and subclasses.

7 In 1995, I joined MPA, and assumed my current position in January 1996.
8 I continue to analyze postal issues and prepare testimony as I have done for my
9 entire professional career. On behalf of MPA, I presented both direct and rebuttal
10 testimony in the reclassification case, Docket No. MC 95-1, presenting alternative
11 structures and rate designs for the proposed publications service subclass.
12

13 II. PURPOSE AND SCOPE OF TESTIMONY AND SUMMARY OF 14 CONCLUSIONS

15 The purpose of this testimony is to describe my review and evaluation of
16 the Postal Service's proposed procedures for distributing mail processing costs to
17 classes and subclasses of mail in this case and to suggest alternatives to the
18 distribution methodologies proposed by witness Degen. The methodologies
19 proposed by me and witness Stralberg (see TW-T-1) are a substantial
20 improvement over the distribution proposed by witness Degen. We offer two
21 alternatives.

22 First, we offer an alternative distribution methodology based on three
23 fundamental principles:

- 24 1. The distribution methodology should avoid unsupported
25 assumptions to the greatest extent possible;
- 26 2. Distribution procedures should use all verifiable and relevant data
27 collected in the IOCS upon which reasonable inferences of
28 causation can be based; and
- 29 3. Pending the development of more complete cost information, cost
30 distributions should generally be done as they have in the past since
31 there is currently no better alternative.

1 Our suggested methodology is described in Part V of this testimony.

2 Second, we offer alternative approaches which recognize that we do not
3 have the data to distribute many of these costs with confidence. We suggest that
4 a portion of these costs be treated as institutional.

5 Unfortunately, neither we nor the Postal Service possess all the data
6 needed to perform a precise distribution of mail processing costs. Our suggested
7 methodologies are simply the best available at the current time. They are
8 certainly more rationale, and therefore more reasonable and equitable than those
9 proposed by witness Degen. I strongly recommend that the Postal Service
10 undertake to collect the additional information needed to develop appropriate
11 distribution keys for this cost segment.

12 As described by witness Degen, the Postal Service's proposed mail
13 processing cost distribution is a departure from the IOCS/LIOCATT methodology
14 used by the Commission since the early 1970s. While still using some IOCS
15 information, the proposed distribution replaces the LIOCATT mixed-mail and
16 overhead cost distribution procedure with a methodology using data from the
17 Management Operating Data System (MODS). Witness Degen suggests that he
18 developed his proposed methodology in response to, and that he "squarely
19 addresses," past criticisms of the existing mail processing cost distribution system.
20 As described in both my testimony and witness Stralberg's, this assessment is
21 incorrect. His proposed methodology neither squarely addresses nor overcomes
22 legitimate past criticisms of the Postal Service's mail processing cost distribution.

23 Rather than improving the distribution of mail processing costs to classes
24 and subclasses, witness Degen has exacerbated the distribution problems
25 associated with mixed mail and overhead costs. The distributions that witness
26 Stralberg and I present, which are more consistent with the Commission-accepted
27 IOCS/LIOCATT procedures, while not eliminating the existing distribution
28 anomalies, at least avoids exacerbating them. Contrary to witness Degen's
29 assertions, the Postal Service's new methodology does not answer questions
30 raised in past cases by the Commission and intervenors, particularly with regard
31 to the reported costs for Periodicals. There is a continuing need for analysis and

1 improvement in the Postal Service's distribution procedures to try to explain and
2 rectify the large and anomalous increase in Periodicals costs in recent years.

3 In part III of my testimony, I summarize concerns raised by Periodicals
4 mailers in dockets R90-1, RM92-2, and R94-1, as well as with Postal Service
5 management, about the alarming and inexplicable growth in mail processing costs
6 distributed to Periodicals in recent years.

7 In part IV, I explain how the Postal Service's proposed distribution of costs
8 to classes and subclasses actually exacerbates the Periodicals cost problem
9 rather than providing an answer to our legitimate questions. I explain why witness
10 Stralberg and I still believe Periodicals costs are incorrectly measured and
11 overstated, and describe the unfounded assumptions that underlie witness
12 Degen's proposed distribution of mixed-mail and not-handling costs (which include
13 the majority of traditionally defined overhead costs – breaks and personal needs,
14 clocking in and out, and moving empty equipment – as well as some costs
15 traditionally defined as mixed mail) in the mail processing, window service, and
16 administrative cost components.

17 In developing my testimony, I have consulted with witness Stralberg, who
18 has been examining the Periodicals cost problem, in particular, and IOCS, in
19 general, since Docket No. R90-1, and who has developed a number of
20 modifications to witness Degen's methodology that avoid reliance on
21 unsubstantiated assumptions. Witness Stralberg's testimony summarizes these
22 modifications, which in large part rely on existing Commission-approved
23 procedures. I believe that witness Stralberg's modifications, while not a long-term
24 solution, are a substantial improvement over the distribution of costs to classes
25 and subclasses proposed by witness Degen.

26 In part V, I describe how I have integrated these modifications into the
27 Postal Service's clerk and mailhandler distribution methodology as presented in
28 USPS-LR-H-146. My proposed distribution is summarized in part V and details
29 are provided in MPA-LR-1. I also describe an alternative approach to the
30 distribution of not-handling costs, explaining why some not-handling costs should
31 properly be treated as institutional.

1 In part VI of my testimony, I explain the need for the Postal Service to
 2 continue to examine the distribution of mail processing costs to more accurately
 3 reflect cost causation. I urge the Commission to act cautiously in setting rates for
 4 Periodicals in this case in light of continuing questions and anomalous results.

5 III. UNEXPLAINED AND EXCESSIVE INCREASES IN MAIL PROCESSING
 6 COSTS FOR PERIODICALS

7 As acknowledged by witness Degen, the Postal Service's methodology for
 8 attributing and distributing mail processing costs for clerks and mailhandlers has
 9 been repeatedly questioned and criticized by the Postal Rate Commission and
 10 intervenors in past cases. This section reviews and summarizes the repeated
 11 efforts of numerous participants and, indeed, the Commission itself, to understand
 12 the puzzling trends in mail processing costs for Periodicals.¹ Despite diligent
 13 efforts, these trends remain largely unexplained. A problem clearly persists, and
 14 the USPS has made no meaningful effort to address it.

15 A. Mail Processing Cost Trends for Periodicals from 1986-1997

16 MPA witness Little points out that mail processing unit costs for Periodicals
 17 increased by 71 percent from fiscal year 1986 through fiscal year 1996. During
 18 this same period mail processing unit costs for First-Class Mail, Standard A, and
 19 Standard B increased by only 35, 20, and 31 percent respectively. Little also
 20 notes that during this period USPS wage rates increased by only 41 percent –
 21 about one half of the increase in Periodicals mail processing costs.²

22 The disproportionate increase in mail processing costs occurred during a
 23 period when the USPS increased worksharing incentives (presort, automation,
 24 and dropship discounts) and invested billions in automation. As a result of these
 25 incentives, Periodicals mailers today do much work previously performed by
 26 USPS employees. In addition, Periodicals mailers have undertaken other

¹ Others have recounted this history in detail. See, e.g., Docket No. R94-1, TW Brief, at 12-36.

² MPA-T-1 at 3. Cost increases are estimated holding subclass shares of class volume constant over the 11-year period.

activities to reduce the cost of processing their mail, such as shifting Periodicals from sacks to pallets and other types of containers.

B. Docket No. R90-1

Periodicals and other mailers raised the issue of these unexplained and excessive cost increases in Docket No. R90-1. Witnesses Stralberg and King reasoned that these increases were probably due to the reassignment of excess workers from automated to manual mail processing operations.³ These workers became, in effect, "automation refugees."

The PRC was sufficiently interested in the question to issue a notice of inquiry.⁴ In the end, however, the PRC did not address the problem directly and, in the absence of sufficient substantive data to support an alternative, relied on a presumption in favor of the traditional method of cost allocation supported by IOCS tallies.⁵

C. Docket No. RM92-2

In June, 1992, a number of parties petitioned the PRC to initiate a rulemaking proceeding to investigate the anomalous increases in mail processing costs since 1986.⁶ Among other things, the petitioners sought to obtain data and analysis in the sole possession of the USPS, such as a Foster Associates study undertaken by USPS witness Hume during Docket No. R90-1.⁷

The USPS refused to cooperate with the petitioners and the PRC. In January, 1994, the PRC terminated the proceeding, stressing "[t]he Service, by its actions in resisting inquiry, has not only failed to dispel the concerns of the rate payers and the Commission, it has if anything heightened them."⁸ The PRC noted

³ Docket No. R90-1, Tr. 27/13295-302 (witness Stralberg); Tr. 27/13473-82 (witness King).

⁴ Second Notice of Inquiry, Order No. 871 (July 18, 1990).

⁵ PRC Op. R90-1, App. J at 10, 11.

⁶ Docket No. RM92-2, Petition to Initiate a Rulemaking Proceeding to Consider the Costing of Automation-Related Mail Processing Costs (June 26, 1992)(hereafter Petition). The petitioners were AMMA, ADVO, DMA, Dow Jones, Harte Hanks Shoppers, MPA, MOAA, and Time Warner.

⁷ Petition at 8.

⁸ PRC Order No. 1002 (January 14, 1994) at 4.

1 that "[t]he petitioners have advanced a disturbing theory that these cost increases
2 have been caused by the automation of First-Class Mail" and described the
3 actions of the Postal Service that had effectively prevented analysis of the effect
4 of automation on these costs.⁹

5 A Foster Associates report was a center of attention in the 1992 rulemaking
6 proceeding. Notwithstanding the fact that the Commission issued two orders to
7 obtain the report,¹⁰ the USPS did not release it until November, 1992, eighteen
8 months after first receiving it.¹¹

9 The report was disappointing, a mere "status report" listing the kinds of
10 data collection and analyses that might be pursued in the future, proving that the
11 Service had not made any progress on the issue since Docket No. R90-1. It
12 provided inadequate support even for instituting formal discovery in Docket No.
13 RM92-2.¹²

14
15 D. Docket No. R94-1

16 In Docket No. R94-1, witness Stralberg again addressed the "automation
17 refugee" problem, and suggested that the In-Office Cost System (IOCS), designed
18 in the early 1970s, was inadequate to distribute mail processing costs in the
19 radically different operating environment of the 1990s. He noted the continued
20 existence of the automation refugee problem, with the USPS still failing to capture
21 the promised workhour reductions from automation. He also described how new
22 procedures for collecting more information about mixed-mail tallies had failed
23 completely, producing biased samples and actually reducing the amount of class-
24 specific information obtained compared with previous procedures. Witness
25 Stralberg pointed out that the sharp increase in mixed-mail and overhead costs
26 (48 percent of all mail processing costs in fiscal year 1993, versus 30 percent in
27 fiscal year 1986), combined with the Postal Service's inability to establish credible

⁹ Id. at 1.

¹⁰ PRC Order No. 933 (August 8, 1992); PRC Order No. 935 (October 7, 1992).

¹¹ PRC Order No. 1002 (January 14, 1994) at 6-7.

¹² Id. at 7.

1 causal relationships between these costs and specific subclasses, added
2 significantly to the unreliability of the Postal Service's distribution assumptions,
3 and to the essential arbitrariness in the resulting distribution of these costs.¹³

4 On rebuttal, USPS witness Barker testified that the disproportionate cost
5 increases in Periodicals mail processing costs since 1986 were due to a
6 "combination of factors," but he discussed only one – the "transfer-hub theory."¹⁴
7 This notion, that increases in mail processing costs were due to the establishment
8 of second class transfer hubs in fiscal year 1985, had been advanced by USPS
9 managers early in 1994, but proved to be erroneous.¹⁵

10 In its Opinion, the PRC stated that it believed the questions raised about
11 the IOCS were serious and expressed concern that the Postal Service was not
12 giving them the attention they deserved, causing the number of questions to
13 increase rather than decrease. The PRC noted:

14 (1) A number of questions concerning the IOCS and mail processing costs
15 were raised in Docket No. R90-1. There has been virtually no cooperation
16 from the Postal Service with either the Commission or the mailers in
17 dealing with these questions since then, and the record demonstrates that
18 answers have not been found....

19 * * *

20 (3) Both the number and proportion of mixed-mail tallies in the IOCS are
21 increasing. The questions about how they should be distributed are
22 serious. The Postal Service should review its distribution techniques to
23 assure that the approach adopted 20 years ago remains the most
24 appropriate.

25 (4) The shift to automation has caused a number of questions. The effects
26 of this change are complex and have not been analyzed. Some parties
27 argue that the IOCS may no longer be well-suited to a changed operating
28 system.
29

¹³ Docket No. R94-1, Tr. 15/7122 et seq.; Tr. 25/11838 et seq. (witness Stralberg).

¹⁴ Docket No. R94-1, Tr. 25/11708-9 (witness Barker).

¹⁵ The transfer hub fiasco occurred in 1985. At the end of that year, the Postal Service was in the process of moving second-class mail back to the BMC's. See Docket No. R87-1, USPS LR-E-103, Postal Inspection Service, "Operations Audit Report: Second-Class Mail" (October 1985). As Time Warner argued, the "transfer-hub theory" could not possibly be right because (1) periodical costs did not decline but remained disproportionately higher after fiscal year 1990 than they had been in fiscal year 1985 when the problem was alleged to have occurred, and (2) the transfer hubs primarily performed platform operations (transfers of sacks and pallets), the costs of which declined during the period in question (fiscal year 1986-fiscal year 1989). Docket No. R94-1, TW Brief at 28-29.

1 (5) Questions exist about the category "working but not handling mail" and
2 about the level of break time....¹⁶

3 Nevertheless, the PRC accepted "the IOCS as a basis for rates," since no
4 other was available.¹⁷ However, it cited the uncertainties about the Postal
5 Service's distribution of mail processing costs as a reason for lowering second-
6 class cost coverage.¹⁸

7 E. Concerns of Others

8 Independent experts also have expressed concern about the "automation
9 refugee" problem. In 1990 congressional testimony, the General Accounting
10 Office (GAO) echoed the views of witness Stralberg in Docket No. R90-1. Its
11 representative reported that the USPS had failed to achieve the predicted
12 savings from automation because the Service's savings estimates were not
13 backed up with actions to achieve them. Workhours that might have been
14 replaced by automation were not put to effective use elsewhere.¹⁹

15 A subsequent May, 1992, GAO report on the automation program indicated
16 that the problem it had identified in 1990, namely that workhours freed by
17 automation were not put to effective use elsewhere, continued to be a problem.²⁰
18 The 1992 Report raised a number of questions concerning the efficiency of the
19 automation program, particularly with respect to staffing and reassignment of mail
20 processing personnel. It noted that work years for "other direct work" had
21 increased above plan, perhaps because "employees who have been displaced by
22 automation have been reassigned temporarily to this work."²¹ The report also cited
23 inefficiencies in the automation program reported by the Postal Inspection
24 Service.²²

¹⁶ PRC Op. R94-1 para. 3023. (emphasis added).

¹⁷ Id. at para 3025.

¹⁸ Id. at 4055.

¹⁹ *Financial Performance of the United States Postal Service*: Statement of Nye Stevens, Director, Government Business Operations Issues, General Government Division, General Accounting Office before the House Committee on Post Office and Civil Service, 101 Cong., 2nd Sess. (February 7, 1990).

²⁰ *Postal Service: Automation Is Restraining But Not Reducing Costs*. (GAO/GGD-92-58)(May 1992).

²¹ Id. at 27-29.

²² Id. at 32.

1 GAO subsequently expressed more doubts and concerns, questioning in a
2 May, 1994, report whether asserted gains in labor efficiency over the previous five
3 years, ascribed by the USPS to automation, should instead be credited to other
4 factors like mailer worksharing in other categories of mail.²³ In February, 1995,
5 testimony summarizing the findings of yet another GAO report,²⁴ its representative
6 testified:

7 This week we reported that automating mail processing and
8 achieving savings have been more difficult to accomplish than
9 anticipated. The obstacles range from equipment not having as
10 much capability as expected to management being unable to gain
11 employee cooperation in changing work methods affected by
12 automation. The Service has not been able to achieve the
13 personnel reductions that were once projected, and any financial
14 savings have been small relative to total operating costs.²⁵
15

16 In a subsequent hearing before the same subcommittee, the Chairman of
17 the Postal Rate Commission noted:

18 [I]ntervenors and the Commission have become concerned about
19 the quality and quantity of information presented by the Service. In
20 the first section of the R94-1 Opinion we stated "[t]he Commission is
21 concerned that data deficiencies in the Postal Service filing reflect a
22 reduced commitment to the task of developing and providing reliable
23 data for parties in Commission proceedings." We noted that these
24 deficiencies "... have been emphasized by many of the parties to
25 this proceeding." Deficiencies ranged from the virtual absence of
26 special studies to reflect changes in operation since the last
27 proceeding four years ago, to serious overstatement of the costs of
28 second class in-county (used primarily by small newspapers) and
29 business reply service. Questions were also raised by the parties
30 regarding the adequacy of current cost systems in light of the
31 significant changes in Postal Service operations in recent years and
32 the reduction of resources devoted to data collection analysis
33 efforts.²⁶

²³ *Postal Service Role in a Competitive Communications Environment*, 12, 13 (GAO/T-66D-94-162) (May 24, 1994).

²⁴ *Postal Service: Automation Is Taking Longer and Producing Less Than Expected* (GAO/GGD-95-89BR) (February 22, 1995).

²⁵ *General Oversight of the U.S. Postal Service: Hearings before the Subcomm. on the Postal Service of the House Comm. On Government Reform and Oversight, 104th Cong., 1st Sess. 64, 65 (1995)* (Statement of Michael E. Motley, Associate Director, Government Business Operations Issues, General Government Division, U.S. General Accounting Office).

²⁶ *Id.* at 81 (Statement of Edward J. Gleiman, Chairman, Postal Rate Commission).

F. Efforts to Focus USPS on the Problem

The Postal Service admits it has not made any meaningful effort to study these problem although "[a]n internal, operations review of Regular Periodicals is planned."²⁷ Nevertheless, the Periodicals industry continues its efforts to obtain USPS recognition that there is a problem and take steps to address it. Late in 1996, we raised the issue with senior Postal Service managers at a series of meetings. We noted that costs reported for Periodicals had escalated very quickly in the period from fiscal year 1993 to fiscal year 1995; we also voiced our concern about the continuing trend in fiscal year 1996 (a concern that ultimately proved justified).

In March of this year, witness Stralberg and I gave a presentation to USPS managers at Postal Service headquarters. Yet again, we documented the unexplained and excessive increases in Periodicals mail processing costs and explained why the Postal Service's mixed-mail and overhead distribution assumptions have led to anomalous results. Defensive USPS managers again raised the so-called "transfer-hub theory," despite the fact that this "theory" had been discredited both previous times they raised it.

In May of this year, at the Postal Forum, other representatives of the Periodicals industry and I met with senior Postal Service officials to discuss the problem. At that meeting, the Postal Service announced its intention to conduct a study of Periodicals costs and asked industry to participate in the study. We readily agreed. Soon thereafter, to ensure that the Postal Service understood the importance of the problem, several industry leaders, including witness Crain, asked to meet with the Postmaster General. That meeting, described by witness Crain, took place on June 4 of this year.²⁸

While that meeting was disappointing in a number of respects, the Postal Service did renew its commitment to conduct a joint industry-USPS study to determine how flat processing costs can be reduced. Unfortunately, the scope and methodology of the study are still to be decided, and data collection must await completion of the rate case. However, I am hopeful that the study will fully

²⁷ Tr. 19B/8822.

²⁸ ABP-T-1 at 2.

1 examine all the issues. Meanwhile, however, the Periodicals industry continues to
2 be saddled with the problem of these puzzling trends in mail processing costs.

3 G. The Continuing Periodicals Cost Problem

4 The Postal Service's presentation in this docket demonstrates that the
5 "automation refugee" problem still exists. There are several disturbing illustrations
6 of this. First, mixed-mail and overhead costs continue to increase at a faster rate
7 than direct costs. In fiscal year 1996, the base year in this docket, direct tallies
8 represented less than 50 percent of mail processing costs²⁹, down even from fiscal
9 year 1993's already low levels. In 1986, by comparison, direct tallies represented
10 70 percent of total mail processing costs. The percentage of costs represented by
11 direct tallies would be slightly lower yet if the Postal Service had not in recent
12 years converted a portion of mixed-mail tallies into direct tallies by "counting" the
13 contents of some mixed-mail items and expanding the use of the top-piece rule.³⁰

14 The increasing cost trend is particularly significant for overhead costs. In
15 his Docket No. R90-1 testimony, witness Stralberg expressed alarm that overhead
16 costs in fiscal year 1989 had grown to 23 percent of direct and mixed-mail costs.³¹
17 From fiscal year 1989 to 1996, traditionally-defined overhead costs
18 (breaks/personal needs, clocking in/out and moving empty equipment) increased
19 8.5 percentage points, to 31.5 percent of direct and mixed-mail costs.³² As
20 defined by witness Degen, the category of not-handling costs, which includes all
21 costs for tallies where the observed employee was not handling a piece of mail,
22 item, or container, has grown to represent over 42 percent of all mail processing
23 costs.³³

24 Second, MODS information presented by witness Degen and summarized
25 in Table 1 shows that the percentage of time spent not-handling mail is at least as
26 large at manual operations as at automated operations.

²⁹ Fiscal Year 1996 LIOCATT.

³⁰ Counting the contents of some mixed-mail items began in fiscal year 1993, the Base Year in Docket No. R94-1; See Docket No. MC97-2, USPS-T5 at 10-11(witness Patelunas) about Top-Piece Rule.

³¹ Docket No. R-90-1, Tr. 25/11842 (witness Stralberg).

³² Cost Segments and Components, 1996.

³³ Calculated from USPS-LR-4-23.

Table 1
Percentage of Time Spent Not Handling Mail

Operation Type³⁴	Not Handling%³⁵
Automated	35%
Mechanized	33%
Manual	33%
Allied	53%
Other	67%
Function 4	56%
All	42%

This phenomenon contradicts witness Barker's testimony in Docket No. R94-1, when he argued that the large increase in not-handling and break time in fiscal year 1993 was not a problem since employees at automated operations are often tending the machines instead of touching the mail.³⁶ Furthermore, the percentage of not-handling costs is much higher at some types of manual operations such as platforms and opening units. Not-handling time is close to 50 percent of total employee time at opening units and more than 60 percent at platforms.³⁷ This is a clear indication of the phenomenon GAO identified – workhours (represented by tallies) replaced by automation not being put to effective use elsewhere. It is interesting that these very high levels of not-handling costs occur at operations where productivity is not measured.

Third, data provided by witness Degen show that, for some item types, employees spend almost as much time handling empty items as handling items containing mail. For example, the costs of handling green sacks and small parcel trays when empty are as high as the costs of handling these items when they

³⁴ Operation type identified in USPS-T12 at 15; Allied, Other, & Function 4 operations are primarily manual operations.

³⁵ Calculated from USPS-LR-H-23.

³⁶ Docket No. R94-1, Tr. 3/1237-39 (witness Barker).

³⁷ Calculated from USPS-LR-H-23.

1 contain mail.³⁸ This result is counterintuitive and suggests that employees do not
2 always have productive work to keep them occupied.

3 Fourth, MODS data contained in witness Bradley's testimony show
4 declining productivity at many operations, including all manual operations except
5 parcel sorting. Table 2 shows the percentage change in productivity in MODS
6 operations since 1988.³⁹

7 **Table 2. Percentage Change in Productivity Between FY 1988 and FY 1996⁴⁰**

8	Operation	Percent Change
9	Optical Character Reader	(38%)
10	Barcode Sorter	2%
11	Letter Sorting Machine	(21%)
12	Manual Letter Sorting	(10%)
13	Manual Flat Sorting	(6%)
14	Flat Sorting Machine	(18%)
15	Manual Parcel Sorting	45%
16	Mechanical Parcel Sorting	60%
17	Small Parcel and Bundle Sorter (Non-Priority)	37%
18	Manual Priority Mail Sorting	(6%)
19	Small Parcel and Bundle Sorter (Priority)	5%
20	Mail Cancellation/Preparation	9%

21 For example, manual letter sorting productivity decreased 10 percent from
22 1988 to 1996 and manual flat sorting decreased 6 percent.⁴¹ While a decline in
23 some automated operations may occur as USPS handles additional more difficult
24 to handle volume on automated equipment, the pervasiveness of the declines and
25 the fact that even manual sortation is affected suggests a systemic problem.

³⁸ Tr. 12/6216; DMA/USPS-T12-14.

³⁹ For operations with no fiscal year 1988 data, the change in productivity is based on the change from fiscal year 1989 to fiscal year 1996.

⁴⁰ Calculated from USPS-LR-H-148.

⁴¹ Tr. 11/5585 (Exh. TW-XE-2).

1 Finally, witness Degen's calculations identify \$685 million in costs for clerks
2 and mailhandlers who are clocked in to mail processing operations but are doing
3 "administrative activities." While witness Degen treats these costs as mail
4 processing costs and suggests that these administrative costs "relate" to mail
5 processing activities, this large pool of "administrative" undefined costs likely
6 includes costs for employees not productively employed.⁴²

7 IV. THE POSTAL SERVICE'S PROPOSAL SIMULTANEOUSLY INCREASES
8 CONFIDENCE IN ATTRIBUTION AND DECREASES CONFIDENCE IN
9 DISTRIBUTION

10 Witness Degen testifies that the Commission and intervenors have
11 criticized the Postal Service's treatment of mail processing costs in past cases in
12 three areas: (1) the dramatic increase in not-handling tallies; (2) accuracy of
13 mixed mail distribution procedures; and (3) the distribution of all mail processing
14 direct labor and overhead (not-handling) costs on the assumption that these costs
15 are 100 percent volume variable. Witness Degen maintains that the new
16 methodology he and witness Bradley present was developed to respond to these
17 criticisms and that the revisions squarely address each of the past criticisms and
18 yield more accurate estimates of attributable cost.⁴³

19 In fact, it is wrong to view the testimonies of witnesses Bradley and Degen
20 as jointly responsive to these past criticisms; the two witnesses undertake
21 fundamentally different analyses. Witness Bradley examines and analyzes the
22 attribution of mail processing costs while witness Degen independently develops
23 a distribution of these costs. In terms of the three criticisms of the Postal Service's
24 treatment of mail processing costs, Bradley and Degen address and attempt to
25 respond to different criticisms.

26 Witness Bradley alone addresses the third criticism, namely the long-
27 standing assumption that mail processing direct labor and overhead costs are 100
28 percent volume variable. He has presented a state-of-the-art econometric

⁴² Tr. 12/6590-95.

⁴³ USPS-T-12 at 5.

1 variability analysis that demonstrates the inaccuracy of this assumption. Bradley
 2 utilizes a sophisticated approach with an unusually rich panel data set that
 3 captures both the cross-sectional variation in the productivity relationship among
 4 individual facilities, as well as the time-varying component. His analysis applies a
 5 fixed-effects model to control for individual office effects, while simultaneously
 6 correcting for the biasing effects of serial correlation. Bradley quantifies variability
 7 coefficients for 25 separate groupings of operations (which witness Degen then
 8 applies directly or by analogy to 46 cost pools).⁴⁴

9 Witness Bradley was meticulous in his approach, performing numerous
 10 analytical and diagnostic calculations. His functional form is flexible. This, as
 11 witness Shew points out, provides "suppleness" and "allows the curve relating
 12 cost and output to take on almost any shape, as dictated by the data."⁴⁵ Witness
 13 Shew explains that some of the more common functional forms may not fit the
 14 data as well for observations far from the mean.⁴⁶

15 There are several objective measures that support the results obtained by
 16 witness Bradley. First, it is clear that there are certain mail processing functions
 17 where the time needed to perform the function doesn't depend on the volume
 18 processed. As witness Bradley testifies:

19 Certain functions, like setting up mail processing equipment or tying
 20 down a manual case are done for each sorting scheme and are not
 21 sensitive to the amount of volume sorted...the existence of these
 22 relatively fixed functions in an activity will cause the activity's
 23 variability to be less than one hundred percent.⁴⁷

24 Witness Moden also describes functions that are not fully volume variable:

25 Most activities have some associated work such as obtaining mail,
 26 positioning rolling stock, or changing schemes that does not change
 27 proportionately with changes in volume, but is driven more by the
 28 operating schedule for the activity.⁴⁸

⁴⁴ USPS-T-14 at 8; USPS-T-12 at 15.

⁴⁵ Dow Jones-T-1 at 18.

⁴⁶ *Ibid.*

⁴⁷ USPS-T-14 at 55, 56.

⁴⁸ USPS-T-4 at 19.

1 Second, witness Bradley's results are consistent with the notion that worker
2 productivity should improve when volume increases, leading to volume variability
3 less than 100 percent. Witness Moden describes this phenomenon:

4 In human-paced operations such as manual sorting, experience suggests
5 that people work faster when there is a steady inventory of mail waiting to
6 be processed. As volume increases, it is easier to maintain such an
7 inventory.⁴⁹

8 Witness Bradley describes a related efficiency effect, namely that workers
9 get more efficient at specialized tasks when they perform such tasks with
10 regularity:

11 [A] large volume permits dedication of the same workers to an activity
12 on a regular basis. This regularity increases their familiarity with the
13 activity and, as a result, their efficiency.⁵⁰

14 I conclude, therefore, that witness Bradley's analysis does in fact squarely
15 address and respond to the third IOCS criticism identified by witness Degen, i.e.,
16 the assumption that mail processing costs are 100 percent volume variable.
17 Unfortunately, with respect to the first area of criticism, the increase in not-
18 handling tallies, neither witness provides an explanation or justification. While
19 witness Bradley's results allow for the appropriate treatment of a portion of these
20 tally costs as institutional, his testimony does not analyze why not-handling costs
21 have increased so much in recent years. Nor does he suggest how to distribute to
22 classes and subclasses of mail the large pool of not-handling costs that he
23 categorizes as volume variable.

24 That task falls to witness Degen, who attempts to address the first criticism
25 as it relates to the distribution of increased not-handling costs as well as the
26 second criticism, concerning the appropriateness of existing mixed-mail
27 distribution procedures. Witness Degen states that his revised approach is a
28 "considerable refinement" of the existing mixed-mail methodology, citing his use of
29 item types and information on container contents. He also cites as a refinement

⁴⁹ Ibid.

⁵⁰ USPS-T-14 at 56.

1 his confining of mixed-mail distributions to direct tallies associated with the same
 2 cost pool, a procedure he also uses for the not-handling tallies.⁵¹

3 As I will show below, while witness Degen believes he has responded to
 4 the past criticisms on the growth in not-handling costs and distribution of mixed-
 5 mail costs, he has not answered legitimate questions raised in past cases, nor has
 6 he arrived at an accurate distribution of mail processing costs.

7 A. Witness Degen's new mail processing cost distribution

8 MPA exhibit Exh. MPA-2A presents a complete comparison of the
 9 IOCS/LIOCATT cost distribution procedures used previously and the "new" Degen
 10 methods for distributing mail processing costs to subclasses and special services.
 11 There are separate distribution methodologies for the three categories of costs –
 12 direct, mixed-mail, and not-handling. These three categories have further
 13 breakdowns that determine the specific distribution used in LIOCATT or proposed
 14 by Degen. Table 3 provides definitions for each type of tally category.

15 Table 3

16
 17 Direct tallies

- 18 • Piece handling - clerk/mailhandler is handling an
- 19 individual piece of mail.
- 20 • Identical item or container - clerk/mailhandler is
- 21 handling an item or container filled with identical
- 22 mail in terms of mail origin, mail class, subclass,
- 23 shape, size, weight, and postage.
- 24 • Items include bundles; flat, letter, and small
- 25 parcel trays; pallets; various color and
- 26 purpose sacks; con-cons; and "other" items.

⁵¹ USPS-T-12 at 5-10.

- 1 • Containers include wheeled equipment, such
2 as hampers, nutting trucks, utility carts,
3 BMC-Over The Road containers, and General
4 Purpose Containers, as well as multiple
5 Items not in a container.
- 6 • Top-piece rule Item - clerk/mailhandler is handling a
7 bundle or tray of nonidentical mail and tally-taker
8 records information on the top piece in the bundle
9 or tray. (Note that some of these tallies used to be
10 part of mixed-mail).
- 11 • Counted Item - clerk/mailhandler is handling an
12 item with nonidentical mail and tally-taker counts
13 the pieces in the item by subclass. (Note that these
14 tallies used to be part of mixed-mail).

15 Mixed-mail tallies

- 16 • Uncounted Item - clerk/mailhandler is handling an
17 item with nonidentical mail and tally-taker does not
18 count the pieces.
- 19 • Identified container - clerk/mailhandler is handling a
20 container of nonidentical mail and tally-taker
21 identifies the percentage of filled volume
22 represented by various items and loose shapes in
23 the container.
- 24 • Unidentified container - clerk/mailhandler is
25 handling a container of nonidentical mail and tally-
26 taker does not identify the contents of the
27 container.
- 28 • Empty items or container - clerk/mailhandler is
29 handling an item or container that does not contain
30 any mail.

Not-handling tallies - clerk/mailhandler is not handling a piece of mail, an item, or container

- **Not-handling - clerk/mailhandler is at an operation but is not handling mail, items or containers.**
 - **Breaks - clerk/mailhandler is on break from an operation.**
 - **Clocking in/out - clerk/mailhandler is leaving one operation and going to another.**
 - **Empty Equipment - clerk/mailhandler is performing some activity relating to empty equipment but is not handling an empty item or container.**
 - **Window service.**
 - **Administration support.**
-

1. Degen's mixed-mail distribution

The changes witness Degen proposes affect the mixed-mail and not-handling categories of costs. For mixed-mail tallies, Degen distributes the uncounted items, empty items and items in identified containers to classes and subclasses in proportion to direct item tallies (identical, top-piece rule, and counted). Loose mail in identified containers is distributed based on direct piece handlings of mail of the same shape. Degen then distributes unidentified and empty container costs to subclass in proportion to identical and identified container costs. Separate distribution keys, generally, are developed for each MODS cost pool, type of item or shape of loose mail, and container type.

The Postal Service considered, but rejected, distributing uncounted item costs on counted item costs in Docket No. R94-1; the Commission concurred with that decision.⁶² The Postal Service and Commission similarly declined in that

⁶² PRC Op. R94-1, para 3059.

1 docket to use information on the contents of identified containers, viewing the
2 value of the information as questionable.⁵³ Despite the record of Docket No. R94-
3 1, witness Degen uses both the counted items and identified containers to
4 distribute costs of uncounted items and unidentified containers. He then further
5 disaggregates the distribution by cost pool and item type.

6 Implicit in Degen's distribution methodology are three assumptions:

- 7 • direct items, which include counted items, are representative of
8 uncounted and empty items for specific item types and cost pools;
- 9 • direct items, which include counted items, and direct piece
10 handlings for mail not in containers are representative of items and
11 loose shapes in containers; and
- 12 • classes and subclasses contained in identical and identified
13 containers are representative of mail contained in unidentified and
14 empty containers of specific container types and cost pool.

15 2. Degen's not-handling costs distribution

16 For not-handling tallies, which under LIOCATT are distributed in proportion
17 to all direct and mixed-mail costs, Degen generally distributes costs to subclasses
18 and special services in proportion to the distribution of all other mail processing
19 costs within the same cost pool. Implicit in this distribution methodology are two
20 assumptions:

- 21 • direct and mixed mail in a cost pool cause the not-handling costs in
22 the cost pool; and
- 23 • not-handling costs should be distributed within cost pool even if an
24 employee was actually working somewhere else.

⁵³ Docket No. R94-1, Tr. 3/1157-59 (witness Barker).

1 B. Fundamental flaws in witness Degen's distribution methodology
2 assumption
3

4 There is a significant problem with the assumptions implicit in witness
5 Degen's methodology. They are totally untested and sometimes plainly wrong.

6 During oral cross examination, witness Degen confirmed that he used
7 numerous assumptions to distribute mixed-mail and not-handling mail costs
8 among classes and subclasses.⁵⁴ He also acknowledged that "[t]he assumptions
9 that go into an analysis are important."⁵⁵ Yet Degen conceded that he did not
10 perform any studies to test any of these assumptions upon which his distributions
11 of mixed-mail and not-handling costs depend.⁵⁶ Witness Degen also admitted that
12 "all activities of an employee clocked into a mail processing MODS operation are
13 counted as part of that mail processing operation, even if the data collector
14 observed the employee working somewhere else."⁵⁷ Finally, witness Degen
15 acknowledged that he did not perform any studies to attempt to determine if the
16 costs his methodology distributes are causally related to the various subclasses of
17 mail, stating that "[i]f I knew a way to do it, I would have proposed it by now."⁵⁸

18 While witness Degen was fairly forthcoming during oral cross-examination
19 regarding his extensive use of assumptions to distribute mixed-mail and not-
20 handling costs, his direct testimony did not adequately convey the extent of his
21 reliance on untested assumptions. Witness Shew discusses the importance of
22 assumptions and the dangers of relying on untested ones.⁵⁹

23 That is certainly the case with regard to Witness Degen's untested
24 assumptions. Over 50% of mail processing costs are distributed on the basis of
25 Degen's untested assumptions, undoubtably establishing a dominant effect on the
26 final results.

⁵⁴ Tr. 12/6660-6664 (witness Degen).

⁵⁵ Id. at 6665 (witness Degen).

⁵⁶ Id. at 6666 (witness Degen).

⁵⁷ Id. at 6665-66 (witness Degen); USPS-T-12 at 6,7.

⁵⁸ Id. at 6666 (witness Degen).

⁵⁹ Dow Jones-T-1 at 21-27.

1 Not only are witness Degen's assumptions untested. There are also many
 2 indications that his assumptions are incorrect. In the discussion that follows I
 3 describe significant problems with two major assumption-based methodologies
 4 employed by witness Degen: (1) the use of subclass proxy assumptions in the
 5 distribution of mixed-mail costs and (2) the distribution of mixed-mail and not-
 6 handling tallies almost exclusively within cost pools.⁶⁰

7 1. Subclass proxy assumptions

8 Witness Degen proposes to use information on counted items and
 9 identified containers to distribute other mixed-mail costs despite the Commission's
 10 rejection of the use of this data for distribution purposes in Docket No. R94-1.
 11 Unfortunately, witness Degen's use of counted item information to distribute
 12 mixed-mail costs still suffers from some of the same problems that witness
 13 Stralberg and I identified in that docket.

14 As was the case in Docket No. R94-1, counting the contents of items
 15 continues to fall short of Postal Service expectations and leads to troubling
 16 questions. As I stated in Docket No. R94-1:

17 When the Postal Service personnel modified IOCS procedures to
 18 count mixed mail, they intended and expected that all mixed mail
 19 items would be counted. But that did not happen. In fact, only 27
 20 percent of the mixed mail sample was ever counted. USPS witness
 21 Barker had no explanation for the failure of data collectors to count
 22 73 percent of mixed mail items.⁶¹

23 This problem still exists. Despite the fact that the IOCS Handbook states
 24 that all items with mixed mail should be counted, witness Degen identifies about
 25 \$60 million in counted item tally costs and \$91 million in uncounted item tally
 26 costs.⁶² Even after three years of experience counting mixed items, IOCS data
 27 collectors manage to count only about 38 percent of eligible item costs.

⁶⁰ The only exceptions are when distribution cells are empty and for platform, miscellaneous, mail processing support, empty equipment, and LDC 48 operations. See USPS-LR-146.

⁶¹ Docket No. R94-1, Tr. 26A/12355-6 (witness Cohen) (emphasis in original).

⁶² Tr. 12/6216; Tr. 12/6164 (witness Degen).

1 In Docket No. R94-1, I suggested that data collectors tended to count items
 2 with fewer pieces. I stated that "[i]f, for example, data collectors encountered
 3 some sacks with many pieces and some sacks with few pieces, they might have
 4 only counted the sacks with fewer pieces."⁶³ Data in this case demonstrate that
 5 the tendency to count items with few pieces still exists. Twenty-one percent of
 6 counted item costs are distributed to Priority Mail and another 12 percent to
 7 Periodicals, much more than would be expected if the selection of items to count
 8 were truly random. Conversely, First-Class Mail only receives 14 percent of
 9 counted item costs, much less than would be expected if the likelihood of an item
 10 being counted were random.⁶⁴ Brown sacks, which are normally used for
 11 Periodicals, were counted 70 percent of the time. Other sack types had
 12 substantially lower counting rates.⁶⁵

13 Witness Degen apparently believes that differing counting percentages are
 14 not a problem since "most of the items have a significant association with shapes
 15 or classes of mail", and he distributes mixed mail costs within item types.⁶⁶ Degen
 16 is wrong. An item does not always contain the subclasses or classes of mail
 17 "associated" with that item as Table 4 shows.

18 **Table 4.**
 19 **Proportion of Direct Tally Costs**
 20 **Where Sacks Were Used for Associated Class⁶⁷**

Sack Color or Type	Associated Class	Associated Class (%)
Blue and Orange	Express	76
Brown	Periodicals	72
Green	First-Class	73
International	International	90
Orange and Yellow	Priority	86
White	Standard A	63

⁶³ Docket No. R94-1, Tr. 26A/12365 (witness Cohen).

⁶⁴ Tr. 12/6160-64 (witness Degen).

⁶⁵ Tr. 12/6216; DMA/USPS-T12-14.

⁶⁶ Tr. 12/6580.

⁶⁷ Tr. 12/6580; DMA/USPS-T12-15(c).

1 For example, while Degen states that brown sacks are associated with
2 Periodicals almost one-third of the direct costs for brown sacks are for classes
3 other than Periodicals. Similarly, almost 40 percent of direct costs for white sacks,
4 which Degen says are associated with Standard A mail, are for classes other than
5 Standard A.⁶⁸

6 The discussion thus far demonstrates the problems with using counted
7 items to distribute mixed-mail costs. Unfortunately, there is also a problem with
8 using identical items to distribute mixed-mail costs. Witness Stralberg
9 demonstrates in his testimony not only that the counted item data are unsuitable
10 for distributing uncounted mixed item costs, but also that the direct item data, and
11 the combination of direct and counted item data are even more unsuitable. As he
12 explains, identical items, particularly sacks and pallets, are generally prepared by
13 bulk mailers, not the Postal Service. In fact, more than 80 percent of the costs
14 from direct non-top piece rule items are either Standard A or Periodicals. These
15 data are not at all suitable for distributing mixed item costs, which include costs
16 associated with collection mail and other mail packaged by the Postal Service
17 rather than mailers.⁶⁹

18 Witness Degen's distribution keys for containers suffer from the same
19 problem. IOCS tallies for identified containers estimate the proportion of different
20 types of items and shapes of loose mail in the container. Tallies for direct and
21 counted items and loose mail in that cost pool are then used to distribute the
22 identified container costs which in turn are used to distribute unidentified and
23 empty container costs to subclasses. However, the composition of mail in
24 containers is likely to be different from the composition of items and loose mail not
25 in containers. Witness Stralberg provides an example of this mismatch,
26 describing how Periodicals are frequently handled individually at sorting
27 operations but are very unlikely to be found loose in containers, since putting
28 loose Periodicals in a container would destroy their presortation.⁷⁰

⁶⁸ Tr. 12/6216; DMA/USPS-T12-15(c).

⁶⁹ DMA/USPS-T12-19.

⁷⁰ TW-T-1.

1 Witness Degen has no basis for assuming that loose mail out of containers
2 is representative of loose mail in containers, or that items out of containers are
3 representative of items within containers.

4 2. Distribution within cost pools

5 Even more troubling than witness Degen's unsupported subclass proxy
6 assumptions is his decision to confine his mixed-mail and not-handling
7 distributions to tallies within cost pools. Witness Degen apparently believes that
8 consistency with witness Bradley dictates distribution within cost pools.⁷¹ I
9 disagree. The only output of witness Bradley's analysis that constrains witness
10 Degen is the variability of costs within a cost pool. As long as witness Degen
11 applies the correct variability percentage to each tally, he is free to distribute costs
12 to classes and subclasses across cost pools. He even does so when he deems it
13 appropriate – when distribution cells are empty and in several other cases.
14 Degen's proposed distribution, not required or implied by witness Bradley's cost
15 pool variabilities, severely exacerbates the mail processing cost distribution
16 problem.

17 Witness Degen states that his main concern in the new methodology is
18 "identifying the activities actually performed by the employees clocked into the
19 operations in a cost pool in order to ensure an accurate distribution of those
20 costs."⁷² However, more than 40 percent of mail processing costs are represented
21 by "not-handling" tallies. For many of these tallies, witness Degen really knows
22 only what employees are not doing, rather than what they are doing.⁷³

23 What is known is that not-handling tallies are a large percentage of total
24 tallies at manual operations, such as opening units and platforms. These
25 operations should have lower not-handling percentages than automated
26 operations.⁷⁴ Table 5 suggests that the high percentage of not-handling time

⁷¹ Tr. 12/6154 (witness Degen).

⁷² USPS-T-12 at 7.

⁷³ For some tallies, witness Degen does know what an employee is doing, but he chooses to ignore that information if it is inconsistent with the cost pool the employee is clocked into. See part V, below.

⁷⁴ Docket No. R04-1, Tr. 3/1237-39 (witness Barker).

1 results from postal supervisors reassigning temporarily idle employees from
 2 sorting operations to allied and other operations where productivity is not
 3 measured.

4 **Table 5**

5 **Percentage of Time Spent**
 6 **Not Handling Mail at MODS Facilities⁷⁵**

7

Cost Pool Type	Not Handling %
8 Productivity measured ⁷⁶	34%
9 Productivity not measured	57%

10 Employees must be clocked in to an operation in order to be paid. There
 11 is, therefore, an incentive for supervisors to send employees to clock in at
 12 operations where piece handlings are not measured, such as opening units. Not-
 13 handling tallies in such operations will not decrease "measured" productivity as
 14 they would in an operation where both labor hours and piece handlings are
 15 collected.

16 Distribution of not-handling costs within cost pools penalizes the mail at
 17 operations with high not-handling ratios. For classes with a large share of the
 18 direct costs at these allied and other operations, such as Periodicals, witness
 19 Degen's distribution method overstates such classes' shares of not-handling
 20 costs.

21 There are also problems with witness Degen's distribution of mixed-mail
 22 costs within cost pools. A very large portion of mixed-mail costs, over \$700
 23 million, represents handling empty items and containers. Witness Degen has no
 24 data from which to determine what subclasses of mail were contained in these

⁷⁵ Calculated from USPS-LR-H-23; USPS-LR-H-148.

⁷⁶ MODS operations with productivity information are those in Exh. TW-XE-2, Tr. 11/5585.

1 items when they were not empty or at which cost pool(s) that mail was processed
2 before the items were emptied. The remaining mixed-mail costs, another \$700
3 million, represent mixed-mail items and containers with mail in them.⁷⁷ As
4 described by witness Stralberg, mail that may be loose in containers at opening
5 units will be handled individually at piece sorting operations. Degen would
6 distribute the container costs only on direct costs at the opening unit when in fact
7 the correct distribution should be in proportion to piece tallies across all sorting
8 operations.⁷⁸

9 An additional problem with witness Degen's distribution within cost pools
10 results from Degen's insistence on distributing costs within the cost pool where an
11 employee is clocked, even if clerk or mailhandler is actually working someplace
12 else. In such cases, Degen's method distributes the mixed or not-handling tally
13 on the basis of direct tallies that bear no relation to the work the employee is
14 performing.

15 C. Statistical Deficiencies in Witness Degen's Distribution Methodology

16 Even if the problems described above did not invalidate witness Degen's
17 methodology, his decision to distribute costs both by item type and within cost
18 pool lead to statistically inappropriate distribution keys. The small number of
19 tallies for which counting is accomplished, the large number of item types and
20 loose shapes (21) and container types (10) and the extensive number of cost
21 pools (49 including non-MODS disaggregated by basic-function and excluding
22 LDC 15 for which IOCS has no subclass data) combine to create a serious
23 problem with data thinness. I described this problem in Docket No. R94-1 as well,
24 explaining that "there is simply not enough data in the counted mixed-mail sample
25 to support distribution".⁷⁹

26 Witness Degen has a potential of 784 distribution keys for mixed items,
27 1029 for items and loose mail in identified containers and 490 for unidentified and
28 empty containers. One hundred thirty eight of the distribution keys for mixed items

⁷⁷ DMA/USPS-T12-16, 16.

⁷⁸ TW-T-1.

⁷⁹ Docket No. R94-1, Tr. 26A/12385 (witness Cohen).

1 and identified containers had no direct items on which to do the distribution.⁸⁰
 2 Witness Degen, unable to distribute costs if a cell is empty, distributes across cost
 3 pools when this happens. However, he does not distribute across cost pools
 4 when he has only a few tallies on which to do his distribution, and as I testified in
 5 Docket No. R94-1, "[G]enerally accepted statistical practices dictate that there
 6 should be *at least five observations to represent adequately a distribution.*"⁸¹
 7 In total, there are 192 distribution keys where witness Degen has fewer than 5
 8 tallies with which to do his distribution of mixed item and identified container costs
 9 and 105 keys for distributing unidentified and empty container costs.⁸²

10 Not surprisingly, statistical analysis of witness Degen's distribution keys
 11 shows the unreliability of the data and the uncertainty of his results. Degen
 12 provides coefficients of variation by cost pool, item type, and subclass.⁸³ A large
 13 coefficient of variation indicates that there is substantial uncertainty in the cost
 14 estimates, and estimates with large coefficients of variation should not be used as
 15 the basis for distribution keys.

16 I examined the coefficients of variation that form the basis for witness
 17 Degen's distribution keys and found that almost 70 percent of the costs by
 18 subclass, item type, and cost pool have coefficients of variation of at least 50
 19 percent. For this 70 percent, it is impossible to conclude (at the 95 percent
 20 confidence level) that the cost is significantly different from zero.

21 As described below, witness Stralberg and I suggest using distribution keys
 22 that are more aggregated, and therefore more statistically reliable, than those
 23 proposed by witness Degen.

24 V. AN IMPROVED MAIL PROCESSING COST DISTRIBUTION — TWO 25 ALTERNATIVES

26 In conjunction with witness Stralberg, I present two alternatives for
 27 addressing the shortcomings of witness Degen's methodology. First, I suggest an

⁸⁰ DMA/USPS-T12-15(b).

⁸¹ Docket No. R94-1, Tr. 26A/12385 (witness Cohen) (emphasis added).

⁸² DMA/USPS-T12-15, 16.

⁸³ DMA/USPS-T-12-15(c).

1 alternative distribution methodology. Second, I point out that the Commission has
2 sufficient authority and reason to treat at least a portion of the not-handling costs
3 as institutional costs.

4 Witness Degen's methodology yields a fundamentally flawed distribution of
5 clerk and mailhandler costs. As described above, his proposed distribution of
6 mixed-mail and not-handling costs suffers from the following critical flaws: (1)
7 testable yet untested assumptions; (2) inadequate data for statistically reliable
8 results; (3) some demonstrably erroneous outcomes; and (4) frequently counter-
9 intuitive results.

10 The Postal Reorganization Act provides that "[p]ostal rates and fees shall
11 be reasonable and equitable and sufficient to enable the Postal Service under
12 honest, efficient, and equitable management to maintain and continue the
13 development of postal services of the kind and quality adapted to the needs of the
14 United States."⁶⁴ As witness Stralberg, Shew, and I have demonstrated, witness
15 Degen's proposed distributions of mail processing costs is neither reasonable nor
16 equitable. Thus, rates and fees based on this proposed distribution could be
17 neither reasonable nor equitable.

18 A. A More Reasonable and Equitable Distribution

19 Witness Stralberg has developed, and I support, an alternative cost
20 distribution for clerk and mailhandler costs. This alternative is based on three
21 fundamental principles:

- 22 1. The distribution methodology should avoid unsupported assumptions to
23 the greatest extent possible;
- 24 2. Distribution procedures should use all verifiable and relevant data
25 collected in IOCS upon which reasonable inferences of causation can
26 be based; and
- 27 3. Pending the development of more complete information, cost
28 distributions should generally be done as they have in the past since
29 there is currently no better alternative.

⁶⁴ 39 U.S.C. 3621 (emphasis added).

1 Witness Stralberg and I do not distribute costs within cost pools. This not
2 only mitigates the data thinness problem, but also avoids the incorrect assumption
3 that mixed-mail and not-handling costs are caused by and relate to direct costs in
4 a particular cost pool. In light of the Postal Service's ability to move employees
5 freely and quickly between operations, the fact that not-handling tallies are
6 clustered at operations where productivity is not measured, the need to match
7 mail in items and containers with individually handled pieces at different
8 operations, and the fact that employees may work in operations other than those
9 into which they are clocked,⁸⁵ it is clear that mixed-mail and not-handling tallies
10 may not be caused by direct activities in the same cost pool.

11 In place of the cost pools, witness Stralberg and I generally distribute costs
12 by CAG and basic function.⁸⁶ As described by Stralberg, this distribution
13 methodology avoids issues related to why an employee is at a particular
14 operation. Employees generally do not move across CAGs, as they are assigned
15 to only one facility. Replacing cost pool distribution keys with keys based on basic
16 function has two important benefits – (1) not-handling costs for which we have no
17 information as to causation are distributed more broadly to classes and
18 subclasses in proportion to the entire workload during a work shift (basic function
19 loosely corresponds to work tours); and (2) spreading the distributions over cost
20 pools increases the depth of information available with which to do the
21 distributions and avoids a great deal of witness Degen's data thinness problem.⁸⁷

22 Witness Stralberg has examined the tallies carefully and determined that
23 there is information that witness Degen ignored that can be used to improve the
24 distribution of costs to classes and subclasses. For example, witness Degen
25 ignored the mixed shapes information (Activity Codes 5610, 5620, and 5650 and
26 5700) described in Docket No. R94-1 and available again in this case. Witness
27 Degen's distribution allocates some mixed letters tallies to flats and parcel mail,
28 some mixed flats tallies to letter and parcel mail, and some mixed parcels tallies to
29 letters and flats. Witness Stralberg and I recommend an improved distribution,

⁸⁵ See USPS-T-12 at 6, 7.

⁸⁶ Basic function is not always defined for certain activity codes.

⁸⁷ TW-T-1.

1 using the information on shape to limit the distribution to direct tallies of that
2 shape mail.⁸⁸

3 Similarly, witness Degen's distribution uses the information on what MODS
4 operation an employee is clocked into, even when it is contradicted by information
5 from the IOCS record about what the employee is really doing. For example, an
6 employee may be clocked into a flats manual operation but be working at a
7 window performing window service activities. Witness Degen would distribute this
8 tally cost to flats mail. Witness Stralberg and I would distribute the costs more
9 appropriately, using window service cost distribution procedures.

10 MPA exhibit Exh. MPA-2B presents the distribution methodology I propose
11 for each category of mixed-mail and not-handling tallies. To summarize:

- 12 • for mixed-mail costs, I propose that these costs be distributed in
13 proportion to direct mail costs, disaggregated by CAG and basic
14 function. This is the procedure used by the Commission in previous
15 dockets. Also, as in R94-1, I propose distributing shape-related mixed-
16 tallies in proportion to direct costs for those shapes within CAG and
17 basic function.
- 18 • for not-handling costs, using IOCS tally information, I propose that not-
19 handling tallies involving window service or administrative activities be
20 distributed on the customary distribution keys for individual activities in
21 these cost components; that not-handling tallies with shape information
22 be distributed in proportion to direct tallies of that shape; that not-
23 handling tallies in special delivery, registry, and Express Mail units be
24 distributed to those services and that class; and that not-handling tallies
25 for specific activities like central mail markup only be distributed to
26 direct mixed tallies for the same activity. As with mixed-mail, these
27 distributions, and distribution of the remaining pool of not-handling
28 costs, should be disaggregated by CAG and basic function. This is

⁸⁸ TW-T-1.

1 consistent with the procedure used by the Commission in previous
2 dockets.⁸⁹

3 I have modified witness Degen's distribution procedures as contained in
4 USPS-LR-H-146 to reflect my proposed methodology. MPA Exhibit Exh. MPA-2C
5 presents my proposed distribution of clerk and mailhandler costs to classes and
6 subclasses, with individual columns for mail processing, window service and
7 administrative costs. MPA Exhibit Exh. MPA-2D presents a summary comparison
8 of my proposed clerk and mailhandler cost distribution with that of witness Degen.
9 Full documentation of my procedures and SAS run outputs is provided in MPA-
10 LR-1.⁹⁰

11 B. Treat a Portion of Volume-Variable Mixed-Mail and Not-Handling
12 Costs as Institutional

13 In Docket No. R94-1, witness Stralberg suggested that mail-processing
14 overhead costs might best be treated as institutional costs. He reasoned that not
15 only had the Postal Service failed to explain why overhead costs were increasing
16 so dramatically, but that the Service also had no basis on which to distribute the
17 vastly increased overhead costs to classes and subclasses of mail.⁹¹

18 In his testimony in this docket, witness Stralberg once again suggests that
19 overhead or, in this case, not-handling costs might appropriately be treated as
20 institutional costs since the Postal Service still has neither explained why not-
21 handling costs continue to grow at such an alarming rate nor found a suitable
22 basis for distributing these costs to classes and subclasses of mail.

23 As discussed above, finally in this docket, the Postal Service agrees that
24 some mail processing costs are institutional costs. Based on witness Bradley's
25 analysis, almost a quarter of all mail processing costs (direct, mixed-mail, and not-
26 handling) are treated as institutional. Witness Stralberg suggests that the

⁸⁹ TW-T-1.

⁹⁰ Witness Stralberg completed his calculations for our cost distribution before I completed the SAS runs, which corroborate his results. In the interest of time, I have used his results for Clerks and Mailhandlers cost in Exhibits MPA-2C and -2D.

⁹¹ Docket No. R94-1, Tr. 25/11858 (witness Stralberg).

1 remaining volume-variable not-handling costs (\$2.7 billion) should also be treated
2 as institutional costs rather than attributed arbitrarily to classes and subclasses.

3 While hopeful that witness Bradley's analysis will open the door to treating
4 some mail processing costs as institutional, both witness Stralberg and I
5 recognize that the Commission has been hesitant in the past to take this step.
6 Fearful that the Commission might hesitate once again to treat all not-handling
7 costs as institutional and dismayed that witness Degen's proposed distribution is
8 even less suitable than the distribution used in previous cases, Witness Stralberg
9 and I have proposed an alternative distribution of mixed-mail and not-handling
10 costs that is more reasonable and equitable than witness Degen's. However,
11 neither witness Stralberg nor I maintain that our alternative distribution is a perfect
12 solution; it is simply the best available distribution methodology in this case if the
13 Commission concludes it must attribute these costs.

14 There are two reasons why the Commission should consider treating some
15 volume-variable mail processing costs as institutional. First, for mixed- and not-
16 handling tallies, there is very limited information available to establish a causal
17 link between these costs and individual classes or subclasses of mail. Second, if
18 mail processing costs are inflated due to inefficiency in mail processing
19 operations, no class or subclass of mail should be held responsible for the
20 portion of these costs resulting from this inefficiency. Even witness Degen agrees
21 that if costs are incurred because of inefficiency, they could be classified as
22 institutional, because they have nothing to do with the amount of mail being
23 processed.⁸²

24 On oral cross examination, witness Degen was asked to hypothetically,
25 "...assume that an employee's work was eliminated when automation equipment
26 was purchased. Further assume that for whatever reason he is still on the Postal
27 Service payroll... Now assume that management instructs [that employee] to clock
28 into manual flats processing but they already have enough employees to do that
29 work. Assume further that his labor input lowers productivity for that operation.

⁸² Tr. 12/6658 (witness Degen).

1 Could a rational costing system assign his salary and benefits to institutional
2 costs?" Witness Degen replied, "Yes."⁸³

3 In addition to the evidence of inefficiency I presented earlier in my
4 testimony, a 1990 study sponsored by the Commission further suggested that the
5 hypothetical to which witness Degen responded is a reality at many postal
6 facilities.⁸⁴ The productivity study found, "virtually all improvement in TFP [Total
7 Factor Productivity]... came during periods of hiring freezes."⁸⁵ In other words, in
8 the absence of a hiring freeze, the Postal Service has been ineffective at either
9 putting work hours freed up by productivity enhancements to productive work or
10 getting rid of the excess labor.

11 I believe that a strong basis exists for treating mixed-mail and not-handling
12 costs that are due to inefficiency as institutional costs. For these costs, we neither
13 have a basis for distribution to subclasses nor are we ever likely to find one.

14 The Commission is expected to select costing methods that reliably reflect
15 the causal relationship between costs and the classes of mail. The Supreme
16 Court and the Commission agree that costs should not be attributed until the
17 Commission has established a "reasonable confidence" that costs are the
18 consequence of providing a particular service, or a "reasoned analysis of cost
19 causation."

20 "Institutionalizing" volume-variable costs is unusual but not unprecedented.
21 Choosing not to attribute these volume-variable costs to classes and subclasses
22 is well within the Commission's discretion. The Commission encountered a similar
23 situation in Docket No. R90-1 with regard to the costs of intra-Alaska air
24 transportation. In that docket, the Commission conducted extensive deliberations
25 about the proper attribution of the intra-Alaska costs, notwithstanding the fact that
26 all parties agreed that the costs were volume variable. In its Decision, the
27 Commission, citing *National Association of Greeting Card Publishers v. United*
28 *States Postal Service*, 462 U.S. 810 (1983) (hereafter *NAGCP*), discusses its

⁸³ Ibid.

⁸⁴ See MPA-LR-2.

⁸⁵ Tr. 12/6652 (witness Degen).

1 discretion to choose appropriate methods of attributing costs to the various
2 classes of mail.⁹⁶

3 In that case the Court noted:

4 We agree with the Rate Commission's consistent position that
5 Congress did not dictate a specific method for identifying casual
6 relationships between costs and classes of mail, but that the Act
7 "envision[s] consideration of all appropriate costing approaches."
8 [citation omitted]. The Rate Commission has held that, regardless of
9 method, the Act requires the establishment of a sufficient causal
10 nexus before costs may be attributed. The Rate Commission has
11 variously described that requirement as demanding a "reliable
12 principle of causality, or "reasonable confidence" that costs are the
13 consequence of providing a particular service, or a "reasonable
14 analysis of cost causation."⁹⁷

15 I recommend that the Commission similarly use its statutory discretion in
16 this case to refrain from attributing to classes and subclasses of mail the portion of
17 volume-variable mixed-mail and not-handling costs that is due to inefficient
18 operations. However, developing an estimate of the inefficient portion of volume-
19 variable mixed-mail and not-handling costs is not a simple matter. There is limited
20 information available in this case to precisely quantify the inefficient portion of
21 these cost categories. However, there are a number of data sources that can be
22 used to develop a set of rough estimates.

23 First, there is a benchmarking study, "Performance Analysis of Processing
24 and Distribution Facilities: Sources of TFP Improvement," which was performed by
25 Christensen Associates in 1994. Witness Degen is a co-author of the study.⁹⁸
26 This study found that if the bottom 75 percent of facilities could increase their
27 efficiency to the average productivity of the top quartile of facilities, then mail
28 processing costs would decrease by \$1.9 to 2.6 billion. On a percentage basis,
29 the Christensen Associates study found that if the bottom 3 quartiles improved
30 efficiency to match the top quartile, mail processing and distribution costs would
31 decrease between 20-25%.⁹⁹ Applying the 20-25 percent figure to the mixed-mail
32 and not-handling portion of mail processing costs (about 50%) yields an estimate

⁹⁶ PRC Op. R90-1, para. 3753.

⁹⁷ NAGCP at 826 (citations omitted).

⁹⁸ USPS-LR-H-275.

⁹⁹ Id. at 21.

1 of \$1.0 to 1.25 billion for volume-variable, inefficient mixed-and not-handling
2 costs.

3 During oral cross-examination, witness Degen provided additional support
4 to the idea that these costs should be treated as institutional. He agreed the high
5 costs at the bottom 75 percent of facilities was not due to "such things as the size
6 of letters or the shape of mail, I should say size of flats, weight of parcels or other
7 characteristics of mail, but rather to other factors."¹⁰⁰

8 Second, as I discussed earlier, witness Bradley's MODs data shows a
9 decrease in productivity for most mail processing operations since fiscal year
10 1988. To get another rough estimate of inefficient costs, I calculated how much
11 lower mail processing cost would be if labor productivity were as high in FY 1996
12 on an operation-by-operation basis as it was in FY 1988.¹⁰¹ Exhibit MPA 2E
13 details my calculations. I found that volume-variable costs would be almost \$900
14 million lower if productivity in FY 1996 were as high as it was in FY 1988. Using
15 the mixed-mail and not-handling portion (50%) yields an estimate of \$450 million
16 for volume-variable, inefficient mixed and not-handling costs due to system wide
17 reductions in productivity.

18 Third, a review of the composition of not handling costs is also informative.
19 While I believe the explosion in total not-handling costs suggests there is
20 inefficiency in all not-handling activities, the large amount of not-handling costs for
21 the mixed all shapes activity code (5750) and the moving empty equipment activity
22 code (6523) are particularly suggestive. Costs for these activity codes, almost by
23 definition, indicate inefficiency. If an employee is not handling a mailpiece, item,
24 or container but monitoring an operation, for most operations he should receive a
25 shape-specific activity code. The fact that a tally-taker used an even vaguer code
26 --mixed all shapes-- that the employee may not have been productively employed
27 at an operation. The not-handling empty equipment code also seems to indicate
28 inefficiency by its very existence. This code is used when an employee who
29 supposedly is moving empty equipment is not handling an empty item or an empty
30 container. Why is this cost category so large? If managed efficiently, these costs

¹⁰⁰ Tr. 12/6657 (witness Degen).

¹⁰¹ When Witness Bradley provided no data for an operation in FY 1988, I used productivity from FY 1989.

1 should be very small. Not even considering the inefficient portion of breaks and
 2 clocking time, the volume-variable costs just for these two vague and likely
 3 inefficient activity codes were about \$1.05 billion in Base Year 1996.¹⁰²

4 While each of these attempts to quantify inefficient mixed-mail and not-
 5 handling costs yields different estimates, all yield substantial pools of cost
 6 (between \$450 million and \$1.0 billion) for which the causal relationship to classes
 7 and subclasses is not established. I believe it would be reasonable to apply the
 8 Christensen Associates TFP improvement estimate of 20 - 25% to the volume
 9 variable mixed- and not-handling costs and to treat that pool of costs as
 10 institutional. Using the more conservative 20 % figure yields almost exactly \$1
 11 billion of volume variable mixed- and not-handling costs that probably should not
 12 be distributed to classes and subclasses of mail.¹⁰³ MPA exhibit Exh. MPA-2 F
 13 shows my revised distribution of mail processing costs by class and subclass with
 14 the \$1 billion removed.

15 VI. THE NEED FOR CONTINUED ANALYSIS AND MODERATION IN RATE 16 INCREASES

17 A. The Need for Additional Information

18 If the Commission is not willing to treat a portion of volume-variable costs as
 19 institutional, the distribution of these costs that witness Stralberg and I propose is
 20 the best available on the current record. Unlike witness Degen's proposed
 21 distribution, it is reasonable and equitable. However, there is still much
 22 information that is needed to develop more accurate distribution keys for this cost
 23 segment.

24 With regard to mixed-mail, the key issue is that there is no adequate
 25 substitute for subclass data for the purpose of cost distribution. Proxy
 26 assumptions are a very poor substitute. For mixed-mail items, the Postal Service
 27 should either figure out a way to achieve a higher percentage of counting or
 28 should rethink the entire procedure. The key piece of information that is needed

¹⁰² TW-T-1.

¹⁰³ USPS-T-12 at 24, table 6.

1 is subclass information. If data collectors can't or won't count the number of
2 pieces of each subclass in an item, perhaps they could simply identify what
3 classes or subclasses of mail are contained in the item. That would provide more
4 data than currently exists and eliminate the need for assumed relationships.

5 Similarly, for mixed containers, the Postal Service needs to obtain more
6 information not only on what types of items are in the container but also on what
7 types of mail are in the items in the containers. Perhaps, as suggested by witness
8 Stralberg, the Postal Service should consider reinstating some form of
9 identification of subclasses in mixed containers. Such containers may contain
10 mail of only one subclass, although the pieces are not identical.¹⁰⁴

11 Collecting information that would allow distribution directly to subclasses
12 would eliminate the need for the current two-tiered system, where tally takers
13 identify the types of items in containers and then witness Degen assumes that the
14 contents of the items are similar to the contents of items outside containers and
15 that loose mail in containers is similar to loose mail outside containers. If the
16 Postal Service identified the subclasses there would be no need for the
17 assumption.

18 For not-handling costs, the problem is more difficult. Simply observing what
19 an employee is doing and where he is doing it is not enough. We need to
20 determine if the work is productive or non-productive and what classes and
21 subclasses cause the productive work. Not handling mail while selling stamps is
22 productive work. Not handling mail at opening units or manual cases is very likely
23 not productive. To gain more insight into why there is so much nonproductive
24 time, we need to understand how employees are assigned to operations.

25 This is what we hope will occur as part of our joint industry-Postal Service
26 study of Periodicals costs. We hope that the Postal Service will agree that the
27 study should include a review of scheduling and staffing tools and procedures at
28 various postal facilities. We also plan to examine processing inefficiencies and
29 evaluate the potential to reduce inefficiency and improve operations.

¹⁰⁴ TW-T-1.

Revised 2/23/98

1 B. Periodicals Cost Coverage and Rate Increase

2 The Postal Service maintains that the cost coverage proposed for regular
3 rate Periodicals in this docket is 107 percent, admittedly lower than the cost
4 coverage traditionally assigned to this Periodicals subclass by the Commission.
5 However, the 107 percent coverage estimate is predicated on witness Degen's
6 flawed distribution methodology. The Stralberg/Cohen distribution methodology
7 and my revised methodology with inefficient mixed and not-handling costs
8 removed both reduce the overstatement of Periodicals costs that results from
9 witness Degen's proposed distribution. If implemented by the Commission, either
10 of the approaches I advocate would yield a higher cost coverage for regular rate
11 Periodicals at the rate levels proposed by the Postal Service.

12 In addition, we have discovered an overstatement in the rural carrier costs
13 attributed to Periodicals. This overstatement is described by witness Glick in
14 MPA-T-3. In his testimony, witness Glick presents an improved distribution of
15 rural carrier costs to subclass. As shown in his Exhibit MPA-3-3, his proposed
16 distribution would reduce test year after rates costs for Periodicals Regular Rate
17 by \$3.5 million.

18 I have combined witness Glick's revised rural carrier cost distribution with
19 test year after rates cost distributions for mail processing costs (including
20 piggybacks) based on the methodologies described in part V of this testimony.
21 The procedure used to calculate piggyback factors and roll-forward the revised
22 base year 1996 mail processing cost distributions is described in MPA-LR-1.
23 MPA exhibits Exh. MPA-2F and MPA-2G provide new total attributable costs by
24 class and subclass, incorporating both rural carrier and mail processing cost
25 adjustments. The costs for regular rate periodicals in these exhibits are \$1.45
26 billion and \$1.39 billion respectively. If implemented by the Commission, these
27 cost distributions would yield cost coverages of 116.5 percent and 121.5 percent
28 if the Commission adopts the rate increase proposed by the Postal Service for
29 regular rate Periodicals.

1 Furthermore, even this increased coverage is likely understated given: (1)
 2 the still unexplained cost increases for Periodicals in the past ten years; (2)
 3 remaining uncertainty with regard to mixed-mail and not-handling tallies and their
 4 appropriate distribution to classes and subclasses; and (3) the fact that the
 5 automation refugee problem discussed in this testimony affects direct costs as
 6 well as mixed-mail and overhead costs. If the Postal Service reassigns
 7 employees from automated to allied and other operations, and those employees
 8 "work" at allied and other operations while awaiting reassignment back to the
 9 automated operations, these employees (and those already there) are likely to
 10 work at a slower pace than if they were really needed.

11 I am pleased that witness O'Hara has freely admitted that the Postal
 12 Service cannot explain the apparent increase in Periodicals costs and intends to
 13 undertake a study to understand and correct the problem.¹⁰⁵ As he and witness
 14 Little point out, the educational, cultural, scientific, and informational value of
 15 Periodicals (39 U.S.C. 3622(b)(8)) has historically led to low cost coverage for this
 16 mail.¹⁰⁶ Witness O'Hara also points out that the proposed rates also exceed
 17 estimated incremental costs, even under the flawed methodology proposed by
 18 witness Degen.¹⁰⁷ Thus, the rates cover costs as required by 39 U.S.C.
 19 3622(b)(3). Most importantly, witness O'Hara testifies that the proposed rate level
 20 is fair and equitable (39 U.S.C. 3622(b)(1)).¹⁰⁸ I agree that the rate level is fair
 21 and equitable, even though based on faulty methodology. The Commission is
 22 justified in approving a lower purported cost markup with the understanding that
 23 coverage on the basis of properly measured costs should and will increase when
 24 costs are properly measured.

25 I urge the Commission to recommend increases no higher than the average
 26 rate increases of 3.5 percent and 3.9 percent proposed by witness O'Hara for
 27 Regular Rate Periodicals and Nonprofit Periodicals, respectively.

¹⁰⁵ USPS-T-30 at 30-31.

¹⁰⁶ USPS-T-30 at 31; MPA-T-1 at 7

¹⁰⁷ USPS-T-30 at 31.

¹⁰⁸ Ibid.

Exhibit MPA-2A. USPS Current and Proposed Methods for Distributing Mail Processing Costs to Subclass/Special Service¹

	Tally Type	IOCS/LIOCATT	Degen
Direct	Direct (0010-4950). Tallies where IOCS data collector recorded subclass/special service and shape of mail being handled. (87,652 Tallies) <ul style="list-style-type: none"> Piece Handlings – Tallies where data collector observed employee handling single piece of mail. (65,970 Tallies) Counted Items – Tallies where data collector counted all subclasses and shapes of mail in item (e.g., bundle, tray, con-con, pallet, or sack). (2,726 Tallies) Top-Piece Rule Items – Tallies where employee was handling nonidentical mail that is loose, in a bundle, or in a tray, and data collector applied top-piece rule. (11,541 Tallies) Identical Items and Containers – Tallies where employee was handling an item or container (e.g., wiretainer) containing identical mail in terms of mail origin, mail class, subclass, shape, weight and postage.² (6,820 Item Tallies and 595 Container Tallies) 	Distributed to subclass/special service based upon subclass information recorded by IOCS data collector.	Distributed to subclass/special service based upon subclass information recorded by IOCS data collector.
	Class Specific (53XX-54XX). Tallies where employee was observed handling specific class of mail but where neither the subclass nor the shape of the mail was recorded. (Included above)	Distributed to subclass/special service in proportion to direct tally costs of same class within CAG and basic function.	Distributed to subclass/special service in proportion to direct tally costs of same class within cost pool.
Mixed	Uncounted/Empty Items (5600-5750, 6523). Tallies where employee was observed handling item containing nonidentical mail, and for which data collector did not record any information regarding the subclasses of mail in the item. This category includes tallies where the employee was handling empty items. (6,574 Tallies)	Mixed shape tallies (e.g., mixed letter tallies) in the current method include costs for activity codes 5600-5750. They are distributed to subclass/special service in proportion to direct tally costs of the same shape within CAGs basic function.	Distributed to subclass/special service in proportion to direct item tally costs of the same item type within cost pool (16 item types).
	Identified Containers (5600-5750). Tallies where data collector observed an employee handling a container of nonidentical mail, and for which the data collector identified the contents (e.g., items and loose shapes) of the container. (9,662 Tallies)	See "Mixed – Uncounted/Empty Items."	Distributed to 21 item types/loose shapes based upon identified container contents within cost pool. Distributed to subclass/special service in proportion to direct item tally costs of same item type/loose shape within cost pool.
	Unidentified/Empty Containers (5600-5750, 6523). Tallies where data collector observed employee handling a container of nonidentical mail or an empty container and for which data collector did not identify container contents. (8,128 Tallies)	See "Mixed – Uncounted/Empty Items."	Distributed to subclass/special service in proportion to identical and identified container tally costs of the same type within cost pool (10 types).
Not Handling	Not Handling (5020-5195, 5600-5750, 60XX-67XX). Tallies where employee was not handling pieces of mail, items, or containers. (88,854 Tallies)	Distributed to subclass/special service in proportion to distribution of all other mail processing costs across all basic functions and CAGs. In current method, this category only includes overhead costs (6521-23).	Distributed to subclass/special service in proportion to distribution of all other mail processing costs within cost pool.

¹Chart Modified from DMA/USPS-T12-20, Attachment 1.

²LR-H-49, Appendix C, Page 146.

Exhibit MPA-2B. Stralberg-Cohen Distribution Method for Mail Processing Costs

Tally Type		Stralberg-Cohen Method
DIRECT. Tallies where IOCS data collector recorded class, subclass, or special service of mail being handled.	Subclass-Specific. <ul style="list-style-type: none"> • Piece handlings • Counted items • Top-piece rule items • Identical items and containers 	Distributed directly to subclass/special service based upon subclass information recorded by IOCS data collector.
	Class-Specific. Tallies where employee was observed handling specific class of mail but where neither the subclass nor the shape of the mail was recorded.	Distributed to subclass/special service in proportion to direct tally costs of same class.
MIXED. Tallies where employee was handling an item or container containing nonidentical mail, and for which data collector did not record any subclass or class information. This category includes tallies where employee was handling empty items or containers.	Shape-Specific. Tallies where data collector recorded the shape or shapes of mail the employee was handling (5610-5700).	Distributed to subclass/special service in proportion to direct tally costs of the same shape within CAG and basic function.
	Other. Tallies where data collector did not record the shape or shapes of mail the employee was handling (Consists primarily of activity codes 5750 and 6523).	Distributed to subclass/special service in proportion to direct tally costs within CAG and basic function.
NOT HANDLING. Tallies where employee was not handling a mailpiece, item, or container.	Shape-Specific. Tallies where data collector recorded the shape or shapes of mail associated with the activity the employee was performing (5610-5700).	Distributed to subclass/special service in proportion to direct tally costs of the same shape within CAG and basic function.
	Class-Specific. Tallies where employee was performing activities associated with special delivery, Registry, and Express Mail (6220, 6230, 6231).	Distributed directly to appropriate classes and special services. Before distribution, Express mail costs are reclassified into C/S 3.3.
	Overhead and Carrier-Related. Tallies where data collector observed the employee on break, clocking in or out, moving empty equipment (other than items or containers), performing carrier-related activities or the data collector recorded a mixed all shapes tally (5750, 6521-23, 6420, and 6430)	Distributed to subclass/special service in proportion to direct tally costs within CAG and basic function.
	Window Service. Tallies where employee was observed performing window service activities and associated break and clocking in and out. This category consists of all tallies with activity codes 5020-5195 and 6020-6200 and some tallies with activity codes 6521 and 6522.	Moved into the Window Service cost component (C/S 3.2) and distributed to subclass using the window service distribution keys.
	Administration/Support Costs. Tallies where employee was observed performing administrative/support activities and associated break and clocking in and out. This category consists of all tallies with activity codes 6320-6519 and 6610-6660 and some tallies with activity codes 6521 and 6522.	Moved into the Window Service cost component (C/S 3.2) and distributed to subclass using the administration/support distribution keys.
	Other Not Handling. This category includes central markup (6570), postage due (6580), nixie (6240), and platform acceptance (6210).	Distributed to subclass/special service in proportion to direct tally costs within CAG, basic function, and uniform operation code.

Revised 2/23/98

Exhibit MPA 2-C. Stralberg-Cohen Attribution of BY 96 Segment 3 Costs (\$000s)

Class	Subclass	3.1	3.2	3.3	Total Segment 3
First Class	Letters & Parcels	4,821,288	515,633	482,312	5,819,232
First Class	Presort Letters & Parcels	1,021,182	22,798	143,563	1,187,543
First Class	Single Piece Cards	157,708	33,190	19,011	209,909
First Class	Presort Private Cards	47,331	792	5,361	53,484
Priority		317,269	42,667	29,499	389,435
Express		53,623	23,797	52,807	130,227
Mailgrams		114	0	17	130
Periodicals	Within County	13,623	473	2,746	16,842
Periodicals	Regular	373,446	2,260	41,116	416,821
Periodicals	Nonprofit	68,988	243	10,201	79,432
Periodicals	Classroom	3,798	0	386	4,184
Standard (A)	Single Piece Rate	73,912	2,481	6,590	82,983
Standard (A)	ECR	206,289	5,953	67,042	279,248
Standard (A)	Regular	1,363,549	23,106	151,282	1,537,937
Standard (A)	Nonprofit ECR	21,312	980	5,248	27,540
Standard (A)	Nonprofit Regular	339,015	8,409	37,612	385,035
Standard (B)	Parcels - Zone Rate	122,366	7,746	12,224	142,337
Standard (B)	Bound Printed Matter	63,601	641	7,328	71,571
Standard (B)	Special Rate	68,170	3,296	6,083	77,549
Standard (B)	Library Rate	15,096	102	1,170	16,367
USPS		103,620	14,202	10,156	127,977
Free for Blind/Handicapped		8,926	187	744	9,857
International		209,994	24,648	21,895	256,537
Special Services	Registry	31,606	12,087	4,903	48,596
Special Services	Certified	23,209	39,092	11,452	73,754
Special Services	Insurance	937	11,938	851	13,725
Special Services	COD	2,406	3,669	878	6,953
Special Services	Special Delivery	49	153	110	312
Special Services	Money Orders	0	82,983	4,139	87,123
Special Services	Stamped Envelopes	0	1,361	67	1,428
Special Services	Special Handling	277	548	41	867
Special Services	Post Office Box	0	69,153	7,163	76,317
Special Services	Other	88,878	10,208	10,265	109,351
Total Volume Variable		9,621,584	964,796	1,154,262	11,740,642
Other		2,805,963	1,059,160	850,338	4,715,462
Total Costs		12,427,547	2,023,956	2,004,601	16,456,103

Revised 2/23/98

**Exhibit MPA 2-D. Comparison of Base Year Attributable Clerk & Mailhandler
Costs by Subclass (\$000s)**

Class	Subclass	USPS Proposal	Stralberg-Cohen	Difference
First Class	Letters & Parcels	5,568,303	5,819,232	252,929
First Class	Presort Letters & Parcels	1,184,689	1,187,543	-7,146
First Class	Single Piece Cards	183,379	209,909	26,530
First Class	Presort Private Cards	41,349	53,484	12,135
Priority		540,853	389,435	-151,418
Express		112,436	130,227	17,791
Mailgrams		88	130	42
Periodicals	Within County	17,388	16,842	-546
Periodicals	Regular	496,960	416,821	-80,139
Periodicals	Nonprofit	88,934	79,432	-9,502
Periodicals	Classroom	6,005	4,184	-1,821
Standard (A)	Single Piece Rate	82,069	82,983	914
Standard (A)	ECR	305,921	279,284	-26,637
Standard (A)	Regular	1,605,824	1,537,937	-67,887
Standard (A)	Nonprofit ECR	32,442	27,540	-4,902
Standard (A)	Nonprofit Regular	385,597	385,035	-562
Standard (B)	Parcels - Zone Rate	168,681	142,337	-26,324
Standard (B)	Bound Printed Matter	76,322	71,571	-4,751
Standard (B)	Special Rate	72,257	77,549	5,292
Standard (B)	Library Rate	16,453	16,387	-66
USPS		112,772	127,977	15,205
Free for Blind/Handicapped		11,042	9,857	-1,185
International		252,743	256,537	3,794
Special Services	Registry	31,718	48,596	16,878
Special Services	Certified	63,305	73,754	10,449
Special Services	Insurance	12,818	13,725	907
Special Services	COD	5,968	6,953	985
Special Services	Special Delivery	216	312	96
Special Services	Money Orders	82,277	87,123	4,846
Special Services	Stamped Envelopes	1,341	1,428	87
Special Services	Special Handling	754	867	113
Special Services	Post Office Box	65,299	76,317	11,018
Special Services	Other	89,524	109,351	19,827
Total Volume Variable		11,723,707	11,740,642	16,935
Other		4,732,392	4,715,462	-16,930
Total Costs		16,456,099	16,456,103	4

Exhibit MPA 2E. Calculation of Volume-Variable Cost Based Upon Base Productivity

Facility	Operation	Productivity			Volume Variable Cost		Dollar Weighted Average Ratio of 1996 Productivity to Base Productivity
		[1]	[2]	[3]	[4]	[5]	
		Base	FY 1996	Ratio of 1996 Productivity to Base Year Productivity	Volume Variable Cost (1996 Productivity)	Volume Variable Cost (Base Year Productivity)	
MODS	BCS	7.143	7.289	1.021	643,885	657,129	
MODS	Cancellation & Mail Preparation - metered	3.110	3.393	1.091	188,154	205,271	
MODS	FSM	0.893	0.734	0.822	676,538	556,439	
MODS	LSM	1.562	1.238	0.793	662,170	524,930	
MODS	Manual Flats	0.503	0.473	0.940	445,858	419,195	
MODS	Manual Letters	0.610	0.547	0.897	1,069,834	959,872	
MODS	Manual Parcels	0.191	0.277	1.450	23,719	34,402	
MODS	Manual Priority	0.241	0.225	0.936	99,685	93,270	
MODS	Mechanized Parcels	0.112	0.179	1.599	8,762	14,009	
MODS	OCR	7.219	4.503	0.624	176,220	109,921	
MODS	SPBS - Non Priority	0.198	0.272	1.374	81,666	112,179	
MODS	SPBS - Priority	0.259	0.272	1.047	46,489	48,683	
MODS	Total	N.A.	N.A.	N.A.	4,122,980	3,735,299	0.906
BMC	Non-Machinable Outside	0.118	0.118	1.006	19,700	19,809	
BMC	Parcel Sorting Machine	1.714	2.290	1.336	76,707	102,473	
BMC	Sack Sorting Machine	0.547	0.476	0.870	30,521	26,557	
BMC	SPBS & Irregular Parcels (IPP & 115)	0.489	0.441	0.902	46,966	42,349	
BMC	Total	N.A.	N.A.	N.A.	173,894	191,189	1.099

Facility	Ratio of 1996 Productivity to Base Year Productivity	Volume Variable Cost (1996 Productivity)	Volume Variable Cost (Base Year Productivity)	Difference
	[7]	[8]	[9]	[10]
MODS	0.906	7,823,779	7,088,115	735,664
BMC	1.099	408,248	448,851	-40,603
Non-MODS	0.906	1,827,050	1,655,254	171,796
Total		10,059,077	9,192,220	866,857

[1] LR-H-148, Procedure from DMA/USPS-T14-16 & 18, first year when Bradley had data (1988 or 1989)

[2] LR-H-148, Procedure from DMA/USPS-T14-16 & 18

[3] = [2] / [1]

[4] USPS-T-12 at 15

[5] = [3] x [4]

[6] = [5] / [4]

[7] = [6]; we applied MODS ratio to Non-MODS facilities as well as MODS facilities

[8] USPS-T-12 at 15

[9] = [7] x [8]

[10] = [9] - [8]

Revised 2/23/98

**Exhibit MPA-2F. Test Year Attributable Cost by Subclass with Stralberg-Cohen
Clerks and Mailhandlers Methodology and MPA Rural Carriers Methodology**

Class	Subclass	MPA Proposal
First Class	Letters & Parcels	\$13,168,743
First Class	Presort Letters & Parcels	\$4,038,550
First Class	Single Piece Cards	\$472,351
First Class	Presort Private Cards	\$184,548
Priority	All	\$2,010,479
Express	All	\$440,857
Mailgrams	All	\$570
Periodicals	Within County	\$80,142
Periodicals	Regular	\$1,450,032
Periodicals	Nonprofit	\$316,364
Periodicals	Classroom	\$10,494
Standard (A)	Single Piece Rate	\$1,303
Standard (A)	ECR	\$1,838,116
Standard (A)	Regular	\$5,057,870
Standard (A)	Nonprofit ECR	\$117,999
Standard (A)	Nonprofit Regular	\$1,107,187
Standard (B)	Parcels - Zone Rate	\$708,266
Standard (B)	Bound Printed Matter	\$337,149
Standard (B)	Special Rate	\$266,877
Standard (B)	Library Rate	\$48,948
Free for Blind/Handicapped	All	\$29,580
International	All	\$1,212,197
Special Services	Registry	\$117,815
Special Services	Certified	\$347,785
Special Services	Insurance	\$49,686
Special Services	COD	\$18,532
Special Services	Money Orders	\$153,072
Special Services	Stamped Envelopes	\$12,386
Special Services	Special Handling	\$1,496
Special Services	Post Office Box	\$606,314
Special Services	Other	\$92,326

Revised 2/23/98

**Exhibit MPA-2G. Test Year Attributable Cost by Subclass with for Stralberg-Cohen
Clerks and Mailhandlers (Treating Inefficient Mixed and Not Handling Costs as
Institutional) Methodology and MPA Rural Carriers Methodology**

Class	Subclass	MPA Proposal
First Class	Letters & Parcels	\$12,385,999
First Class	Presort Letters & Parcels	\$3,851,682
First Class	Single Piece Cards	\$448,453
First Class	Presort Private Cards	\$174,751
Priority	All	\$1,954,530
Express	All	\$431,099
Mailgrams	All	\$552
Periodicals	Within County	\$78,006
Periodicals	Regular	\$1,389,577
Periodicals	Nonprofit	\$305,653
Periodicals	Classroom	\$10,008
Standard (A)	Single Piece Rate	\$12,382
Standard (A)	ECR	\$1,803,778
Standard (A)	Regular	\$4,782,701
Standard (A)	Nonprofit ECR	\$114,797
Standard (A)	Nonprofit Regular	\$1,046,397
Standard (B)	Parcels - Zone Rate	\$686,182
Standard (B)	Bound Printed Matter	\$324,794
Standard (B)	Special Rate	\$253,520
Standard (B)	Library Rate	\$46,368
Free for Blind/Handicapped	All	\$27,874
International	All	\$1,179,539
Special Services	Registry	\$110,027
Special Services	Certified	\$342,659
Special Services	Insurance	\$49,507
Special Services	COD	\$18,148
Special Services	Money Orders	\$153,072
Special Services	Stamped Envelopes	\$12,386
Special Services	Special Handling	\$1,442
Special Services	Post Office Box	\$606,314
Special Services	Other	\$77,475

1 CHAIRMAN GLEIMAN: Ms. Cohen, have you had an
2 opportunity to examine the packet of designated written
3 cross-examination that was made available earlier today?

4 THE WITNESS: Yes, I have.

5 CHAIRMAN GLEIMAN: And if these questions were
6 asked of you today, would your answers be the same as those
7 you previously provided in writing?

8 THE WITNESS: Yes, they would.

9 CHAIRMAN GLEIMAN: That being the case, I am going
10 to provide two copies of the designated written
11 cross-examination of Witness Cohen to the reporter and
12 direct that it be accepted into evidence and transcribed
13 into the record at this point.

14 [Designation of Written
15 Cross-Examination of Rita D. Cohen,
16 MPA-T-2, was received into evidence
17 and transcribed into the record.]

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 1997

Docket No. R97-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF MAGAZINE PUBLISHERS OF AMERICA
WITNESS RITA D. COHEN
(MPA-T2)

Party

Interrogatories

Newspaper Association of America

NAA/MPA-T2-1-9
UPS/MPA-T2-2-3

Office of the Consumer Advocate

UPS/MPA-T2-1-9

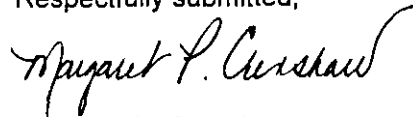
United Parcel Service

UPS/MPA-T2-1-2, 6-7, 9
USPS/MPA-T2-9, 11

United States Postal Service

NAA/MPA-T2-1-9
UPS/MPA-T2-1-9
USPS/MPA-T2-1-23

Respectfully submitted,



Margaret P. Crenshaw
Secretary

INTERROGATORY RESPONSES OF
MAGAZINE PUBLISHERS OF AMERICA
WITNESS RITA D. COHEN (T2)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory:

NAA/MPA-T2-1
NAA/MPA-T2-2
NAA/MPA-T2-3
NAA/MPA-T2-4
NAA/MPA-T2-5
NAA/MPA-T2-6
NAA/MPA-T2-7
NAA/MPA-T2-8
NAA/MPA-T2-9
UPS/MPA-T2-1
UPS/MPA-T2-2
UPS/MPA-T2-3
UPS/MPA-T2-4
UPS/MPA-T2-5
UPS/MPA-T2-6
UPS/MPA-T2-7
UPS/MPA-T2-8
UPS/MPA-T2-9
USPS/MPA-T2-1
USPS/MPA-T2-2
USPS/MPA-T2-3
USPS/MPA-T2-4
USPS/MPA-T2-5
USPS/MPA-T2-6
USPS/MPA-T2-7
USPS/MPA-T2-8

Designating Parties:

NAA, USPS
NAA, USPS
NAA, USPS
NAA, USPS
NAA, USPS
NAA, USPS
NAA, USPS
NAA, USPS
NAA, USPS
OCA, UPS, USPS
NAA, OCA, UPS, USPS
NAA, OCA, USPS
OCA, USPS
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Interrogatory:

USPS/MPA-T2-9
USPS/MPA-T2-10
USPS/MPA-T2-11
USPS/MPA-T2-12
USPS/MPA-T2-13
USPS/MPA-T2-14
USPS/MPA-T2-15
USPS/MPA-T2-16
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USPS/MPA-T2-19
USPS/MPA-T2-20
USPS/MPA-T2-21
USPS/MPA-T2-22
USPS/MPA-T2-23

Designating Parties:

[illegible]

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of NAA**

NAA/MPA-T2-1. You state in your direct testimony at page 15, line 28, that Professor Bradley developed a "...state-of-the-art econometric variability analysis..." to measure volume variability of mail processing costs, and go on to state at page 16, lines 9-10 that "Witness Bradley was meticulous in his approach, performing numerous analytical and diagnostic calculations."

- a. Please specify all documents, including workpapers, that you relied upon to draw the above conclusions.
- b. As a part of your review of Professor Bradley's analysis, did you examine the data to assess its accuracy or reliability? If yes, please describe your examination of the data and what conclusions you drew based upon this examination.
- c. As a part of your review of Professor Bradley's analysis, did you examine the data that Professor Bradley excluded from his analysis? If so, did you determine whether the exclusion of these data was appropriate? Please explain.
- d. As a part of your review of Professor Bradley's analysis, did you investigate alternative specifications of his recommended models? If so, please describe these investigations and what conclusions you drew based upon these investigations.
- e. As a part of your review of Professor Bradley's analysis, did you perform any independent analysis, including but not limited to recalculation of the resulting cost variabilities by MODS operation, to verify the results of Professor Bradley's analysis? If so, please describe this independent analysis and provide a copy of the analysis.

Response:

(a) I based my statements on my review of witness Bradley's testimony, his discussion of his data scrubs in library reference USPS-LR-H-148, and discussions with professional colleagues familiar with Bradley's testimony.

(b) - (c) I did not perform an independent analysis of witness Bradley's data. However, I did review the procedures he used to edit his data. I directed a spot check of the information witness Bradley presented in Table H-148-1 describing the results of his data

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of NAA**

scrubs for several direct mail processing operations and found the information presented therein to be accurate. Our review of his scrubs also supports witness Bradley's statement that the eliminated observations clearly contained some extreme values.

(d) It is not clear what is meant by "investigate" alternative specifications. If this means did I perform additional regression analyses with different functional forms or alternative sets of maintained restrictions than those presented by witness Bradley, the answer is I did not fit other models. However, I did look at the tests he conducted to evaluate his model. In my discussions with colleagues, we noted several good attributes of Bradley's model and tests including his use of the translogarithmic functional form, a flexible functional form which permits the data to largely determine the shape of the regression surface, his application of a Gauss-Newton regression to test for the presence of significant facility-specific effects, his use of Hausman's test to rule out the use of a random-effects model; and his correction for serial correlation in the residuals.

(e) Yes. Using witness Bradley's data and programs, provided in library references USPS-LR-H-148 and USPS-LR-H-149, I directed a replication of a subset of the results Bradley presented in his Table 7. We checked his results for Manual Letters, Manual Flats, FSM, OCR, and BCS and found them to be accurate. A copy of our results will be filed as a Library Reference (MPA-LR-6).

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of NAA**

NAA/MPA-T2-2. Please refer to pages 32-33 of your direct testimony. You discuss an alternative cost distribution for clerk and mailhandler costs and suggest this method is consistent with the methods used in previous rate hearings. Would your distribution methodology yield the same cost distribution as the methodology used by the Commission in R94-1 ? If no, please describe and quantify any differences by class and subclass of mail using your method and the method employed in R94-1.

Response:

I have not run the Commission R94-1 method since I started with witness Degen's method and modified it in ways that returned parts of witness Degen's approach to Commission accepted methods. I therefore cannot quantify differences by class and subclass between my method and the method employed by the Commission in R94-1. However, there are strong similarities between my method and the Commission method. There are also differences:

- The Commission methodology used IOCS tally information contained in IOCS Question 18 to partition the accrued cost of Clerks and Mailhandlers into its three components: mail processing, window service, and administration. Witness Degen did the same partitioning for BMCs and non-MODS facilities. However, for MODS facilities he used MODS Pay Data System costs to divide costs to component. This led to a shifting of costs from window service and administration to mail processing. In the methodology advocated by witness Stralberg and I, not-handling costs that would have been defined as window service and administration under the Commission methodology are shifted back to those cost components.
- The Commission methodology classified costs for some activity codes as mail processing fixed. Witness Degen determined attributable costs by applying witness Bradley's volume variability estimates to accrued costs from the Payroll Data System on a cost pool by cost pool basis. I have accepted witness Degen's implementation of

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of NAA**

witness Bradley's variability calculations.

- The Commission methodology distributes mixed mail costs to subclass within CAG and basic function. Witness Degen performs separate distributions for MODS, non-MODS, and BMC facilities. I also perform separate distributions for MODS, non-MODS and BMC facilities, using CAG and basic function within facility type.
- The Commission methodology distributes overhead costs as the last step in the distribution process, distributing aggregate overhead costs in proportion to the distribution of all other mail processing costs. Witness Degen does not distribute overhead costs separately - he handles the category of not-handling costs at the same time as mixed mail costs, distributing not-handling costs for MODS, non-MODS, and BMCs separately, and confining the distribution within cost pools. Since witness Degen's program is my starting point, I also distribute not-handling costs at the same time as mixed mail costs separately for MODS, non-MODS and BMCs. However, my distribution is across cost pools, using CAG and basic function, an extension of the Commission's mixed-mail approach.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of NAA**

NAA/MPA-T2-3. In Docket No. R94-1, you and Witness Stralberg presented arguments for treating certain mail processing overhead costs as institutional costs and alternative options for distributing these costs across mail classes and subclasses. These arguments are similar to those you are presenting in the current proceeding. In R94-1, the Commission did not accept the suggestion to exclude mixed-mail data from the distribution of mail processing costs, concluding that, "Using the counted mixed-mail tallies as part of the direct tally base for distributing uncounted mixed-mail costs is the preferable approach." [p. 3072]

- a. Please describe any differences in the arguments you are putting forth in this proceeding compared to the arguments in your testimony in Docket No. R94-1.
- b. Do you believe that the Commission's decision was incorrect in Docket No. R94-1?
- c. What circumstances, if any, have changed to suggest that the Commission should reverse its previous decision in the current proceeding? Please explain.

Response:

(a) - (c) There appears to be some confusion as to the nature of my testimony in R94-1. My testimony in that Docket dealt with a proposal by United Parcel Service to use counted mixed-mail tallies as the sole basis for distributing uncounted mixed-mail tallies. I argued against this treatment of uncounted mixed-mail costs, pending more information, and the Commission agreed, using both counted and direct tallies to distribute uncounted mixed-mail costs.

Also in R94-1, Witness Stralberg testified on the possibility of treating some mail processing costs as institutional costs. The Commission declined to treat these costs as institutional but expressed concern that the USPS was not paying enough attention to unanswered questions about the IOCS and mail processing costs. As I noted in my testimony, the Commission raised concerns regarding the increase in the number and proportion of mixed-mail tallies, effects on costs of the shift to automated mail processing, and questions about the category "working but not handling mail" and about the level of

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of NAA**

break time.

The situation in this Docket is somewhat different than in R94-1 since the Postal Service has proposed an entirely new attribution and distribution methodology. In my testimony I present two alternatives for the Commission's consideration, (1) an alternative cost distribution methodology and (2) treating a portion of mixed-mail and not-handling costs as institutional.

I believe there are a number of reasons why the Commission may want to consider both of my recommendations in this case. As I stated in my testimony, my alternative distribution of costs to classes and subclasses avoids unsupported assumptions to the greatest extent possible, uses all verifiable and relevant data collected in IOCS upon which reasonable inferences of causation can be based, and, pending the development of more complete information, follows past distribution practices. I believe my proposal is consistent with the Commission's Decision in R94-1, where they declined to institute a new cost distribution methodology without adequate support.

With regard to my suggestion to treat some volume-variable mail processing costs as institutional, I rely on both the lack of an established causal link between these costs and individual classes or subclasses of mail as well as substantial evidence that a portion of mixed-mail and overhead costs are due to postal inefficiency. I believe my effort to quantify the portion of volume-variable mixed-mail and not-handling costs due to inefficiency provides the Commission with a basis to treat such costs as institutional.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of NAA**

NAA/MPA-T2-4. You contend in your direct testimony at page 33, lines 23-26, that "...the Postal Service agrees that some mail processing costs are institutional costs," and go on to state that, "Based on witness Bradley's analysis, almost a quarter of all mail processing costs (direct, mixed mail, and not-handling) are treated as institutional."

- a. Please confirm that the Postal Service's recommendation to treat a portion of mail processing costs as institutional costs is based on Professor Bradley's conclusion, generated by his new methodology, that a portion of mail processing costs are not volume variable. If you cannot confirm, please discuss your response fully.
- b. Please confirm that none of the mail processing costs the Postal Service is categorizing as institutional in this proceeding would be considered volume variable using Professor Bradley's methodology. If you cannot confirm, please discuss your response fully.
- c. If you confirm parts (a) and (b) above, please discuss how Professor Bradley's testimony supports the notion of categorizing volume variable mail processing costs as institutional costs.

Response:

(a) Confirmed.

(b) Confirmed.

(c) I did not state that Professor Bradley's testimony discusses the potential treatment of volume-variable costs as institutional. What I stated is that witness Bradley's testimony opens the door to reconsidering distributing 100 percent of mail processing costs to classes and subclasses of mail. Treating volume variable mail processing costs as institutional can be justified on the basis of an inadequate causal link between these costs and classes and subclasses of mail.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of NAA**

NAA/MPA-T2-5. Please refer to your direct testimony, page 34, lines 1-2 and page 36, lines 15-18. Is it your testimony that all volume variable not-handling costs be treated as institutional costs or only those volume variable not-handling costs resulting from "inefficient" operations. Please discuss your response fully.

Response:

I propose that a portion (\$1 billion) of volume variable not-handling costs be treated as institutional costs in this case. These costs represent mixed-mail and not-handling costs that I estimate are due to inefficiency. As I stated in my testimony, for these costs, we neither have a basis for distribution to subclasses nor are we ever likely to find one. I would note that the first quote in this question, page 34, lines 1-2 describes witness Stralberg's testimony.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of NAA**

NAA/MPA-T2-6. In preparing your testimony, did you investigate possible inefficiencies in Postal Service operations related to any other cost categories besides mail processing, including, for example, transportation or carrier costs? Please explain your response.

Response:

No. My testimony continues an examination of mail processing cost questions first raised by Periodicals and other mailers in Docket No. R90-1 and discussed again in RM92-2 and R94-1 as well as in other venues.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of NAA**

NAA/MPA-T2-7. Assume, for example, that inefficiencies were found to exist in the transportation of mail between BMCS. If this were the case, would you recommend *that a portion of the inter-BMC transportation costs be classified as "institutional" costs*? Please explain your response.

Response:

Before I would venture to make a recommendation on how transportation inefficiencies should be handled, I would want to undertake a careful analysis of cost causation and distribution methodologies. However, in theory I would agree that if there is no causal link between a subclass of mail and the inefficient costs, then such costs should be treated as institutional costs. For example, if we assume that the average capacity utilization for a truck is ten percent for a year and that the reason for this low capacity utilization is that the Postal Service is unwilling to reduce capacity, then the cost of the 90% of the truck that is empty should not be attributed to the subclasses that take up the 10% of utilized truck capacity.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of NAA**

NAA/MPA-T2-8. Please refer to page 36 of your direct testimony. You cite a Christensen Associates study to derive your estimates of the proportion of mixed-mail and not-handling costs resulting from Postal Service "inefficiencies."

- a. Have the facilities in the top quartile of productivity experienced the same increase in not-handling costs as those facilities in the bottom 75 percent over the last ten years? Please discuss your response.
- b. Based on the results of the Christensen Associates study, please confirm that the bottom 75 percent of facilities experience some inefficiency in direct mail handling costs in addition to inefficiencies in mixed-mail and not-handling costs? If you cannot confirm, please explain your response.
- c. If part (b) is confirmed, should direct mail handling costs resulting from inefficient operations be attributed to classes or subclasses of mail? Why or why not?

Response:

(a) I do not have any data that would allow me to test whether the top quartile of facilities experienced the same increase in not-handling costs as those facilities in the bottom 75 percent over the last ten years.

(b) Christensen Associates did not discuss their benchmarking results with respect to IOCS direct, mixed-mail, or not-handling tallies. Given the magnitude of the potential improvements that they found, it is likely, however, that there is room for improvement in direct mail handling activities as well as mixed-mail and not-handling activities.

(c) In theory, if there is no causal connection between the subclasses of mail being handled and direct tally costs, such costs should not be attributed to the subclasses being handled. However, I was concerned in preparing my testimony that the Commission would be hesitant to ignore the known subclasses associated with direct tallies. Therefore, at the current time I recommend that the Commission classify volume-variable mixed-mail and

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of NAA**

not-handling costs that are due to inefficiency as institutional costs, but accept the direct volume-variable costs in Degen's testimony. As I stated earlier, for the mixed-mail and not-handling costs we neither have a basis for distribution to subclasses nor are we ever likely to find one.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of NAA**

NAA/MPA-T2-9. Considering your arguments relating to inefficient mail processing costs:

- a. According to economic theory, how might the price signals sent to a consumer of an "inefficiently produced" product be affected when that product's price is artificially set at "efficient" levels?
- b. What are the consequences of these price signals in terms of overall economic efficiency?
- c. Assume that an inefficient producer of a product prices the product at the cost of producing the product inefficiently. Will this inefficient producer lose business to more efficient competitors? If no, please explain why not.
- d. If your response to part (c) above is yes, does this price signal promote efficiency by having consumers buy the product from the most efficient producer? Please explain your response.
- e. Now assume instead that an inefficient producer of a product prices the product at less than his actual cost of producing the product. Will this inefficient producer maintain business that would otherwise go to more efficient producers? Please explain why or why not.
- f. If your response to part (e) above is yes, does this price signal reduce economic efficiency by having consumers buy the product from a less efficient producer? Please explain your response.

Response:

(a) -(f) In a truly competitive market, if an inefficient producer charges consumers less for a product than it actually costs to produce it, several economic consequences result: consumers will buy more product from the firm and the firm will produce more product than is socially efficient; the inefficient producer may keep customers that it should have lost to more efficient competitors; and the inefficient producer may even take business away from more efficient competitors. All of these consequences would reduce economic

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of NAA**

efficiency.

Again in a truly competitive market, if an inefficient producer prices a product at the cost of production, the inefficient producer will lose business to more efficient competitors. This would promote economic efficiency.

However, I would note that this situation is not applicable to the Postal Service for a number of reasons. First, the Postal Service is a monopolist in many of its markets. Thus, it is not subject to the same market pressures as those who produce in competitive markets. Even if it produces inefficiently, it will not lose its entire market share as would a producer in a perfectly competitive market. Second, the Postal Service, which must break even, does not price its products at marginal cost. If products were priced at marginal cost, the Postal Service would not recover enough revenue to cover expenses. Therefore, the rates charged customers are based on marginal costs (attributable costs) plus a markup (institutional cost contribution).

Also in this case, the Postal Service has performed incremental cost tests to ensure that rates are not below incremental cost for any subclasses. As long as each subclass of mail passes the incremental cost test, rates will not be below cost. I am not proposing any changes to the rates proposed by the Postal Service. Therefore, all subclasses will pass the incremental cost test, whether or not the volume-variable costs I suggest be classified as institutional costs are included in incremental costs.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of UPS**

UPS/MPA-T2-1. Please refer to your Table 4 (page 24) and the attached table.

(a) Please confirm that the distribution of the costs of mixed mail sacks by witness Degen (USPS-T-1 2) approximately follows the percentages listed in your Table 4. For example, mixed Blue & Orange sacks would be distributed about 76% to Express Mail, while mixed Brown sacks would be distributed about 72% to periodicals. If not confirmed, please explain and provide the correct proportions for each of the examples in your Table 4.

(b) Please confirm that under your method, the distribution of the costs of mixed mail sacks would approximately follow the percentage listed in the "Cohen Distribution to Assoc. Class" in the attached table. For example, mixed Blue & Orange sacks would be distributed about 1% to Express Mail, while mixed Brown sacks would be distributed about 5% to periodicals. If not confirmed, please explain and provide the correct proportions for each of the examples in your Table 4.

(c) Please confirm that, with the exception of Green Sacks (associated with First Class Mail), your distribution methodology would result in a significantly reduced proportion of mixed mail sack costs being distributed to their associated classes relative to witness Degen's distribution.

Association of Sack Type and Mail Class

<u>Sack Color or Type</u>	<u>Associated Class</u>	<u>Associated Class %</u>	<u>Cohen Distribution to Assoc. Class</u>
Blue and Orange	Express	76%	1%
Brown	Periodicals	72%	5%
Green	First Class	73%	74%
International	International	90%	2%
Orange and Yellow	Priority	86%	4%
White	Standard A	63%	22%

Source: MPA-T-2 Table 4, and MPA-LR-1.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of UPS**

Response:

(a) I confirm that the distribution of the costs of mixed mail sacks by witness Degen should approximately follow the percentages listed in my Table 4. There will be differences because witness Degen used separate distribution keys for each cost pool.

(b) I cannot confirm because I do not know how you calculated the percentages in the "Cohen Distribution to Assoc. Class" column. I did not perform such a calculation because I distributed mixed mail costs by activity code, not by item type. As an approximation, I list below my overall distribution of mixed mail costs to the classes listed in my Table 4 as well as the corresponding distribution of Direct Costs.

Table 1. Distribution of Direct and Mixed Mail Costs to Mail Class

Express	0.5%	0.6%
Periodicals	5.0%	4.6%
First-Class	61.9%	60.0%
International	1.8%	2.5%
Priority	3.2%	3.4%
Standard A	22.2%	22.3%

(c) I cannot confirm as this question is stated. The question seems to suggest that there is a known association between classes and sack type for mixed sack tallies. My Table 4 only provides data on the association in direct sack costs. Neither the Postal Service nor I have any data on the existence or extent of associations between classes and sack type in mixed sack tallies. There is strong evidence on the record that such associations would be far weaker in mixed sack tallies than in direct sack tallies, particularly identical sack tallies.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of UPS**

First, as witness Stralberg and I testified, identical sacks are generally prepared by bulk mailers, not the Postal Service. This leads to a higher proportion of Standard A and Periodicals mail in identical sacks than is likely in mixed sacks, which may contain collection mail and other mail packaged by the Postal Service.

Second, as I described in my testimony, witness Degen's data demonstrate that there is a tendency to count sacks with fewer pieces, which leads to a higher percentage of Priority Mail and Periodicals in the counted sack tallies than is likely in the uncounted sack tallies.

Third, data underlying my Table 4 demonstrate that associations for counted sacks are weaker than for identical sacks. The results contained in my Table 4 are actually a composite of the results for identical sacks and counted sacks. The table below shows the association between class and sack type for identical and counted sacks separately for First-Class, Periodicals, and Standard A mail. As this table shows, for each of these classes, the association between class and sack type is less strong for counted sacks than for identical sacks. For white sacks, which represent more than 40% of the direct sack costs, the association is much weaker in the counted sacks.

Table 2. Association Between Sack Color and Class for MODS Offices

Color	Class	Associated Class	Associated Class
		% of Identical	% of Counted
Brown	Periodicals	75%	67%
Green	First-Class	90%	75%
White #1	Standard A	66%	32%
White #2	Standard A	73%	41%
White #3	Standard A	81%	58%

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of UPS**

Please also note that the high sampling errors in witness Degen's item type and cost pool distributing sets affects the reliability of associations measured in the direct item costs. As I stated in my testimony, approximately 70% of the item type-cost pool-subclass combinations of direct tallies have coefficients of variation greater than or equal to 50 percent. These statistically questionable combinations distribute approximately 25 percent of mixed item and identified container costs to subclass.

I would also note that the table attached to this interrogatory makes it appear that witness Degen's proposal and mine yield vastly different distributions of costs to classes and subclasses. This impression is inaccurate. While my proposed method may distribute less cost for a particular sack type to a particular class, that same class may get a correspondingly higher share of the costs of some other item type. Overall, my proposed distribution is not that different from that proposed by witness Degen.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of UPS**

UPS/MPA-T2-2 Please refer to page 34, lines 17-20, of your testimony where you state, "Second, if mail processing costs are inflated due to inefficiency in mail processing operations, no class or subclass of mail should be held responsible for the portion of these costs resulting from this inefficiency."

(a) Please explain how your proposal to treat not handling costs as institutional costs would render no class or subclass of mail responsible for those costs.

(b) Please confirm that moving costs from attributable costs to institutional costs results in those costs being "allocated" to classes and subclasses of mail by markup factors. If not confirmed, please explain.

Response:

(a) My proposal to treat the portion of mail processing costs that is due to inefficiency as institutional would remove these costs from the attributable cost floor established in section 3622(b)(3) of the Postal Reorganization Act. The Act requires all subclasses and services to at least cover those costs attributable to the subclass or service. Under my proposal, subclasses would not be held responsible in the sense that no subclass would have to cover these costs for rates to be above the attributable cost floor.

Please also note that if the Commission chooses to do so, it has authority under its "honest, economical, and efficient management" mandate to disallow costs due to inefficiency. This would remove the inefficient costs not only from the attributable cost floor but from institutional cost assignments as well.

(b) Confirmed.

UPS/MPA-T2-3. Please refer to your proposal to "treat a portion of volume-variable mixed mail and not-handling costs as institutional" (beginning on page 33 of your testimony). Please confirm that this proposal would decrease the overall ratio of attributable costs to total cost in Cost Segment 3 from about 71% (Postal Service case) to about 65%. If not confirmed, please explain.

Response:

Not confirmed. Based upon Exhibit USPS-151 in witness Patelunas' testimony, I calculate that the ratio of attributable costs to total costs in Cost Segment 3 would change from 72%.

**MAGAZINE PUBLISHERS OF AMERICA WITNESS COHEN
RESPONSES TO INTERROGATORIES OF UPS**

UPS/MPA-T2-4. Please confirm that using your proposed distribution technique (and the LIOCAT method), the cost for empty letter trays would be distributed, in part, to subclasses which are predominantly or exclusively comprised of flats and parcels. If not confirmed, please explain.

Responses:

Not confirmed. Unlike witness Degen's methodology, I do not propose a separate distribution key for empty letter trays. My proposed methodology distributes all "moving empty equipment costs" on the basis of total direct tallies by CAG and basic function. In Table 1 below, I show, for all facilities, the breakdown of tally costs for the moving empty equipment category. As this table shows, one-third of the category consists of tallies where the employee is not handling any item or container. Not handling and general purpose containers together represent almost half of total moving empty equipment costs. Empty letter trays are less than 10 percent of the total.

Table 2 shows my distribution of moving empty equipment costs (as well as mixed all shapes, clocking in and out, breaks/personal needs, and carrier-related costs) to classes of mail. It would appear that letter-shaped mail is assigned more than 10 percent of the costs. I would not, however, draw any conclusions from these results as to the causal connection between empty letter tray costs and subclasses of mail.

MAGAZINE PUBLISHERS OF AMERICA WITNESS COHEN RESPONSES TO INTERROGATORIES OF UPS

Table 1. Moving Empty Equipment Tally Costs

Type	Tally Cost (\$000s)	Percent
Not Handling	360,580	32.8%
gpc/apc/	145,627	13.3%
Letter Tray	105,777	9.8%
hamper	90,560	8.2%
Flat Tray	59,410	5.4%
bmc-otr	55,614	5.1%
u-cart	48,108	4.4%
nut.trck	41,230	3.8%
z-oth cn	30,682	2.8%
White #2 Sack	19,262	1.8%
wiretain	18,832	1.7%
White #1 Sack	18,028	1.6%
emmc	13,244	1.2%
Pallet	12,121	1.1%
Orange or Yellow Sack	11,411	1.0%
White #3 Sack	10,996	1.0%
Other Item	10,740	1.0%
Brown Sack	9,654	0.9%
p-pack	8,864	0.8%
Green Sack	7,692	0.7%
Con-Con	6,702	0.6%
Other Color Sack	4,531	0.4%
Small Parcel Tray	4,202	0.4%
Blue and Orange Sack	3,623	0.3%
International Sack	1,402	0.1%
notin cn	0	0.0%
Total	1,098,892	100.0%

Table 2. MPA Distribution of Overhead and Carrier-Related Costs

Class	Distribution
First	61.14
Priority	3.35
Express	0.58
Periodicals	4.72
Standard A	21.85
Standard B	3.30
Spec. Svcs.	5.08

**MAGAZINE PUBLISHERS OF AMERICA WITNESS COHEN
RESPONSES TO INTERROGATORIES OF UPS**

UPS/MPA-T2-5. Please confirm that using your proposed distribution technique (and the LIOCATT method), the cost for empty flat trays would be distributed, in part, to subclasses which are predominately or exclusively comprised of letters and parcels. If not confirmed, please explain.

Responses:

Not confirmed. Unlike witness Degen's methodology, I do not propose a separate distribution key for empty flat trays. My proposed methodology distributes all "moving empty equipment costs" on the basis of total direct tallies by CAG and basic function. In Table 1 of my response to interrogatory UPS/MPA-T2-4, I show the breakdown of tally costs for the moving empty equipment category. As this table shows, one-third of the category consists of tallies where the employee is not handling any item or container. Not handling and general purpose containers together represent almost half of total moving empty equipment costs. Empty flat trays are approximately 5 percent of the total.

Table 2 of my response to interrogatory UPS/MPA-T2-4 shows my distribution of moving empty equipment costs (as well as mixed all shapes, clocking in and out, breaks/personal needs and carrier-related costs) to classes of mail. It would appear that flat-shaped mail is assigned more than 5 percent of the costs. I would not, however, draw any conclusions from these results as to the causal connection between empty flat tray costs and subclasses of mail.

**MAGAZINE PUBLISHERS OF AMERICA WITNESS COHEN
RESPONSES TO INTERROGATORIES OF UPS**

UPS/MPA-T2-6. Please confirm that an empty item, before being emptied, could have been an IOCS identical item. If confirmed, please explain how it is unreasonable to use identical items to distribute the cost of empty items. If not confirmed, please explain.

Responses:

I agree that an empty item could have previously contained identical mail. Depending on the type of item, it may also have previously contained top-piece rule mail, counted mixed-mail or uncounted mixed-mail. Once the item is empty I don't know how you would know which of these were true.

Furthermore, the question seems to assume that all empty item costs are related to productive mail activities. However, as I explained in my testimony, there has been a very significant growth in the costs of not-handling mail, including moving empty equipment costs, in recent years leading to uncertainty about the causal connection between empty equipment costs and any classes of mail. Moving empty equipment has traditionally been included in overhead costs which grew from 23 percent of all other mail processing costs in 1989 to 31.5 percent in 1996.

In light of this uncertainty, I have recommended two courses of action to the Commission. First, I have recommended reverting to the previous more aggregated distribution methodology for mixed-mail costs to avoid reliance on unsupported assumptions. Second, I have recommended that the Commission recognize the alarming growth in empty equipment and other traditionally defined overhead costs and the likelihood that some portion of these costs are caused by inefficiency related to automation by treating a portion of these costs as institutional costs pending further data collection and analysis by the Postal Service.

**MAGAZINE PUBLISHERS OF AMERICA WITNESS COHEN
RESPONSES TO INTERROGATORIES OF UPS**

UPS/MPA-T2-7. Please refer to page 29, lines 7-9, of your testimony.

- (a) Please confirm that only 8 percent of empty and uncounted item costs are distributed on by Mr. Degen the basis of fewer than 5 tallies, as shown in DMA-LR-1. If not confirmed, please explain.
- (b) Please confirm that less than 3 percent of identified mixed container costs are distributed by Mr. Degen on the basis of fewer than 5 tallies, as shown in DMA-LR-1. If not confirmed, please explain.
- (c) Please confirm that less than 4 percent of unidentified/empty container costs are distributed by Mr. Degen on the basis of fewer than 5 tallies, as shown in DMA-LR-1. If not confirmed, please explain.
- (d) Please confirm that your analysis of distribution keys with fewer than 5 tallies includes distribution keys which would contain fewer than five tallies under the LIOCAT system (e.g., Nonmods Outgoing, Incoming, Transit, and Other pools). If not confirmed, please explain.
- (e) Please confirm that LIOCAT uses distribution keys with fewer than 5 tallies in the distributing set. If not confirmed, please explain.
- (f) Please confirm that your distribution analysis would result in distribution keys with fewer than five tallies. If not confirmed, please explain.

Responses:

(a) Not confirmed. I calculate 9.3 percent. My calculations are contained in MPA-LR- 9, worksheet UPS7.xls. I would further note that 32 percent of the costs of empty items and 51 percent of the costs of uncounted items are distributed based upon distribution sets with coefficients of variation greater than 50 percent, for which there is no statistical basis to conclude that the distributing key is not zero.

(b) Not confirmed. I calculate 3.2 percent. My calculations are contained in MPA-LR-9,

**MAGAZINE PUBLISHERS OF AMERICA WITNESS COHEN
RESPONSES TO INTERROGATORIES OF UPS**

worksheet UPS7.xls. I would further note that 17 percent of the cost of identified containers is distributed based upon distribution sets with coefficients of variation greater than 50 percent, for which there is no statistical basis to conclude that the distributing key is not zero.

(c) Not confirmed. I calculate 5.8 percent. My calculations are contained in MPA-LR-9, worksheet UPS7.xls. I would further note that since unidentified and empty containers are distributed primarily on identified containers, the coefficient of variation deficiencies described above for identified containers would also affect unidentified and empty containers.

(d) - (e) Not confirmed. Witness Degen does not use the same distribution keys as LIOCATT and my analysis of the coefficients of variation for witness Degen's distributing sets pertain to his distribution methodology and not to LIOCATT. I agree that there could be distributing sets in LIOCATT with fewer than 5 observations, however it is much less likely than if distribution is done by item type and within cost pool.

(f) I assume the question refers to my proposed distribution keys rather than my distribution analysis of witness Degen's distribution keys. In MODS and BMC facilities, I have 7 distribution keys with fewer than 5 tallies. Six of these are in the nixie, central markup, and postage due activity codes. There are more distribution keys with fewer than 5 observations in the non-MODS offices, particularly for the smaller CAGs. These could be avoided by collapsing over some of the CAGs.

**MAGAZINE PUBLISHERS OF AMERICA WITNESS COHEN
RESPONSES TO INTERROGATORIES OF UPS**

UPS/MPA-T2-8. Please refer to your testimony at page 13 at which you discuss the proportion of not handling mail costs by operation type.

- (a) Please confirm that alternative explanations exist, other than that this data is a "clear indication of the phenomenon GAO identified," to explain this data. If not confirmed, please explain.
- (b) Please confirm that some operations may, by their very nature, involve more "not handling mail" than other operations. If not confirmed, please explain.
- (c) Please confirm that the ratio of not handling costs to direct/mixed costs in the LSM pool is 0.35, while the same ratio for SPBS Priority Mail (SPBSPRIO) is 0.92 (as shown in LR-H-23 and Exhibit DMA-2). If not confirmed, please explain.
- (d) Please assume that the ratios discussed above are the result of the nature of the LSM and SPBS Priority Mail operations. Please explain why it is not appropriate to distribute the costs for not handling mail by cost pools in this hypothetical example.

Responses:

(a) Not confirmed. Periodicals' mailers have been seeking an explanation for the alarming increase in not-handling costs since 1990. So far, the Postal Service has not offered one. This failure has occurred, as I explained in my testimony, despite extensive efforts by the Commission to press the USPS to answer questions about the category "working but not handling mail" and about the amount of break time. MPA-T2 at 9. Witness Stralberg and I have concluded that the rapid growth in not-handling costs at operations where productivity is not measured and where employees are frequently assigned while awaiting productive work elsewhere is due to inefficiency related to automation. The Postal Service has offered no reasonable alternative explanation.

(b) I agree that some operations may involve more not-handling operations than others.

**MAGAZINE PUBLISHERS OF AMERICA WITNESS COHEN
RESPONSES TO INTERROGATORIES OF UPS**

In fact, as I pointed out in my testimony, witness Barker attested to this fact in Docket R94-1, suggesting that the large increase in not-handling and break time in fiscal year 1993 was not a problem since employees at *automated operations* are often tending the machines instead of touching the mail. MPA-T2 at 13. This theory does not explain why there would be so much not-handling at *manual operations*, particularly allied operations, or why there should have been such rapid growth in not-handling tallies at *manual operations*.

(c) Confirmed.

(d) I find it hard to assume that the "nature" of small parcel and bundle sorter (SPBS) activity would suggest that not-handling costs should be as large as direct and mixed costs at the operation. Employees working at the SPBS would generally be keying, feeding mail onto the belt, or removing sorted mail from the machine. It seems clear, therefore, that most legitimate activity at the SPBS should result in handling tallies rather than not-handling tallies. I do not think that the distribution of not-handling costs should be done on the basis of assumptions that seem counterintuitive.

**MAGAZINE PUBLISHERS OF AMERICA WITNESS COHEN
RESPONSES TO INTERROGATORIES OF UPS**

UPS/MPA-T2-9. Please refer to your Table 2, at page 14 of your testimony.

- (a) Please confirm that the "automation refugee" problem could be evidenced by increasing (or stable) productivity in automated operations and simultaneous decreasing productivity in manual operations. If not confirmed, please explain.
- (b) Please confirm that your Table 2 (reproduced in part below) shows average productivity change of + 4.5% for automated operations and + 5.8% for manual operations. Please explain how this is evidence of an "automation refugee" problem.
- (c) Please confirm that an alternative explanation for the data presented in your Table 2 (reproduced in part below) is that letter productivity (whether manual or automated) has declined 16.8% while non-letter productivity has increased 16.7%. If not confirmed, please explain.

Percent Change In Productivity: FY 1988 - FY 1996

Percent Operation			Letter	Non-
Operation	Change	Type	Letter	
Optical Character Reader	(38.0)	A	(38.0)	
Bar Code Sorter	2.0	A	2.0	
Letter Sorting Machine	(21.0)	A	(21.0)	
Manual Letter	(10.0)	M	(10.0)	
Manual Flat	(6.0)	M		(6.0)
Flat Sorting Machine	(18.0)	A		(18.0)
Manual Parcel	45.0	M		45
Mechanical Parcel	60.0	A		60
SPBS (Non-Priority)	37.0	A		37
Manual Priority	(6.0)	M		(6.0)
SPBS (Priority)	5.0	A		5.0
Mail Cancellation/Prep	9.0	A		
Average Automated	4.5	A		
Average Manual	5.8	M		
Overall Average			(16.8)	16.7

Source: MPA-T-2, page 14.

**MAGAZINE PUBLISHERS OF AMERICA WITNESS COHEN
RESPONSES TO INTERROGATORIES OF UPS**

Responses:

(a) It is possible that the automation refugee problem could lead to increased or stable productivity in automated operations and simultaneous decreasing productivity in manual operations. I would note that the inability to find productive assignments could affect productivity at all operations, but is most likely to affect productivity at operations where productivity is not monitored, such as opening units and platforms. I would further note that the productivity at automated operations may also be affected by the quality of the automated mailstream and that productivity at all operations is affected by managerial decisions and priorities.

(b) Not confirmed. The 4.5 percent and 5.8 percent figures represent simple averages of the productivity change columns, not a meaningful calculation. A dollar-weighted average of the productivity change for manual operations yields an average productivity change of -8 percent. The reason that the simple average masks this productivity decline is that the manual operation at which productivity increases significantly is the manual parcel sorting operation. This operation, however, only comprises a very small portion of manual sorting costs.

(c) Not confirmed. The -16.8 and 16.7 percent figures represent simple averages of the productivity change columns, not a meaningful calculation. A dollar weighted average of the productivity changes by shape shows that productivity dropped for both letters and flats, with letter productivity decreasing 12 percent and flats productivity decreasing by 13 percent. The only shape of mail experiencing productivity gains is parcels, perhaps not coincidentally, the shape of mail for which the Postal Service has significant competitors and therefore an incentive to improve productivity and lower costs.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-1. Please refer to MPA-T-2 at pages 13-14. Please explain in detail why it is "counterintuitive" for the costs of handling empty items to be a significant fraction of the cost of handling non-empty items.

Response:

I find it difficult to provide a precise answer to this question as I am not sure exactly what is meant by "significant fraction". Obviously, I am not suggesting that there should be no costs for handling empty items. However, as I stated in my testimony, I find it counterintuitive that for some item types the costs of handling empty items are almost as high, and in some cases as high, as the costs of handling these items when they contain mail. There are several reasons for my conclusion. First, and foremost, items containing mail will undergo a variety of mail processing distribution operations, including loading, unloading and sortation, with each item handled individually as it makes its way from origin to destination. The item may go through multiple facilities and multiple handlings and sortations. Conversely, empty items do not need sortation; they only have to be moved. Nor do empty items need to be handled individually. For example, a mailhandler can handle a stack of pallets or a bundle of sacks as one unit. Also, an empty item will not need to travel as far through the postal system as an item containing mail. An empty item can probably be reused as soon as it is emptied rather than being returned to the facility where the full item originated. Second, given the long-standing understanding that weight has an impact on mail processing costs, it should always take longer and cost more to process items with mail in them than items without mail in them.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-2. Please refer to MPA-T-2 at page 23. You state that IOCS data collectors "manage to count only about 38 percent of eligible item costs."

(a) Please confirm that the 38 percent figure you provide is derived from the same data as presented in witness Stralberg's Table 4-1, Exhibit 4, TW-T-1. If you do not confirm, please explain.

(b) Please confirm that the 38 percent figure you provide is derived in the same way as the identical figure in TW-T-1, page 15, line 20. If you do not confirm, please provide a detailed derivation of the figure in electronic spreadsheet format.

Response:

(a) and (b). The 38 percent figure on page 23 of my testimony is the same figure referred to by witness Stralberg on page 15 of TW-T-1. However, using the data in the preceding sentence on page 23 of my testimony yields 40 percent as the percentage of eligible item costs counted. The difference between these two estimates is based on using tally costs versus volume variable costs and using slightly different source data. Witness Stralberg used data provided by witness Degen in LR-H-296. My estimate is based upon data provided by witness Degen in LR-H-277 and LR-H-304. The cost data provided by witness Degen in LR-H-277 and LR-H-304 are slightly different than those provided in LR-H-296. A detailed derivation of the 40% figure will be filed as MPA-LR-3, spreadsheet usps2b.xls.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-3. Please refer to your Table 4 (MPA-T-2 at page 24), and TW-T-1, at page 13.

(a) Do you agree with witness Stralberg that Regular Rate Periodicals account for 3.86% of all direct volume variable costs in MODS offices? If not, please explain.

(b) Please confirm that, according to your Table 4, Periodicals are approximately 18 times more common in brown sack tallies than in direct tallies as a whole. If you do not confirm, please explain.

Response:

(a) I am not sure exactly how witness Stralberg derived his 3.86 percent figure on page 13 of TW-T-1. However, I am able to come close to his estimate. If I exclude counted item costs, I calculate that regular rate Periodicals costs are 3.8 percent of direct volume variable costs in MODS facilities.

(b) Not confirmed. First, please note that the costs included in my Table 4 are based on tally costs, not volume variable costs. Second, please note that part (a) deals with regular rate Periodicals while my Table 4 covers all Periodicals. Third, the question seems to ask for a conclusion with regard to brown sack mixed mail tallies. However, neither the Postal Service nor I have any data to determine how common Periodicals are in mixed mail brown sack tallies. I would note that data underlying my Table 4 suggest that Periodicals are less common in brown sack mixed mail tallies than in brown sack direct mail tallies. The results in Table 4 are actually a composite of the results for identical and counted sacks. There are differences between the percent of costs for the associated class between identical and counted tallies, with the association between class and sack type less strong for counted items than for identical items. For brown sacks in MODS offices, the percentage of costs for Periodicals is 67 percent in the counted tallies, compared with 75 percent for the identical tallies. I believe the association will be even lower for uncounted brown sacks

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

because, as I stated in my testimony, the Postal Service tends to count items with few pieces. Because Periodicals mail, due to shape and weight characteristics, is likely to be in sacks with fewer pieces, sacks containing Periodicals are more likely to be counted.

With the caveats noted above, if I assume that the proportions in Table 4 would stay the same if I had used volume variable costs, and using total direct volume variable costs for Periodicals (5% of the total) rather than just regular rate Periodicals, I calculate that the ratio of the percent of direct brown sack costs (both identical and counted) attributed to Periodicals to the percent of total direct volume variable costs attributed to Periodicals is 14.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-4. Please refer to your Table 4 (MPA-T-2 at page 24), and spreadsheet TW-19.xls, USPS-LR-H-260.

(a) Please confirm that Express Mail tallies account for 0.5% of direct volume variable costs in TW-19.xls. If you do not confirm, please provide the figure you believe to be correct.

(b) Please confirm that, according to your Table 4, Express Mail is approximately 152 times more common in blue and orange sack tallies than in direct tallies as a whole. If you do not confirm, please explain.

Response:

(a) Confirmed, if costs for activity codes 53xx - 54xx are excluded.

(b) Not confirmed. The question asks how common Express Mail is in blue and orange sack tallies. Some of the blue and orange sack tallies will be direct tallies, which include identical tallies and counted sack tallies, and some will be mixed-mail tallies. Neither the Postal Service nor I have any data on how common Express Mail is in mixed-mail blue and orange sack tallies. I can confirm only that the ratio of the percent of direct blue and orange sack costs attributed to Express Mail to the percent of total direct volume variable costs attributed to Express Mail is 152.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-5. Please refer to your Table 4 (MPA-T-2 at page 24), and spreadsheet TW-19.xls, USPS-LR-H-260.

(a) Please confirm that Priority Mail tallies account for 3.2% of direct volume variable costs in TW-19.xls. If you do not confirm, please provide the figure you believe to be correct.

(b) Please confirm that, according to your Table 4, Priority Mail is approximately 27 times more common in orange and yellow sack tallies than in direct tallies as a whole. If you do not confirm, please explain.

Response:

(a) Confirmed, if costs for activity codes 53xx - 54xx are excluded.

(b) Not confirmed. The question asks how common Priority Mail is in orange and yellow sack tallies. Some of the orange and yellow sack tallies will be direct tallies, which include identical tallies and counted sack tallies, and some will be mixed-mail tallies. Neither the Postal Service nor I have any data on how common Priority Mail is in mixed-mail orange and yellow sack tallies. I can confirm only that the ratio of the percent of direct orange and yellow sack costs attributed to Priority Mail to the percent of total direct volume variable costs attributed to Priority Mail is 27.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-6. Please refer to your Table 4 (MPA-T-2 at page 24), and spreadsheet TW-19.xls, USPS-LR-H-260.

(a) Please confirm that Standard Mail (A) tallies account for 21.9% of direct volume variable costs in TW-19.xls. If you do not confirm, please provide the figure you believe to be correct.

(b) Please confirm that, according to your Table 4, Standard Mail (A) is approximately three times more common in white sack tallies than in direct tallies as a whole. If you do not confirm, please explain.

Response:

(a) Confirmed, if costs for activity codes 53xx - 54xx are excluded.

(b) Not confirmed. The question asks how common Standard A mail is in white sack tallies. Some of the white sack tallies will be direct tallies, which include identical tallies and counted sack tallies, and some will be mixed-mail tallies. Neither the Postal Service nor I have any data on how common Standard A mail is in mixed-mail white sack tallies. However, data underlying my Table 4 suggest that Standard A mail is much less common in white sack mixed mail tallies than in white sack direct mail tallies. The results I show in Table 4 are actually composites of the results for both identical and counted sacks. There are very significant differences between the percent of costs for Standard A mail in identical and counted white sack tallies, with the association between class and sack type much less strong for counted items. For white sacks in MODS offices, the percentage of costs for Standard A is only 42 percent in the counted tallies, compared with 76 percent for the identical tallies.

If I ignore the difference between identical and counted sacks, I calculate that the ratio of direct white sack costs attributed to Standard A mail to the percent of total direct volume variable costs attributed to Standard A is 3.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-7. Please refer to your Table 4 (MPA-T-2 at page 24), and spreadsheet TW-19.xls, USPS-LR-H-260.

(a) Please confirm that International tallies account for 1.7% of direct volume variable costs in TW-19.xls. If you do not confirm, please provide the figure you believe to be correct.

(b) Please confirm that, according to your Table 4, International Mail is approximately 53 times more common in international sack tallies than in direct tallies as a whole. If you do not confirm, please explain.

Response:

(a) Confirmed, if costs for activity codes 53xx - 54xx are excluded.

(b) Not confirmed. The question asks how common International Mail is in international sack tallies. Some of the international sack tallies will be direct tallies, which include identical tallies and counted sack tallies, and some will be mixed-mail tallies. Neither the Postal Service nor I have any data on how common International Mail is in mixed-mail international sack tallies. I can confirm only that the ratio of the percent of direct international sack costs attributed to International Mail to the percent of total direct volume variable costs attributed to International Mail is 53.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-8. Please refer to your Table 4 (MPA-T-2 at page 24), and spreadsheet TW-19.xls, USPS-LR-H-260.

(a) Please confirm that First-Class tallies account for 62.6% of direct volume variable costs in TW-19.xls. If you do not confirm, please provide the figure you believe to be correct.

(b) Please confirm that, according to your Table 4, First-Class Mail is approximately 1.17 times more common in green sack tallies than in direct tallies as a whole. If you do not confirm, please explain.

Response:

(a) Confirmed, if costs for activity codes 53xx - 54xx are excluded.

(b) Not confirmed. The question asks how common First-Class Mail is in green sack tallies. Some of the green sack tallies will be direct tallies, which include identical tallies and counted sack tallies, and some will be mixed-mail tallies. Neither the Postal Service nor I have any data on how common First-Class Mail is in mixed-mail green sack tallies. However, data underlying my Table 4 suggest that First-Class Mail is less common in green sack mixed mail tallies than in green sack direct mail tallies. The results I show in Table 4 are actually composites of the results for both identical and counted sacks. There are differences between the percent of costs for the associated class between identical and counted tallies, with the association between class and sack type less strong for counted items than for identical items. For green sacks, the percentage of costs for First-Class Mail is 75 percent in the counted tallies, compared with 90 percent for the identical tallies.

If I ignore the difference between identical and counted sacks, I calculate that the ratio of direct green sack costs attributed to First-Class Mail to the percent of total direct volume variable costs attributed to First-Class Mail is 1.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-9. Based on your answers to USPS/MPA-T2-3 to USPS/MPA-T2-8, do you still dispute witness Degen's assertion that there are "significant associations" between certain item types and shapes or subclasses of mail? Please explain fully how your response affects your testimony.

Response:

Yes. Questions 3-8 contain no new information that would change my testimony. The fact remains that there is no strict association between sack types and mail classes that would allow someone to know the contents of an item without looking inside. The data referenced in questions 3-8 pertains only to direct tallies. There are likely to be differences between the content of mixed sacks as compared to direct sacks for a number of reasons, including the fact that identical sacks are prepared by mailers rather than the Postal Service and the likelihood that items with fewer pieces are counted.

Data underlying my Table 4 demonstrate the differences in class association between different types of tallies. For most classes, the association between sack color and class is weaker for counted sacks than for identical sacks. The results for Periodicals, First-Class and Standard A mail at MODS facilities are summarized in the following table.

Color	Class	Associated Class % of Identical	Associated Class % of Counted
Brown	Periodicals	75%	67%
Green	First-Class	90%	75%
White #1	Standard A	66%	32%
White #2	Standard A	73%	41%
White #3	Standard A	81%	58%

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

With the costs associated with white sacks accounting for over 40 % of total sack costs, it is clear that, overall, class association is much less strong in counted tallies than in identical tallies.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-10. Please refer to MPA-T-2 at page 25, lines 14-17. Please confirm that both mailer prepared and Postal Service prepared items can appear as mixed item tallies. If you do not confirm, please explain fully.

Response:

Confirmed, although please note that while mailer-prepared items can appear as mixed item tallies, Postal Service- prepared items will not contain identical mail. A much higher percentage of mailer-prepared items will be direct tallies than the corresponding percentage for Postal Service- prepared items.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-11. Please refer to MPA-T-2 at page 29, lines 16-20.

(a) Please confirm that the 70 percent figure was derived by counting the number of records in spreadsheet DMA15c.xls, USPS-LR-H-305, with coefficients of variation greater than or equal to 50%, and dividing that number by the total number of records in the spreadsheet. If you do not confirm, please provide a detailed derivation of the figure.

(b) Please confirm that 1,106 records, 30.97% of the total, in spreadsheet DMA15c.xls, USPS-LR-H-305 have coefficients of variation less than 50 percent. If you do not confirm, please explain.

(c) Please refer to the "Tally Cost (\$000)" column of spreadsheet DMA15c.xls, USPS-LR-H-305. Please confirm that the observations with coefficients of variation less than 50 percent account for 94.90% of the distributing costs reported in spreadsheet DMA15c.xls. If you do not confirm, please explain. If you confirm, please explain fully how your response affects your testimony.

Response:

(a) Confirmed.

(b) Confirmed.

(c) Confirmed, however I would note that the approximately 5 % of distributing costs with coefficients of variation greater than or equal to 50 % distribute about 25 % of distributed mixed item and identified container costs. This finding is detailed in MPA-LR-3, spreadsheet USPS11C.xls.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-12. Please refer to MPA-T-2 at page 26, and to program ALB105C5, USPS-LR-H-21. You state that it is "troubling" that witness Degen confines his mixed mail distributions within cost pools.

(a) Please confirm that the shape-related mixed mail codes (5610, 5620, 5700) are assigned based on the mail processing operation recorded in IOCS question 19. If you do not confirm, please explain.

(b) Please confirm that witness Degen's distribution cost pools (BCS, LSM, Manual Flats, etc.) are MODS-based analogues to IOCS question 19 operations. If you do not confirm, please explain.

(c) Please confirm that the assignment of the shape-related mixed mail codes in program ALB105C5 does not take into account whether the mail processing operation is a manual, mechanized, or automated operation. If you do not confirm, please explain.

(d) Is it your testimony that you should obtain more accurate mixed-mail distributions by employing mixed-mail activity codes that ignore whether the tally was taken in a manual, mechanized, or automated operation? Please explain fully.

Response:

(a) While I have not reviewed program ALB105C5, my general understanding of IOCS procedures is consistent with this statement.

(b) Not confirmed. First, Degen's cost pools for non-MODS facilities are based on basic function, not operation. Basic function is not assigned based upon question 19. Second, question 19 asks about the activity an employee is actually performing. MODS cost pools are based upon the activity into which an employee is clocked. Degen's response to DMA/USPS-T12-17 (Tr. 17/8147) indicates that employees are not always clocked into the operation that they are actually performing. For example, there are \$10 million of direct tally costs for letters and cards in FSM operations and \$3 million of direct tally costs for flats at LSMs. For more examples, please see USPS-LR-H-305, spreadsheet dma17.xls.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

(c) While I have not reviewed program ALB105C5, my general understanding of IOCS procedures is consistent with this statement.

(d) Even if there was not the clocking problem described in my response to part (b), I would not advocate using information on whether the tally was at a manual, mechanized, or automated operation to lock-in mixed mail tally distributions. Mail of a specific shape can be handled individually or mixed with other mail at manual, mechanized, or automated operations depending on particular staffing decisions or operating circumstances. These operations are interrelated. Therefore, mixed mail costs in one operation are not related solely to direct piece handlings in that operation and there is no basis to assume that direct tallies in a cost pool are representative of the contents of mixed-mail tallies in the same cost pool. Furthermore, as I showed in my testimony, excess labor appears to be assigned to manual allied operations where productivity cannot be calculated. This assignment could inflate both mixed mail costs as well as not handling costs which can have activity codes 5610, 5620, and 5700. It is not reasonable to assign high mixed mail and not handling costs that are due to excess labor to classes of mail which represent a large share of the direct tallies in allied operations.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-13. Please refer to MPA-T-2 at pages 27-28.

- (a) Consider an employee who is loading mail onto the feeder mechanism of an MPBCS. If that employee is sampled in IOCS while handling an empty tray, is it reasonable to assume that the tray's contents were emptied into the MPBCS? Please explain.
- (b) Consider an employee who is sweeping the output bins of an MBPCS. If the employee is sampled in IOCS while handling an empty tray, is it reasonable to assume that the tray would be filled with mail that had been sorted on the MPBCS? Please explain.
- (c) Consider an employee who is working in an opening unit. If the employee is sampled in IOCS while handling an empty brown sack, is it reasonable to assume that the sack was emptied so that the bundles therein could be sorted? Please explain.

Response:

- (a) No. If an employee is sampled at a MPBCS handling an empty tray, the tally record does not contain any information on what the employee was doing before he or she handled an empty tray. I do not believe that it is reasonable to make any assumption about the employee's previous activity. Furthermore, witness Degen's data show that item type may not always be a reliable indicator of the activity in a cost pool, both for empty items and items containing mail. One example of this phenomenon is that at the BCS, where only letter mail is worked, there are \$2 million of costs for tallies involving empty flat trays.
- (b) No. If an employee is sampled at a MPBCS handling an empty tray, the tally record does not contain any information on what the employee will do next. I do not believe it is reasonable to make any assumption about the employee's future activity. Furthermore, as I stated in part (a), the data show that item type may not be a reliable indicator of activity in a particular cost pool.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

(c) No. If an employee is sampled in an opening unit handling an empty brown sack, the tally record does not contain any information on what the employee was doing before he or she handled an empty brown sack. I do not believe that it is reasonable to make any assumption about the employee's previous activity. I would note that for empty item costs as for all other types of tallies, there is a particular problem with making assumptions about employee activities while they are clocked into opening units. As found by the USPS Inspection Service, there are two problems with opening units. The Inspection Service noted on page 19 of their report on allied work hours (USPS-LR-H-236) that employees who must clock in to some operation in order to be paid, will frequently clock into opening units, where productivity is not measured, while waiting for another assignment. The Inspection Service further noted that when these employees move from the opening unit to another unit when productive work has become available, employees may not change the clocking operation. Because of excess labor and misclocking at opening units, it is not reasonable to assume that just because an employee is handling an empty item while clocked into an opening unit, the empty item tally is related to a productive activity at the opening unit.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-14.

(a) Please refer to MPA-T-2 at page 25, lines 23-28. Is it your testimony that loose flats found in containers are unlikely to resemble piece handlings in distribution operations? Please explain fully.

(b) Consider an identified container tally in a MODS allied labor operation (IPlatform, IOPref, IOPBulk, ICancMPP, etc.) that contains loose flats. Please confirm that witness Degen's proposed methodology does not assume that piece handlings in distribution operations represent the subclass distribution of loose flats observed in MODS allied operations. If you do not confirm, please explain. If you confirm, please explain how your answer affects your testimony.

(c) Please refer to MPA-T-2 at page 28, lines 6-8. Is it your testimony that the appropriate distribution key for loose flats in containers in an opening unit is piece tallies in flat distribution operations? If your answer is negative, please explain your testimony.

(d) Please explain the apparent contradiction between MPA-T-2 at page 25, lines 23-28, and at page 28, lines 6-8. Please explain how your answer affects your testimony.

Response:

(a) It is my testimony that there is no basis to assume that the distribution of loose flats in containers resembles the distribution of flats piece handling tallies. Loose flats in containers are likely to be from collection mail. As I stated in my testimony, putting presorted flats loose in a container would destroy their presortation. The distribution of collection mail is dissimilar to the distribution of all mail.

(b) Confirmed. Degen assumes something even more unreasonable. He assumes that the few pieces of loose flats handled individually at the allied labor operations are representative of the large pool of loose flats in container costs at these operations. As witness Stralberg testified (See TW-T-1, page 21), only a small percentage of direct piece handlings occur at platform and opening units in MODS facilities, 7 % for letter and 9 %

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

for flats, while a large percentage of loose pieces in containers tallies are found at these operations, 53 % for letters and 49 % for flats. Degen's method distributes about half of the loose mail in containers costs based on only a small and incidental part of total piece handling costs.

(c) & (d) It is my testimony that until the Postal Service collects more information on mixed mail tallies, the correct distribution is to collapse on both container contents and cost pools. My point on pages 25 and 28 is that there is no basis to assume either that loose mail in containers is similar to loose mail not in containers regardless of operation or that mixed container tallies in one cost pool necessarily relate to individual piece handlings in the same cost pool.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-15. Please refer to your testimony at page 28-29 and to Tr. 17/81438144. Please confirm that you have not calculated the variance of witness Degen's distribution key entries (the ratio of IOCS costs for a particular subclass in a distribution key to total IOCS costs for the distribution key) or of distributed volume variable costs. If you do not confirm, please provide complete results of your analysis, along with complete documentation of statistical formulas and assumptions.

Response:

Confirmed. I would note that the coefficients of variation that I examined represent the numerator of the distribution key entries for most distribution keys. I would further note that for 70 percent of the numerators, the coefficients of variation are so large that there is no basis to suggest that the numerators are not zero. If the numerators are zero, the ratios would also be zero.

If there is positive correlation between the numerator and denominator, the variance of the ratio could be smaller than the variance of either the numerator or denominator. However, that does not suggest that the numerator is statistically different from zero.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-16. Please refer to your testimony at page 29. What fraction of mixed mail costs is distributed using five or fewer tallies in witness Degen's methodology? Please provide any intermediate calculations in electronic spreadsheet format.

Response:

Six percent. The requested spreadsheet will be filed as MPA-LR-8, spreadsheet usps16.xls. I would note, however, that a more important measure of the statistical validity of witness Degen's distribution is the coefficient of variation for the numerator of the distribution keys (see interrogatory USPS/MPA-T2-15). As I stated in response to USPS/MPA-T2-11(c), a quarter of mixed-item and identified-container costs are distributed using distributing costs with coefficients of variation of at least 50 percent.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-17. Please refer to your testimony at pages 31.

(a) Is it your testimony that "not handling costs" are not causally related to mail handlings in the same cost pool? If not, please explain fully.

(b) Is it your testimony that witness Degen's not-handling distribution is incorrect primarily because you believe that "not handling costs" are not causally related to mail handlings in the same cost pool? If not, please explain fully.

(c) Suppose it is correct to assume that "not handling costs" are causally related to mail handlings in the same cost pool. Would it then be appropriate to distribute the "not handling costs" within the same cost pool? Please explain any negative response.

Response:

(a) It is my testimony that for many not-handling tallies we do not currently have enough information to determine causality. Not-handling tallies may be causally related to direct tallies in the same cost pool, they may be causally related to direct tallies in a different cost pool, they may be causally related to direct tallies in multiple cost pools, or they may not be causally related to direct tallies in any cost pool.

(b) It is my testimony that witness Degen's not-handling distribution methodology is fatally flawed for the following reasons: (1) witness Degen assumed that all not-handling tallies are causally related to direct tallies in the same cost pool and made no attempt to obtain data to verify his assumption; (2) witness Degen's own data provide clear evidence that his assumption is unreasonable. Witness Degen surely knows that productivity is not measured at allied operations and that employees are frequently assigned to allied operations while waiting for productive work at other operations. Given that not-handling tallies represent over 50 percent of all tallies at allied and other operations, witness Degen should have reconsidered the validity of his assumption, in my opinion.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

(c) I don't believe that such a determination should be made on the basis of an assumption alone. I believe the Postal Service should determine causality before deciding how to distribute costs.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-18. Please refer to your testimony at page 31.

(a) Please confirm that you and witness Stralberg propose to distribute most not-handling costs "by CAG and basic function." If you do not confirm, please explain fully.

(b) Please confirm that your distribution methodology assumes that most "not-handling costs" are caused by mail handlings in the same CAG and basic function. If you do not confirm, please explain the theory of cost causality that underlies your proposed distribution methodology.

(c) Please provide the quantitative analysis of volume variability and/or cost causality, including all statistical tests that demonstrate the causal relationship between your cost driver(s) and "not handling costs," upon which your proposed "not handling cost" distribution is based.

(d) If your answer to part (a) indicates that you have performed no quantitative analysis of volume variability or cost causality, please confirm that your proposed "not handling cost" distribution is based on untested assumptions regarding patterns of cost causality.

Response:

(a) Confirmed.

(b) Not confirmed. As I explained in my testimony, the fact that not-handling costs have increased so dramatically in the past 10 years has led witness Stralberg and I to conclude that a significant portion of these costs are "caused" by inefficiency related to automation. This conclusion would suggest some not-handling costs should be treated as institutional costs as I have recommended to the Commission. Lacking that solution, my proposal would avoid penalizing the least automated mail for not-handling costs it did not cause.

My proposal avoids assumptions as to why an employee is clocked in to a particular

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

operation and avoids assigning not-handling costs at allied operations, which are most likely caused by Postal Service management assigning excess labor there, only to the subclasses present at allied operations. Postal Service managers do not have a similar incentive to park excess labor in specific CAGs or basic functions so my proposed distribution does not introduce a bias against mail handled in manual operations.

(c) As I stated earlier, I do not hypothesize that not-handling costs are necessarily caused by any particular subclass of mail. Lacking a demonstrated "cost driver", I have recommended that the Commission treat a portion of not-handling costs as institutional costs in this proceeding. Lacking a demonstrated cost driver, I also recommend that the Commission avoid untested assumptions for which there is countervailing evidence.

(d) I take the reference to be to part (c) not part (a). My proposal is to avoid untested assumptions to the maximum extent possible. This can be done by avoiding attributing costs when causation has not been proved and by avoiding assumptions for which there is countervailing evidence.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-19. Please refer to your testimony at page 31, lines 16-17. Please provide a precise definition of "not-handling costs for which we have no information as to causation."

Response:

In fact, most not-handling costs are costs for which we have no information as to causation. This category has grown at an alarming pace over the past 10 years, leading the Commission and mailers to increasingly press the Postal Service to study the causality of these costs. As mentioned in my response to interrogatory UPS/MPA-T2-18, my proposal is to treat a portion of these costs as institutional and to distribute the remaining costs more broadly.

As I discuss on page 32 of my testimony, there is a subset of not-handling costs for which there is additional information that can help improve the distribution to subclasses. Witness Stralberg and I recommend that not handling tallies that relate to window service or administrative functions be distributed on the basis of customary distribution keys for individual activities in those cost components; that not-handling tallies with shape information be distributed in proportion to direct tallies of that shape; that not-handling tallies in special delivery, registry, and Express Mail units be distributed to those services and that class; and that not-handling tallies for specific activities like central mail markup be distributed on direct mail tallies for the same activity.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-20. Please refer to your response to USPS/MPA-T2-2, and to spreadsheet USPS2b.xls, MPA-LR-3. In your response, you state that "40 percent... of eligible item costs [were] counted." Spreadsheet USPS2b.xls, from which the 40 percent figure is derived, identifies \$60.364 million in "counted" item costs and \$91.381 million in "uncounted" item costs.

- (a) Please confirm that the \$91.381 million in uncounted item costs reported in spreadsheet USPS2b.xls includes \$34.57 million in costs for "uncounted" items not subject to counting, i.e., bundles, letter trays, and flat trays. If you do not confirm, please provide the figure(s) you believe to be correct. Also please provide the derivation of any such figure(s) in electronic spreadsheet format.
- (b) Please confirm that excluding the \$34.57 million in costs for "uncounted" not subject to counting yields 52 percent as the percentage of eligible item costs counted according to spreadsheet USPS2b.xls. If you do not confirm, please provide the figure(s) you believe to be correct. Also please provide the derivation of any such figure(s) in electronic spreadsheet format.
- (c) Please confirm that both the 40 and 52 percent figures exclude the costs for items eligible for counting that were determined to contain identical mail. If you do not confirm, please explain.
- (d) Please provide total direct (identical plus counted) costs for each item type eligible for counting and cost pool, in an electronic spreadsheet format comparable to spreadsheet USPS2b.xls.

Response:

(a) I would agree that the uncounted cost pool includes \$34.57 million in costs for uncounted bundles, letter trays, and flat trays. I am not sure how to characterize these costs, as these types of items should presumably not lead to either counted or uncounted tallies. These items are subject to the top-piece rule, a procedure far simpler and less time-consuming than counting. Therefore their presence in the uncounted category is surprising.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

(b) I confirm that \$60.364 million is 51.5 percent of \$117.175 million.

(c) I do not consider identical mail eligible for counting. The procedures spelled out in the IOCS data collectors Handbook (Codes-IOCS Data Entry User's Guide, F-45, Library Reference H-49) specify that one piece of identical mail be selected to complete the IOCS questionnaire. (See question 21B, Rule 6) These items should not be counted.

(d) The USPS2b.xls spreadsheet I prepared does not contain any data on identical items. My calculation was limited to a comparison of counted mixed item costs to uncounted mixed item costs. I believe the Postal Service can obtain ready access to the information requested in this interrogatory by referring to witness Degen's library reference H-277.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-21. Please refer to your response to USPS/MPA-T2-9. By "strict association," do you mean that 100% of the mail inside a given sack type would have to be of a single subclass? Please explain.

Response:

Not necessarily. If a given sack type could only be used for a single subclass that would certainly be a strict association. There could also be a strict association that combined specific subclasses in known and constant proportions. What I mean by strict association is that the usage of a sack type would be so predictable that a data collector could infer what was in the sack without looking inside. I believe the data clearly demonstrate that this is not the case for IOCS data collectors.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-22. Please refer to your responses to USPS/MPA-T2-9 and USPS/MPA-T2-10.

- (a) Do you believe that an IOCS data collector can determine whether a sack contains identical mail or non-identical mail without opening the sack? Please explain.
- (b) Are the reasons you give that the contents of mixed sacks may be different from the contents of identical sacks necessarily applicable to uncounted sacks, for which it is not known whether the contents are identical or non-identical mail?
- (c) For items subject to the Top Piece Rule, is there any reason why an observation of a mailer-prepared item should be more likely to result in a direct tally than a Postal Service-prepared item? Please explain fully.

Response:

(a) In many cases, I believe employees will know if a sack contains identical mail or not. For example, the employee may know that a certain magazine is being unloaded into the facility and that sacks coming off the truck are likely to contain identical quantities of that magazine. However, the instructions contained in the IOCS data collectors handbook state that the data collector should open the sack and if the pieces are identical should pick a random piece on which to record data (Library Reference H-49, Question 21B, Rule 6). If the pieces in the sack are not identical, the data collector is instructed to count the contents of the sack (Rule 9).

(b) An uncounted mixed sack should not contain identical mail. The IOCS data collectors Handbook instructs data collectors to select one piece from a sack of identical mail to record information. This is a simpler and less time-consuming procedure than counting the contents of an entire sack. I believe that most uncounted sacks probably contain mixed mail which is likely different from identical mail.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

(c) All top-piece rule items should result in direct tallies. For mailer prepared items, which are likely to contain identical mail, the data collector selects one piece on which to record information. For mixed items, the IOCS data collectors Handbook instructs data collectors to select the top or first piece in mixed bundles, letter trays, and flat trays and to record direct tally information about that piece.

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

USPS/MPA-T2-23. Please refer to your response to USPS/MPA-T2-12 part b, and to the table provided as Attachment 1 to this interrogatory.

- (a) Please confirm that the table provided as Attachment 1 to this interrogatory shows a breakdown of the tally counts from spreadsheet DMA17.xls, USPS-LR-H-305, by the IOCS question 19 response. If you do not confirm, please provide the breakdown you believe to be correct.
- (b) Please confirm that the breakdown of tallies by the question 19 response indicates that there are letter tallies for employees whose sampled activity is FSM operations, and flat tallies for employees whose sampled activity is LSM operations. If you do not confirm, please explain.
- (c) Please confirm that the observation of letter-shape pieces at FSMs, and of flat-shape pieces at LSMs, need not indicate that employees "are not... clocked into the operation they are actually performing." If you do not confirm, please explain how such "misclocking" would affect the mix of mail observed in the employee's sampled activity from question 19.

[Attachment 1 on following page]

Attachment to USPS/MPA-T2-23

Attachment 1

FY96 IOCS Clerk/Mailhandler Tallies by IOCS Q18 Response and Shape
All Offices

Q18 Response	Title	Tally Count					Total
		Letters/Cds	Flats	IPPs	Parcels	No Shape	
A	Manual						
F9211	A - Letter Case Distrib	21,395	422	57	24	11,157	33,095
F9211	B - Flat Case Distrib	116	8,601	54	133	4,884	13,788
F9211	C - Parcel Piece Distrib	63	412	517	2,090	3,418	6,500
F9211	D - Coll/Cancel MM Proc	398	118	27	29	809	1,381
F9211	E - Presort Mail Units	294	112	5	10	569	991
F9211	F - Opening Units	1,157	939	182	278	4,262	6,838
F9211	G - Pouch/Rack Units	609	1,126	569	776	4,702	7,782
F9211	H - Platform Units	407	450	67	232	5,744	6,900
F9211	I - Other Manual	2,802	1,432	215	582	11,526	16,557
	Total Manual	27,251	13,612	1,704	4,154	47,111	93,832
B	OCR	2,596	16	0	1	2,592	5,205
C	Mail Proc BCR/BCS	3,527	28	5	4	3,409	6,973
D	Delivery BCR/BCS	2,588	6	0	0	2,155	4,849
E	Carrier Sequence BCS	421	4	0	0	404	829
F	MPLSM/SPLSM	8,217	135	8	0	3,594	11,954
G	Letter Facet/Canceler	803	23	2	2	782	1,562
H	Flat Facet/Canceler	82	259	0	5	261	557
I	Sack Sorting Machine	155	251	42	161	1,356	1,965
J	Parcel Sorting Machine	28	177	305	1,269	1,992	3,771
K	Flat Sorting Machine	82	6,020	20	31	4,302	10,455
L	Small Parcel & Bundle	405	965	441	462	3,460	5,733
M	NMO Machine	31	16	4	87	222	360
N	Multislide	70	107	27	121	857	1,182
P	ACDCS	88	45	25	106	1,198	1,462
Q	Central Banding	171	50	2	7	552	782
R	Cutting Machine	153	61	10	13	346	583
S	Remote Barcoding Mach	16	6	2	10	149	183
T	Transport Equipment	79	189	22	68	6,583	6,941
U	All Other	461	353	91	312	5,806	7,023
	Blank	3,266	1,525	126	338	29,414	34,669
	Grand Total	50,540	23,848	2,836	7,151	116,495	200,870

**Magazine Publishers of America Witness Rita Cohen
Responses to Interrogatories of USPS**

Response:

(a) I can only confirm that the tally counts in the Grand Total row of Attachment 1 are the same as those in the Grand Total row of spreadsheet DMA17.xls in USPS-LR-H-305. I cannot confirm whether or not Attachment 1 is a breakdown of the tally counts according to possible responses to IOCS question 19.

(b) Confirmed, assuming that this data accurately portrays responses to IOCS question 19.

(c) Again assuming that this data accurately portrays responses to IOCS question 19, this data may be evidence of something other than misclocking. I would note that the frequency of letter tallies at manual flats operations and flats tallies at manual letters operations in particular, is much less for the question 19 results than for witness Degen's cost pool results. Witness Stralberg discussed these results in detail in his response to interrogatory USPS/TW-T1-23, part d. These results suggest that misclocking is one explanation for the existence of such tallies in witness Degen's data base but not the only explanation. I would also note that for many of the operations it is not possible to determine the frequency of misclocking by looking at the resulting activity code since the activity code may not be specific enough to prove or disprove misclocking. The Inspection Service noted the problem of misclocking in the MODS System, particularly at allied operations, where analysis of shapes handled cannot prove the misclocking.

1 CHAIRMAN GLEIMAN: Does any participant have
2 additional written cross-examination for the witness?

3 [No response.]

4 CHAIRMAN GLEIMAN: If not, we will move on to oral
5 cross-examination.

6 Three participants have requested oral
7 cross-examination of the witness: Newspaper Association of
8 America; United Parcel Service; and United States Postal
9 Service.

10 Does any other party wish to cross-examine?

11 [No response.]

12 CHAIRMAN GLEIMAN: Mr. Yourshaw?

13 CROSS-EXAMINATION

14 BY MR. YOURSHAW:

15 Q Good morning, Ms. Cohen.

16 A Good morning.

17 Q I just have a few short questions for you.

18 CHAIRMAN GLEIMAN: If you could just identify the
19 party you are representing?

20 MR. YOURSHAW: I am Michael Yourshaw and I am
21 representing the Newspaper Association of America.

22 CHAIRMAN GLEIMAN: Thank you, sir.

23 MR. YOURSHAW: Okay. Got me now? Okay.

24 BY MR. YOURSHAW:

25 Q Ms. Cohen, could you characterize for me the way

1 presort is performed in the magazine industry?

2 Do most magazine publishers perform presort? Do
3 most not?

4 A Are you asking about the entire periodicals
5 industry or my membership?

6 I am not sure.

7 Q I am asking about your membership or if you are
8 familiar with the entire industry I would appreciate that
9 answer too.

10 A You want to know for presort --

11 Q Yes.

12 A -- mailers? Well, we all have permits, so we are
13 bulk mailers.

14 We are required to perform various levels of
15 presort on our mail and if you want to know in terms of the
16 outcome of that, there are billing determinants which show
17 how much of the mail is presorted to the various categories
18 and also we have provided in response to interrogatories
19 from the Postal Service what our members look like in terms
20 of their presort breakdown.

21 I can go into detail on that, but I am not sure if
22 you want me to.

23 Q I am looking more for a global picture.

24 A We try to presort our mail to the maximum extent
25 possible, both because we are required to by the

1 regulations, and because we try to do as much work sharing
2 as we can.

3 Q Do some of your members use presort bureaus?

4 A Not for periodicals mail, but they might for some
5 of their other class of mail.

6 Q Right. Are you aware of whether or not other
7 mailers use presort bureaus?

8 A I believe so.

9 Q Would you characterize the Postal Service's
10 presort function as a monopoly service or as a competitive
11 service?

12 MR. CREGAN: Mr. Chairman, I object. This is way
13 beyond the scope of Ms. Cohen's testimony.

14 MR. YOURSHAW: Mr. Chairman, I am referring to
15 NAA-MPA-T-2-9, in which Ms. Cohen describes the Postal
16 Service as being a monopolist in many of its markets, and I
17 think this is appropriate.

18 MR. CREGAN: It might be helpful if counsel
19 referred Ms. Cohen to the interrogatory response before
20 asking his question, following-up.

21 CHAIRMAN GLEIMAN: Thank you.

22 MR. CREGAN: And I will withdraw the objection.

23 THE WITNESS: Okay. Could you repeat the
24 question?

25 BY MR. YOURSHAW:

1 Q The question is would you regard the presort
2 function as a monopoly activity of the Postal Service or one
3 that is competitive with your members and presort bureaus?

4 A I believe it would be competitive.

5 Q Very good, thank you.

6 Secondly, could you again, in a global overview
7 sort of way describe for me your understanding of how the
8 presort discount is calculated?

9 A Well, the presort discounts are calculated based
10 on the savings from mail processing activities for
11 operations bypassed by the mail that is presorted to various
12 levels, and the cost savings would differ depending on the
13 level of presort as would the discount offered.

14 Q Is the computation what you would call a marginal
15 analysis that is made or some other cost type analysis?

16 A It is an operational analysis of cost bypass.

17 They use operational models of the flows through
18 the postal system and what the cost bypassed would be.

19 Q Would you say it captures the Postal Service's
20 marginal costs or avoided marginal costs?

21 A Well, yes. The savings are multiplied by
22 variability, so to that extent they capture the variable
23 cost.

24 MR. YOURSHAW: That is all I have for this
25 witness.

1 CHAIRMAN GLEIMAN: United Parcel Service?

2 MR. McKEEVER: Thank you. We have no questions,
3 Mr. Chairman.

4 CHAIRMAN GLEIMAN: United States Postal Service?
5 Mr. Koetting?

6 MR. KOETTING: Thank you, Mr. Chairman.

7 CROSS-EXAMINATION

8 BY MR. KOETTING:

9 Q Good morning, Ms. Cohen.

10 A Good morning.

11 MR. KOETTING: Before I begin, Mr. Chairman, I
12 would like to announce for the record that during the break
13 we were able to obtain through the good graces of a number
14 of the parties the information that we had been attempting
15 to elicit from Mr. Stralberg earlier and we have gotten the
16 information we need and there is therefore no pending
17 homework assignment for either Mr. Stralberg or Ms. Cohen.

18 CHAIRMAN GLEIMAN: Thank you. I am pleased to
19 hear that and I know that Mr. Stralberg and Ms. Cohen are
20 happy about that also.

21 BY MR. KOETTING:

22 Q Could we start with your response to Postal
23 Service Interrogatory 22(b).

24 A Well, I am in better shape already. We went
25 straight to 22(b).

1 Q I am afraid I am not going in order --

2 [Laughter.]

3 CHAIRMAN GLEIMAN: Mr. Koetting forgot to inform
4 you that he is working from the back end.

5 THE WITNESS: Okay. I have that.

6 BY MR. KOETTING:

7 Q In the first sentence in your response to subpart
8 (b) there, you note that an uncounted mixed mail sack should
9 not contain identical mail, correct?

10 A Correct.

11 Q Would you agree that if for some reason the data
12 collector was unable to open the sack there would be no way
13 for the data collector to know whether the sack contained
14 identical mail or not?

15 A Maybe, maybe not.

16 I think if it doesn't open it, he is not supposed
17 to determine that it's identical mail, but what I
18 hypothesized in (a) is that based on familiarity with
19 operations, having been a data collector for a long time,
20 knowing the mail and the facility, they may be able to
21 determine more than you might think just by knowing what
22 mail is present at the facility.

23 Q So you are saying that there might be instances in
24 which even though the data collector was unable to open the
25 sack, they would have in your experience sufficient grounds

1 to believe that it contained identical mail?

2 A Right. I don't know obviously whether they would
3 use that to record an identical count. I am just saying I
4 think the data collector may surmise that they know if they
5 can identify, oh, we got Time Magazine in or something like
6 that, they might say this is Time today.

7 Q They may surmise that in some instances, correct?

8 A Yes.

9 Q But would you also agree that in other instances
10 if the data collector couldn't open the sack either for
11 safety reasons or because it was on a sack sorting machine
12 and it would interfere with the disposition of the mail to
13 open it that there could be instances in which the data
14 collector was unable to open the sack and yet would not be
15 able to speculate with enough confidence to know whether the
16 sack contained identical mail or not?

17 A Well, your handbook gave an example. It said that
18 if there were sacks shrunk-wrapped on a pallet that you
19 couldn't get to them, so certainly there might be times
20 where you could not open it.

21 I don't know, you know, to what extent that
22 happens.

23 Q So you would agree therefore that it is possible
24 that there might be instances in which a sack which is
25 tallied as an uncounted, mixed mail sack actually contains

1 identical pieces?

2 A It could happen.

3 Q Now in that same question, Number 22, could you
4 look at the question and answer to subpart (c)?

5 Have you looked at that?

6 A I have.

7 Q Just to be as clear as possible, would it be fair
8 to say that your response there is that -- to our specific
9 question is that there is no reason why an observation of a
10 mailer prepared item is more likely to result in a direct
11 tally than a Postal Service prepared item?

12 A I guess I was agreeing that both types of items
13 should result in a direct tally.

14 Q Could you please refer to your response to Postal
15 Service Interrogatory Number 14, subpart (a)?

16 A Subpart (a)?

17 Q A as in Adam.

18 A Okay.

19 Q In the last sentence you indicate that the
20 distribution of collection mail is dissimilar to the
21 distribution of all mail; correct?

22 A Correct.

23 Q Does your proposed mixed mail distribution make
24 use of this observation for example by using unique
25 distribution keys for mixed collection mail?

1 A No, I do not.

2 Q I would like to look at your testimony at page 31,
3 and specifically on lines 5 to 6 there you make the
4 statement that not handling tallies are clustered at
5 operations where productivity is not measured. And I'd like
6 to explore that statement a little bit, if we could.

7 A Okay.

8 Q I'd like to compare two operations. One operation
9 would be a cross-docking operation in which for example
10 forklifts are moving pallets from an incoming truck to an
11 outgoing truck.

12 A Okay.

13 Q And would you agree that the nature of that
14 operation would be in instances in which the forklift is
15 moving with a pallet from the incoming truck to the outgoing
16 truck and the operator was tallied that would result in a
17 handling mail tally? Correct?

18 A Yes.

19 Q And on the return trip, after the pallet had been
20 deposited with the outgoing truck and he was returning to
21 the original truck, that would result if tallied at that
22 time in a not handling tally; correct?

23 A Correct.

24 Q And if we compare that with something like a
25 manual distribution operation, either flat manual

1 distribution or a letter manual distribution, there really
2 isn't any corresponding type of return trip activity in
3 those operations, is there?

4 A If they are staying at the operation, they don't
5 have as much time. Well, I mean, I guess if they move some
6 mail, then there might be some return time.

7 Q But the nature of the activity is such that it's
8 going to be not nearly as significant a proportion as it is
9 at the cross-docking; correct?

10 A I guess I would agree.

11 Q And that's consistent with the statement in your
12 testimony that we just talked about, not handling tallies
13 are clustered at operations where productivity is not
14 measured; correct?

15 A You're saying that that's one possible explanation
16 for that?

17 Q No, I'm just saying that that's -- that this
18 disparity in proportions of not handling tallies within
19 operations is -- we've just gone through an example of the
20 kind of thing that you're talking about in your statement.

21 A I agree that that could lead to some not handling
22 on the platform that you wouldn't have in a distribution
23 operation.

24 Q So would you agree that different operations have
25 different levels of not handling, and that's directly

1 related to the functions performed in those operations?

2 A Well, I agree with the first part. We have
3 observed based on the data that was provided that different
4 operations have different amounts of not handling. I don't
5 necessarily agree that it is characteristic of the function
6 of the operations, because I think as I documented
7 throughout my testimony there's a lot of reasons to consider
8 that some of that is nonproductive time.

9 Q Well, an example we just went through, we compare
10 the cross-docking operation and the manual distribution
11 operation. Would you agree in those instances that the
12 different levels of not handling are directly related to the
13 functions performed in those two operations?

14 A Well, I don't know that there aren't canceling
15 factors. I mean, yes, you've identified something that is
16 not handling at the platform, but you'd have monitoring
17 operations at the distribution which could be not handling.
18 And so those could compensate. I really don't -- I don't
19 think you can draw a conclusion that there's a certain
20 percent of not handling that's the right number based on
21 what we have before us.

22 Q Can you give me any examples in those two
23 operations of, you know, in a distribution operation of
24 other examples that you think might rise to the same
25 proportion of the activity as return trips are in

1 cross-docking, for example?

2 A Well, I mean, I remember in the last case, and I
3 think I cited that Witness Barker said that the increases in
4 not handling at the distribution operations would be because
5 there's more monitoring time compared to the time that's
6 actually spent doing the distribution when you've moved from
7 a situation with 12 employees at an LSM to a situation where
8 you've got two loading and unloading.

9 So I think as a relative proportion that should
10 have been a larger percent. And to some extent if there is
11 equipment downtime you would have more breaks perhaps at
12 that kind of an operation with equipment maintenance or
13 scheme changes or things like that.

14 Q Do you have any evidence that these kinds of
15 things would cancel each other out?

16 A I don't believe any of us know what the right
17 number is for not handling.

18 MR. KOETTING: That's all we have, Mr. Chairman.
19 Thank you, Ms. Cohen.

20 CHAIRMAN GLEIMAN: Is there any followup?
21 Questions from the bench?

22 That brings us to redirect. Would you like some
23 time with your witness, Mr. Cregan.

24 MR. CREGAN: A couple minutes, please.

25 CHAIRMAN GLEIMAN: And while you're heading over

1 there, I'll note for our record that inasmuch as a lot of
2 the testimony today has to do with Witness Degen and the
3 Magazine Publishers of America are doing the cross, it's
4 only appropriate, I notice that Witness Degen has a red tag
5 around his neck.

6 [Discussion off the record.]

7 CHAIRMAN GLEIMAN: Mr. Cregan.

8 MR. CREGAN: No redirect.

9 CHAIRMAN GLEIMAN: That being the case, Ms. Cohen,
10 I want to thank you. We appreciate your appearance here
11 today and your contributions to our record.

12 THE WITNESS: Thank you.

13 CHAIRMAN GLEIMAN: If there's nothing further,
14 you're excused.

15 [Witness excused.]

16 CHAIRMAN GLEIMAN: Our next witness is Stephen E.
17 Sellick. He is appearing on behalf of United Parcel Service
18 and will be presenting two pieces of testimony, his direct
19 testimony and supplemental testimony filed in response to
20 Presiding Officer's Information Request No. 11.

21 To reduce confusion, I propose that we proceed
22 first with his initial testimony, USPS-T-2, and after we
23 complete action on that, we will then enter his supplemental
24 testimony.

25 MR. MCKEEVER: Mr. Chairman, if it does not

1 constitute an imposition on the bench, we would prefer to at
2 least put both pieces of testimony in at the same time,
3 since the second piece of testimony in one sense makes some
4 revisions to the first piece.

5 CHAIRMAN GLEIMAN: I would have no objection if
6 parties indicating an interest in crossing had no problem
7 with that, and there were five parties that did want to
8 cross on the initial testimony -- American Business Press,
9 CTC Distribution, Nashua District, Parcel Shippers, and
10 United States Postal Service.

11 If those parties have no objection, then we'll
12 move both pieces of testimony in and we'll rely on counsel
13 to try and divine which of the two pieces of testimony a
14 cross-examination is being made on.

15 MR. McKEEVER: Thank you, Mr. Chairman.

16 CHAIRMAN GLEIMAN: If you'd introduce your
17 witness, so that I can swear him in.

18 MR. McKEEVER: United Parcel Service calls to the
19 stand Stephen E. Sellick.

20 CHAIRMAN GLEIMAN: I'll give you a moment to get
21 settled there, Mr. Sellick.
22 Whereupon,

23 STEPHEN E. SELLICK,
24 a witness, was called for examination by counsel for United
25 Parcel Service and, having been first duly sworn, was

1 examined and testified as follows:

2 DIRECT EXAMINATION

3 BY MR. McKEEVER:

4 Q Mr. Sellick, I'm handing you a copy of two
5 documents, the first entitled Direct Testimony of Stephen E.
6 Sellick on behalf of United Parcel Service and designated as
7 UPS-T-2, and the second entitled Supplemental Testimony of
8 Stephen E. Sellick on behalf of United Parcel Service
9 pursuant to Presiding Officer's Information Request No. 11,
10 and designated as UPS-ST-2.

11 The piece designated as UPS-T-2 already reflects
12 some revisions to your testimony that were filed and served
13 on January 14, 1998, relating to the premium pay adjustment.

14 Mr. Sellick, were both those documents prepared by
15 you or under your supervision?

16 A Yes, they were.

17 Q And if you were to testify orally here today,
18 would your testimony be as set forth in those two documents?

19 A Yes, it would be.

20 Q Do you have any revisions to make to either of
21 those documents?

22 A Just one, which is on the first page of my
23 testimony. I believe it said at the time I was an
24 associated at Putnam, Hayes & Bartlett. I am presently a
25 principal at Putnam, Hayes & Bartlett. Just that one

1 change..

2 MR. McKEEVER: Mr. Chairman, that change has been
3 made in the copies that I will provide to the reporter if
4 and when this testimony is admitted into evidence.

5 I now move that the documents designated UPS-T-2
6 and UPS-ST-2 representing the testimony of Stephen E.
7 Sellick be admitted into evidence and transcribed into the
8 record.

9 CHAIRMAN GLEIMAN: Are there any objections?

10 Hearing none, Mr. Sellick's testimony, T-2 and
11 ST-2, and associated exhibits, are received into evidence,
12 and I direct that they be transcribed into the record at
13 this point.

14 [Direct Testimony and Exhibits and
15 Supplemental Testimony and Exhibits
16 of Stephen E. Sellick, UPS-T-2 and
17 UPS-ST-2, was received into
18 evidence and transcribed into the
19 record.]

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UPS-T-2

BEFORE THE
POSTAL RATE COMMISSION

POSTAL RATE AND FEE CHANGES, 1997

:
:
:
DOCKET NO. R97-1

DIRECT TESTIMONY OF
STEPHEN E. SELICK
ON BEHALF OF
UNITED PARCEL SERVICE

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
PURPOSE OF TESTIMONY	2
MODS-BASED ALLOCATION OF MAIL PROCESSING COSTS	3
A. Mr. Degen's MODS-Based Approach Is An Improvement Over Past Practice	4
B. The Criticisms of MODS Piece Handling Data Do Not Apply to Mr. Degen's Use of MODS Workhours Data	11
C. Mr. Degen's Distribution Method Should Be Used With Minor Modifications	12
BASE YEAR AND TEST YEAR COST CALCULATIONS	15
PRIORITY MAIL PROCESSING COST DIFFERENCES BY SHAPE	18
RECALCULATION OF DBMC NON-TRANSPORTATION COSTS AVOIDED IN OUTGOING OPERATIONS	19
SUMMARY OF CONCLUSIONS	21

LIST OF TABLES

Table 1 --	Comparison of Key Elements: LIOCATT versus Postal Service Proposal	7
Table 2 --	BY 1996 Volume Variable Cost Segment 3.1 Costs by Subclass	14
Table 3 --	BY 1996 Volume Variable Costs by Subclass	16
Table 4 --	Test Year 1998 Volume Variable Costs by Subclass	17
Table 5 --	Mail Processing Costs by Shape for Priority Mail (TY 1998) Mail Processing Labor Costs 100% Attributable	19
Table 6 --	Parcel Post Costs Excluded from DBMC Avoided Cost Calculation	21

BEFORE THE
POSTAL RATE COMMISSION

POSTAL RATE AND FEE CHANGES, 1997

:
:
:
DOCKET NO. R97-1

DIRECT TESTIMONY OF
STEPHEN E. SELICK
ON BEHALF OF
UNITED PARCEL SERVICE

INTRODUCTION

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My name is Stephen E. Sellick. I am a Principal at Putnam, Hayes & Bartlett, Inc. ("PHB"), an economic and management consulting firm with offices in Washington, D.C.; Cambridge, Massachusetts; Los Angeles and Palo Alto, California; a New Zealand subsidiary with offices in Auckland and Wellington; an Australian subsidiary with offices in Melbourne and Sydney; and a United Kingdom affiliate, Putnam, Hayes & Bartlett Ltd., with offices in London. I am located in PHB's Washington, D.C., office, 1776 Eye Street, N.W., Washington, D.C. 20006.

I have more than eight years of consulting experience, including a wide range of assignments in regulatory economics, cost accounting, and financial analysis of regulated industries. In addition, I have extensive experience in environmental litigation, including projects dealing with the allocation of common costs.

1 I have worked on PHB's analytic investigations of United States
2 Postal Service ("Postal Service") costing issues since 1990. In Docket No. R90-1
3 and again in Docket No. R94-1, I assisted Dr. George R. Hall in the preparation of
4 testimony regarding the attributable costs of Parcel Post, Priority Mail, and Express
5 Mail. In Docket No. R94-1, I assisted Dr. Colin C. Blaydon in the preparation of
6 analyses and testimony concerning the treatment of mixed mail costs in the In-
7 Office Cost System ("IOCS"). In Docket No. MC95-1, I assisted Ralph L. Luciani in
8 the preparation of analyses and testimony regarding the costs associated with
9 parcels handled by the Postal Service in First Class and Standard (A) Mail and in
10 supplemental testimony regarding rate design for Standard Mail (A) parcels.

11 Since 1995 I have visited and observed the operations of a number of
12 Postal Service facilities, including the Washington, D.C., BMC on two different
13 occasions, a Sectional Center Facility, two Processing and Distribution Centers,
14 two Associate Offices/Delivery Units, a HASP (Hub and Spoke Project) facility, and
15 an Airport Mail Center.

16 I hold a B.S. in Economics from the University of Pennsylvania's
17 Wharton School of Business and an M.A. in Public Policy Studies from the
18 University of Chicago.

19 PURPOSE OF TESTIMONY

20 I have been asked to review those aspects of the costing proposals of
21 the Postal Service which are discussed below. In so doing, I reviewed the
22 testimony and workpapers of Postal Service witnesses Degen (USPS-T-12),

1 Alexandrovich (USPS-T-5), Moden (USPS-T-4), Patelunas (USPS-T-15), Crum
2 (USPS-T-28), Bradley (USPS-T-14), and Daniel (USPS-T-29).

3 My testimony provides the following:

4 1. An examination of Mr. Degen's Management Operating Data
5 System-based ("MODS") costing changes to Cost Segment 3, and suggested
6 revisions.

7 2. A recalculation of base year and test year costs under 100
8 percent mail processing labor cost variability as recommended by UPS witness
9 Kevin Neels (UPS-T-1).

10 3. A calculation of the mail processing unit cost differences
11 between Priority Mail flats and Priority Mail parcels. UPS witness Ralph L. Luciani
12 (UPS-T-3) uses this cost differential to develop a Priority Mail parcel surcharge.

13 4. The identification of the costs of certain Parcel Post operations
14 which are then used by Mr. Luciani to calculate a more appropriate DBMC
15 discount.

16 **MODS-BASED ALLOCATION**
17 **OF MAIL PROCESSING COSTS**

18 The Postal Service presents two witnesses who address mail
19 processing labor costs in Cost Segment 3: Mr. Degen (USPS-T-12) and Dr.
20 Bradley (USPS-T-14). These two witnesses address entirely separate aspects of
21 this subject; Mr. Degen's testimony deals with how to distribute mail processing

1 labor costs among the subclasses of mail, while Dr. Bradley testifies about the
2 degree to which mail processing labor costs are variable and therefore attributable.

3 In my testimony, I address only the subject covered by Mr. Degen, the
4 distribution of costs to subclasses of mail.¹ Specifically, I discuss why Mr. Degen's
5 approach represents an improvement over past practice. I also explain why
6 criticisms of MODS piece handling data applicable to Dr. Bradley's analysis do not
7 affect Mr. Degen's methodology, which uses MODS workhours data to distribute
8 those costs found to be attributable. Finally, I recommend that, with minor
9 programming modifications, Mr. Degen's approach to distributing mail processing
10 labor costs to each mail subclass be adopted by the Commission.

11 A. Mr. Degen's MODS-Based Approach Is An
12 Improvement Over Past Practice.

13 Mr. Degen's approach to distributing attributable mail processing
14 labor costs to subclasses is an improvement over past Postal Service and
15 Commission practice in two important respects: (1) it links the distribution of mixed
16 mail and "overhead" (not handling mail) costs with the operational characteristics of
17 mail processing; and (2) it incorporates information on the contents of items (e.g.,
18 sacks, bundles, trays, and pallets) and containers more completely into the
19 distribution of mixed mail costs. I discuss each of these improvements in turn.

20 In previous cases, the Postal Service has relied on IOCS and
21 LIOCATT (a series of Postal Service computer programs) to distribute attributable

1. Dr. Neels addresses Dr. Bradley's testimony.

1 mail processing costs for clerks and mailhandlers by subclass. IOCS is a work
2 sampling system which estimates the proportion of time clerks and mailhandlers
3 spend on different activities associated with the processing of each type of mail
4 and providing each type of special service. The time proportions are then used to
5 distribute attributable in-office costs to subclasses of mail and special services.

6 IOCS observations can be "direct" or "mixed." Direct observations are
7 recorded when the IOCS data collector observes an employee handling (a) a single
8 piece of mail; (b) an item or container that contains only one subclass of mail
9 ("identical" items and containers); or (c) a sufficiently random non-identical item by
10 recording the subclass of the top piece using the "top piece rule." Mixed tallies are
11 those observations in which the employee is engaged in an activity involving a
12 mixture of different classes or shapes of mail. Mixed mail tallies include uncounted
13 items and containers as well as "working but not handling mail" observations.
14 IOCS also records "overhead" tallies, which are observations when the employee is
15 on break, clocking in or clocking out, or moving empty equipment.

16 The LIOCATT procedure formerly used by the Postal Service
17 distributed the costs associated with mixed mail to the subclasses of mail in
18 proportion to the class and shape distribution of direct mail tallies. LIOCATT
19 accomplished this process through cost pools ("strata") grouped by CAG and Basic
20 Function.² Overhead costs were then distributed to subclasses of mail in
21 proportion to the final distribution of direct and mixed mail costs.

2. CAG stands for Cost Ascertainment Group, a classification of facilities based on revenue.

1 Mr. Degen's revised methodology differs from the previous
2 methodology in four ways: (1) hours data from MODS are used to partition clerk
3 and mailhandlers' compensation costs into "cost pools" based on certain mail
4 processing activities and machinery types; (2) the distribution of mixed mail costs is
5 stratified by these cost pools rather than by CAG and Basic Function; (3) the mixed
6 mail distribution incorporates IOCS data on container contents; and (4) variability
7 estimates, developed by Dr. Bradley, are then applied to each of the cost pools.

8 Table 1 compares the Postal Service's current approach in this case
9 with the previous methodology for the key elements involved:

Table 1

Comparison of Key Elements: LIOCATT versus Postal Service Proposal

Issue	R94-1 (LIOCATT)	R97-1 (MODS/IOCS)
Division of Cost Segment 3 Labor Costs Among Mail Processing, Window Service, and Administrative Costs	IOCS Based	MODS Based
Cost Pools for Distributing Mixed Mail Tallies	CAG and Basic Function Only	MODS operation, BMC operation type, or Basic Function
Uncounted Items Distribution Key	All Direct Mail and Counted Mixed Mail within Cost Pool	Mail subclasses observed for the same type of item within the same Cost Pool
Uncounted Container: Items Distribution Key	All Direct Mail and Counted Mixed Mail within Cost Pool	Mail subclasses observed for the same type of item within the same Cost Pool
Uncounted Container: Loose Mail Distribution Key	All Direct Mail and Counted Mixed Mail within Cost Pool	Mail subclasses observed for the same mail shape within the same Cost Pool
Not Recorded and Empty Container Distribution Key	All Direct Mail and Counted Mixed Mail within Cost Pool	Mail subclasses observed for the same container type within the same Cost Pool
Overhead Distribution Key	Final Cost Distribution	Mail subclass in the cost pool where overhead is incurred

The Postal Service's new approach is a significant improvement over previous practice. The primary point of difference between the new and the old techniques is to refine the mixed mail distribution methodology. As the table above notes, the previous method (LIOCATT) for distributing mixed mail costs grouped costs into "pools" based on (1) CAG, which relates to the amount of revenue generated by a postal facility, and (2) the Basic Function involved, which relates to the type of processing operation -- Incoming, Outgoing, Transit, and Other. The

1 new method also uses cost "pools," but these cost pools represent a much finer
2 level of distribution than LIOCATT. The new pools relate to operational
3 characteristics and machine type, which affect the costs incurred in processing
4 mail, instead of CAG and Basic Function, which do not drive mail processing labor
5 costs.³

6 The new method treats mixed mail observed in OCR operations, for
7 example, as likely to be similar to direct mail at OCR operations. The old method
8 was much less refined; it assumed that mixed mail observed in OCR operations
9 was similar to all direct mail at postal facilities of a similar size and Basic Function.
10 The old method ignored the fact that mixed mail at OCR operations is more likely to
11 resemble direct mail at OCR operations than direct mail at OCR and non-OCR
12 operations. In fact, the old method completely ignored available operational data
13 which recognize the different character of various mail processing operations.

14 In adopting this refinement, the Postal Service has addressed long-
15 standing concerns that intervenors and the Commission have expressed about the
16 costs associated with "not handling mail" IOCS tallies. The new method assures
17 that the costs of "not handling mail" are allocated to the subclasses of mail that are
18 found on the same machine type or in the same processing operation when
19 employees are handling mail. If, for example, postal employees in the manual
20 Priority Mail processing operation are more frequently observed working but not
21 handling mail, the costs of the time they spend while not actually handling mail will

3. For non-MODS offices, the new approach continues to use Basic Function to define the cost pools.

1 be allocated only to the subclasses of mail with which those employees work when
2 they are handling mail.

3 Postal Service reports as far back as 1992 have recommended
4 essentially this approach. For example, a report prepared for the Postal Service by
5 Foster Associates states:

6 "the present undifferentiated allocation of equipment
7 handling costs as 'overhead' needs review because,
8 with automation (and, for that matter, mechanization) as
9 distinct from manual processing, some mail classes are
10 apparently more dependent on containerization and
11 related handling equipment than others."⁴

12
13 This observation clearly indicates that distributing "not handling mail" costs (in this
14 case, the costs of moving empty equipment) to subclasses of mail on the basis of
15 machine-specific and operation-specific cost pools (as proposed by the Postal
16 Service in this case) results in a more accurate measurement of the relationship
17 between "not handling mail" costs and the subclasses of mail which give rise to
18 those costs.

19 This logic is not limited to the cost of moving empty equipment. The
20 same report made a similar observation for break time, another significant
21 component of "not handling mail" costs; because "continuing negotiated increases
22 of break time can be expected as automation is extended to previously non-

4. *Overhead and Subclass Cost Study*, prepared for the United States Postal Service under Contract No. 104230-90-B-0505 by Foster Associates Inc., November 1992 ("Foster Associates Report"), page 5.

1 automated situations," the cost of breaks should be distributed within operation and
2 machine-specific cost pools, as proposed by the Postal Service.⁵

3 An additional improvement in the new cost methodology is that mixed
4 mail distributions now reflect actual data on the contents of items and containers.
5 Previous Postal Service practice allocated the costs of containers with mixed
6 shapes of mail in proportion to the set of all direct mail tallies. This ignores the fact
7 that different types of containers are used for different types (subclasses) of mail.
8 On the other hand, Mr. Degen "exploits the association of item types within certain
9 shapes and/or subclasses of mail."⁶ He does so by "using the corresponding
10 piece- or item-handling distribution" by cost pool to allocate the costs of containers
11 for which the contents were identified as (a) items or (b) loose mail shapes.⁷ This
12 technique recognizes the relationship between item types and certain classes or
13 shapes of mail by distributing the costs of uncounted items in proportion to the
14 direct mail in those item types.⁸ For those containers for which the contents are not
15 identified, Mr. Degen similarly makes use of the association of different container
16 types with different classes or subclasses of mail and allocates non-identified

5. Foster Associates Report, page 5.

6. USPS-T-12, page 10.

7. USPS-T-12, pages 9-10.

8. For example, the cost of uncounted Blue & Orange sacks (used for Express Mail) are distributed in proportion to the direct mail in Blue & Orange sacks. LIOCATT would distribute those costs in proportion to all direct mail, ignoring the fact that Blue & Orange sacks are designated for Express Mail use. See Tr. 12/6580.

1 container costs in proportion to direct plus identified container contents by cost
2 pool.

3 In summary, the Postal Service's new methodology (using cost pools
4 based on machine and operation type as well as counted mixed mail) is superior to
5 the old LIOCATT process. The new system takes advantage of "more and better
6 information for the mixed-mail distribution."⁹ It should be adopted by the
7 Commission.

8 B. The Criticisms of MODS Piece Handling
9 Data Do Not Apply to Mr. Degen's Use of
10 MODS Workhours Data.

11 Postal Inspection Service audits have directed significant criticisms at
12 the MODS piece handlings data relied upon by Dr. Bradley.¹⁰ Dr. Neels discusses
13 how crucial this piece handling data is to Dr. Bradley's analysis and how its lack of
14 reliability calls into serious question Dr. Bradley's conclusions regarding the degree
15 to which mail processing labor is other than 100 percent variable with volume.

16 It is important to understand that while Dr. Bradley's analysis is
17 undermined by these criticisms, Mr. Degen's analysis is not affected by them. Mr.
18 Degen does not rely upon the MODS piece handling data in his analysis; he relies
19 only upon the employee workhours data from MODS in order to partition mail
20 processing labor costs into cost pools, as described above. The MODS workhours

9. Tr. 12/6421.

10. *National Coordination Audit: Mail Volume Measurement and Reporting Systems, United States Postal Inspection Service, December 1996, LR-H-220.*

1 data are directly linked to the Postal Service's payroll system, creating additional
2 accounting and managerial controls, and have been measured on the same basis
3 for at least nine years.¹¹

4 In short, criticisms of the ability of MODS to measure piece handlings
5 have no bearing on Mr. Degen's analysis since he does not use that data.¹²

6 C. Mr. Degen's Distribution Method Should
7 Be Used With Minor Modifications.

8 The improvements the Postal Service has implemented in distributing
9 the costs in Cost Segment 3 should be adopted whether or not the Commission
10 chooses to continue the long-standing practice of attributing 100 percent of mail
11 processing labor costs. Two improvements made by Mr. Degen -- addressing the
12 increase in overhead/not handling mail tallies and refining the methods used to
13 distribute mixed mail costs -- have no necessary relationship to the degree of
14 variability of mail processing labor costs. The methodology outlined by Mr. Degen
15 can be easily adapted to incorporate full attribution of mail processing labor costs.

16 Decoupling Mr. Degen's distribution key analysis from the Postal
17 Service's proposal to abandon the historical attribution level of mail processing
18 labor costs does, however, require some small modifications. The Commission has

11. Tr. 11/5878.

12. Some questions have been raised about the degree to which Postal employees actually clock into the MODS operation in which they are working. Postal supervisors have a strong incentive for ensuring the accuracy of the workhours data, since different supervisors are responsible for different operations. Mr. Degen has adequately responded to these questions. See, e.g., Tr. 12/6554-56.

1 found, in very limited instances, that some mail processing labor costs are fixed
2 and not attributable.¹³ In addition, the "migration" of some costs previously
3 classified as administrative (and assigned to Cost Segment 3.3) but now included
4 in Cost Segment 3.1 must be reversed to ensure treatment consistent with the
5 Commission's established practice. The essential improvements introduced by the
6 Postal Service -- stratifying the mixed mail distribution process on the basis of
7 operational characteristics and more fully utilizing actual data on counted mixed
8 mail -- are maintained in this approach. Table 2 compares the Postal Service's
9 proposal with Dr. Neels' recommended treatment of Cost Segment 3, which returns
10 attribution to 100 percent.

13. One example is "working, but not handling mail" while working on the Platform (Activity Code 6210).

Table 2

**BY 1996 Volume Variable Cost Segment 3.1 Costs by
Subclass**

Class and Subclass of Mail or Special Service	Postal Service Proposal	100% Attribution
Letters and sealed parcels	4,774,417	5,692,578
Presort letters and sealed parcels	1,080,864	1,266,581
Single Piece Cards	140,336	169,913
Presort private post cards	37,457	44,141
Total First Class Mail	6,033,074	7,173,213
Priority Mail	477,606	691,160
Express Mail	83,202	134,947
Mailgrams	79	96
Within county	15,210	18,324
Regular rate publications	467,201	579,246
Nonprofit publications	81,970	101,269
Classroom publications	5,720	7,510
Total Periodicals Mail	570,101	706,348
Single piece rate	75,564	94,605
Bulk - Regular Carrier Presort	256,941	321,133
Bulk - Regular Other	1,486,117	1,816,337
Total Standard (A) Regular	1,743,058	2,137,471
Bulk - Nonprofit Carrier Presort	27,934	34,457
Bulk - Nonprofit Other	353,421	419,303
Total Bulk Nonprofit	381,355	453,760
Total Standard (A) Mail	2,199,977	2,685,835
Parcels (zone rate)	153,080	222,030
Bound printed matter	71,247	98,253
Special rate	65,485	92,035
Library rate	15,647	22,020
Total Standard (B) Mail	305,459	434,339
Penalty - U. S. Postal Service	92,173	133,141
Free Mail for Blind/Handicapped	10,378	14,066
International Mail	214,584	277,141
Total All Mail	9,986,633	12,250,286
Total Special Services	116,331	189,666
Total Volume Variable	10,102,964	12,439,952
Other	3,144,448	386,232
Total Costs	13,247,412	12,826,184

Sources: Postal Service Proposal – USPS-T-5, WP A-2, pages 3-4; 100% Attribution
– UPS-Sellick-WP-I-A2, Mail Processing Adjustments Sheet.

BASE YEAR AND TEST YEAR
COST CALCULATIONS

I have calculated Base Year 1996 (BY1996) and Test Year 1998 After Rates (TYAR) costs with mail processing labor costs at 100 percent attribution.¹⁴ To estimate the effect that changes in the level of attribution and in the distribution of BY1996 mail processing labor costs in Cost Segment 3 have on TYAR costs, I developed a simplified roll-forward model. Under this model, BY1996 to TYAR costs change in the same proportion as in the Postal Service's proposal. In particular, for each BY1996 cost component which changes as a result of modifications I make to Cost Segment 3, the following calculation is made:

- The TYAR/BY1996 ratio resulting from the Postal Service's proposal is calculated for each subclass; and
- My revised BY1996 cost by subclass is then multiplied by the Postal Service TYAR/BY1996 ratio to calculate the new TYAR costs.

A comparison of the Postal Service's proposal with my results is presented in Tables 3 (Base Year) and 4 (Test Year).

14. In so doing, I have used the Postal Service's treatment of Alaska Air costs, that is, Alaska Air is essentially 100% attributable to Parcel Post. The result of using the Commission's Docket No. R94-1 treatment of TYAR Alaska Air costs is presented by the Postal Service in LR-H-215 (Rule 54(a)(1) Alternate Commission Cost Presentation) (Rollforward) (Revised).

Table 3

BY 1996 Volume Variable Costs by Subclass

Class and Subclass of Mail or Special Service	Postal Service Case	Recommended Approach
Letters and sealed parcels	\$12,046,631	13,400,624
Presort letters and sealed parcels	3,804,528	4,087,648
Single Piece Cards	429,135	472,880
Presort private post cards	125,994	136,169
Total First Class Mail	16,406,288	18,097,321
Priority Mail	1,584,229	1,867,621
Express Mail	342,623	410,971
Mailgrams	432	461
Within county	75,056	79,844
Regular rate publications	1,448,904	1,607,084
Nonprofit publications	317,766	345,527
Classroom publications	14,874	17,338
Total Periodicals Mail	1,856,600	2,049,792
Single piece rate	188,355	215,018
Bulk - Regular Carrier Presort	1,821,927	1,925,248
Bulk - Regular Other	4,164,366	4,640,443
Total Standard (A) Bulk Regular	5,986,293	6,565,691
Bulk - Nonprofit Carrier Presort	136,575	146,685
Bulk - Nonprofit Other	969,720	1,066,513
Total Bulk Nonprofit	1,106,295	1,213,199
Total Standard (A) Mail	7,280,943	7,993,908
Parcels (zone rate)	694,997	789,067
Bound printed matter	285,041	322,853
Special rate	226,526	263,321
Library rate	47,835	56,599
Total Standard (B) Mail	1,254,399	1,431,840
Penalty - U. S. Postal Service	196,097	250,816
Free Mail for Blind/Handicapped	26,406	31,595
International Mail	1,158,518	1,244,755
Total All Mail	30,106,535	33,379,080
Total Special Services	1,236,416	1,332,188
Total Volume Variable	31,342,951	34,711,268
Other	23,633,646	20,265,331
Total Costs	54,976,597	54,976,599

Sources: Postal Service Case – Exhibit USPS-5A, pages 7-8; Recommended Approach
 -- UPS-Sellick-WP-I-CI, Base Year Costs Sheet.

Table 4

Test Year 1998 Volume Variable Costs by Subclass

Class and Subclass of Mail or Special Service	Postal Service Case	Recommended Approach
Letters and sealed parcels	\$12,466,968	13,821,126
Presort letters and sealed parcels	4,002,534	4,307,303
Single Piece Cards	432,141	474,538
Presort private post cards	158,372	171,401
Total First Class Mail	17,060,015	18,774,368
Priority Mail	2,138,518	2,456,169
Express Mail	410,906	489,151
Mailgrams	502	532
Within county	80,424	85,339
Regular rate publications	1,561,106	1,724,399
Nonprofit publications	327,861	355,223
Classroom publications	12,619	14,634
Total Periodicals Mail	1,982,010	2,179,595
Single piece rate	221,691	251,857
Bulk - Regular Carrier Presort	1,894,839	2,000,034
Bulk - Regular Other	5,360,184	5,954,194
Total Standard (A) Bulk Regular	7,255,023	7,954,228
Bulk - Nonprofit Carrier Presort	128,014	137,208
Bulk - Nonprofit Other	1,120,767	1,228,893
Total Bulk Nonprofit	1,248,781	1,366,101
Total Standard (A) Mail	8,725,495	9,572,186
Parcels (zone rate)	731,136	828,452
Bound printed matter	328,929	370,998
Special rate	254,900	294,772
Library rate	48,569	57,136
Total Standard (B) Mail	1,363,534	1,551,359
Penalty - U. S. Postal Service	172,926	219,791
Free Mail for Blind/Handicapped	31,429	37,377
International Mail	1,193,999	1,278,539
Total All Mail	33,079,334	36,559,067
Total Special Services	1,364,626	1,457,421
Total Volume Variable	34,443,960	38,016,489
Other	26,246,161	22,677,365
Total Costs	60,690,121	60,693,854

Sources: Postal Service Case -- USPS-T-15, WP-G, Table D, pages 7-8, adjusted for misallocation of Phase I PMPC contract, Tr. 13/7293-96; Recommended Approach -- UPS-Sellick-WP-1-I-C1, TYAR Summary Sheet.

1 These revised TYAR costs are used by UPS witness J. Stephen
2 Henderson (UPS-T-3) to develop his pricing proposals for certain subclasses of
3 mail.

4 PRIORITY MAIL PROCESSING COST
5 DIFFERENCES BY SHAPE

6 The Postal Service's own data show that Priority Mail parcels are, on
7 average, more expensive to process than are Priority Mail flats.

8 The SAS program MODSHAPE in LR-H-146 calculates “costs by
9 shape for selected BASE YEAR rate categories” using the new MODS cost pools
10 for mail processing costs.¹⁵ While the output provided by the Postal Service does
11 not include costs by shape for Priority Mail, the MODSHAPE program is easily
12 modified to include Priority Mail costs by shape in its output.¹⁶ Essentially, the
13 Postal Service has made this calculation but has not presented the results. My
14 modification uses the Postal Service’s data and analytic techniques; I simply
15 extract from the Postal Service’s data the results for Priority Mail in addition to the
16 results the Postal Service calculates for other subclasses of mail.

17 The following table shows the resulting mail processing costs by

18 Shape for Priority Mail (TY 1998):

15. LR-H-146, Part III, pages III-2 through III-15.

16. See UPS-Sellick-WP-1-III-C for the details of the modifications to MODSHAPE needed to make this calculation.

Table 5

Mail Processing Costs by Shape for Priority Mail (TY 1998)
Mail Processing Labor Costs 100% Attributable

Mail Shape	BY 1996 Mail Processing Cost	BY 1996 Volume	Cost per Piece
Flats	\$214,628	344,192	\$0.624
IPPs & Parcels	\$442,427	589,192	\$0.751
Difference			0.127
times BY Piggyback Factor			1.45
times TY/BY Wage Adjustment			1.053
Adjusted TY Difference			\$0.195

Source: UPS-Sellick-WP-1-III-A, page 2.

This mail processing cost difference between Priority Mail flats and Priority Mail parcels is used by Mr. Luciani in proposing a Priority Mail parcel surcharge.

**RECALCULATION OF DBMC NON-TRANSPORTATION
COSTS AVOIDED IN OUTGOING OPERATIONS**

In his Exhibit C, Postal Service witness Crum (USPS-T-28) attempts to estimate the test year outgoing mail processing unit costs avoided by DBMC Parcel Post. He calculates avoided costs of 37.7 cents per piece.

In his calculation, Mr. Crum uses a methodology different from that used by the Commission and the Postal Service in previous proceedings. In particular, the Commission's established methodology excludes the costs for Mail

1 Preparation (Operation Code 01) and Platform Acceptance (Operation Code 07) in
2 calculating the costs avoided by DBMC Parcel Post. Mr. Crum, on the other hand,
3 treats these costs as part of the costs avoided by DBMC Parcel Post. In his
4 testimony, Mr. Luciani recommends that the Commission's methodology should be
5 adopted in this case.

6 In response to an interrogatory asking why he did not adjust his
7 avoided cost calculation to exclude mail preparation and platform acceptance
8 costs, Mr. Crum indicated that "it would not have been possible to make the
9 adjustments as such."¹⁷ However, the SAS data sets in LR-H-146 contain the data
10 needed to make these adjustments. The results are presented in Table 6. This
11 table also shows the amount of the premium pay adjustment traditionally made by
12 the Commission.

17. Tr. 5/2285.

Table 6
Parcel Post Costs Excluded from
DBMC Avoided Cost Calculation

Summary by Office Type	Postal Service Attribution of Cost Segment 3	100 Percent Attribution of Cost Segment 3
All Offices Operation Codes 01 and 07	\$4,250	\$5,867
BMC Offices Excluding Operation Codes 01 and 07	\$31,686	\$51,187
Premium Pay Adjustment		\$1,295

Source: UPS-Sellick-WP-1-IV-A, page 1.

Mr. Luciani uses these calculations to arrive at a revised DBMC discount.

SUMMARY OF CONCLUSIONS

In conclusion, I find that:

- Mr. Degen's MODS-based approach to distributing attributable mail processing labor costs to subclasses is an improvement over past practice and should be adopted by the Commission. Mr. Degen's approach more closely aligns the distribution of mixed mail and overhead costs to mail processing operational characteristics and more fully utilizes Postal Service data on counted mixed mail. The result is an improved distribution of the costs in Cost Segment 3.
- MODS-based costing can be implemented while returning to the historical practice of attributing 100 percent of mail processing labor costs. Mr. Degen's MODS-based approach should be adopted by the

1 Commission. The Base Year and Test Year results of such an
2 analysis are provided in my testimony.

- 3 • Extraction of existing data based on the Postal Service's own analytic
4 techniques demonstrates that Priority Mail parcels are, on average,
5 more expensive to process than are Priority Mail flats. This data is
6 presented in my testimony and is used by Mr. Luciani to develop a
7 surcharge for Priority Mail parcels.
- 8 • The data are available to revise the Postal Service's computation of
9 the non-transportation costs avoided by DMBC in outgoing operations
10 in accordance with previous Commission and Postal Service practice.
11 These data are presented in my testimony and are used by Mr.
12 Luciani to calculate a revised DBMC discount.

UPS-ST-2

BEFORE THE
POSTAL RATE COMMISSION

POSTAL RATE AND FEE CHANGES, 1997

DOCKET NO. R97-1

SUPPLEMENTAL TESTIMONY OF
STEPHEN E. SELICK ON BEHALF
OF UNITED PARCEL SERVICE
PURSUANT TO PRESIDING OFFICER'S
INFORMATION REQUEST NO. 11

BEFORE THE
POSTAL RATE COMMISSION

POSTAL RATE AND FEE CHANGES, 1997

DOCKET NO. R97-1

**SUPPLEMENTAL TESTIMONY OF
STEPHEN E. SELICK ON BEHALF
OF UNITED PARCEL SERVICE
PURSUANT TO PRESIDING OFFICER'S
INFORMATION REQUEST NO. 11**

1 My name is Stephen E. Sellick. I am submitting this Supplemental
2 Testimony in response to Presiding Officer's Information Request No. 11 (January 30,
3 1998) ("POIR 11").

MIGRATION OF COSTS

5 1. POIR 11 asks why, in my original testimony and workpapers, I did
6 not back out from Mail Processing costs \$385,172,000 of Administrative and Window
7 Service costs which the Postal Service has identified as migrating to Mail Processing
8 under the MODS-based approach. It requests that I "prepare a presentation that
9 moves the administrative and window service costs that the Postal Service identifies as
10 migrating to mail processing under the MODS based cost system and calculate the
11 base year and test year costs by subclass." POIR 11 at 2. As a result, I have further
12 identified the costs which have migrated, and I have returned them to their IOCS-
13 defined cost component for attribution. I have recalculated UPS's recommended base

1 year and test year costs at 100% Mail Processing variability to take into account these
2 changes. The result is shown in Table 1 at the end of this testimony.

3 Background

4 My original testimony was intended primarily to ensure that previous
5 Commission practice with respect to the level of cost attribution was followed in
6 returning Mail Processing costs in Cost Segment 3.1 to "100% volume variability."¹ In
7 particular, I attempted to isolate costs that had previously been classified as "Fixed
8 Mail Processing." In doing so, I discovered that a significant portion of the costs which
9 had "migrated" from Cost Segments 3.3 (Window Service and Administrative,
10 respectively) to Cost Segment 3.1 were contained in a few Administrative activity codes
11 identified in Mr. Alexandrovich's B-series workpaper 3.0.4, and that transferring those
12 costs from Cost Segment 3.1 to 3.3 was a relatively simple matter. I did not attempt to
13 reverse all of the migration into Cost Segment 3.1. Thus, my calculations yielded a
14 result different from that which the Postal Service later provided in its response to
15 Commission Order No. 1203.

16 Also, in its response to Order No. 1203 the Postal Service used a
17 methodology different from mine. Whereas my approach actually moves costs from
18 Mail Processing to Window Service and Administrative, the Postal Service's method
19 leaves those costs in Mail Processing (using the MODS pool approach to costing) but
20 applies a re-calculated variability to them.² Specifically, the Postal Service divides the

1. References to "100% volume variability" are shorthand for the previous Commission and Postal Service practice of treating most Mail Processing costs as fully variable and a limited portion as fixed.

2. The Postal Service's method is not inherently inferior or superior to the approach I took. It merely represents a different way of getting to the same point. However, as I later discuss, the Postal Service made an error in implementing its approach.

1 cost pools currently in Cost Segment 3.1 (Mail Processing) into four categories:
2 Variable Mail Processing, Fixed Mail Processing, Migrated Window Service Costs, and
3 Migrated Administrative Costs. The appropriate variability factor for each category is
4 used to derive a weighted variability factor for Mail Processing and the Degen cost
5 distributions are then performed.³

6 The Postal Service states that under its method, "fundamental differences
7 between the old and new Cost Segment 3 methodologies make it impossible to
8 implement the exact variability analysis of one method in the other." Revised
9 Response of U.S. Postal Service to Interrogatories of the Office of the Consumer
10 Advocate, OCA/USPS-71 through 76. I believe my method partially avoids some of
11 these complications. Because of our different approaches, however, my results differ
12 somewhat from those of the Postal Service.

13 The Postal Service quantifies what costs would go to which of the
14 different cost categories in applying its approach. However, it slightly understates the
15 correct effective variability in its presentation. Perhaps the best way to explain this is to
16 review the three separate types of costs that are relevant in combining the
17 Commission's previous methodology and definitions of Mail Processing, Window
18 Service, and Administrative costs with the improved MODS cost pool distribution of
19 costs within Mail Processing. The three types of costs are (1) Fixed Mail Processing
20 costs, (2) costs that have migrated from Window Service to Mail Processing, and (3)
21 costs that have migrated from Administrative to Mail Processing.

3. The variabilities applied by the Postal Service are 100% for Variable Mail Processing (except for Registry), 0% for Fixed Mail Processing, 58.1% for Window Service, and 62.1% for Administrative costs. See Table A of the Postal Service's response to Order No. 1203 in LR-H-315.

1 Fixed Mail Processing Costs

2 Fixed Mail Processing costs were, in previous cases, enumerated in "B-
3 Series" worksheet 3.0.2 and include the IOCS activity codes for Platform Acceptance
4 (6210), Nixie (6240), Performing Routine Office Work (6420), Obtaining
5 Mail/keys/checking vehicle (6430), as well as the institutional portions of Special
6 Delivery (0010 and 6220) and Registry (0060 and 6230). See Worksheet 3.0.2,
7 Workpaper UPS-Sellick-2. My original testimony and the approach taken in this
8 supplemental testimony both treat these costs as non-volume variable within Mail
9 Processing (Cost Segment 3.1).

10 The Postal Service's response to Order No. 1203 erroneously includes
11 General Administrative Services (6630), Quality Control/Revenue Protection (6480),
12 and Supplies & Equipment (6320), which fall into the Administrative cost component, in
13 the Fixed Mail Processing cost category. As a result, the Postal Service's calculation of
14 the overall variability of Mail Processing costs should be 94.9% rather than the 93.46%
15 shown by the Postal Service.

16 Costs that Have Migrated from Window Service to Mail Processing

17 These are primarily costs associated with activity codes in the ranges of
18 5020-5180 and 6000-6200, which are assigned to Window Service in IOCS but are
19 classified as Mail Processing in Mr. Degen's MODS approach. The Postal Service
20 identifies \$127,182,000 of such costs.

21 My original testimony did not focus on Window Service costs (Cost
22 Segment 3.2) and I did not return these costs to Cost Segment 3.2. This supplemental
23 testimony identifies \$111,893,000 of these costs and returns them to Cost Segment 3.2
24 for attribution and distribution.

1 The majority of the \$15,289,000 difference between my calculation and
2 that of the Postal Service represents costs that are already assigned to mail subclasses
3 and special services in IOCS (and in Mr. Degen's MODS approach) and that would be
4 100 percent volume variable in either event. Therefore, I have not returned them to the
5 Window Service cost component. I thereby avoid considerable complexity which would
6 not make any significant difference in the resulting attributable costs. That is the
7 primary reason why the costs I identify as migrating from Window Service are lower
8 than the costs the Postal Service identifies.

9 Costs that Have Migrated from Administrative to Mail Processing

10 These are costs for which IOCS defines the observation as belonging to
11 Cost Segment 3.3 (Mail Processing Administrative) while Mr. Degen's MODS approach
12 includes them in Cost Segment 3.1 (Mail Processing). These costs are in activity
13 codes detailed in B-series workpaper 3.0.4 for various administrative activities such as
14 Data Collection and Processing (6495 and 6660), General Office and Clerical Work
15 (6460 and 6630), Time & Attendance (6610, 6640, and 6650), Scheme Examination
16 (6500), and Other Administrative (6430 and 6460). The Postal Service quantifies these
17 costs as \$679,221,000 in its response to Order No. 1203. See LR-H-315. In my
18 original testimony, I quantified these costs as \$421,231,000 -- a difference of
19 \$247,990,000.

20 The primary difference lies with a portion of the costs in two activity codes
21 which IOCS and the Postal Service (in its response to Order No. 1203) identify as
22 Administrative: 6521 (Breaks) and 6523 (Moving Empty Equipment). My original
23 testimony did not move these costs from Mail Processing to Administrative. In addition,
24 several activity codes (6480, 6519, 6320, and 6511 through 6516) which I previously
25 defined as Fixed Mail Processing should be included in the Administrative category.

Table 1: Summary of Results of UPS Recommended Approach

	Base Year Costs at 100% Variability			Test Year AR Costs at 100% Variability		
	As Filed 12/30/97	POIR 11 Correction	% Incr. from Filed	As Filed 12/30/97	POIR 11 Correction	% Incr. from Filed
Letters & Parcels	13,400,624	13,420,664	0.15%	13,821,126	13,850,901	0.22%
Presort Ltr & Pcl	4,087,648	4,087,524	0.00%	4,307,303	4,306,759	-0.01%
Single Piece Cards	472,880	475,567	0.57%	474,538	477,740	0.67%
Presort Cards	136,169	136,389	0.16%	171,401	171,681	0.16%
Total First	18,097,321	18,120,144	0.13%	18,774,368	18,807,081	0.17%
Priority Mail	1,867,621	1,856,660	-0.59%	2,456,169	2,444,918	-0.46%
Express Mail	410,971	407,464	-0.85%	489,151	484,912	-0.87%
Mailgrams	461	462	0.35%	532	531	-0.18%
Within Country	79,844	79,930	0.11%	85,339	85,449	0.13%
Outside Country:						
Reg Rate Pub	1,607,084	1,601,808	-0.33%	1,724,399	1,719,184	-0.30%
Nonprofit Pub	345,527	345,210	-0.09%	355,223	354,989	-0.07%
Classroom Pub	17,338	17,371	0.19%	14,634	14,651	0.12%
Total Second	2,049,792	2,044,320	-0.27%	2,179,595	2,174,273	-0.24%
Single Piece Rate	215,018	214,795	-0.10%	251,857	251,717	-0.06%
Bulk Rate-Reg						
Car Presort	1,925,248	1,926,958	0.09%	2,000,034	2,001,786	0.09%
Other	4,640,443	4,633,943	-0.14%	5,954,194	5,948,470	-0.10%
Bulk Rate-Nonprofit						
Car Presort	146,685	146,366	-0.22%	137,208	136,924	-0.21%
Other	1,066,513	1,064,234	-0.21%	1,228,893	1,226,972	-0.16%
Total Third	7,993,908	7,986,296	-0.10%	9,572,186	9,565,869	-0.07%
Parcel Zone Rate	789,067	791,042	0.25%	828,452	831,303	0.34%
Bound Pmt Matter	322,853	323,908	0.33%	370,998	372,427	0.39%
Spc 4th-Cl. Rate	263,321	264,656	0.51%	294,772	296,521	0.59%
Library Rate	56,599	56,930	0.58%	57,136	57,508	0.65%
Total Fourth	1,431,840	1,436,535	0.33%	1,551,359	1,557,759	0.41%
US Postal Service	250,816	232,336	-7.37%	219,791	203,822	-7.27%
Free Mail - Blind & Hndc & Servicemen	31,595	31,586	-0.03%	37,377	37,414	0.10%
International Mail	1,244,755	1,235,981	-0.70%	1,278,539	1,270,111	-0.66%
Total All Mail	33,379,080	33,351,784	-0.08%	36,559,067	36,546,691	-0.03%
Special Services:						
Registry	115,173	91,703	-20.38%	101,630	82,899	-18.43%
Certified	305,397	305,922	0.17%	351,872	352,374	0.14%
Insurance	36,758	37,187	1.17%	41,703	42,185	1.16%
COD	21,399	21,466	0.31%	18,218	18,281	0.35%
Special Delivery	3,541	3,544	0.10%	28	28	0.03%
Money Orders	123,797	126,666	2.32%	146,767	150,089	2.26%
Stamped Envelopes	10,938	10,891	-0.44%	12,193	12,149	-0.36%
Special Handling	1,248	1,276	2.24%	1,381	1,413	2.33%
Post Office Boxes	525,696	527,714	0.38%	585,299	587,117	0.31%
Other	188,241	186,782	-0.77%	198,331	196,933	-0.70%
Total Special Services	1,332,188	1,313,150	-1.43%	1,457,421	1,443,470	-0.96%
Total	34,711,268	34,664,934	-0.13%	38,016,489	37,990,161	-0.07%
Other	20,265,331	20,312,200	0.23%	22,677,365	22,673,319	-0.02%
Total Costs	54,976,599	54,977,134	0.00%	60,693,854	60,663,480	-0.05%

1 CHAIRMAN GLEIMAN: Mr. Sellick, have you had an
2 opportunity to examine the packet of designated written
3 cross-examination that was provided this morning?

4 THE WITNESS: Yes, I have.

5 CHAIRMAN GLEIMAN: And if those questions were
6 asked of you today, would your answers be the same as those
7 you previously provided in writing?

8 THE WITNESS: Yes, they would be.

9 CHAIRMAN GLEIMAN: That being the case, I have
10 provided the two copies of the designated written
11 cross-examination of Witness Sellick to the reporter, and
12 I'll direct that they be accepted into evidence and
13 transcribed into the record at this point.

14 [Designation of Written
15 Cross-Examination of Stephen E.
16 Sellick, UPS-T-2, was received into
17 evidence and transcribed into the
18 record.]

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 1997

Docket No. R97-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED PARCEL SERVICE
WITNESS STEPHEN E. SELICK
(UPS-T2)

Party

Direct Marketing Association, Inc.

Office of the Consumer Advocate

United States Postal Service

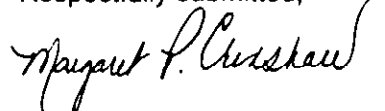
Interrogatories

DMA/UPS-T2-1-2, 4-5

DMA/UPS-T2-1-5
USPS/UPS-T2-1-27
USPS/UPS-T4-27b, 27c redirected to T2

DMA/UPS-T2-1-5
USPS/UPS-T2-1-27

Respectfully submitted,



Margaret P. Crenshaw
Secretary

Designating Parties:

[illegible]

Interrogatory:

USPS/UPS-T2-22

USPS/UPS-T2-23

USPS/UPS-T2-24

USPS/UPS-T2-25

USPS/UPS-T2-26

USPS/UPS-T2-27

USPS/UPS-T4-27b rd. to T2

USPS/UPS-T4-27c rd. to T2

Designating Parties:

OCA, USPS

OCA, USPS

OCA, USPS

OCA, USPS

OCA, USPS

OCA, USPS

OCA

OCA

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE DIRECT MARKETING ASSOCIATION, INC.**

DMA/UPS-T2-1. Please refer to your direct testimony (UPS-T-2) at pages 4 through 10, where you state that Postal Service witness Degen's approach to distributing mail processing costs to classes and subclasses is "an improvement over past practice" because "it links the distribution of mixed mail and 'overhead' (not handling mail) costs with the operational characteristics of mail processing." Please refer also to Tr. 12/6218, where witness Degen states that he is unaware of any studies that test the validity of three assumptions underlying his testimony. Please refer as well to Tr. 12/6658, line 22, through Tr. 12/6666, line 19, where witness Degen confirms several assumptions that underlie his distribution method for mail processing costs and admits that he did not test any of these assumptions: "If I knew a way to do it, I would [have] proposed it by now."

a. Please confirm that the assumptions which underlie an analysis are important. If not confirmed, please explain fully.

b. Please confirm that you have performed no statistical analysis to test the validity of any of the assumptions underlying witness Degen's cost distribution methodology. If not confirmed, please explain fully:

- i. which assumptions you tests;
- ii. your methodology for testing each assumption; and
- iii. the results of your analysis.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE DIRECT MARKETING ASSOCIATION, INC.**

Response to DMA/UPS-T2-1.

a. I am unable to confirm or not confirm. The importance of assumptions which underlie an analysis depends on the impact a change in the assumptions would have on the final results.

b. Confirmed.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE DIRECT MARKETING ASSOCIATION, INC.**

DMA/UPS-T2-2. Please refer to your direct testimony at page 10, line 3, through page 11, line 2, where you state that "mixed mail distributions now reflect actual data on the contents of items and containers."

a. Please describe the "actual data" to which you are referring, including the types of items or containers to which such "data" relates.

b. Except through analogy to the subclass composition of direct items, please explain fully whether you have any specific data on the subclass composition of (i) mixed items or (ii) mixed containers. If so, please summarize and provide a copy such data.

Response to DMA/UPS-T2-2.

a. By "actual data" I am referring to the counted mixed mail item data, identical and top-piece rule items data, and identified container information collected by IOCS data collectors and provided by the Postal Service in Library Reference H-23. This data pertains to mixed mail items (including bundles, con-cons, pallets, sacks of various colors, flat trays, letter trays, and parcel trays) and identified containers including BMC-OTRs, ERMCS, GPC/APCs, hampers, nutting trucks, postal packs, u-carts, and wiretainers.

b. Specific data on the subclass composition of mixed items is available in the form of counted mixed mail items. While these are called "direct" items, they are

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE DIRECT MARKETING ASSOCIATION, INC.**

nevertheless mixed mail items (neither identical nor subject to the top piece rule) for which the actual contents have been counted by the IOCS data collector. This data is provided by the Postal Service in Library Reference H-23. The subclass composition of identified mixed mail containers is established by "analogy" to direct items including counted mixed mail items and shapes of loose mail not in containers.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE DIRECT MARKETING ASSOCIATION, INC.**

DMA/UPS-T2-3. Please refer to page 9, lines 6 through 11, of your direct testimony where you quote a Foster Associates report as stating, "the present undifferentiated allocation of equipment handling costs as 'overhead' needs review because, with automation (and, for that matter, mechanization) as distinct from manual processing, some mail classes are apparently more dependent on containerization and related handling equipment than others."

a. Is it your understanding that the Foster Associates report takes the position that overhead and equipment handling costs should, in general, be higher at automated and mechanized operations than at manual operations? If your answer is other than an unqualified "yes," please explain fully.

b. Please provide a copy of the Foster Associate's report Overhead and Subclass Cost Study, cited on page 9 of your direct testimony.

Response to DMA/UPS-T2-3.

a. The Foster Associates report referred to in my testimony reaches no conclusions with respect to the expected relative magnitude of overhead and equipment handling costs at automated, mechanized, or manual operations. While it repeats a number of "working hypotheses" (originally presented by the Postal Service) on this subject, the report does not reach any conclusions about them.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE DIRECT MARKETING ASSOCIATION, INC.**

The working hypotheses were originally presented by the Postal Service in response to intervenor allegations in Docket No. R90-1 that both overhead and subclass cost increases resulted from automation, and that those increases should not be attributed to second and third class mail as a result. In response to this hypothesis, the Foster Associates report notes that the list of working hypotheses "demonstrates that there are sufficiently many factors other than automation potentially affecting overhead and subclass costs that the intervenors' proposed methods of attributing . . . cost increases are simplistic."

b. This report was filed with the Commission as USPS-LR-MPC-4 in Docket No. RM92-2 and is available at the Commission library.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE DIRECT MARKETING ASSOCIATION, INC.**

DMA/UPS-T2-4. Please refer to your direct testimony at page 8, line 14, through page 9, line 2, concerning the distribution of "not handling mail" tally costs.

a. Please confirm that you have performed no quantitative analysis to determine whether the not handling costs in each of the 50 cost pools are caused by the mail being handled in each cost pool. If not confirmed, please summarize the results of your analysis and provide a copy of any report detailing your analysis.

b. Please assume that not handling activities within cost pools are not caused by the handling activities within these pools. Please explain whether, in this situation, not handling costs should be distributed within these cost pools.

Response to DMA/UPS-T2-4.

a. Confirmed.

b. Whether not handling costs in a cost pool should be distributed within the same cost pool in the hypothetical example you cite would depend on the other alternatives available. If, for example, the alternatives to distributing the not handling costs within the same cost pool would be to ignore other important factors, then the best method may be to distribute the not handling costs within the same cost pools.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE DIRECT MARKETING ASSOCIATION, INC.**

DMA/UPS-T2-5. Please refer to your direct testimony at page 12, note 12, where you state that "[p]ostal supervisors have a strong incentive for ensuring the accuracy of the workhours data, since different supervisors are responsible for different operations."

a. Have you performed any quantitative analysis concerning the percentage of time postal mail processing employees are clocked into one operation but are performing another? If so, please summarize the results of your analysis and provide a copy of any report detailing your analysis.

b. Have you performed any quantitative analysis concerning whether "the MODS activity at the operation group level and the employee's activity are consistent in the vast majority of cases"? (See Tr. 12/6154). If so, please summarize the results of your analysis and provide a copy of any report detailing your analysis.

c. Assume that you were developing a mail processing cost distribution system. Would you distribute mixed mail and not handling costs based upon the operation into which an employee is clocked or based upon the operation that the employee is actually performing? Please explain your reasoning fully.

Response to DMA/UPS-T2-5.

a. I have not performed any quantitative analysis concerning the percentage of time postal mail processing employees are clocked into one operation but are

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE DIRECT MARKETING ASSOCIATION, INC.**

performing another. I have, however, reviewed Postal Service witness Degen's testimony on this point, which concludes in part that "the MODS activity at the operation group level and the employee's activity are consistent in the vast majority of cases" (DMA/USPS-T-12-3(b)).

b. I have not performed any such quantitative analysis. However, I note that after reviewing the Postal Service inspection reports which raised these questions, witness Degen stated that "we determined that the conclusions of the report did not detract from our use of MODS data in the costing system" (Tr. 18/8247).

c. If I were developing a mail processing cost distribution system de novo, or were to suggest changes to the current system, I would likely recommend distributing mixed mail and not handling costs based upon the operation in which an employee is actually performing work, as that would seem to more closely reflect actual mail processing practices. However, since I do not have the data in this format, I support Mr. Degen's approach. The improvements he proposes in this case are significant.

USPS/UPS-T2-1. Please refer to UPS-Sellick-WP-1-I-C2 and UPS-Sellick-WP-D2. In the first workpaper, please refer to RLL100.XLS, CS 2 Sheet and in the second workpaper, please refer to ROLL_0.XLS, CS 2.

- a. Please confirm that the sources for columns [22] - [28] of both sheets is "PHB Base Year Recalculation Model, CS 2 Sheet". If you do not confirm, please explain fully.
- b. Please confirm that the amounts shown for columns [22] - [28] are different for both sheets. If you do not confirm, please explain fully.
- c. Please confirm that the amounts on page 2 of ROLL_0.XLS, CS 2 Sheet, columns [22] - [28] are intended to replicate the Postal Service base year amounts shown on page 1, columns [1] - [7]. If you do not confirm, please explain fully.
- d. Please confirm that on page 4 of ROLL_0.XLS, CS 2 Sheet, columns [34] - [42], are intended to replicate the test year amounts appearing on page 1, columns [8] - [14]. If you do not confirm, please explain fully.
- e. Please explain fully the calculation and purpose of the line labeled "Factor" for columns [36] - [42] on page 4 of ROLL_0.XLS, CS 2 Sheet.

Response to USPS/UPS-T2-1. (a) Not confirmed. The source for columns [22]-[27] of both sheets is PHB Base Year Recalculation Model, CS-2 Sheet, and the source for column [28] of both sheets is PHB Base Year Recalculation Model, PESSA Costs Sheet. To clarify the citation, the PHB Base Year Recalculation Models for RLL100.XLS and ROLL_0.XLS are BSE100.XLS and BASEO.XLS, respectively.

- (b) Confirmed.
- (c) Confirmed.
- (d) Confirmed.
- (e) These factors are used to adjust for the effect on test year costs of weighting differences between the Postal Service and UPS calculations of base year

costs. Because the simplified roll-forward model used in my analysis adjusts base year costs on an individual subclass basis to arrive at test year costs, differences between the Postal Service and UPS base year costs in the weight of certain subclasses of mail within a cost component can result in different total test year costs, even when the two base year total costs are equal. To account for this, each subclass of each cost component was multiplied by a factor equal to the rate of the Postal Service test year total costs to UPS test year total costs for that cost component.

USPS/UPS-T2-2. Please refer to UPS-Sellick-WP-1-I-C2 and UPS-Sellick-WP-D2. In the first workpaper, please refer to RLL100.XLS, CS 3 Sheet and in the second workpaper, please refer to ROLL_0.XLS, CS 3 Sheet.

- a. Please confirm that the sources for columns [46] - [60] of both sheets is "PHB Base Year Recalculation Model, CS 3 Sheet". If you do not confirm, please explain fully.
- b. Please confirm that the amounts shown for columns [46] - [60] are different for both sheets. If you do not confirm, please explain fully.
- c. Please confirm that the amounts on page 4 of ROLL_0.XLS, CS 3 Sheet, columns [46] - [60] are intended to replicate the Postal Service base year amounts shown on page 1, columns [1] - [15]. If you do not confirm, please explain fully.
- d. Please confirm that on page 6 of ROLL_0.XLS, CS 3 Sheet, columns [76] - [90] are intended to replicate the test year amounts appearing on page 2, columns [16] - [30]. If you do not confirm, please explain fully.
- e. Please explain fully the calculation and purpose of the line labeled "Factor" for columns [76] - [90] on page 6 of ROLL_0.XLS, CS 3 Sheet.

Response to USPS/UPS-T2-2. (a) Not confirmed. The source for columns [46]-[59] of both sheets is PHB Base Year Recalculation Model, CS 3 Sheet, and the source for column [60] of both sheets is PHB Base Year Recalculation Model, PESSA Costs Sheet. To clarify the citation, the PHB Base Year Recalculation Models for RLL100.XLS and ROLL_0.XLS are BSE100.XLS and BASEO.XLS, respectively.

- (b) Confirmed.
- (c) Confirmed.
- (d) Confirmed.
- (e) See my response to USPS/UPS-T2-1(e).

USPS/UPS-T2-3. Please refer to UPS-Sellick-WP-1-I-C2 and UPS-Sellick-WP-D2. In the first workpaper, please refer to RLL100.XLS, CS 4 Sheet and in the second workpaper, please refer to ROLL_0.XLS, CS 4 Sheet.

- a. Please confirm that the sources for column [4] of both sheets is "PHB Base Year Recalculation Model, CS 4 Sheet". If you do not confirm, please explain fully.
- b. Please confirm that the amounts shown for column [4] are different for both sheets. If you do not confirm, please explain fully.
- c. Please confirm that the amounts on page 2 of ROLL_0.XLS, CS 4 Sheet, column [4] are intended to replicate the Postal Service base year amounts shown on page 1, column [1]. If you do not confirm, please explain fully.
- d. Please confirm that on page 2 of ROLL_0.XLS, CS 4 Sheet, columns [6] are intended to replicate the test year amounts appearing on page 1, column [2]. If you do not confirm, please explain fully.
- e. Please explain fully the calculation and purpose of the line labeled "Factor" for column [6] on page 2 of ROLL_0.XLS, CS 4 Sheet.

Response to USPS/UPS-T2-3. (a) Confirmed. See my response to USPS/UPS-T2-1(a) for clarification of the citation.

- (b) Confirmed.
- (c) Confirmed.
- (d) Confirmed.
- (e) See my response to USPS/UPS-T2-1(e).

USPS/UPS-T2-4. Please refer to UPS-Sellick-WP-1-I-C2 and UPS-Sellick-WP-D2. In the first workpaper, please refer to RLL100.XLS, CS 11 Sheet and in the second workpaper, please refer to ROLL_0.XLS, CS 11 Sheet.

a. Please confirm that the source for column [13] of both sheets is "PHB Base Year Recalculation Model, CS 11 Sheet" and the sources for columns [14] - [16] of both sheets is "PHB Base Year Recalculation Model, PESSA Costs Sheet". If you do not confirm, please explain fully.

b. Please confirm that the amounts shown for columns [13] - [16] are different for both sheets. If you do not confirm, please explain fully.

c. Please confirm that the amounts on page 2 of ROLL_0.XLS, CS 11 Sheet, columns [13] - [16] are intended to replicate the Postal Service base year amounts shown on page 1, columns [1] - [4]. If you do not confirm, please explain fully.

d. Please confirm that on page 3 of ROLL_0.XLS, CS 11 Sheet, columns [21] - [24] are intended to replicate the test year amounts appearing on page 1, columns [5] - [8]. If you do not confirm, please explain fully.

e. Please explain fully the calculation and purpose of the line labeled "Factor" for columns [21] - [24] on page 3 of ROLL_0.XLS, CS 11 Sheet.

Response to USPS/UPS-T2-4. (a) Confirmed. See my response to USPS/UPS-T2-1(a) for clarification of the citation.

(b) Confirmed.

(c) Confirmed.

(d) Confirmed.

(e) See my response to USPS/UPS-T2-1(e).

USPS/UPS-T2-5. Please refer to UPS-Sellick-WP-1-I-C2 and UPS-Sellick-WP-D2. In the first workpaper, please refer to RLL100.XLS, CS 15 Sheet and in the second workpaper, please refer to ROLL_0.XLS, CS 15 Sheet.

- a. Please confirm that the sources for columns [7] - [8] of both sheets is "PHB Base Year Recalculation Model, PESSA Costs Sheet". If you do not confirm, please explain fully.
- b. Please confirm that the amounts shown for columns [7] - [8] are different for both sheets. If you do not confirm, please explain fully.
- c. Please confirm that the amounts on page 2 of ROLL_0.XLS, CS 3 Sheet, columns [7] - [8] are intended to replicate the Postal Service base year amounts shown on page 1, columns [1] - [2]. If you do not confirm, please explain fully.
- d. Please confirm that on page 2 of ROLL_0.XLS, CS 3 Sheet, columns [11] - [12] are intended to replicate the test year amounts appearing on page 1, columns [3] - [4]. If you do not confirm, please explain fully.
- e. Please explain fully the calculation and purpose of the line labeled "Factor" for columns [11] - [12] on page 2 of ROLL_0.XLS, CS 3 Sheet.

Response to USPS/UPS-T2-5. (a) Confirmed. See my response to USPS/UPS-T2-1(a) for clarification of the citation.

- (b) Confirmed.
- (c) Confirmed.
- (d) Confirmed.
- (e) See my response to USPS/UPS-T2-1(e).

USPS/UPS-T2-6. Please refer to UPS-Sellick-WP-1-I-C2 and UPS-Sellick-WP-D2. In the first workpaper, please refer to RLL100.XLS, CS 16 Sheet and in the second workpaper, please refer to ROLL_0.XLS, CS 16 Sheet.

- a. Please confirm that the sources for column [4] of both sheets is "PHB Base Year Recalculation Model, PESSA Costs Sheet". If you do not confirm, please explain fully.
- b. Please confirm that the amounts shown for column [4] are different for both sheets. If you do not confirm, please explain fully.
- c. Please confirm that the amounts on page 2 of ROLL_0.XLS, CS 16 Sheet, column [4] are intended to replicate the Postal Service base year amounts shown on page 1, columns [1]. If you do not confirm, please explain fully.
- d. Please confirm that on page 2 of ROLL_0.XLS, CS 16 Sheet, column [6] are intended to replicate the test year amounts appearing on page 1, column [2]. If you do not confirm, please explain fully.
- e. Please explain fully the calculation and purpose of the line labeled "Factor" for column [6] on page 2 of ROLL_0.XLS, CS 3 Sheet.

Response to USPS/UPS-T2-6. (a) Confirmed. See my response to USPS/UPS-T2-1(a) for clarification of the citation.

- (b) Confirmed.
- (c) Confirmed.
- (d) Confirmed.
- (e) See my response to USPS/UPS-T2-1(e).

USPS/UPS-T2-7. Please refer to UPS-Sellick-WP-1-I-C2 and UPS-Sellick-WP-D2. In the first workpaper, please refer to RLL100.XLS, CS 18 Sheet and in the second workpaper, please refer to ROLL_0.XLS, CS 18 Sheet.

- a. Please confirm that the sources for columns [43] - [56] of both sheets is "PHB Base Year Recalculation Model, PESSA Costs Sheet". If you do not confirm, please explain fully.
- b. Please confirm that the amounts shown for columns [43] - [56] are different for both sheets. If you do not confirm, please explain fully.
- c. Please confirm that the amounts on page 4 of ROLL_0.XLS, CS 18 Sheet, columns [43] - [56] are intended to replicate the Postal Service base year amounts shown on page 1, columns [1] - [14]. If you do not confirm, please explain fully.
- d. Please confirm that on page 6 of ROLL_0.XLS, CS 18 Sheet, columns [71] - [84] are intended to replicate the test year amounts appearing on page 2, columns [15] - [28]. If you do not confirm, please explain fully.
- e. Please explain fully the calculation and purpose of the line labeled "Factor" for columns [71] - [84] on page 6 of ROLL_0.XLS, CS 18 Sheet.

Response to USPS/UPS-T2-7. (a) Not confirmed. The source for columns [43]-[46] of both sheets is APHB Base Year Recalculation Model, CS 18 Sheet. The source for columns [47]-[56] of both sheets is APHB Base Year Recalculation Model, PESSA Costs Sheets. See my response to USPS/UPS-T2-1(a) for clarification of the citation.

- (b) Confirmed.
- (c) Confirmed.
- (d) Confirmed.
- (e) See my response to USPS/UPS-T2-1(e).

USPS/UPS-T2-8. Please refer to UPS-Sellick-WP-1-I-C2 and UPS-Sellick-WP-D2. In the first workpaper, please refer to RLL100.XLS, CS 20 Sheet and in the second workpaper, please refer to ROLL_0.XLS, CS 20 Sheet.

- a. Please confirm that the sources for columns [10] - [12] of both sheets is "PHB Base Year Recalculation Model, PESSA Costs Sheet". If you do not confirm, please explain fully.
- b. Please confirm that the amounts shown for columns [10] - [12] are different for both sheets. If you do not confirm, please explain fully.
- c. Please confirm that the amounts on page 2 of ROLL_0.XLS, CS 20 Sheet, columns [10] - [12] are intended to replicate the Postal Service base year amounts shown on page 1, columns [1] - [3]. If you do not confirm, please explain fully.
- d. Please confirm that on page 3 of ROLL_0.XLS, CS 20 Sheet, columns [16] - [18] are intended to replicate the test year amounts appearing on page 1, columns [4] - [6]. If you do not confirm, please explain fully.
- e. Please explain fully the calculation and purpose of the line labeled "Factor" for columns [16] - [18] on page 3 of ROLL_0.XLS, CS 20 Sheet

Response to USPS/UPS-T2-8. (a) Confirmed. See my response to USPS/UPS-T2-1(a) for clarification of the citation.

- (b) Confirmed.
- (c) Confirmed.
- (d) Confirmed.
- (e) See my response to USPS/UPS-T2-1(e).

USPS/UPS-T2-9. Please refer to UPS-Sellick-WP-1-i-C2 and UPS-Sellick-WP-D2. In the first workpaper, please refer to RLL100.XLS, CS 18 Sheet and in the second workpaper, please refer to ROLL_0.XLS, CS 18 Sheet.

a. Please confirm that the sources listed for columns [29] - [42] on page 3 of each workpaper should read:

[29]	=[15] / [1]
[30]	=[16] / [2]
[31]	=[17] / [3]
[32]	=[18] / [4]
[33]	=[19] / [5]
[34]	=[20] / [6]
[35]	=[21] / [7]
[36]	=[22] / [8]
[37]	=[23] / [9]
[38]	=[24] / [10]
[39]	=[25] / [11]
[40]	=[26] / [12]
[41]	=[27] / [13]
[42]	=[28] / [14]

If you do not confirm, please explain fully.

b. Please refer to columns [34], [39], [41] and [42]. These columns show negative PESSA costs. Please fully explain the reason for negative PESSA costs. Should the impact of these negative PESSA costs be absorbed by volume variable costs of other classes and subclasses of mail or by "Other" costs? Please explain fully.

c. Please provide a complete explanation why in column [41], the subclasses of Fourth Class Mail show a 0% change from base year to test year while Total Fourth shows a 200% change from base year to test year.

Response to USPS/UPS-T2-9. (a) Confirmed. However, an additional note should be made indicating that if the denominator of the ratio equals zero, then the ratio equals zero.

(b) The negative PESSA costs indicated in columns [34], [39], [41], and [42] are derived from the negative PESSA costs in columns [20], [25], [27], and [28], respectively, which are in turn taken directly from USPS-T-15, WP-G, Table C. I did not consider whether or not witness Patelunas treated such negative PESSA costs correctly. Therefore, I am not in a position to comment on the cause of such negative costs or the impact they should have on other subclasses.

(c) As indicated in part (a) of this response, in instances where the Postal Service base year cost is zero, the spreadsheet enters a value of zero for the ratio of test year cost to base year cost. That is why, in column [41], the test year subclasses of Fourth Class Mail are 0% of those for the base year while test year Total Fourth Class is 200% of base year Total Fourth Class. Two of the subclasses of Fourth Class Mail go from zero in the base year to one in the test year, while one subclass goes from one in the base year to zero in the test year. As a result, all subclasses show test year costs as 0% of base year costs, even though there is a net increase of 100% in Total Fourth Class Mail costs from base year to test year. The overall effect of this is minimal.

USPS/UPS-T2-10. Please refer to UPS-Sellick-WP-1-I-A2,BSE100.XLS, CS 3 Sheet, page 2 of 3.

a. The source for footnote [4] is WS 3.2.1, column 6, but the amounts shown in column [4] are not found on WS 3.2.1. Please provide the source of the amounts that appear in column [4].

b. Please refer to the following statement from footnote [8]: "distributed on summation of mail processing other distribution keys." Please provide a complete explanation of the "other distribution keys" used in the summation. Include in your explanation component numbers, component titles, all calculations and documentation to source materials.

Response to USPS/UPS-T2-10. (a) Footnote [4] should read: "WS 3.3.2, Column 6."

(b) Footnote [8] should read: "Total from WS 3.0.4 Sheet, distributed on component 466." Please see Adjusted Distribution Keys sheet for explanation of calculation and source of component 466.

USPS/UPS-T2-11. Please refer to Table 4 on page 17 of your testimony.

a. Please confirm that the Postal Service, in moving from base year to test year costs, applies a mail volume effect to volume variable costs. If you do not confirm, please explain in detail.

b. Please confirm that, in moving from base year to test year costs, if the amount of total base year volume variable costs increases, then the test year mail volume effect will be greater. If you do not confirm, please explain in detail.

c. Please confirm that assuming 100 percent variability of mail processing labor costs will increase the total amount of base year volume variable costs above that shown in the Postal Service's filing. If you do not confirm, please explain in detail.

d. Please explain in detail why your TY 1998 recommended approach total costs are only \$3.7 million higher than those shown in the Postal Service's filing.

Response to USPS/UPS-T2-11. (a) Confirmed.

(b) Confirmed.

(c) Confirmed.

(d) The simplified roll-forward model I used does not account for an incremental mail volume effect on volume variable costs. The \$3.7 million difference between my recommended base year costs and the Postal Service's base year costs is the result of cumulative rounding effects rather than an effort to account for mail volume effects. As far as I can determine, omitting an incremental mail volume effect resulted in only a minimal difference in my calculation.

USPS/UPS-T2-12. On pages 12-13 of your testimony, you acknowledge that in earlier cases, the Commission (and the Postal Service) treated some portion of mail processing costs as fixed, yet in other places in your testimony (e.g. page 12, lines 10-11), you refer to the previous practice of "attributing 100 percent of mail processing labor costs."

a. Please clarify your understanding of the old methodology. Specifically, when you refer to "100 percent attribution," is this a shorthand reference to the previous practice of treating most costs as fully variable, and only a limited portion as fixed?

b. Are the analyses which produced the results reported in the Tables 2-6 in your testimony predicated on an assumed "100 percent attribution," or are they predicated on the same set of assumptions as the previous methodology (which actually attributed less than 100 percent of mail processing labor costs)? Please clarify.

Response to USPS/UPS-T2-12. (a) My references to "100 percent attribution" are shorthand references to the previous practice of treating most costs as fully variable and a limited portion as fixed.

(b) The analyses which produced the results reported in Tables 2-6 in my testimony are predicated on the same set of assumptions as the previous methodology which actually attributed less than 100 percent of mail processing labor costs.

USPS/UPS-T2-13. Please provide any statistical, econometric, or empirical analysis performed by either you or anyone else that validates the assumed 100 percent volume variability you use in calculating TY 1998 mail processing costs by shape for Priority Mail.

Response to USPS/UPS-T2-13. Please refer to the testimony of UPS witness Kevin Neels (UPS-T-1).

USPS/UPS-T2-14. Please explain your rationale for assuming that the Priority Mail Processing Cost Differences by Shape analysis isolates the cost differences due solely to shape, and for assuming that the results of the analysis are not driven by other factors such as zone-mix, presort, or dropshipping. In your explanation, please indicate all of the factors that you believe drive the cost difference.

Response to USPS/UPS-T2-14. I am not aware of any reason that the shape mix of Priority Mail would vary for the factors cited. Note that presorting accounts for a trivial amount of Priority Mail; in fact, witness Sharkey (USPS-T-33) is proposing to eliminate Priority Mail presorting in this case. Other factors which could drive the cost difference include differential ease or difficulty of mail processing due to shape.

USPS/UPS-T2-15. Please refer to UPS-SELLICK-WP-1-II-B1 to -B7.

- a. Please confirm that your programs are based upon the SAS programs in OCA-LR-1. If you do not confirm, please explain fully.
- b. If you confirm part (a), please list all changes you made to the SAS programs in OCA-LR-1. Please also describe the purpose of each change.

Response to USPS/UPS-T2-15. (a) Confirmed.

(b) The changes made and the purposes of each are generally noted in my workpapers. In addition, changes were made to SAS LIBNAME statements to account for subdirectory data location and miscellaneous changes to report titles. See, for example, UPS-SELLICK-WP-1-II-B1 through B6. Specific changes are noted below. All references, unless otherwise note, are to UPS-Sellick-WP-1-II-B.

MOD1DIR.SAS:

Line11 - create data set EXEMPT to hold observations with activity codes associated with fixed mail processing costs.

Lines 28-33 - select observations with activity codes associated with fixed mail processing costs.

MOD4DIST.SAS

Lines 221-231 and 239 - prepare exempt tallies for re-introduction to data processing.

Line 615 - weight report by COSTS instead of VCOSTS.

BMC1.SAS

Line 139 - create data set EXEMPT to hold observations with activity codes associated with fixed mail processing costs.

Lines 145-149 - select observations with activity codes associated with fixed mail processing costs.

BMC4.SAS

Lines 89-93 and 99 - prepare exempt tallies for re-introduction to data processing.

Line 274- weight report by COSTS instead of VCOSTS.

NONMODS12.SAS

Line 40 - create data set EXEMPT to hold observations with activity codes associated with fixed mail processing costs.

Lines 45-48 - select observations with activity codes associated with fixed mail processing costs.

NONMODS4.SAS

Lines 165-165 and 171 - prepare exempt tallies for re-introduction to data processing.

Lines 440 - weight report by COSTS instead of VCOSTS.

PREMITIOT.SAS

Lines 71-77 - switch definition of VCOSTS to ignore Postal Service volume variability.

Line 180 - switch definition of VCOSTS to ignore Postal Service volume variability.

MODSHAPE.SAS (UPS-Sellick-WP-III-C)

Lines 1-12 - as noted.

Lines 149-150 - include Priority Mail in class definitions.

Lines 165-180 - include Priority Mail in report printouts.

USPS/UPS-T2-16. Please refer to UPS-SELLICK-WP-1-II-B1 to -B7. Do your programs account for the institutional portion of Registry and Special Delivery costs? If your answer is affirmative, please provide reference(s) to the relevant sections of code. If your answer is negative, please explain.

Response to USPS/UPS-T2-16. My programs do not separately account for the institutional portion of Registry and Special Delivery costs. This was an oversight on my part (which I believe affects only Registry and Special Delivery) that I anticipate correcting in the response to POIR #11.

USPS/UPS-T2-17. Please refer to your testimony at pages 12-13.

a. Is it your testimony that the existing methodology for distributing "administrative" costs is more accurate than witness Degen's proposed methodology? Please explain fully.

b. If some "administrative" costs are related to a specific mail processing operation, would it be reasonable to distribute such costs in proportion to the subclasses of mail processed in that operation? Please explain fully.

Response to USPS/UPS-T2-17. (a) I have not testified that the existing methodology for distributing administrative costs is more accurate than witness Degen's proposed methodology. I have noted that witness Degen's methodology is different from the existing methodology.

(b) It may be reasonable to distribute the costs you describe in proportion to the subclasses of mail processed in that operation. I have not examined that question in detail.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T2-18. Please refer to UPS-Sellick-WP-1-I-C2. Please confirm that the title should read:

**UPS-SELLICK-WP-1-I-C2
Development of Test Year Costs - UPS Case
File RII100.xls**

If you do not confirm, please explain fully.

Response to USPS/UPS-T2-18. Confirmed.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T2-19. Please refer to UPS-Sellick-WP-1-I-C1 and UPS-Sellick-WP-1-I-D1. In the first workpaper, please refer to RLL100.XLS, Summary of Affected Components, pages 1-5, and in the second workpaper, please refer to ROLL_0.XLS, Summary of Affected Components, pages 1-5. Please confirm that the title on these pages was edited in one of the versions to either include or exclude the qualifier "TYAR". If you do not confirm, please explain fully.

Response to USPS/UPS-T2-19. Confirmed.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

14225

USPS/UPS-T2-20. Please refer to UPS-Sellick-WP-1-I-C2 and UPS-Sellick-WP-1-I-D2. In the first workpaper, please refer to RLL100.XLS, CS 3 Sheet, page 6 of 6, and in the second workpaper, please refer to Roll_.XLS, CS 3 Sheet, page 6 of 6.

- a. Please confirm that the function of this page is to adjust test year after rates, after workyear mix adjustment costs. If you do not confirm, please explain fully.
- b. Please confirm that the "Factor" row above "First Class Mail." is different in the two files. If you do not confirm, please explain fully.
- c. Please provide all calculations and sources used in the calculation of each of the factors appearing in the "Factor" row.
- d. Please explain fully the purpose of the factors in the ROLL_0.XLS spreadsheet and how they are applied in this spreadsheet. Are these factors used elsewhere in any of the workpapers? If the response is affirmative, please provide a complete list of citations.
- e. Please explain fully the purpose of the factors in the RLL100.XLS spreadsheet and how they are applied in this spreadsheet. Are these factors used elsewhere in any of the workpapers? If the response is affirmative, please provide a complete list of citations.
- f. Please confirm that the title appearing on the RLL100.XLS sheet, "Adjusted PHB TY AR After WY Mix", is also the appropriate title for the comparable sheet on ROLL_0.XLS. If you do not confirm, please explain fully.

Response to USPS/UPS-T2-20.

- a. Confirmed.
- b. Confirmed.
- c. For RLL100.XLS, CS 3 sheet, the factors were calculated as follows:

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

1. For each cost component, the Postal Service's base year total cost was subtracted from the UPS base year total cost.

2. The resultant number was rolled forward to the test year by multiplying it by the ratio of the Postal Service's test year total cost to the Postal Service's base year total cost.

3. This number was then subtracted from the UPS unadjusted test year total cost (columns 61-75).

4. The factors were calculated as the ratio of the Postal Service's test year total costs to the number calculated in step 3.

For an explanation of the factor row in the ROLL_0.XLS sheet, please see my response to USPS/UPS-T2-1(e).

d. Please see my response to USPS/UPS-T2-1(e) for an explanation of the purpose and application of these factors. These factors are not used elsewhere in any of the workpapers.

e. Changes from the Postal Service's proposed methodology to UPS's proposed methodology resulted in the transfer of costs among different cost components within Cost Segment 3. Because this changed the relative weight of subclass costs within cost components, applying the ratio of the Postal Service's TY Costs to BY Costs resulted in an incorrect increase in the total cost for Cost Segment 3. To offset this effect, each mail subclass of each cost component was multiplied by the appropriate factor discussed in part (c) of this response. These factors are not used elsewhere in any of the workpapers.

f. Confirmed.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T2-21. Please refer to UPS-Sellick-WP-1-I-C2 and UPS-Sellick-WP-1-I-D2. In the first workpaper, please refer to RLL100.XLS, CS 11 Sheet and in the second workpaper, please refer to ROLL_0.XLS, CS 11 Sheet.

a. Please confirm that the sources listed for columns [9] - [12] on page 2 of 3 of each workpaper should read:

[9]	=[5] / [1]
[10]	=[6] / [2]
[11]	=[7] / [3]
[12]	=[8] / [4]

If you do not confirm, please explain fully.

b. Please confirm that the sources listed for columns [17] - [20] on page 3 of 3 of each workpaper should read:

[17]	=[11] / [15]
[18]	=[12] / [16]
[19]	=[13] / [17]
[20]	=[14] / [18]

If you do not confirm, please explain fully.

c. Please provide all calculations and sources used in the calculation of each of the factors appearing in the "Factor" row of page 3 of 3 in the ROLL_0.XLS spreadsheet.

d. Please explain fully the purpose of the factors in the ROLL_0.XLS spreadsheet and how they are applied in this spreadsheet. Are these factors used elsewhere in any of the workpapers? If the response is affirmative, please provide a complete list of citations.

e. Please explain fully the purpose of the factors in the RLL100.XLS spreadsheet and how they are applied in this spreadsheet. Are these factors used

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

elsewhere in any of the workpapers? If the response is affirmative, please provide a complete list of citations.

Response to USPS/UPS-T2-21. a. Confirmed.

 b. Not Confirmed. The sources listed for columns [17]-[20] on page 3 of 3 of each workpaper should read:

[17]	=	[9]	x	[13]
[18]	=	[10]	x	[14]
[19]	=	[11]	x	[15]
[20]	=	[12]	x	[16]

 c. Please see my response to USPS/UPS-T2-1(e) for an explanation of the calculation of these factors.

 d. Please see my response to USPS/UPS-T2-1(e) for an explanation of the purpose of these factors. These factors are not used elsewhere in any of the workpapers.

 e. Please see my response to USPS/UPS-T2-1(e) for an explanation of the purpose of these factors. These factors are not used elsewhere in any of the workpapers.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T2-22. Please refer to UPS-Sellick-WP-1-I-C2 and UPS-Sellick-WP-1-I-D2. In the first workpaper, please refer to RLL100.XLS, CS 15 Sheet and in the second workpaper, please refer to ROLL_0.XLS, CS 15 Sheet.

a. Please confirm that the sources listed for columns [4] - [5] on page 1 of 2 of each workpaper should read:

[4] =[3] / [1]
[5] =[4] / [2].

If you do not confirm, please explain fully.

b. Please confirm that the sources listed for columns [9] - [10] on page 2 of 2 of each workpaper should read:

[9] =[5] X [7]
[10] =[6] X [8].

If you do not confirm, please explain fully.

c. Please provide all calculations and sources used in the calculation of each of the factors appearing in the "Factor" row.

d. Please explain fully the purpose of the factors in the ROLL_0.XLS spreadsheet and how they are applied in this spreadsheet. Are these factors used elsewhere in any of the workpapers? If the response is affirmative, please provide a complete list of citations.

e. Please explain fully the purpose of the factors in the RLL100.XLS spreadsheet and how they are applied in this spreadsheet. Are these factors used elsewhere in any of the workpapers? If the response is affirmative, please provide a complete list of citations.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

Response to USPS/UPS-T2-22.

a. Confirmed.

b. Confirmed.

c. Please see my response to USPS/UPS-T2-1(e) for an explanation of the calculation of these factors.

d. Please see my response to USPS/UPS-T2-1(e) for an explanation of the purpose of these factors. These factors are not used elsewhere in any of the workpapers.

e. Please see my response to USPS/UPS-T2-1(e) for an explanation of the purpose of these factors. These factors are not used elsewhere in any of the workpapers.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T2-23. Please refer to UPS-Sellick-WP-1-I-C2 and UPS-Sellick-WP-1-I-D2. In the first workpaper, please refer to RLL100.XLS, CS 18 Sheet, page 6 of 6, and in the second workpaper, please refer to ROLL_0.XLS, CS 18 Sheet, page 6 of 6.

a. Please provide all calculations and sources used in the calculation of each of the factors appearing in the "Factor" row.

b. Please explain fully the purpose of the factors in the ROLL_0.XLS spreadsheet and how they are applied in this spreadsheet. Are these factors used elsewhere in any of the workpapers? If the response is affirmative, please provide a complete list of citations.

c. Please explain fully the purpose of the factors in the RLL100.XLS spreadsheet and how they are applied in this spreadsheet. Are these factors used elsewhere in any of the workpapers? If the response is affirmative, please provide a complete list of citations.

Response to USPS/UPS-T2-23. a. Please see my response to USPS/UPS-T2-1(e) for an explanation of the calculation of these factors.

b. Please see my response to USPS/UPS-T2-1(e) for an explanation of the purpose of these factors. These factors are not used elsewhere in any of the workpapers.

c. Please see my response to USPS/UPS-T2-1(e) for an explanation of the purpose of these factors. These factors are not used elsewhere in any of the workpapers.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

14232

USPS/UPS-T2-24. Please refer to UPS-Sellick-WP-1-I-C2 and UPS-Sellick-WP-1-I-D2. In the first workpaper, please refer to RLL100.XLS, CS 20 Sheet and in the second workpaper, please refer to ROLL_0.XLS, CS 20 Sheet.

a. Please confirm that the sources listed for columns [7] - [9] on page 1 of each workpaper should read:

[7]	=[4] / [1]
[8]	=[5] / [2]
[9]	=[6] / [3]

If you do not confirm, please explain fully.

b. Please provide all calculations and sources used in the calculation of each of the factors appearing in the "Factor" row of page 3 of 3 in the ROLL_0.XLS spreadsheet. Please explain fully the purpose of the factors in the ROLL_0.XLS spreadsheet and how they are applied in this spreadsheet. Are these factors used elsewhere in any of the workpapers? If the response is affirmative, please provide a complete list of citations.

c. Please provide all calculations and sources used in the calculation of each of the factors appearing in the "Factor" row of page 2 of 2 in the RLL100.XLS spreadsheet. Please explain fully the purpose of the factors in the RLL100.XLS spreadsheet and how they are applied in this spreadsheet. Are these factors used elsewhere in any of the workpapers? If the response is affirmative, please provide a complete list of citations.

d. Please confirm that the titles referring to "TY BR" on page 2 of each spreadsheet should refer to "TY AR". If you do not confirm, please explain fully.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

Response to USPS/UPS-T2-24.

a. Confirmed.

b. Please see my response to USPS/UPS-T2-1(e) for an explanation of the calculation, purpose, and application of these factors. These factors are not used elsewhere in any of the workpapers.

c. Please see my response to USPS/UPS-T2-1(e) for an explanation of the calculation, purpose, and application of these factors. These factors are not used elsewhere in any of the workpapers.

d. Confirmed.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

14234

USPS/UPS-T2-25. Please refer to Table 6 on page 21 of your testimony. Please confirm that you have included both BMC and ASF costs in your calculation of "All Offices Operation Codes 01 and 07." If you do not confirm, please explain fully how these were excluded.

Response to USPS/UPS-T2-25. Confirmed.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T2-26. Please confirm that you do not provide testimony on the average weight of Priority Mail pieces observed in IOCS, by shape, either in your direct testimony or in your workpapers. If not confirmed, please provide a reference, and explain how they were derived.

Response to USPS/UPS-T2-26. Not confirmed. Please see my workpaper UPS-Sellick-WP-1-VI-A for the average weight of Priority Mail pieces by shape and UPS-Sellick-WP-1-VI-B for the SAS code which derived these calculations.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS SELICK TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T2-27. a. Please confirm that the ODIS volumes reported in workpaper UPS-Sellick-1-III-A, page 2, are average daily volumes. If not, confirmed please explain fully.

 b. Please confirm that when multiplied by 302 delivery days, the aggregate ODIS volume estimates for Priority Mail are within 5% of the BY 96 Priority Mail volume. If not confirmed, please explain fully.

Response to USPS/UPS-T2-27. (a) Confirmed.

 (b) Confirmed. The total ODIS 1996 average daily volume for Priority Mail is 3,259,991. The total 1996 Priority Mail volume is 937,273 (000). $3,259,991 \times 302 = 984,517$ (000); $937,273 / 984,517 = 95\%$.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS STEPHEN E. SELICK TO INTERROGATORY
OF UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-27. Please refer to pages 43-44 of your direct testimony, where you state that "the average weight of Priority Mail parcels observed in IOCS was 3.34 pounds" with footnote 41 referring to UPS-Sellick-WP-1-III-A.

* * *

(b) Please confirm that the 3.34 pounds was derived by computing an unweighted mean of the weight recorded on any IOCS direct tally of a Priority Mail IPP or parcel. If not confirmed, please explain how it was computed or derived.

(c) Please list all assumptions needed for an average weight estimate obtained in this manner to be an unbiased estimate of the average weight of a Priority Mail IPP or parcel.

Response to USPS/UPS-T4-27. (b) Confirmed. Note that the mean weighted by IOCS Tally Dollars (F9250) would be 3.10 pounds for Priority Mail IPP/parcels and 1.03 pounds for Priority Mail flats.

(c) The unweighted average is an unbiased estimate if the average weight does not vary by IOCS sampling strata, essentially CAG. As noted in (b) above, the weighted average is not significantly different from the unweighted average.

1 CHAIRMAN GLEIMAN: Does any participant have
2 additional written cross-examination for the witness?

3 [No response.]

4 CHAIRMAN GLEIMAN: If not, that brings us to oral
5 cross-examination. As I indicated earlier, five parties
6 have requested oral cross-examination -- American Business
7 Press, CTC Distribution, Nashua District, Parcel Shippers
8 Association, and the Postal Service.

9 Does any other party wish to cross-examine?

10 [No response.]

11 CHAIRMAN GLEIMAN: Those requests were with
12 respect to the original testimony. As I understand it,
13 there were no parties who indicated an interest in crossing
14 on the supplemental testimony.

15 If there are no additional parties who wish to
16 cross-examine, Mr. Straus, you may begin when you're ready.

17 MR. STRAUS: Thank you.

18 CROSS-EXAMINATION

19 BY MR. STRAUS:

20 Q Mr. Sellick, I'm David Straus for American
21 Business Press.

22 Is the Postal Service efficient?

23 A I'm not sure I've looked into that specifically.

24 Q So you don't know.

25 A I don't think I have examined that question. I

1 don't have an opinion at this time on that.

2 Q Okay. Would you agree that postal ratesetting has
3 two basic components, one is an objective component of
4 determining the costs, and the other is a more subjective
5 component of marking up those costs?

6 A Those are two components of postal ratemaking;
7 yes.

8 Q Are those the -- okay.

9 For certain subclasses where the markup is low,
10 such as parcels and periodicals, would you also agree that
11 for those classes especially an accurate measurement of
12 costs is important?

13 A I think an accurate measurement of costs would be
14 important in any class or subclass; yes.

15 Q Is it therefore a high enough standard to use in
16 assigning costs that one cost is likely to be similar to
17 another, or would you want a greater degree of certainty and
18 a greater degree of identity than likelihood of similarity?

19 A It depends on what the alternatives are that are
20 available.

21 Q So if the best you have is that cost A is likely
22 to be similar to cost B, it would be perfectly okay to treat
23 the two as identically caused?

24 A If that's the best that you have and there's not
25 an alternative, or it's better than other alternatives, I

1 think yes.

2 Q In a situation where you have very little
3 certainty about cost causality, what would you do then?

4 A Again, it would depend on the alternatives and the
5 circumstances in the particular -- particular question at
6 hand.

7 Q Well, you could treat it as an overhead cost,
8 couldn't you?

9 A That would be one option.

10 Q And how would you determine whether the better
11 option was to treat it as an overhead cost, or in a case
12 where all you have is likelihood of similarity, to treat it
13 as an assigned cost?

14 A Again, it is difficult to address that in the
15 abstract. It would depend on the particular circumstances
16 of the costs and what one knew about it and what the
17 alternatives were to treating it as an overhead cost, and
18 even overhead costs are assigned to specific classes or
19 subclasses of mail. It just distributed across many instead
20 of a single one.

21 Q Please look at your response to DMA-1, Part A.

22 A I have that.

23 Q Okay. As I recall, Mr. Degen did agree, during
24 his appearance, that assumptions are important. Your
25 statement, though, is that you refuse to agree that

1 assumptions are important. You said it, quote, "depends on
2 the impact a change in the assumptions would have on the
3 final results," close quote. Have you examined what the
4 impact would be of a change in assumptions in this case?

5 A I have changed the assumption of volume
6 variability in this case, but I have not specifically
7 examined other changes in Witness Degen's assumptions in
8 this case.

9 Q Okay. So you haven't determined then whether the
10 assumptions are important or not?

11 A I haven't look at it in an analytical way.

12 Q Have you -- in Part B of that same question, you
13 confirmed that you did not test the validity of the
14 assumptions. Have you done that yet?

15 A I have not.

16 Q Okay. So you don't know if the assumptions are
17 important, and you don't know if the assumptions are valid,
18 is that correct?

19 A I am not sure I have said the assumptions are not
20 important. I believe said that it depends on what the
21 alternatives are to making an assumption.

22 Q But you said you -- I thought you said you did not
23 examine the alternatives to determine whether the
24 assumptions are important.

25 A I have examined the alternative that is the

1 present system that the Postal -- or the previous system
2 that the Postal Service has used, that is LIOCATT, and there
3 are assumptions made in LIOCATT which the current
4 information presented by the Postal Service has shown to be
5 demonstrably not correct.

6 Q Well, then, are the assumptions important or
7 aren't they important?

8 A Assumptions can be important, yes.

9 Q But are they here?

10 A Certainly.

11 Q Well, your answer to the question was that you
12 don't know unless you examine the alternatives. Now, have
13 you since examined those alternatives? Have you -- is this
14 an update to your answer? That previously you said you
15 could not determine whether assumptions are important, and
16 now you are saying that some of the assumptions are
17 important?

18 MR. McKEEVER: Objection, Mr. Chairman, that
19 mischaracterizes the testimony. The question that was asked
20 in the Interrogatory was in the abstract. Please confirm
21 that the assumptions which underlie analysis are important.
22 Mr. Sellick never said, as Mr. Straus said he said, in his
23 testimony that the assumptions which underlie Mr. Degen's
24 analysis are not important. In fact, his testimony was to
25 the contrary.

1 BY MR. STRAUS:

2 Q Okay. So the assumptions that underlie Mr.
3 Degen's analysis are important?

4 A Yes.

5 Q But you did not test their validity?

6 A I have not tested their validity in the abstract.
7 I have looked at Mr. Degen's assumptions relative to the
8 assumptions made under the previous Postal Service system,
9 LIOCATT.

10 Q Let's look at DMA-4(b).

11 A I have that.

12 Q Okay. You state that even if the not handling
13 costs in a pool are not caused by the handling activities,
14 it may still be best to distribute not handling costs within
15 those same cost pools if to do otherwise would ignore what
16 you call, quote, "other important factors," close quote.
17 What other factors did you have in mind?

18 A Other factors could -- would primarily be what the
19 alternatives were to distributing those overhead costs that
20 one had in mind. If the alternative were to, for instance,
21 to distribute the overhead costs of a function that is known
22 not to involve another function on that function, then that
23 would be an important consideration to take into effect.

24 Q Your answer, here, again, it says that if to do
25 otherwise, would ignore. Have you tested whether, in fact,

1 other important factors would be ignored?

2 A Again, I have compared Witness Degen's proposal to
3 the previous Postal Service systems and I believe that his
4 proposal has important improvements over the previous
5 system. I have not compared Witness Degen's proposal to
6 other abstract situations or methods that could be proposed.

7 Q Well, tell me what other important factors would,
8 in fact, be ignored here if not handling costs -- let me
9 start again. Your testimony in response to DMA-4 was that
10 it might be okay to distribute not handling costs, even if
11 they are not caused by the handling activities, in
12 accordance with those handling costs, if to do so would
13 ignore other factors. Are there other factors that would,
14 in fact, be ignored here?

15 A I believe in some circumstances, the other factors
16 -- other factors ignored would be, for example, that the not
17 handling costs are not evenly distributed throughout the
18 Postal system. Some of the MODs pools constructed by
19 Witness Degen demonstrate different levels of not handling
20 costs within those pools. It would be an important factor
21 to recognize that, and to ignore that, I believe would be
22 incorrect. LIOCATT, for example, does not take that into
23 account.

24 Q So because of variability across pools, it is
25 acceptable -- it would be acceptable to distribute not

1 handling costs that are not caused by handling costs, as if
2 they were?

3 A I believe that Witness Degen's proposal is an
4 improvement over the past system which did ignore that
5 variability.

6 Q So it is okay?

7 A It is an improvement, and I believe it is okay,
8 yes.

9 Q In response to DMA-5, you state that you
10 personally did not perform an analysis concerning the
11 percentage of time that mail processing employees are
12 clocked into one operation while performing another. I
13 assume you still have not performed that analysis?

14 A That is correct.

15 Q Instead, you cite Witness Degen's testimony that,
16 quote, "The MODs activity at the vast" -- excuse me -- "The
17 MODs activity at the operation level and the employee's
18 activity are consistent in the vast majority of cases.",
19 close quote. That is the testimony you are relying on?

20 A Yes, it is.

21 Q What did Mr. Degen mean by vast majority, was that
22 65 percent or 85 percent, or 99 percent, or what?

23 A I don't recall a specific proportion that he cited
24 at that time.

25 Q Well, do you know what -- do you know what, to Mr.

1 Degen, is a vast majority?

2 A I do not.

3 Q But whatever it is to Mr. Degen, that's fine with
4 you?

5 A I recall that he investigated it, as I recall,
6 including meeting with some of the Postal Inspection Service
7 personnel which conducted the audit, looked into it, and
8 determined to his satisfaction that the misclocking question
9 was not of sufficient significance for him to be concerned
10 about it, and his opinion in that matter is what I am
11 relying on, and I am -- I am relying on that opinion.

12 Q He was defending his own study with that opinion?

13 A That is correct.

14 Q And you have analyzed his study and have decided
15 that it is appropriate for use in this case?

16 A Yes.

17 Q Wouldn't that take a different degree of
18 independent analysis on your part to know what vast majority
19 is? What if Mr. Degen meant 65 percent, would that still be
20 okay?

21 A Again, I would need to -- 65 percent might be
22 okay, again, considering the alternatives. I am not sure
23 what the --

24 Q I mean if an employee is clocked into one
25 operation, working in another 65 percent of the time, that's

1 fine?

2 A It depends on the context.

3 Q There has been talk -- you were here this morning,
4 weren't you?

5 A Yes, I was.

6 Q There was a lot of discussion about not handling
7 costs. Could you, for all of us, list some of the major
8 components of not handling costs, what those actually are?

9 A The not handling mail costs, or --

10 Q Yes.

11 A -- overhead, what have been called overhead costs?

12 Q What have been called by the Postal Service not
13 handling, and by Mr. Degen, not handling costs. What are
14 they? What are people doing when they are registered as not
15 handling?

16 A It could be any number of actual functions where
17 they do not have an actual piece, an item, a container of
18 mail in hand or are at a machine where the IOCS data
19 collector, or machine or a process, where the IOCS data
20 collector is not allowed to select a specific piece, item or
21 container of mail from which to sample.

22 Q I mean that is what they are not doing. What
23 would they be doing when they are classified as not handling
24 mail?

25 A They could be, for example, waiting to -- waiting

1 at a machine to, for mail to come in to be processed.

2 Q Can you give me a few more of the examples of not
3 handling? There are a number of relatively specific
4 activities included within the not handling mail category.
5 What, in your mind, what are the major components?

6 A I would refer to Library Reference, it's the
7 handbook F-45, Library Reference H-49. And I haven't -- I
8 don't recall specifically, sitting here now, what some of
9 those codes might be. But if I were to look at that, I
10 would look at H-49 and also, in conjunction with the IOCS
11 computer programs, which assign not handling mail activity
12 codes based on the response to the IOCS questions.

13 Q But sitting here today, you are not quite sure
14 what the not handling activities are?

15 A I don't recall the other specific functions that
16 might be classified as not handling mail.

17 Q Is moving empty equipment -- do you know whether
18 moving empty equipment is a not handling?

19 A I believe that is classified as one of the
20 overhead costs, the 6521, 22 and 23, if I am not mistaken.

21 Q Let me ask you another question. Can any of the
22 costs, the not handling costs, in one cost pool, vary
23 because of what is or is not happening in another cost pool?

24 A I am not sure there have been any analyses in that
25 regard.

1 Q So you don't know whether activities in one cost
2 pool can affect the level of not handling costs in another
3 cost pool?

4 A I suspect it is possible, but I haven't seen any
5 analyses in that regard.

6 Q It's true, isn't it, that Mr. Degen's analysis
7 assumes that within each cost pool, each of the non-handling
8 costs is caused by mail in the same proportion as directly
9 documented costs, plus the assumed allocation of mixed
10 costs?

11 A That is the approach that his method takes, yes.

12 Q Do you know what percentage then of these costs
13 are actually assigned on the basis of assumptions about
14 mixed mail and assumptions about not handling costs?

15 A I don't recall the specific percentage, no.

16 Q Would it bother you if it was more than half?

17 A Not necessarily, because the same not handling
18 mail and overhead costs are assigned under LIOCATT. I
19 believe it really is a question of which system is -- takes
20 better -- takes into account the information available, and
21 has better assumptions about the way overhead costs and
22 mixed mail costs might be assigned. Relative to LIOCATT,
23 that does not concern me because it would have the same
24 basic approach there, just using a different method.

25 Q How does one determine whether the assumptions are

1 better or not?

2 A One examines them, considers what the alternatives
3 are, thinks about what the effects of those assumptions
4 might be, and things of that sort.

5 Q What about testing, couldn't you test an
6 assumption?

7 A If an assumption can be tested, and there were
8 time available, that would not be -- that would be a good
9 thing to do, yes.

10 Q Wouldn't that be the best thing to do?

11 A It would be -- best relative to what? But, yes --

12 Q Best relative to not testing.

13 A Sure. Testing is better than not testing, all
14 other things considered.

15 Q Relative to any of the other alternatives you gave
16 other than testing?

17 A Yes.

18 Q It's true, isn't it, that \$700 million of mixed
19 mail costs consists of handling empty items and containers?

20 A Subject to check, I'll accept that number.

21 Q Okay. Isn't it also true that Witness Degen had
22 no data from which to determine what subclasses of mail were
23 in those containers when they were not empty, or at what
24 cost pools the mail was processed before the items were
25 empty?

1 A I'm sorry. Could you repeat the question?

2 Q Mr. Degen had no data from which he could
3 determine what was in those contains before they were empty,
4 or at what cost pools they were empty?

5 A I believe that is correct. There is no way to
6 sample something that is not in a container. Literally,
7 there was nothing there, so there was nothing to be known
8 about it.

9 Q There is no way to test whether an empty container
10 used to have First Class mail or used to have Second Class
11 mail?

12 A There is nothing in that container, you said,
13 correct?

14 Q No, but is there a way to find out what used to be
15 in that container?

16 A I am not sure I can think of one.

17 Q You don't think -- you don't think the employee
18 could be asked where he got it? You don't think a good
19 detective could trace that container back to where it was
20 emptied and figure out what was in it?

21 A Theoretically, I suppose that is possible, but I
22 am not sure that is consistent within the context of IOCS
23 and the, I think, 600,000-some-odd observations or so that
24 they make every year.

25 Q We are talking about \$700 million of mixed mail

1 costs being allocated on the basis of empty containers, and
2 are you saying that it is not worthwhile to try to figure
3 out what was in those containers?

4 A I said I am not sure it is consistent with the
5 nature of IOCS. It is possible that it would be. And
6 whether it is worthwhile would depend on the relative cost
7 of doing that, and a host of other factors.

8 Q Please look at your own testimony on page 5, lines
9 6 through 9.

10 A I have that.

11 Q You refer, more precisely, on lines 8 to 9, an
12 item containing one subclass of mail, and then you say, in
13 quotes, "identical items and containers". Do you see that?

14 A Yes, I do.

15 Q Let me show you two magazines here. And for the
16 record, I will say that they are the same size. Would you
17 agree that these are the same size?

18 A They appear to be, yes.

19 Q And let's say that, as well, that they are in --
20 that they are both in the same subclass, let's say they are
21 both non-profit, Second Class. That they are non-profit
22 periodicals rate pieces, same size. Okay.

23 A I have your assumption.

24 Q Okay.

25 MR. McKEEVER: Mr. Chairman, if Mr. Straus is

1 going to ask Mr. Sellick some questions about the
2 periodicals, I would appreciate it if Mr. Sellick could have
3 the periodicals.

4 MR. STRAUS: That would be okay.

5 THE WITNESS: Thank you.

6 BY MR. STRAUS:

7 Q As you in the Postal Service use the term, are
8 these pieces identical?

9 A I would need again to refer to Handbook F-45 to
10 refresh my memory on the rules of determining whether
11 identical conditions apply.

12 Q First, -- you can certainly do that. But before
13 you do it, your testimony says, contain only one subclass of
14 mail, paren, (identical items and containers). Do you need
15 more refreshing than that?

16 A I would like to check back with Handbook F-45, if
17 I may.

18 Q Okay.

19 A Handbook F-45, which, as I mentioned, I think is
20 Library Reference H-49, at page 88, describes the conditions
21 which meet the identical mailing. It read as follows, "An
22 identical mailing is one in which the mail pieces have the
23 same origin, mail class, subclass, shape, size, weight and
24 postage. The pieces are the same except for their
25 destinations." My testimony refers only to one subclass of

1 mail which, I would characterize, is shorthand for the full
2 definition of identical mail, as in Library Reference H-49.

3 Q Did you write this particular portion of your
4 testimony yourself?

5 A Yes, I did.

6 Q And you are saying that subclass is a shorthand
7 reference to class, subclass, shape, size, weight and
8 postage?

9 A It's -- I may not have specifically referred back
10 to H-49 at that time. I was attempting to characterize
11 identical mail in a shorthand fashion.

12 Q In the same paragraph of your prepared testimony,
13 you talk about mixed mail.

14 A Yes.

15 Q You say -- you say, quote, "those observations in
16 which the employee is engaged in an activity involving a
17 mixture of different classes or shapes of mail". Do you
18 want to make any modifications to that statement about --
19 make it more precise as to what mixed mail really is?

20 A Mixed mail can be different classes of mail, as
21 well as different shapes of mail. It can also be -- not
22 handling mail is also a category of mixed mail.

23 Q But mixed mail can also be the same class and the
24 same shape, can't it?

25 A In some circumstances, it could be, yes.

1 Q I guess that's why I am asking for a more precise
2 statement. In your testimony, you say here -- you seem to
3 be saying mixed tallies are those involving different
4 classes or shapes. Now, you have just said that you can
5 have different classes or shapes without having mixed mail.

6 A Yes.

7 Q Okay.

8 A Again, it's -- there's a whole series of
9 definitions of mixed mail, identical items and such that are
10 defined by the Postal Service. My testimony was -- in that
11 section, was not meant to be a definitive definition as
12 such, but a shorthand description.

13 Q You state at page 10 of your testimony, lines 6
14 and 7, that different types of containers are used for
15 different types, and then put in parentheses, (subclasses of
16 mail). Could you give me some examples of the kinds of
17 containers you are talking about and subclasses of mail they
18 are used for?

19 A The containers, generally, are used for different
20 functions in the Postal Service. Containers are, as I
21 recall from the Container Methods Handbook, which the
22 specific reference I don't -- I don't recall right now, but
23 containers are used for different, sometimes different item
24 types and different functions, and those item types and
25 functions, in turn, have a relationship to different class

1 types of subclasses of mail.

2 Q Okay. But I asked you a different question.

3 A I'm sorry.

4 Q You said -- you use the phrase "different types of
5 containers are used for different types of mail". Give me
6 some examples, give me five examples, or four examples of
7 the types of containers that you are referring to there.

8 A I am not sure sitting here now I could
9 specifically enumerate the types of containers and functions
10 and types of mail that they might be used for in the Postal
11 Service. But there are definitions within Container Methods
12 and Postal Operations that describe the circumstances under
13 which specific containers generally are intended to be used,
14 and that's what I had in mind when writing that section.

15 Q You wrote this sentence?

16 A Yes, I did.

17 Q Page 9 of your testimony, you refer to a 1992
18 report by Foster Associates. Do you consider that report to
19 be authoritative?

20 A I reviewed the report and it discusses the issue
21 that I address in my testimony. As I recall, I am not sure
22 it answered a lot of questions. It discussed some issues.

23 Q Was it consistent with your testimony, or was just
24 this particular portion consistent with your testimony?

25 A I don't recall. Obviously, the pieces that I

1 present here, I believe are consistent with my testimony.
2 If you have specific sections in mind, I am not sure what
3 else might be in there that you are referring to.

4 Q Let me read you from that report. This is called
5 "Overhead and Subclass Cost Study Prepared for the United
6 States Postal Services, Foster Associates, November 1992".
7 Do you have it with you?

8 A I have parts of it, I am not sure if I have the
9 section you are referring to.

10 Q Do you have the Executive Summary?

11 A I do not have all of the Executive Summary, no.

12 Q Do you have page 2 of the Executive Summary, where
13 it lists the four main conclusions?

14 A I do not.

15 MR. STRAUS: May I approach the witness, Your
16 Honor?

17 CHAIRMAN GLEIMAN: Certainly.

18 MR. McKEEVER: Mr. Chairman, if Mr. Strauss has a
19 copy for counsel, I would appreciate one. Thank you.

20 MR. STRAUS: I have one.

21 MR. McKEEVER: Thank you.

22 BY MR. STRAUS:

23 Q Mr. Sellick, could you read -- I don't have any
24 left -- the paragraph with the caption Data?

25 A Page 2, paragraph data, reads, "Additional field

1 operating data are necessary to determine the proper
2 (causative) attribution of the break and sub-class cost in
3 question and those other costs which are presently
4 attributed as mixed mail or overhead activities.

5 Q Thank you.

6 Do you have any reason to disagree with that
7 conclusion by Foster Associates?

8 MR. McKEEVER: Mr. Chairman, I'll object. This is
9 one statement on one page of a report that's fairly long.
10 Mr. Sellick has not been provided with a complete copy of
11 the report. I don't know how he could possibly address that
12 without seeing the whole report and being directed to the
13 discussion of the whole report in there. I don't know what
14 some of these terms mean and what they relate to.

15 MR. STRAUS: He quotes the report in his own
16 direct testimony to support him. I assume he would have
17 read it before he quoted it. If not, he could say so, I
18 suppose. I didn't bring it up; he did.

19 MR. McKEEVER: Mr. Chairman, Mr. Sellick did not
20 quote this particular portion of the report in his testimony
21 and, as far as I can tell from the state of the record right
22 now, did not rely on it.

23 CHAIRMAN GLEIMAN: I don't know what Mr. Sellick
24 relied on or not or whether he read the whole report or not.
25 I'm going to overrule the objection. If Mr. Sellick is not

1 familiar with it and doesn't feel he can answer the
2 question, then he can state so.

3 MR. McKEEVER: May I ask that the question be
4 repeated?

5 CHAIRMAN GLEIMAN: Certainly.

6 BY MR. STRAUS:

7 Q I recall the question was do you have any reason
8 to disagree with this conclusion by Foster Associates?

9 A I do not believe I have any reason to disagree
10 with the conclusion that more data are good, but I would
11 like to make two points on that. One, --

12 Q Well perhaps on redirect, you can make your
13 points. I think you answered my question.

14 MR. McKEEVER: Mr. Chairman, I don't think he has
15 completely answered the question unless he has given a full
16 responsive answer to it, and I think the witness should be
17 permitted to give his answer now.

18 MR. STRAUS: I withdraw the objection.

19 THE WITNESS: It's just two very basic points.
20 One is, as I recall, IOCS was modified at one point in time
21 to gather more information about exactly the question raised
22 in that paragraph; and two, Witness Degen's MODS pool
23 approach to allocating these costs would encompass some of
24 the causative factors of break time and keep them within the
25 origins of the operation that those breaks were from.

1 BY MR. STRAUS:

2 Q Are you familiar with the MODS manual?

3 A I reviewed it briefly at one point, but I wouldn't
4 say I'm familiar with it.

5 Q It lists a number of mods -- well, it gives the
6 mods operations numbers. Are you familiar with those
7 operations numbers?

8 A In a general sense.

9 Q Does the Degen approach that you support combine a
10 large set of operation codes into a smaller set of cost
11 pools?

12 A Yes, it does.

13 Q And have you examined that work to determine
14 whether his particular groupings most accurately segregate
15 mail processing functions into discrete areas?

16 A I have not examined them -- I have not examined
17 his groupings of MODS pools into the -- of MODS codes into
18 the pools that he proposes, no.

19 Q Might an alternative grouping be more accurate?

20 A It's possible.

21 Q Have you examined the impact of any alternative
22 groupings?

23 A I have not.

24 Q Did Degen divide his cost pools the way he did in
25 order to be consistent with the analysis performed by Postal

1 Service Witness Bradley?

2 A There is a relationship between the two. I don't
3 recall specifically which one was the origin of the other.

4 Q So you don't know whether Degen followed Bradley's
5 analysis in order to determine his cost pools?

6 A It's possible; I just don't specifically recall
7 now. I know they have the same -- generally the same sets
8 of pools.

9 Q Do you know what MODS Code 175 is?

10 A No, I don't.

11 Q If I gave you the MODS handbook, could you tell
12 us?

13 A I could look it up, I suppose.

14 Q Here you are.

15 A Thanks. Actually, I think Witness Degen may have
16 included some of those in his testimony or in his library
17 reference, but I'll check here first.

18 MR. KOETTING: Appendix A.

19 THE WITNESS: Thank you.

20 MODS Code 175 appears to be incoming flat
21 secondary composite.

22 BY MR. STRAUS:

23 Q A little more than that, maybe?

24 A The description -- that's the title of it --
25 appears to be described as manual distribution of flat mail

1 received for distribution to local carrier routes, boxes and
2 firms.

3 Q It's an incoming secondary sort basically of a
4 carrier route?

5 A It sounds like it, yes.

6 Q Okay. Now, that's pretty much -- would you agree
7 that that's the only manual flat sorting operation for most
8 periodicals in Standard A flats?

9 A I'm not sufficiently familiar with the particular
10 processing aspects to comment on that.

11 Q Now, this is going to be the only additional code
12 I'm going to ask you about, so would you tell us what Code
13 60 is.

14 A Sixty reads: outgoing flat primary composite. Do
15 you want me to also read the --

16 Q Yes, please.

17 A It reads, manual distribution of mixed states
18 flats of all classes for separation to states, combination
19 of states, sectional centers, cities and foreign countries.

20 Q Now, is this going to be mostly first class mail?

21 A I'm not sure, to be honest.

22 Q Are Codes 175 and 60 in the same cost pool?

23 A Without looking at how the cost pools are defined,
24 I couldn't say right now.

25 Q Having read these descriptions, one being incoming

1 flats to carrier route and being the only manual flat
2 sorting operation for most periodicals, the other going --
3 an outgoing primary for flats without prior sortation, would
4 you expect that they should be in the same cost pool?

5 MR. McKEEVER: Mr. Chairman, objection, because
6 Mr. Straus assumed as facts facts that Mr. Sellick said he
7 wasn't aware of. If Mr. Straus wants to just ask the
8 witness to assume those facts, I have no problem with him
9 answering the question.

10 MR. STRAUS: Then why don't we just make it much
11 simpler.

12 BY MR. STRAUS:

13 Q Should 175 and 60 be in the same cost pool?

14 A I haven't investigated that and I don't have an
15 opinion on it.

16 Q But you have an opinion that Mr. Degen's cost
17 pools are perfectly appropriate in this case?

18 A I believe that Mr. Degen's cost pools are an
19 improvement over past practice, yes.

20 Q But you don't know if this particular grouping
21 makes any sense or not.

22 A I haven't specifically examined this grouping, no

23 Q Do you understand the implications on rates of
24 United -- your client, United Parcel Service's acceptance of
25 Mr. Degen's approach?

1 A I haven't specifically looked into the rate
2 calculations that result from the base year, test year cost.

3 MR. STRAUS: I have no further questions. Thank
4 you.

5 CHAIRMAN GLEIMAN: CTC Distribution Services? Mr.
6 Miles?

7 MR. MILES: Mr. Chairman, CTC Distribution
8 Services has no further questions at this time.

9 CHAIRMAN GLEIMAN: Nashua District Mystic Seattle?

10 MR. MILES: On behalf of Nashua, District, Mystic
11 and Seattle, no further questions.

12 CHAIRMAN GLEIMAN: Thank you. That brings us to
13 Parcel Shippers Association.

14 Mr. May, you have no questions also?

15 MR. MAY: Just really one.

16 [Laughter.]

17 CHAIRMAN GLEIMAN: Another one of those multipart
18 questions -- a single multipart question, okay, when you are
19 ready.

20 CROSS-EXAMINATION

21 BY MR. MAY:

22 Q Mr. Sellick, would you look at your Table 2 on
23 page 14 of your testimony?

24 MR. MCKEEVER: Mr. Chairman, is Mr. May looking at
25 the original testimony or the supplemental testimony?

1 MR. MAY: The original, I'm sorry.

2 MR. McKEEVER: Thank you.

3 CHAIRMAN GLEIMAN: All the parties who requested
4 cross-examination indicated that they wanted to cross on the
5 original testimony and to the extent that anyone does have a
6 question related to the supplemental, I would respectfully
7 request that they indicate that the question refers to the
8 supplemental and that will keep us all on the same track.
9 Thank you.

10 MR. McKEEVER: Thank you, Mr. Chairman.

11 BY MR. MAY:

12 Q On that page and on that table, you have,
13 conveniently for all of us, itemized the amount of cost
14 segment 3.1 costs that are attributed under the Postal
15 Service's methods of attribution and under its proposal and
16 under UPS's 100 percent attribution proposal of mail
17 processing costs.

18 Is that what that table does?

19 A Yes, it does.

20 Q Now I note there that if you go down that column
21 UPS proposes to increase the total volume mail processing
22 variable costs for all classes and services -- third line
23 from the bottom -- from \$10.1 billion to \$12.44 billion,
24 which I calculate roughly to be a 23 percent increase, Mr.
25 Sellick, over what the Postal Service is proposing as

1 attributions.

2 Now I see that you have proposed to increase also
3 the total mail processing volume variable costs attributed
4 to Priority Mail from 477,607,000 to 691,160,000, which I
5 calculate to be around a 44 percent increase.

6 You can check my math if you want -- and right
7 next to that is Express Mail, and Express Mail is you
8 increase that from 83,202,000 to 134,947,000, which I
9 calculated to be a 62 percent increase roughly, and then
10 finally if you go down the table, it comes to zone rated
11 Parcel Post, and your cost proposal there goes from
12 153,080,000 to 222,030,000 or roughly a 45 percent increase.

13 Now my question is do you have any explanation of
14 how it would be that under your methodology the increase in
15 attributable costs systemwide is only 23 percent but for the
16 three classes of -- subclasses of mail which UPS competes
17 with the increases are more than -- they are at least double
18 or more than they are for the systemwide?

19 Would you have any explanation for that?

20 A Well, it is purely a function of, as I intended to
21 say in my testimony, purely a function of removing the
22 volume variability assumptions that Witness Degen includes
23 from Witness Bradley and returning the assumptions back to
24 or returning the calculation back to the previous Commission
25 and Postal Service approach of 100 percent volume

1 variability.

2 Q And it is a mere coincidence then that it just
3 happens that the three classes of mail with which UPS
4 competes happened to get increases at least double or more
5 than everybody else?

6 Is that a pure coincidence?

7 A It is a necessary outcome, if you will, from
8 returning to 100 percent volume variability.

9 Q Didn't have anything to do with a desire by your
10 client to push up the competitive class, the rates for the
11 class with which it competes? It didn't have anything to do
12 with that?

13 MR. McKEEVER: Mr. Chairman, objection. It is
14 argumentative.

15 I could just as easily ask whether the Postal
16 Service is reducing overall attribution by 23 percent in
17 this segment, but reducing the attribution to the classes
18 affected by substantially more had any nefarious motive or
19 any target for the competitive classes of services.

20 We are talking about two sides of the same coin.

21 MR. MAY: Mr. Chairman --

22 MR. McKEEVER: I believe it is argumentative and
23 Mr. Sellick has already answered it.

24 MR. MAY: Well, Mr. Chairman, indeed counsel could
25 have and probably should have asked the Postal Service that

1 question.

2 [Laughter.]

3 MR. MAY: If he didn't, that's not by problem --

4 MR. McKEEVER: Mr. Chairman, I believe it is
5 irrelevant if the method is -- if this is the result the
6 method produces, I don't care what their intent or desire
7 was. It is either right or it is wrong.

8 BY MR. MAY:

9 Q There was no effort, Mr. Sellick, to make it come
10 out this way so that the classes that you compete with, UPS
11 competes with, got the extra hit?

12 There was no effort to do that?

13 A Absolutely not. In fact, I didn't know what the
14 outcome was going to be before I set the programs to
15 running.

16 MR. MAY: That's all, Mr. Chairman.

17 CHAIRMAN GLEIMAN: Thank you, Mr. May.

18 That brings us to the United States Postal
19 Service.

20 MR. KOETTING: Thank you, Mr. Chairman.

21 CROSS-EXAMINATION

22 BY MR. KOETTING:

23 Q I think by a few minutes it is still good morning,
24 Mr. Sellick, although that will probably not be the case
25 when we finish but we won't be long.

1 I would like to, and if you are still on Table 2
2 on page 14 you might leave your testimony open to that -- if
3 you are there. If you are not, we'll get back to it.

4 A Okay, I have that.

5 Q The primary focus is going to be on your response
6 to Postal Service Interrogatory Number 11 and the general
7 subject of this interrogatory was we were trying to explore
8 the expected effect on test year accrued cost of changing in
9 the base year the level of volume variable mail processing
10 costs.

11 As you just went through with Mr. May, I believe,
12 that under the Postal Service's proposal the total volume
13 variable mail processing cost shown on Table 2 on page 14
14 would have been approximately 10.1 billion, and under your
15 approach would have been 12.4 billion, correct?

16 A Yes.

17 Q And you have in your testimony a methodology used
18 to move from base year costs to test year costs, correct?

19 A Yes, I have a replication, simplified replication,
20 of the Postal Service's roll-forward model.

21 Q And I would just like to explore some of the
22 ramifications of some of the simplifications that you might
23 have built in for purposes of exposition or whatever it was
24 you were trying to achieve in your testimony.

25 In trying to move from base year costs to test

1 year costs, one of the factors that the Postal Service and
2 the Rate Commission have customarily taken into account
3 would be changes in mail volume, correct?

4 A That is one of the factors, yes.

5 Q And changes in mail volume would not necessarily
6 be expected to affect all Postal Service's costs, would
7 they?

8 A It depends on the factor. You are speaking
9 specifically of the mail volume factor now?

10 Q Right. My question is simply that by definition
11 basically volume variable costs are the ones that you would
12 expect to be affected by changes in mail volume and other
13 costs you would expect not to be affected by changes in mail
14 volume?

15 A As they are generally defined, yes.

16 Q And therefore when one is comparing two different
17 base years, if the level of volume-variable cost were
18 increased and you were to apply the same mail-volume effect
19 to each of those two varying levels of volume-variable cost,
20 you would expect under the logic of the roll-forward
21 process, would you not, some change in the accrued cost in
22 the test year as a result?

23 A That would be -- isolating specifically the mail
24 volume effect; yes.

25 Q Right. And I'm glad you pointed that out. I'm

1 going to try to just focus on that fact. There are other
2 factors, and I don't believe they have any bearing on our
3 discussion. If at any time you feel that they do, you can
4 feel free to say so. But I don't think that they do.

5 As we've gone through your -- moving from your
6 approach to the Postal Service's approach -- moving to your
7 approach from the Postal Service's approach increases
8 volume-variable mail processing costs something in excess of
9 \$2 billion; correct?

10 A I'm sorry, could you restate the question?

11 Q Right. I'm just looking at your table 2 on page
12 14.

13 A Oh.

14 Q Comparing total volume-variable costs, yours 12.4,
15 Postal Service 10.1. So the difference is something in
16 excess of \$2 billion.

17 A Yes. For cost segment 3.1

18 Q Right. And I think what we just went through was
19 parts A, B, and C of the interrogatory response No. 11, and
20 I'd like to focus on your response to subpart D and try to
21 get a better understanding of what's going on here.

22 Let's assume hypothetically -- well, first of all,
23 are you familiar enough with the roll-forward process to
24 know that the mail-volume effect is actually applied on a
25 subclass-by-subclass basis?

1 A Yes.

2 Q So that it's difficult to talk about a particular
3 mail-volume effect because they vary by subclass.

4 A Yes.

5 Q However, for purposes of our discussion I'd like
6 to talk about a mail-volume effect which is in essence the
7 cumulative effect of those. Is that something --

8 A That's fine.

9 Q Let's assume that -- hypothetically that the
10 mail-volume effect moving from 1996 to 1997 was 2.5 percent,
11 and let's compare again for purposes of simplification a
12 hypothetical of \$10 billion cost in one model, which
13 obviously would be the Postal Service, versus \$12 billion in
14 another model, which would be yours.

15 If we're using 2.5 percent, applying that to a
16 base of \$10 billion, would you agree that the mail-volume
17 effect would be \$250 million?

18 A Yes.

19 Q And applying that same mail-volume effect of 2.5
20 percent to a base of \$12 billion, the mail-volume effect you
21 would expect would be \$300 million?

22 A Yes.

23 Q And so the difference between \$300 million and
24 \$250 million is \$50 million; correct?

25 A Yes; that's right.

1 Q And that's -- assuming that the mail-volume effect
2 that we've hypothesized is in the ballpark, that is
3 something of a ballpark estimate of what we might expect to
4 see moving from the Postal Service's test year -- excuse me,
5 the Postal Service's base year volume-variable cost to your
6 volume-variable cost. That's the expected effect on a crude
7 cost in a test year, something in the neighborhood of \$50
8 million?

9 A ^{Accepting}~~Excepting~~ the 2-1/2-percent mail-volume effect
10 that you've indicated, yes, that would be correct.

11 Q Now in your response to subpart D, you point out
12 that in your -- let me call it roll-forward process for want
13 of a better term --

14 A Um-hum.

15 Q The difference is -- in total volume-variable
16 costs by subclass is \$3.7 million; correct?

17 A Yes. That's the difference between -- I believe
18 in the test year -- between my total and the Postal
19 Service's test year total.

20 Q And having tried to go through some of the logic
21 that we've gone through today, which is if you increase
22 volume-variable costs in the base year and apply a
23 mail-volume effect moving to the test year, you'd expect to
24 see some result. And we were asking you why is it that the
25 difference is only \$3.7 million. And your response

1 indicates that the \$3.7 million as I read it appears to be
2 the effect of cumulative rounding.

3 Is that the essence of your response on that?

4 A Yes, it is.

5 Q And the fact that there's no larger effect for
6 this \$2 billion increase in mail-volume effects -- does that
7 suggest that in oversimplifying you've overlooked something?

8 A The simplified roll-forward that I employed didn't
9 separately account for either the year-to-year roll-forward
10 that the Postal Service employs in its model or the separate
11 incremental individual effects that the Postal Service
12 employs in its roll-forward model. I went, as I think are
13 described in my work papers and testimony, calculated the
14 increase in costs from test year Postal Service -- from base
15 year Postal Service to test year Postal Service, and applied
16 that same increase in aggregate, in total, for all factors
17 in both years of the roll-forward to my recalculated base
18 year costs. As a result of that, the nature of that
19 calculation, it applied the same increase and didn't
20 separately account for mail-volume effects in
21 any incremental or individual way.

22 And as I indicated in the interrogatory response,
23 the simplification as far as I could determine at that time
24 did not result in a dramatic or significant difference
25 compared to if I had separately and independently accounted

1 for each element. I believe it's on the order of less than
2 a 1-percent total difference in test-year costs. That's not
3 to say that the more detailed approach wouldn't be
4 preferable, but it's the result of my simplification and
5 less-detailed approach to the roll forward.

6 Q One percent of total test-year costs?

7 A I believe that's correct.

8 Q So that figure if we lose total test-year costs of
9 something in the neighborhood of 50 or 60 billion would be
10 \$500 or \$600 million?

11 A Less than 1 percent. I think -- you provided me
12 with some numbers earlier that indicate in aggregate \$73
13 million, I believe.

14 Q And that would be -- that was -- would be
15 something -- that would be moving from '96 to '97; correct?

16 A No, I believe that's from '96 all the way through
17 to -- I guess I haven't -- oh, that is from '96 to '97. I'm
18 sorry.

19 Q I guess if I could just conclude by -- there might
20 be some -- well, logic would dictate, the arithmetic of the
21 roll-forward process would dictate that there's -- if we
22 consider something in the magnitude of \$100 million as a
23 substantial amount of money that moving from a base-year
24 mail processing volume-variable cost of 10.1 billion to 12.4
25 billion would have some very, you know, 100 million, in that

1 neighborhood, effect on accrued cost to the Postal Service.

2 A I haven't looked specifically into the entire
3 effects of the roll-forward or potentially offsetting
4 effects, which I haven't looked at, but the mail-volume
5 effect would, as you've described it, increase the
6 volume-variable costs relative to the Postal Service's
7 proposal in the test year.

8 Q And that would be an increase in accrued cost in
9 the test year; correct?

10 A I believe so; yes. That effect separately again.

11 MR. KOETTING: That's all we have, Mr. Chairman.

12 Thank you, Mr. Sellick.

13 CHAIRMAN GLEIMAN: Is there any followup?

14 Questions from the bench?

15 I have one.

16 Mr. Sellick, in order to ensure that there are no
17 misunderstandings on exactly which programs you used to
18 develop the distributions given in UPS-ST-2, could you
19 please submit in electronic form the full set of programs
20 that you used to develop your distributions, and could you
21 include both the programs from the OCA Library Reference 1
22 that you modified and those that you used without
23 modification and the logs of the program run?

24 THE WITNESS: Certainly.

25 CHAIRMAN GLEIMAN: Also, when data files have been

1 transferred from a library reference to one of your files
2 and given a new name, would you please provide us a
3 cross-reference between the original filename and location
4 and the change that you made?

5 THE WITNESS: Yes, I can.

6 CHAIRMAN GLEIMAN: Is there any followup as a
7 consequence of questions from the bench?

8 If not, that brings us to redirect.

9 Would you like some time with your witness,
10 counselor?

11 MR. McKEEVER: Yes, Mr. Chairman, I would like
12 about five minutes or so.

13 CHAIRMAN GLEIMAN: Okay. Five minutes you've got.

14 [Recess.]

15 CHAIRMAN GLEIMAN: Mr. McKeever?

16 MR. McKEEVER: Mr. Chairman, we have no redirect.

17 CHAIRMAN GLEIMAN: Well, I am going to talk real
18 quiet, and maybe the people who are all hovering around in
19 the middle of the aisle won't know that we are going to take
20 a break for lunch now, and they will all stand there and
21 continue to talk for the next hour and 15 minutes.

22 If that is the case then, Mr. Sellick, I want to
23 thank you for your appearance here today, on both your
24 original testimony and your supplemental testimony.

25 We thank you for your contributions to the record,

1 and if there is nothing further, you are excused.

2 [Witness excused.]

3 CHAIRMAN GLEIMAN: We are going to come back at
4 1:30 and pick up with our next witness at that point in
5 time. Thank you.

6 [Whereupon, at 12:16 p.m., the hearing was
7 recessed, to reconvene at 1:30 p.m., this same day.]

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AFTERNOON SESSION

[1:30 p.m.]

CHAIRMAN GLEIMAN: Mr. McKeever, would you identify your next witness so that I can swear him in?

MR. MCKEEVER: Yes. United Parcel Services calls to the stand Ralph L. Luciani.

Whereupon,

RALPH L. LUCIANI,
a witness, was called for examination by counsel for United Parcel Service and, having been first duly sworn, was examined and testified as follows:

CHAIRMAN GLEIMAN: Please be seated.

Now, Mr. Luciani is here today primarily for his original testimony in the case on behalf of UPS, but he also submitted supplemental testimony, Supplemental Testimony Number 4, as I recall, in response to Presiding Officer's Information Request No. 13.

The Postal Service was on the hook to let us know before February 27th whether they intended to cross-examine counsel for UPS, and the Postal Service advised me before the lunch break that they had discussed the supplemental testimony and that the Postal Service did not intend to cross-examine.

Consequently, what we will do is, on the supplemental testimony, you do not intend to cross-examine.

1 Make sure we are clear on that. Consequently, what we are
2 going to do is we are going to introduce into the record
3 today, hopefully, without objection, both pieces of Mr.
4 Luciani's testimony. We will introduce them separately,
5 after which he will stand cross-examination on both pieces
6 of testimony.

7 In the absence of a notice from some other party
8 that they wish to cross-examine on his supplemental
9 testimony, which was previously scheduled for March the 3rd,
10 Mr. Luciani will be excused today and will not have to
11 return. So I just want to make clear what we are up to here
12 in the event that there is a party who decides that they
13 would like to cross-examine on Mr. Luciani's ST-4.

14 With that, Mr. McKeever, if you would please
15 proceed to introduce the testimony.

16 DIRECT EXAMINATION

17 BY MR. McKEEVER:

18 Q Mr. Luciani, I am handing you a copy of a document
19 entitled "Direct Testimony of Ralph L. Luciani on Behalf of
20 United Parcel Service" and marked UPS-T-4, with associated
21 exhibits going from UPS-T-4A through UPS-T-4H. I would like
22 to ask you, was that document and those exhibits prepared by
23 you or under your supervision and direction?

24 A Yes, it was.

25 Q The copy that I have handed you reflects certain

1 revisions that were filed and served on January 14th, 1998
2 concerning the premium pay adjustment. So those changes
3 have already been made in the document.

4 Do you have any other changes to make to the
5 document today?

6 A Yes, I do. In response to certain
7 Interrogatories, I noted the need for the following changes.
8 On page 14, line 16 -- page 14, line 16, "DBMC", the
9 initials DBMC should be changed to "DSCF".

10 On page 42, line 8, this is in Table 14, the
11 "2.66" for pre-bar-coding should be changed to "2.73", and
12 further along on that line, the "2.0" should be changed to
13 "2.1".

14 In the next line on the table, for DSCF
15 non-transportation, line 9, the "36.7" should be changed to
16 "36.8".

17 Further down on the table, line 11, for DDU
18 non-transportation, the "71.7" should be changed to "71.8"
19 and the "55.2" should be changed to "55.3".

20 And, finally, on page 44 of my testimony, in
21 footnote 41, the Roman numeral "III" in footnote 41, should
22 be changed to Roman numeral "IV".

23 MR. McKEEVER: Mr. Chairman, as Mr. Luciani has
24 noted, these changes were all noted in Interrogatory
25 responses of his filed in response to Interrogatories of the

1 Postal Service, so prior notice has been given of those at
2 the time the Interrogatory responses were filed and served.
3 Those changes have been made in the copies that I will
4 tender to the reporter if this document is admitted into
5 evidence.

6 BY MR. McKEEVER:

7 Q With that -- Mr. Luciani, with those revisions, if
8 you were to testify orally today, would your testimony be
9 set forth -- be as set forth in that document?

10 A Yes, it would.

11 MR. McKEEVER: Mr. Chairman, I move that the
12 "Direct Testimony of Ralph L. Luciani on Behalf of United
13 Parcel Service", and designed UPS-T-4, be admitted into
14 evidence and transcribed into the record.

15 CHAIRMAN GLEIMAN: Are there any objections?

16 [No response.]

17 CHAIRMAN GLEIMAN: Hearing none, Mr. Luciani's
18 testimony and exhibits are received into evidence, and I
19 direct that they be transcribed into the record at this
20 point.

21 [Direct Testimony and Exhibits of
22 Ralph L. Luciani, UPS-T-4, was
23 received into evidence and
24 transcribed into the record.]

25

UPS-T-4

BEFORE THE
POSTAL RATE COMMISSION

POSTAL RATE AND FEE CHANGES, 1997

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DOCKET NO. R97-1

DIRECT TESTIMONY OF
RALPH L. LUCIANI
ON BEHALF OF
UNITED PARCEL SERVICE

TABLE OF CONTENTS

INTRODUCTION	1
PURPOSE OF TESTIMONY AND SUMMARY OF CONCLUSIONS	3
THE POSTAL SERVICE HAS OVERSTATED THE COSTS AVOIDED BY PARCEL POST WORKSHARING	4
A. DBMC Entry	4
1. Mr. Crum overstates the pool of costs that DBMC entry avoids	6
2. Mr. Crum fails to adjust DBMC avoided costs for ASF costs	8
3. Revised DBMC entry avoided cost	10
B. OBMC Entry	11
C. DSCF Entry	12
1. The number of DSCF entry parcels per container is overstated	12
2. The Postal Service's analysis ignores the cost of Postal Service assistance in unloading DSCF entry parcels	15
3. The Postal Service overstates the transportation cost avoided by DSCF entry	16
4. Revised DSCF Avoided Costs	18
D. DDU Entry	18
E. Prebarcoding	20
F. Summary of Revisions	22
THE POSTAL SERVICE'S EXCESSIVELY HIGH PASSTHROUGHS FAIL TO REFLECT THE UNCERTAINTY OF THE AVOIDED COST ESTIMATES	22

THE POSTAL SERVICE HAS FAILED TO FOLLOW COMMISSION POLICY IN THE DERIVATION OF WORKSHARED RATES	31
A. The DBMC Rates Are Based on a Reduction in DBMC's Institutional Cost Contribution, Not Just Avoided Costs	31
B. DDU Rates Are Not Computed off of the Correct Base Rate	32
C. Failure to Follow Commission Policy on Rate Cell Decreases	34
THE POSTAL SERVICE'S NEW TRANSPORTATION COST ANALYSIS LEADS TO RATE ANOMALIES	34
NON-TRANSPORTATION WEIGHT RELATED COSTS	39
RECOMMENDED DISCOUNTS AND RATES USING 100% VARIABILITY FOR MAIL PROCESSING	41
PRIORITY MAIL COSTING AND RATE DESIGN	42
A. Separate Rate Treatment for Parcels	42
B. Delivery Confirmation	45
ALASKA AIR	48
CONCLUSIONS	49

LIST OF TABLES

Table 1	-- Postal Service Calculation of DBMC Entry Avoided Costs	7
Table 2	-- Revised Calculation of DBMC Entry Avoided Costs	8
Table 3	-- Revised DBMC Entry Avoided Mail Processing Costs	11
Table 4	-- DSCF Transportation Cost	18
Table 5	-- Revised DSCF Avoided Costs	18
Table 6	-- Postal Service Derivation of Prebarcode Savings	20
Table 7	-- Revised Parcel Post Worksharing Avoided Costs	22
Table 8	-- Percentage Changes in Parcel Post Rates for Existing Volume by Rate Category, Including Impact of New Rate Discounts	24
Table 9	-- Proposed Parcel Post Worksharing Avoided Costs	27
Table 10	-- Highway Capacity Utilization Factors, FY 1996	28
Table 11	-- Revised Parcel Post Worksharing Avoided Costs and Discounts	31
Table 12	-- Relationship Between Distance Traveled and GCD	36
Table 13	-- Breakdown of Non-Transportation Discounts for DBMC, DSCF, and DDU Entry into Per Piece and Per Pound Components	40
Table 14	-- Revised Parcel Post Worksharing Avoided Costs and Discounts with 100% Mail Processing Labor Variability	42
Table 15	-- Delivery Confirmation Costs and Proposed Charges in Priority Mail	45
Table 16	-- Allocation of Costs of Scanners, TY 1998	47
Table 17	-- Recommended Attributable Cost by Subclass for Capital Cost of New Scanners	48

BEFORE THE
POSTAL RATE COMMISSION

POSTAL RATE AND FEE CHANGES, 1997

DOCKET NO. R97-1

DIRECT TESTIMONY OF
RALPH L. LUCIANI
ON BEHALF OF
UNITED PARCEL SERVICE

INTRODUCTION

1
2 My name is Ralph L. Luciani. I am a Director of Putnam, Hayes &
3 Bartlett, Inc., an economic and management consulting firm with offices in
4 Washington, D.C.; Cambridge, Massachusetts; Los Angeles and Palo Alto,
5 California; a New Zealand subsidiary and an Australian subsidiary; and a United
6 Kingdom affiliate, Putnam, Hayes & Bartlett, Ltd., with an office in London. I have
7 more than twelve years of consulting experience analyzing economic and financial
8 issues affecting regulated industries, including costing, ratemaking, business
9 planning, and competitive strategy issues. In addition to my consulting duties, I
10 serve as the Director of Professional Development at Putnam, Hayes & Bartlett,
11 Inc.

12 Since 1990, I have directed Putnam, Hayes & Bartlett, Inc.'s analytic
13 investigations of United States Postal Service ("Postal Service") costing and rate

1 design issues. In Docket No. R90-1 and again in Docket No. R94-1, I assisted Dr.
2 George R. Hall in the preparation of analyses and testimony regarding the
3 attributable costs, cost coverages, and rate design of Parcel Post, Priority Mail, and
4 Express Mail. In Docket No. R94-1, I assisted Dr. Colin C. Blaydon in the
5 preparation of analyses and testimony concerning the treatment of mixed mail costs
6 in the In-Office Cost System ("IOCS"). In Docket No. MC95-1, I presented
7 testimony regarding the costs associated with parcels handled by the Postal
8 Service in First Class and Standard (A) Mail. I also presented supplemental
9 testimony in Docket No. MC95-1 regarding rate design for Standard (A) parcels.

10 Since 1995, I have visited and observed the operations at a number
11 of Postal Service facilities, including the Washington BMC on two different
12 occasions, two Sectional Center Facilities, two Associate Offices/Delivery Units, a
13 HASP ("Hub and Spoke Project") facility, and an Air Mail Center.

14 I hold a B.S. with University Honors in Electrical Engineering and
15 Economics from Carnegie Mellon University. I also hold an M.S. with Distinction
16 from the Graduate School of Industrial Administration at Carnegie Mellon
17 University. Prior to joining Putnam, Hayes & Bartlett, Inc. in 1985, I worked as an
18 Edison engineer at General Electric Company and as a financial analyst at IBM
19 Corporation.

**PURPOSE OF TESTIMONY AND
SUMMARY OF CONCLUSIONS**

I have been asked to investigate the costing and rate design proposals of the Postal Service as they pertain to Parcel Post and Priority Mail. As part of this investigation, I reviewed the testimony and workpapers of Postal Service witnesses Crum (USPS-T-28), Daniel (USPS-T-29), Hatfield (USPS-T-16), Mayes (USPS-T-37), Plunkett (USPS-T-40), Sharkey (USPS-T-33), and Treworgy (USPS-T-22).

Based on my review, I have reached the following conclusions with respect to the Postal Service's proposals:

1. The Postal Service has overstated the avoided costs underlying the proposed Parcel Post worksharing discounts.

2. The passthroughs proposed for the Parcel Post worksharing discounts do not reflect the uncertainties associated with the avoided cost estimates and should be reduced.

3. The methodology used to derive the rates for workshared Parcel Post mail deviates from prior Postal Service and Commission practice and should be modified.

4. The Postal Service's treatment of intermediate Parcel Post transportation costs should be refined. In addition, rate design changes are needed to minimize rate inconsistencies resulting from the proposed change in transportation costing.

1 5. The cost of processing Priority Mail parcels is significantly
2 higher than the cost of processing Priority Mail flats. As a result, separate rate
3 treatment for Priority Mail parcels is required.

4 6. The Postal Service's treatment of Priority Mail delivery
5 confirmation costs is inequitable and should be revised.

6 7. Alaska non-preferential air costs should be fully attributed.
7 However, if the Commission does not do so, at a minimum all non-bypass Alaska
8 non-preferential Parcel Post air transportation costs should be attributed to Parcel
9 Post.

10 THE POSTAL SERVICE HAS OVERSTATED
11 THE COSTS AVOIDED BY PARCEL
12 POST WORKSHARING

13 In addition to the existing DBMC discount, the Postal Service
14 proposes five new discounts for: (1) Inter-BMC presorting, (2) OBMC entry, (3)
15 DSCF entry, (4) DDU entry, and (5) Prebarcoding. As discussed in detail below,
16 five of these six worksharing discounts are based on overstated estimates of
17 avoided costs.

18 A. DBMC Entry

19 Mr. Crum estimates that DBMC entry saves 9.2 cents per piece in
20 window and acceptance costs and 37.7 cents per piece in mail processing costs,

1 for a total non-transportation avoided cost of 46.9 cents per piece.¹ The estimate
2 of 37.7 cents per piece in avoided mail processing costs represents a dramatic
3 increase from the (pre-passthrough) estimated avoided mail processing costs of
4 11.3 cents per piece and 13.4 cents per piece determined by the Commission in
5 Docket Nos. R90-1 and R94-1, respectively.² When compared to the estimated
6 avoided costs actually passed through by the Commission in those cases, the
7 difference is even more dramatic -- a proposed mail processing discount of 37.7
8 cents in this case compared to 8.7 cents and 10.3 cents in Docket Nos. R90-1 and
9 R94-1, respectively.³

10 This dramatic increase in estimated avoided costs raises questions
11 about the validity of the Postal Service's estimates in this case. In fact, in
12 computing estimated avoided mail processing costs for DBMC entry, Mr. Crum
13 failed to follow past Postal Service and Commission practice in at least two
14 significant ways.

1. USPS-T-28, p. 3.

2. Docket No. R90-1, PRC-LR-7, DBMC Calculations, p. 2; Docket No. R94-1, PRC-LR-12, Development of Parcel Post Rates, p. 18.

3. Id.

REVISED 1/13/98

1 1. Mr. Crum overstates the pool of costs
2 that DBMC entry avoids

3 DBMC entry avoids outgoing mail processing costs at non-BMCs, i.e.,
4 mail processing costs incurred at the origin AO and the origin SCF. In the past, the
5 Postal Service has not counted as part of the costs avoided by DBMC entry any of
6 the costs of the mail preparation and platform acceptance operations.⁴ In addition,
7 the Postal Service also made a premium pay adjustment to the costs avoided.⁵

8 Mr. Crum removed the costs of these two operations and also made a
9 premium pay adjustment in his derivation of the avoided cost for DBMC entry in
10 Docket No. MC97-2.⁶ However, in this proceeding Mr. Crum has not removed the
11 costs of these operations from his avoided cost estimate. As can be seen from
12 Table 1, adjusting for the costs of these excluded operations reduced the estimated
13 DBMC entry avoided costs significantly in Docket Nos. R90-1 and MC97-2.

-
4. Mail preparation is the operation in which mail is prepared for distribution, including the rewrapping of damaged pieces; platform acceptance is the operation in which mail is accepted at the platform. LR-H-1, pages 3-3, 3-2. In the past, the Postal Service (and the Commission) also did not count the costs of the postage due and central mail markup operations as avoided costs. However, in FY 1996 there are no outgoing costs for the postage due and central mail markup operations.
5. Docket No. R90-1, USPS-T-12, Exhibit L. A premium pay adjustment takes into account differences in the extent to which individual subclasses incur night and Sunday labor costs.
6. Docket No. MC97-2, USPS-T-7, Exhibit C; id., USPS-LR-PCR-39, Table 1, p. 1.1.

Table 1: Postal Service Calculation of DBMC Entry Avoided Costs

(Thousands of Base Year Dollars)

	USPS R90-1	Crum MC97-2	Crum R97-1
Outgoing Mail Processing Costs	26,884	53,484	56,746
(minus) Cost of Excluded Operations	5,565	6,450	N/A
(minus) Outgoing Costs at BMCs	12,975	33,188	32,769
(minus) Premium Pay Adjustment	405	716	N/A
Outgoing Costs Avoided by DBMC Entry	7,937	13,129	23,977

Sources: Docket No. R90-1, USPS-T-12, Exhibit L; Docket No. MC97-2, USPS-LR-PCR-39, Table 1, p. 1.1; LR-H-144, Table 1, p. 5.

The platform acceptance cost savings are reflected in Mr. Crum's avoided window and acceptance costs for DBMC entry. By not excluding platform acceptance operation costs in deriving the avoided mail processing costs for DBMC entry, Mr. Crum counts these same costs as avoided twice. This clear double-count inflates the proposed discount.

On cross-examination, Mr. Crum stated that he did not exclude the costs of these operations from his avoided cost calculations in this case because he was no longer able to separately break out these costs. Tr. 5/2285, 2294. However, UPS witness Sellick (UPS-T-2) has done so using the Postal Service's IOCS database and modified versions of Postal Service witness Degen's computer programs.⁷ Table 2 compares the avoided costs underlying the Postal Service's proposed discount with the avoided costs resulting from the established methodology.

7. UPS-T-2, p. 21, Table 6.

REVISED 1/13/98

Table 2: Revised Calculation of DBMC Entry Avoided Costs

(Thousands of Base Year Dollars)

	Crum R97-1 (Proposed)	Crum R97-1 (Revised)
Outgoing Mail Processing Costs	56,746	56,744
(minus) Cost of Excluded Operations	N/A	4,250
(minus) Outgoing Costs at BMCs	32,769	31,686
Outgoing Costs Avoided by DBMC Entry	23,977	20,808

Sources: LR-H-144, Table 1, p. 5; UPS-T-2, p. 21, Table 6.

As shown in Exhibit UPS-T-4A, removing the costs of these operations from the avoided cost calculation decreases the non-transportation avoided cost for DBMC entry by 5.0 cents per piece.

2. Mr. Crum fails to adjust DBMC avoided costs for ASF costs

Contrary to prior Commission rulings,⁸ Mr. Crum also failed to exclude any ASF costs from the pool of outgoing mail processing costs avoided by DBMC entry. On cross-examination he stated, without giving any analytic basis, that the exclusion of ASF data from the avoided mail processing cost calculation in this proceeding would make little or no difference. Tr. 5/2297. However, the Commission's exclusion of ASF costs from the pool of mail processing costs

8. Opinion and Recommended Decision, Docket No. R90-1, p. V-349.

1 avoided by DBMC entry decreased the DBMC discount considerably in both Docket
2 Nos. R90-1 and R94-1.⁹

3 ASFs are unique facilities that act as SCFs and also as BMCs. Tr.
4 5/2297. The In-Office Cost System classifies a substantial amount of BMC costs as
5 outgoing mail processing costs. These costs are incurred in two operations: (1)
6 unloading at the BMC's platform through the primary sort for DBMC and intra-BMC
7 parcels, and (2) all processing activities for inter-BMC parcels at the origin BMC.¹⁰
8 Thus, ASFs incur outgoing costs when acting as SCFs and also when acting as
9 BMCs.

10 Mr. Crum treats outgoing mail costs at BMCs as not avoided by
11 DBMC parcels. Under similar logic, those outgoing mail costs which are incurred at
12 ASFs when the ASF is acting as a BMC also should not be treated as avoided by
13 DBMC parcels.¹¹ Those outgoing mail costs which are incurred at ASFs when the
14 ASF is acting as a BMC should therefore be removed from Mr. Crum's DBMC entry
15 cost savings.

16

17

9. Docket No. R90-1, PRC-LR-7, DBMC Calculations, p. 2; Docket No. R94-1, PRC-LR-12, Development of Parcel Post Rates, p. 18.

10. LR-H-49, Appendix B, p. 144.

11. DBMC and intra-BMC parcels originating and destinating in the same ASF area are generally not handled at a BMC. Tr. 19/9591. Thus, outgoing costs at ASFs include the costs of processing DBMC parcels that are dropped at the ASF and never handled at a BMC. Yet, Mr. Crum assumes that these outgoing costs at ASFs, which are clearly incurred by DBMC parcels, are avoided by DBMC parcels. This simply cannot be the case.

1 I used Ms. Daniel's model of Parcel Post BMC operations to derive
2 the mail processing costs in cents per piece that are classified as "outgoing" at the
3 BMC. I then applied these average outgoing BMC mail processing costs per piece
4 to the ASF Parcel Post volumes supplied by Ms. Mayes (Tr. 8/4121-31) in order to
5 estimate the outgoing mail processing costs incurred at ASFs when an ASF is
6 acting as a BMC. This yields an estimate of \$3.4 million. See Exhibit UPS-T-4B.
7 This is a conservatively low estimate, since the parcel sorting productivity at ASFs
8 is almost certainly lower -- and therefore the ASF costs are almost certainly higher -
9 - than what Ms. Daniel derives for the fully-mechanized BMCs.

10 I then deducted these ASF outgoing mail processing costs from Mr.
11 Crum's avoided mail processing costs for DBMC entry. This correction lowers the
12 DBMC non-transportation discount by an additional 5.3 cents per piece. See
13 Exhibit UPS-T-4B.

14 3. Revised DBMC entry avoided cost

15 The combined effect of the revisions discussed above is shown in
16 Table 3.

Table 3: Revised DBMC Entry Avoided Mail Processing Costs

(Thousands of Base Year Dollars)

	Crum R97-1 (Proposed)	Crum R97-1 (Revised)
Outgoing Mail Processing Costs	56,746	56,744
(minus) Cost of Excluded Operations	0	4,250
(minus) Outgoing Costs at BMCs	32,769	31,686
(minus) ASF Outgoing Costs when ASF Acts As a BMC	0	3,372
Outgoing Costs Avoided by DBMC Entry	23,977	17,436
DBMC Avoided Mail Processing Costs (TY cents per piece)	37.7	27.4

Sources: Docket No. R90-1, USPS-T-12; Docket No. MC97-2, USPS-LR-PCR-39;
LR-H-144; UPS-T-2; Exhibit UPS-T-4B.

These changes reduce the DBMC mail processing avoided cost estimate by 10.3 cents per piece, yielding a revised DBMC mail processing avoided cost of 27.4 cents per piece. Adding the window and acceptance cost savings of 9.2 cents per piece yields a total revised non-transportation avoided cost for DBMC entry of 36.6 cents per piece.

B. OBMC Entry

The OBMC entry avoided cost (which is deducted from the inter-BMC rates) is calculated as the sum of the DBMC entry non-transportation avoided cost plus additional costs saved at the OBMC itself (due to the presorting requirement for the OBMC discount).¹² Thus, the 10.3 cents per piece decrease in avoided

12. USPS-T-28, p. 4. Mr. Crum estimates OBMC entry avoided costs to be 57.6 cents per piece.

costs for DBMC entry derived above also reduces the avoided costs for OBMC entry by 10.3 cents per piece. This yields a revised OBMC entry avoided cost of 47.3 cents per piece.

C. DSCF Entry

The Postal Service overstates the avoided costs for DSCF entry in three ways: (1) it overstates the number of DSCF parcels per container; (2) it fails to include in the cost of DSCF parcels the cost of Postal Service assistance in unloading DSCF parcels; and (3) it overestimates the transportation costs avoided by DSCF entry.

1. The number of DSCF entry parcels per container is overstated

In deriving the non-transportation cost avoided by DSCF entry, Mr. Crum assumed that, on average, sacks would contain 10 machinable DSCF parcels and GPMCs would contain 25 non-machinable DSCF parcels.¹³ On cross-examination, Mr. Crum stated that the source of his assumption is the Domestic Mail Manual, Quick Service Guide 700 (machinable parcels). Tr. 5/2290. However, that document cannot be used to determine the number of machinable parcels that will, on average, actually be in a sack. It merely requires that each sack contain, at a minimum, 10 pieces or 20 pounds or 1000 cubic inches. Consequently, a sack could contain one 20-pound parcel, or two 10-pound parcels,

13. USPS-T-28, page 5.

1 or four 5-pound parcels (for example). Moreover, there is a 70 pound weight limit
2 on sacks.¹⁴ Thus, no more than three 20-pound parcels are allowed in a sack.

3 Rather than assuming how many machinable parcels would be in a
4 sack, Ms. Daniel uses actual data to derive the average number of machinable
5 parcels per sack for Parcel Post as a whole. Tr. 5/2649. Based on prior Postal
6 Service studies and current Postal Service data, Ms. Daniel arrives at an average
7 of 5.8 machinable parcels per sack. Tr. 5/2649. Ms. Daniel applies this 5.8 pieces
8 per sack figure throughout her Parcel Post cost analysis, including her analysis of
9 machinable DBMC entry parcels.

10 Moreover, Ms. Daniel bases her Parcel Post cost analysis on the
11 assumption that, on average, parcels will comprise 85% of the effective cubic
12 capacity of a container, including containers used for non-machinable DBMC entry
13 mail.¹⁵ She assumes that parcels will comprise a slightly higher percentage -- 88%
14 -- of the effective cubic capacity of the gaylords used for OBMC entry parcels.¹⁶ To
15 be conservative, I similarly assumed that DSCF entry parcels would comprise 88%
16 of the effective cubic capacity of GPMCs. This yields an average of 17.4 non-
17 machinable DSCF pieces per GPMC. See Exhibit UPS-T-4C.

18 On cross-examination Mr. Crum suggested -- again without relying on
19 any data -- that while the Postal Service may, on occasion, transport less than fully
20 loaded sacks or containers, DSCF mailers would likely fill their sacks and GPMC

14. Docket No. MC97-2, response to OCA/USPS-T13-11.

15. USPS-T-29, Appendix V, p. 17.

16. USPS-T-29, Appendix V, page 17.

1 containers completely. Mr. Crum's assertion has no analytic basis, as there has
2 been no special study performed of DSCF entry parcels. Mr. Crum acknowledged
3 that the last DSCF sack to a 5-digit area is unlikely to be fully loaded. Tr. 5/2291.
4 Moreover, the data indicate that there will be fewer pieces per container for DSCF
5 mail than for Parcel Post as a whole. In particular, Mr. Hatfield's data shows that
6 DBMC entry mail -- which includes DSCF entry mail -- is significantly less dense
7 than Parcel Post as a whole.¹⁷ Thus, a sack of DSCF parcels will, on average,
8 contain fewer pieces than a sack of regular Parcel Post. Ms. Daniel's derivation of
9 5.8 machinable pieces per sack is based on data for all of Parcel Post and
10 therefore likely overstates the number of DSCF pieces in a sack. Similarly, fewer
11 non-machinable DSCF pieces will fit in a GPMC than the 17.4 pieces per GPMC
12 derived using Ms. Daniel's methodology, which also is based on all Parcel Post
13 pieces.

14 In short, there is substantial reason to believe that 5-digit sacks and
15 GPMCs entered at a DSCF will have fewer pieces, on average, than is the case for
16 Parcel Post as a whole. As such, the derivation of the avoided cost for DSCF mail
17 should be based on no more than the average number of pieces per container for
18 Parcel Post as a whole -- 5.8 machinable pieces per sack and 17.4 non-machinable
19 pieces per GPMC. This lowers the non-transportation DSCF cost savings by 4.8
20 cents per piece, as shown in Exhibit UPS-T-4C.

17. USPS-T-16, page 14, and Appendix II thereto, page 9 of 9.

1 **2. The Postal Service's analysis ignores the cost of Postal**
2 **Service assistance in unloading DSCF entry parcels**

3 In deriving the costs avoided by DSCF entry, Mr. Crum assumes that
4 the shipper will unload the dropshipped parcels without Postal Service assistance.
5 Tr. 5/2271. On cross-examination, he agreed that this assumption is contrary to
6 current Postal Service DSCF dropshipment procedures. Tr. 5/2282-83. Those
7 procedures explicitly provide that the Postal Service will unload dropshipped
8 containers at the DSCF and will assist in unloading dropshipped bedloaded mail.
9 Tr. 5/2400. There is no reason to believe that the Postal Service will not follow its
10 current procedures at SCFs for DSCF Parcel Post volume. Indeed, given Mr.
11 Crum's revision to his initial testimony on this point, the Postal Service apparently
12 has no intention of changing its current SCF dropshipment unloading procedures.
13 Tr. 5/2398.

14 Consistent with this Postal Service policy, DSCF costs should include
15 100% of the cost of unloading DSCF entry GPMC containers and the Postal
16 Service should be assumed to incur 50% of the cost of unloading bedloaded DSCF
17 entry Parcel Post sacks for "assisting" in unloading bedloaded mail. This
18 decreases the DSCF entry non-transportation avoided cost by an additional 1.9
19 cents per piece. See Exhibit UPS-T-4D.

1 **3. The Postal Service overstates the transportation**
 2 **cost avoided by DSCF entry**

3 According to Mr. Hatfield, DSCF parcels will incur local transportation
 4 costs of \$0.3997 per cubic foot, of which \$0.3337 is from the DSCF to the DDU
 5 and \$0.0660 is for transportation below the level of the DDU.¹⁸ In deriving these
 6 costs, Mr. Hatfield simply assumes that DSCF parcels will have the same local
 7 transportation cost as DBMC parcels.

8 However, as Ms. Daniel and Mr. Crum agree, only 87.7% of Parcel
 9 Post volume travels from a DSCF to the DDU.¹⁹ The remaining 12.3% travels
 10 directly from the DBMC to the DDU; these parcels currently do not incur any local
 11 transportation cost for the DSCF to DDU leg. Thus, the actual cost incurred by
 12 parcels that travel on the DSCF to DDU leg – which all DSCF entry parcels will do -
 13 - is 12.3% higher than Mr. Hatfield calculates. Mathematically, the proper
 14 calculation is as follows:

15 *Average cost incurred* *Actual cost incurred*
 16 *from DSCF to DDU* = 87.7% * *from DSCF to DDU* + 12.3% * Zero = \$0.3337 per cubic
 17 foot.

18 Therefore, using simple algebra,

19 Actual cost incurred from DSCF to DDU = \$0.3337 per cubic foot / 87.7% = \$0.3805 per cubic foot.

18. USPS-T-16, p. 24; Exhibit USPS-16A; and Appendix III to USPS-T-16, p. 9 of 9.

19. USPS-T-28, p. 5; USPS-T-29, Appendix V, p.1.

1 This 12.3% upward adjustment to DSCF transportation costs has
2 exactly the same basis as the 12.3% upward adjustment that Mr. Crum makes to
3 Ms. Daniel's Parcel Post costs in deriving the DSCF non-transportation discount.²⁰
4 Since 100% of DSCF mail will inevitably travel from the DSCF to the DDU, the
5 transportation cost incurred by DSCF mail from the DSCF to the DDU must be
6 \$0.3805 per cubic foot, not \$0.3337 per cubic foot.²¹ This yields a revised total
7 DSCF transportation cost of \$0.4465 per cubic foot, as shown in Table 4.

20. See USPS-T-28, Exhibit G, page 2 of 3.

21. On cross-examination, Mr. Hatfield admitted that the transportation cost from the DSCF to the DDU would be higher for DSCF mail than for DBMC mail, except when the DSCF is co-located with the DDU. Tr. 8/3957-58. On follow-up, the Postal Service stated that parcels dropshipped to a co-located DSCF/DDU which destinate within the DDU's service area would qualify for the DDU discount, not the DSCF discount. Tr. 19/9555. This means that 100% of the parcels receiving the DSCF discount will travel to a non-co-located DDU. In other words, Mr. Hatfield's co-location point is not relevant to the proper calculation of DSCF costs.

Table 4: DSCF Transportation Cost

(\$ per cubic foot)

Transportation Segment	Postal Service	Revised
DSCF to DDU Leg	0.3337	0.3805
Below the level of the DDU	0.0660	0.0660
Total	0.3997	0.4465

Sources: Exhibit USPS-16A; USPS-T-16, Appendix III, p. 9 of 9.

4. Revised DSCF Avoided Costs

Table 5 compares the Postal Service's DSCF avoided costs to the avoided costs resulting from the revisions discussed above.

Table 5: Revised DSCF Avoided Costs

	Proposed	Revised
DSCF Avoided Non-Transportation Cost (off of DBMC costs)	31.4 cents/piece	24.8 cents/piece
DSCF Transportation Cost	\$0.3997/c.f.	\$0.4465/c.f.
DSCF Avoided Transportation Cost (off of DBMC Zone ½ costs)	\$0.3138/c.f.	\$0.2670/c.f.

Sources: Exhibit UPS-T-4C; Exhibit UPS-T-4D; Exhibit USPS-16A; USPS-T-28, p. 6. DBMC Zone ½ transportation cost is \$0.7135 per cubic foot, per Exhibit USPS-16A; therefore, DSCF avoided transportation cost = \$0.7135 - \$0.4465, or \$0.2670.

D. DDU Entry

The Postal Service made no effort to determine the container profile of DDU entry parcels. On cross-examination, Mr. Crum stated that he does not need to know anything about the containerization of DDU parcels, since the mailer

1 will unload the parcels. Tr. 5/2263. However, Mr. Crum admitted that in deriving
2 the non-transportation cost avoided by DDU entry, he simply assumed that the
3 mailer will shake out the DDU entry sacks after unloading them. Tr. 5/2316.

4 Under current Postal Service policy, there is no requirement for DDU
5 entry mailers to shake out sacks (Tr. 5/2310), and it is highly unlikely that they will
6 do so. It is unclear where the sacks would be shaken out by the mailer. Would this
7 take place on the platform? If so, would this be an efficient place to shake out the
8 sacks? Or would the mailer actually enter the DDU and shake out the sacks in the
9 parcel sortation area? That is unlikely.

10 On cross-examination, Mr. Crum had no specific answer. Tr. 5/2316.
11 In the absence of any evidence that the practice will be contrary to current policy, it
12 is more likely that the sacks would merely be unloaded onto the platform by the
13 DDU entry mailer and left for the Postal Service to shake out once the sacks reach
14 the manual parcel sortation area.

15 The percentage of sacks in DDU entry mail is unknown. Assuming
16 that the number of sacks in these dropshipments would be consistent with the
17 percentage arriving at the DDU for Parcel Post as a whole reduces the DDU
18 discount by 1.1 cents per piece. See Exhibit UPS-T-4E. In the absence of a
19 special study of the costs incurred through different containerization for DDU entry,
20 the 1.1 cents per piece of sack shakeout costs should be eliminated from the

estimate of the costs avoided by DDU entry. This lowers the avoided cost for DDU entry as compared to DBMC mail to 44.8 cents per piece. See Exhibit UPS-T-4E.²²

E. Prebarcoding

In deriving the prebarcode discount, Ms. Daniel computes a cost savings (including piggybacked costs) of 2.16 cents per piece. She then applies a 1.621 "adjustment" factor that increases this amount to 3.50 cents, and adds 0.5 cents per piece in ribbon costs to derive an estimated savings of 4 cents per piece, as shown below.

Table 6: Postal Service Derivation of Prebarcode Savings
(cents per piece)

Cost of Keying	5.76
(minus) Cost of Scan	3.60
Savings of Scan vs. Key	2.16
(times) Adjustment Factor	1.621
Adjusted Savings	3.50
(plus) Ribbon Cost	0.50
Total Savings	4.00

Source: Exhibit USPS-29E, p. 6 of 6.

Ms. Daniel's adjustment factor attempts to adjust for costs that were not explicitly captured in her Parcel Post processing flow models. While the use of a non-modeled cost factor may arguably be appropriate when determining a cost

22. Correcting the rounding errors in Mr. Crum's analysis yields a DDU discount of 45.9 cents per piece, rather than the 46.0 cents per piece he shows. The 1.1 cents per piece reduction noted above is in addition to that correction.

1 differential across a broad range of numerous processing activities (such as that
2 between inter-BMC and intra-BMC Parcel Post), the use of this highly aggregate
3 multiplier in the derivation of the narrowly focused prebarcode savings, where only
4 one operation is involved, inflates the modeled cost savings.

5 Prebarcoding simply replaces one key punch with a scan. Ms. Daniel
6 has derived the exact cost difference between these two actions. That cost
7 difference is 2.16 cents per piece and includes the impact of piggybacked indirect
8 costs. To say that this very small and specific difference should then be grossed
9 up by an additional 62% because Ms. Daniel has missed 38% of the cost she
10 expected to find in her analyses for Parcel Post in its entirety is erroneous.

11 Ms. Daniel stated that non-modeled costs in the PSM key/scan area
12 could be comprised of such activities as miskeying, the barcode label peeling off,
13 and running out of labels. Tr. 5/2556. However, one could just as easily presume
14 that non-modeled costs could include the prebarcoded label falling off, the
15 prebarcoded label being incorrect, the prebarcoded label being obstructed or
16 otherwise unreadable, or the prebarcoded piece being inadvertently keyed. In
17 other words, there is no difference in these respects between Postal Service
18 barcoded pieces and mailer prebarcoded pieces.

19 Ms. Daniel has not shown that there are non-modeled costs for keying
20 in comparison to scanning that are proportional to modeled costs. In the absence
21 of any evidence that there are non-modeled costs which have a proportional
22 relationship to the cost of scanning in comparison to keying, the computation of the

prebarcode avoided cost should exclude Ms. Daniel's highly aggregate adjustment factor.

F. Summary of Revisions

Table 7 shows revised avoided cost estimates for Parcel Post worksharing resulting from the corrections discussed above.

Table 7: Revised Parcel Post Worksharing Avoided Costs
(cents per piece, unless noted)

Avoided Cost	Proposed	Revised
DBMC Non-Transportation (off of Intra-BMC)	46.9	36.6
OBMC Non-Transportation (off of Inter-BMC)	57.2	47.3
BMC Presort Non-Transportation (off of Inter-BMC)	12.5 to 13.9	12.5 to 13.9
Prebarcoding	4.00	2.66
DSCF Non-Transportation (off of DBMC)	31.3	24.8
DSCF Transportation (off of DBMC Zone 1/2)	\$0.3138/cubic foot	\$0.2670/cubic foot
DDU Non-Transportation (off of DBMC)	46.0	44.8
DDU Transportation (off of DBMC Zone 1/2)	\$0.6475/cubic foot	\$0.6475/cubic foot

Sources: USPS-T-37, WP I.I., page 1; USPS-T-29, Exhibit 29E, p. 1; Exhibit USPS-16A; USPS-T-28, p. 8.

THE POSTAL SERVICE'S EXCESSIVELY HIGH PASSTHROUGHS FAIL TO REFLECT THE UNCERTAINTY OF THE AVOIDED COST ESTIMATES

The Postal Service passes through 98% to 100% of the estimated mail processing cost savings and 100% of the estimated transportation cost savings for all but one of the proposed discounts.²³ These high passthroughs fail to reflect the significant uncertainty surrounding the estimated cost savings,

23. The passthrough for the machinable BMC presort discount is 90%.

1 especially for the new discounts. In fact, in Docket No. R90-1 and again in Docket
2 No. R94-1 the Commission passed through only 77% of the identified DBMC non-
3 transportation cost savings.²⁴

4 As outlined below, the same 77% passthrough for DBMC non-
5 transportation savings applied in prior cases should also be applied to the DBMC
6 cost savings estimated in this case, since the uncertainty surrounding this
7 worksharing program has not diminished. For the five new discounts, a 77%
8 passthrough should be applied for both the transportation and non-transportation
9 avoided costs.

10 The first reason for using 77% passthroughs for the new discounts is
11 based on the Commission's decision in Docket No. R90-1 regarding the
12 passthroughs for the new DBMC, DDU, and DSCF destination entry discounts
13 proposed in that case for what was then Third Class mail. The Postal Service there
14 proposed 70% passthroughs of both transportation and non-transportation cost
15 savings for these new discounts. The Commission, after correcting the avoided
16 cost estimates and noting that a passthrough as high as 80% could be applied,
17 accepted the discounts proposed by the Postal Service. This yielded effective
18 passthroughs of 76% to 80%.²⁵ These Docket No. R90-1 passthroughs for new
19 destination entry discounts are consistent with the 77% passthrough applied by the

24. Opinion and Recommended Decision, Docket No. R94-1, page V-118.

25. Opinion and Recommended Decision, Docket No. R90-1, pages V-283 to V-284.

Commission to the DBMC Parcel Post worksharing savings estimated in Docket Nos. R90-1 and R94-1.

The second reason for limiting the passthroughs to 77% is the impact of the new worksharing programs on non-worksharing mailers. The Postal Service proposes a 10.2 percent increase in Parcel Post rates as a whole.²⁶ Hidden in this average rate increase are significantly larger rate increases for the non-workshared rate categories of Parcel Post than for the workshared rate categories, as Table 8 shows.

Table 8: Percentage Changes in Parcel Post Rates for Existing Volume by Rate Category, Including Impact of New Rate Discounts

	TYBR Revenue per Piece (\$/piece)	TYAR Revenue per Piece (\$/piece)	Percentage Increase
Non-workshared Inter-BMC	4.69	5.46	16.5%
Non-workshared Intra-BMC	2.69	3.27	21.6%
Inter-BMC Presort	4.69	5.33	13.6%
OBMC Entry	4.69	4.88	4.2%
DBMC Entry	2.46	2.55	3.7%
DSCF Entry	2.39	1.91	-20.3%
DDU Entry	2.40	1.48	-38.3%
TOTAL	3.05	3.31	8.5%

Source: UPS-Luciani-WP-1. Workshared categories also include impact of prebarcode discount.

The overall percentage increase declines from 10.2% to 8.5% when the new rate discounts are taken into consideration. In fact, the rates for many large mailers would decrease significantly. The larger increases for single piece

26. Exhibit USPS-30D.

1 and small volume mailers result from the fact that all of the proposed new discounts
 2 yield revenue losses significantly in excess of the additional cost savings that
 3 would be realized because many shippers are already performing these same
 4 worksharing activities in the absence of a discount. For example, 96% of the
 5 volume that will qualify for the prebarcode discount is already being prebarcoded.
 6 Tr. 8/4139-40. The resulting revenue loss from offering the prebarcode discount
 7 without additional offsetting cost savings would be recovered from Parcel Post as a
 8 whole.²⁷ Lower passthroughs would mitigate these differentials between the rate
 9 changes for non-worksharing mailers compared to worksharing mailers.

10 The third and perhaps the most important reason for using 77%
 11 passthroughs is simply uncertainty about the amount of the costs avoided. That
 12 uncertainty is particularly great in the case of the new discounts. The Commission
 13 specifically stated in Docket No. R90-1,

14 "We are reluctant to recommend any 100 percent
 15 passthrough for a 'new' discount. There is no track
 16 record to use to assure ourselves that projected savings
 17 will be realized fully, and revenue shortfall avoided."²⁸

18 Certainly, in a subclass with a cost coverage as low as that for Parcel Post,
 19 protecting against uncertainty is even more important, since an over-estimated cost

27. Based on the rate increases shown in Table 8, it is no surprise that the Postal Service projects that intra-BMC and inter-BMC volume will decrease significantly in the Test Year After Rates, but that DBMC volume will actually increase. USPS-T-6, p. 6.

28. Opinion and Recommended Decision, Docket No. R90-1, page V-134.

1 avoidance passed through at 100% can lead to significant volumes of parcels
2 being carried at below cost rates.²⁹

3 Outlined below are nine uncertainties associated with the estimated
4 cost savings in Parcel Post. Many of these uncertainties also apply to the existing
5 DBMC worksharing discount.

6 1. Imperfect Execution. The Postal Service presumes perfect
7 execution in implementing the new worksharing programs. For example, if inter-
8 BMC presort or OBMC entry parcels are not merely cross-docked at the OBMC but
9 rather are inadvertently sent through OBMC sortation, cost savings would be
10 eliminated. In addition, under the Postal Service's assumptions, a prebarcoded
11 piece would never be inadvertently keyed, DSCF entry pieces would never be sent
12 back to the BMC for rerouting, DDU entry pieces would never be sent back to the
13 DSCF or BMC for rerouting, and the Postal Service would never assist in the
14 unloading of DDU entry pieces. Common sense suggests that such perfection is
15 simply not possible, particularly in the case of new programs.

16 2. Inexplicable Changes from Prior Cases. The change in the
17 estimated mail processing DBMC entry savings from 11.3 cents per piece in Docket
18 No. R90-1 and 13.4 cents per piece in Docket No. R94-1 to 37.7 cents in this case
19 (27.4 cents with my corrections) is significant. The magnitude of this increase in
20 estimated cost savings is unexplained. This increase affects the OBMC, DBMC,
21 DSCF, and DDU discounts. Moreover, just a few months before this proceeding

29. On cross-examination, Ms. Mayes agreed that there was a "smaller margin of error" in subclasses with very low cost coverages. Tr. 8/4099.

was filed, the Postal Service's estimates of avoided costs were significantly different from those presented here, as shown in Table 9.

Table 9: Proposed Parcel Post Worksharing Avoided Costs

(cents per piece, unless noted)

Avoided Cost	MC97-2	R97-1
DBMC Non-Transportation (off of Intra-BMC)	35.1	46.9
OBMC Non-Transportation (off of Inter-BMC)	49.8	57.2
BMC Presort Non-Transportation (off of Inter-BMC)	16.6 to 21.3	12.5 to 13.9
Prebarcoding	4.30	4.00
DSCF Non-Transportation (off of DBMC)	32.5	31.3
DSCF Transportation (off of DBMC Zone 1/2)	\$0.3770/cf.	\$0.3138/cf.
DDU Non-Transportation (off of DBMC)	50.0	46.0
DDU Transportation (off of DBMC Zone 1/2)	\$0.5619/cf.	\$0.6475/cf.

Sources: USPS-T-37, WP I.I, p. 1; USPS-T-29, Exhibit 29E, p. 1; Docket No. MC97-2, USPS-T-13, WP I.I, p. 1; Docket No. MC97-2, Exhibit USPS-6A.

3. DBMC Parcels Are Different from Other Parcels. DBMC is less dense than Parcel Post as a whole. As a result, for those operations DBMC parcels undergo, it costs more per piece to process DBMC parcels since there are fewer pieces per container. Yet, in the Postal Service's derivation of non-transportation costs, DBMC Parcel Post is assumed to have the average density of Parcel Post as a whole. This assumption inevitably understates the Postal Service's estimates of DBMC costs. Given the lower density of DBMC mail, DBMC mail must have higher unit processing costs than intra-BMC mail from the BMC onward. This difference in density in and of itself justifies retaining a 77%

passthrough for DBMC entry. This difference in density for dropshipped mail supports a conservative passthrough for the other entry discounts as well.

4. Plant Load Clerks. Some DBMC mail is verified by Postal Service clerks at the mailer's plant, but these costs are simply attributed to Parcel Post as a whole, not to DBMC specifically. Tr. 19/9585. The fact that this special cost is not allocated to the DBMC, OBMC, DSCF, and DDU mail which causes it supports lowering the passthrough.

5. Empty Inbound Trucks. Increased dropshipping increases the amount of empty space in highway transportation on inbound routes. This is evident from Table 10, which compares capacity utilization for inbound and outbound routes.

Table 10: Highway Capacity Utilization Factors, FY 1996

	Intra-SCF Transportation		Intra-BMC Transportation	
	Inbound SCF	Outbound SCF	Inbound SCF	Outbound SCF
PQ 1	33%	52%	57%	74%
PQ 2	42%	56%	61%	75%
PQ 3	35%	51%	60%	72%
PQ 4	29%	52%	57%	66%

Source: Tr. 7/3260.

Clearly, dropshipping causes capacity imbalances. Fairness requires that dropshipped mail should bear an extra portion of the cost of the unused capacity it causes on the inbound legs. This decreases the transportation costs avoided for DBMC, DDU, and DSCF entry from the levels estimated by the Postal Service.

1 6. Intra-SCF Transportation Below the DDU Level. The
2 percentage of Parcel Post intra-SCF transportation cost assumed to be avoided by
3 DDU mail (84%) is based on an analysis of total intra-SCF transportation costs, not
4 Parcel Post intra-SCF transportation costs. Tr. 8/3964. Moreover, the percentage
5 is based on intra-SCF data that excludes Postal Owned Vehicles but is applied to
6 Parcel Post transportation costs that include Postal Owned Vehicles. Tr. 8/3954.
7 Thus, there is significant uncertainty surrounding the avoided transportation cost
8 for DDU entry mail.

9 7. Containerization of DDU Parcels. DDU entry mail could very
10 well arrive in containers that are more costly to handle in the manual parcel
11 sortation area than Parcel Post arriving from the DSCF or the DBMC. For example,
12 currently 27% of the machinable parcels arriving at DDUs are sacked.³⁰ If more
13 than 27% of DDU entry parcels were sacked, sack shakeout costs would increase.

14 8. Anecdotal, Ignored, and Incomplete Survey. The survey
15 performed by the Postal Service to estimate the volume of mail that already is
16 performing each worksharing activity and to estimate the additional volume that
17 would perform each worksharing activity if a discount were offered was, in the
18 words of the survey itself, based on "summary anecdotal customer information."³¹
19 In addition, Ms. Mayes simply ignored the survey data for companies that deposit
20 mail for other companies. Tr. 8/4140. Thus, there is considerable uncertainty
21 surrounding the volumes that will respond to the new worksharing discounts. This

30. USPS-T-29, Appendix V, p. 2.

31. LR-H-163, Overview.

1 in turn creates significant uncertainty about the revenue losses that will result.

2 Moreover, there was no survey to estimate DDU volume in light of the new

3 discount. Tr. 8/4152. This creates extreme uncertainty about the revenue losses

4 associated with offering the DDU discount.

5 9. Simplistic Flowpath Study. Mr. Hatfield used a flowpath study
6 that did not take into account eight of the 13 flowpaths in the postal transportation
7 system that were used by Mr. Acheson in his study of avoided transportation costs
8 for Third Class mail in Docket No. R90-1. In particular, Mr. Hatfield ignored the
9 impact of inter-SCF (i.e., SCF to SCF) travel. Tr. 8/3940. Mr. Acheson sketched
10 out the same 5-path flowpath version used by Mr. Hatfield for Parcel Post, but
11 rejected using it because it was "simplistic."³² Parcels that "skip around" the five
12 illustrative flowpaths used by Mr. Hatfield onto one of the other eight flowpaths
13 used by Mr. Acheson will incur fewer transportation legs. Common sense suggests
14 that there is more opportunity for an intra-BMC or inter-BMC parcel to "skip around"
15 than there is for a parcel entered midway into the postal network, such as a DBMC
16 parcel. Thus, taking into account these other eight flowpaths would likely lower
17 inter-BMC and intra-BMC transportation costs, and increase DBMC transportation
18 costs.

19 For the reasons outlined above, the DBMC non-transportation
20 passthrough should be set at 77% as in prior cases, and all Parcel Post
21 worksharing cost avoidances for new discounts should have a 77% passthrough for

32. Docket No. R90-1, USPS-T-12, p. 7.

1 both transportation and non-transportation avoided costs. The effect of uniformly
2 applying a 77% passthrough is shown in Table 11.

3 **Table 11: Revised Parcel Post Worksharing Avoided Costs and Discounts**
4 *(cents per piece, unless noted)*

Avoided Cost/Discount	Revised Avoided Cost	Discount with 77% Passthrough
DBMC Non-Transportation (off of Intra-BMC)	36.6	28.2
OBMC Non-Transportation (off of Inter-BMC)	47.3	36.4
BMC Presort Non-Transportation (off of Inter-BMC)	12.5 to 13.9	9.6 to 10.7
Prebarcoding	2.66	2.0
DSCF Non-Transportation (off of DBMC)	24.8	19.1
DSCF Transportation (off of DBMC Zone 1/2)	\$0.2670/cubic foot	\$0.2056/cubic foot
DDU Non-Transportation (off of DBMC)	44.8	34.5
DDU Transportation (off of DBMC Zone 1/2)	\$0.6475/cubic foot	\$0.4986/cubic foot

13 **THE POSTAL SERVICE HAS FAILED TO**
14 **FOLLOW COMMISSION POLICY IN THE**
15 **DERIVATION OF WORKSHARED RATES**
16

17 The Postal Service has failed to follow Commission policy in the
18 derivation of Parcel Post rates in three particular instances.

19 **A. The DBMC Rates Are Based on a Reduction**
20 **in DBMC's Institutional Cost Contribution,**
21 **Not Just Avoided Costs.**

22 In the past, DBMC rates have always been derived directly as a
23 worksharing discount off of the intra-BMC Parcel Post rates. Ms. Mayes has
24 abandoned this past Postal Service and Commission practice in her rate design.
25 Instead, Ms. Mayes uses the separate derivation of DBMC transportation costs

1 provided by Mr. Hatfield to build this part of DBMC's costs from the ground up,
 2 rather than from intra-BMC down. Tr. 8/4116-17. This implicitly passes through
 3 not only 100% of DBMC entry transportation cost savings, but also a 15 percent
 4 "markup factor" on those savings.

5 This is a significant departure from well-established Commission
 6 practice. On cross-examination, Ms. Mayes could supply no real reason -- beyond
 7 analytic convenience -- to depart from the normal procedure. Tr. 8/4116-17. I
 8 recommend that the Commission continue, as in the past, to derive the DBMC rates
 9 as a worksharing discount off of the intra-BMC rates, by simply subtracting the
 10 passed through avoided DBMC costs off of the intra-BMC rates, as follows:

11 *DBMC Rate = Intra-BMC Rate - DBMC Non-Transportation Discount - DBMC Transportation Discount.*

12 Since intra-BMC and DBMC transportation costs have been
 13 separately estimated by Mr. Hatfield (taking into account the different densities of
 14 intra-BMC and DBMC mail), the DBMC transportation discount would be the
 15 difference between the intra-BMC transportation cost in each rate cell minus the
 16 DBMC transportation cost in the same rate cell.

17 **B. DDU Rates Are Not Computed off**
 18 **of the Correct Base Rate**

19 DSCF entry and DDU entry represent additional worksharing beyond
 20 DBMC entry. Ms. Mayes quite logically derives DSCF rates by subtracting the
 21 costs avoided by DSCF entry from the DBMC rates (albeit with passthroughs that
 22 are too high). However, inexplicably, Ms. Mayes derives DDU rates by subtracting

1 cost avoidances from intra-BMC local rates rather than from the DBMC zone 1/2
2 rates.

3 On cross-examination, Ms. Mayes stated that since the DDU volume
4 estimate was obtained by using bulk entered local zone intra-BMC volume, the
5 DDU rates should be based on intra-BMC local zone rates rather than on the
6 DBMC or DSCF rates. Tr. 8/4171-72. This is a non-sequitur. Mr. Hatfield, in
7 deriving the cost of DDU transportation, implicitly assumes that DDU has the same
8 density profile as DSCF and DBMC, since he uses the local transportation costs for
9 the DSCF and DBMC categories to derive the DDU transportation cost avoidance.³³
10 Despite this, Ms. Mayes' procedure assumes that DDU entry mail will have the
11 same density as intra-BMC Parcel Post. Mr. Hatfield's approach is much more
12 logical.

13 The use of intra-BMC local rates as the base is also highly
14 problematic because it is the least certain of the Parcel Post rates. Mr. Hatfield
15 simply assumes because he has no data that 50% of intra-BMC local parcels would
16 travel to the BMC. Tr. 8/3941.

17 Based on the above, I recommend that the Commission calculate
18 rates for DDU entry in the same manner as Ms. Mayes does for DSCF entry, i.e., by
19 subtracting the DDU avoided costs from the zone 1/2 DBMC rates.

33. USPS-T-16, page 24, and Appendix III thereto, page 9.

1 **C. Failure to Follow Commission Policy**
2 **on Rate Cell Decreases**

3 In her rate design, Ms. Mayes allows the DBMC rates in zones 1/2 to
4 decrease from current rates. Tr. 8/4118. The practical effect of Ms. Mayes'
5 approach is to decrease rates for 41% of DBMC volume. Tr. 8/4245. On cross-
6 examination, she agreed that this is inconsistent with past Commission practice;
7 the Commission has not allowed rates for individual Parcel Post rate cells to
8 decrease when an overall rate increase is applied to the subclass. Tr. 8/4106. The
9 Commission should apply its long-standing practice of not decreasing rates in any
10 Parcel Post rate cells when the class as a whole is facing a rate increase.

11 **THE POSTAL SERVICE'S NEW TRANSPORTATION**
12 **COST ANALYSIS LEADS TO RATE ANOMALIES**

13 Mr. Hatfield departs from the Commission's traditional treatment of
14 Parcel Post transportation costs. In large part, his analysis is an improvement.
15 However, his treatment of intra-BMC intermediate transportation costs as not
16 distance related is counter-intuitive and creates serious rate anomalies.

17 Mr. Hatfield's position is based on the argument that intra-BMC
18 intermediate transportation costs are not necessarily distance-related, and thus
19 should never increase as zone increases. Tr. 8/3930. Yet, he also argues that
20 DBMC intermediate transportation costs are distance related, and thus should
21 increase as zone increases.³⁴ Accepting Mr. Hatfield's argument at face value

34. USPS-T-16, page 11.

1 leads to the conclusion that zone 4 and zone 5 intra-BMC parcels cost less to
2 transport than do zone 4 and zone 5 DBMC entry parcels.³⁵ In other words,
3 additional worksharing yields an increase in transportation costs in the case of a
4 zone 4 or zone 5 DBMC parcel.

5 This leads the Commission to a dilemma. Should the Commission
6 permit a workshared category to have rates which exceed the non-workshared
7 category on which it is based? Ms. Mayes sweeps this problem under the rug by
8 having a constraint in her "final" rate iteration that caps DBMC rates at the final
9 rates for intra-BMC parcels of the same weight and zone. A review of the final
10 DBMC rates shows that nearly 150 DBMC rates are decreased by this treatment.
11 Her "solution" still yields a non-intuitive rate design for DBMC (e.g., the DBMC
12 rates in zone 4 are identical to the zone 4 intra-BMC rates even though the DBMC
13 mailer takes the parcel all the way to the BMC and, in doing so, supposedly saves
14 over 25 cents of processing costs).

15 Rather than attempting to correct these anomalies solely by capping
16 the rates, I suggest a minor modification to Mr. Hatfield's transportation analysis
17 that mitigates the crossover problem. My review of Mr. Hatfield's analysis indicates
18 that he has not fully justified his position that no intra-BMC intermediate
19 transportation costs should be treated as distance related. As Mr. Hatfield
20 suggests, intra-BMC intermediate transportation costs sometimes are linked to

35. USPS-T-16, Exhibit A.

distance as measured by Great Circle Distance ("GCD"), and sometimes are not.³⁶

The greater the difference in the distance from the origin SCF to the BMC and the distance from the BMC to the destination SCF, the more likely that the intermediate transportation distance traveled is linked to GCD.

This is illustrated in Table 12, which shows four possible cases in which there are two "close" SCFs, located 10 miles from the BMC, and two "far" SCFs, located 160 miles from the BMC.

Table 12: Relationship Between Distance Traveled and GCD

	Distance from OSCF to BMC	Distance from BMC to DSCF	Transportation Distance from OSCF to BMC to DSCF	Minimum GCD Distance from OSCF to DSCF	Maximum GCD Distance from OSCF to DSCF
1	Close (10)	Close (10)	20	0	20
2	Close (10)	Far (160)	170	150	170
3	Far (160)	Close (10)	170	150	170
4	Far (160)	Far (160)	320	0	320

As can be seen from Table 12, when the OSCF and the DSCF are equidistant from the BMC (cases 1 and 4), transportation distance and GCD are not related.

However, when the OSCF and the DSCF are not equidistant from the BMC (cases 2 and 3), intermediate transportation is related to GCD.

Moreover, Parcel Post can travel in a circuitous route (from SCF to SCF to BMC, for example) rather than the direct routes that Mr. Hatfield uses in his examples. The impact of these types of routes on the relationship between GCD

36. GCD is the distance from the origin SCF to the destination SCF and is used to determine zone. USPS-T-16, pp. 5-6.

1 and distance is unknown. Consideration of these types of routes is needed if one
2 is to determine the real relationship between distance traveled and GCD.

3 In the absence of a more complete analysis, one cannot say whether
4 intra-BMC intermediate transportation is more fully distance-related or more fully
5 non-distance-related. Mr. Hatfield has not made a convincing case for treating
6 intra-BMC intermediate transportation as completely non-distance related. There is
7 no doubt that intra-BMC intermediate transportation costs are at least partially
8 distance related.

9 Considering all of the relevant issues from both a costing and a rate
10 design perspective, I recommend treating intra-BMC intermediate transportation
11 costs as partially distance-related. To do this, I adjust the transportation costs for
12 intra-BMC Parcel Post so that total intra-BMC transportation costs by zone are an
13 equal amount (in dollars per cubic foot) below the corresponding total of inter-BMC
14 transportation costs by zone.³⁷ This helps solve the crossover problem between
15 intra-BMC rates and DBMC rates, yields comprehensible rate differentials between
16 intra-BMC rates and inter-BMC rates in all zones, and is as likely to be correct from
17 a cost causation standpoint as Mr. Hatfield's approach. Moreover, it is consistent
18 with historical practice, in that transportation costs for all Parcel Post categories
19 would increase as a function of zone. In Exhibit UPS-T-4F, I have calculated the
20 transportation costs for intra-BMC based on this method.

37. Increasing intra-BMC transportation costs by zone at a greater rate than inter-BMC transportation costs could yield a crossover problem between inter-BMC rates and intra-BMC rates.

1 Treating intra-BMC intermediate transportation costs as distance
2 related helps to alleviate the crossover problem between intra-BMC rates and
3 DBMC rates. However, some crossovers remain. Ms. Mayes' approach, i.e.,
4 capping DBMC rates at the final intra-BMC rates for the same rate cells, has two
5 infirmities. First, Ms. Mayes recovers the lost DBMC revenue from all other Parcel
6 Post rate cells. That is unfair to the single-piece mailer. Ms. Mayes should have
7 recovered the revenue loss by increasing the rates in the unaffected DBMC rate
8 cells. Second, Ms. Mayes' approach results in intra-BMC rates that are equal to
9 DBMC rates in some rate cells. A more logical rate design would be to set the
10 DBMC rate to be no higher than the corresponding intra-BMC rate minus the DBMC
11 non-transportation discount. Capping the affected DBMC rates in this manner
12 means that the DBMC rates would always be lower than the corresponding intra-
13 BMC rates by the amount of the non-transportation cost avoided by DBMC entry.
14 This is similar to the logic of setting Parcel Post rates to be at least 5 cents below
15 the corresponding Priority Mail rates. The recovery of the revenue lost from the
16 affected cells should be recovered from the unaffected DBMC rate cells.

17 Leaving Mr. Hatfield's underlying costs and Ms. Mayes' crossover
18 treatment unchanged would leave the Commission with a permanent severe
19 crossover issue between intra-BMC and DBMC rates, and a permanent non-
20 intuitive rate design for DBMC. My recommendations alleviate both of those
21 concerns.

1 **NON-TRANSPORTATION**
2 **WEIGHT RELATED COSTS**

3 In the past, the Postal Service and the Commission have added 2
4 cents per pound to Parcel Post rates to account for the effect of weight on non-
5 transportation costs. I am not aware of any empirical basis for the 2 cents per
6 pound figure. However, its complete removal at this time would result in serious
7 disruptions to the rate chart.

8 On the other hand, with the advent of significant worksharing
9 programs in Parcel Post, the 2 cents per pound charge probably overstates the
10 impact of weight on non-transportation costs for workshared mail. For example, if
11 the weight-related mail processing cost for intra-BMC parcels is 2 cents per pound,
12 the weight-related mail processing costs for DDU mail must be substantially less
13 than 2 cents per pound because there are fewer mail processing operations in the
14 case of DDU parcels. The more worksharing, the lower the net non-transportation
15 cost per pound.

16 Reducing the adder for workshared categories would be consistent
17 with the Commission's rate design for Bound Printed Matter, which includes a
18 different non-transportation cost per pound for each of the worksharing
19 categories.³⁸ I propose that the non-transportation worksharing discounts for
20 DBMC, DSCF, and DDU entry Parcel Post similarly reflect the diminishing impact of
21 weight for workshared categories by using separate per piece and per pound
22 components for non-transportation costs. The 2 cents per pound non-

38. Opinion and Recommended Decision, Docket No. R87-1, page 725.

REVISED 1/13/98

1 transportation charge would continue to be applicable to inter-BMC and intra-BMC
 2 mail. The non-transportation worksharing discounts for DBMC, DSCF, and DDU
 3 would have a pro rata share of this 2 cents per pound charge applied. The
 4 discount then would reflect the portion of the 2 cents per pound charge that is
 5 "avoided" by the worksharing category. After subtracting the discount, the resulting
 6 rates for DBMC, DSCF, and DDU mail would have a lower cent per pound non-
 7 transportation charge embodied within them, reflecting the lower number of
 8 processing operations that mail in these categories undergoes.

9 Using this logic, the per piece and per pound components that I
 10 recommend for the DBMC, DSCF, and DDU non-transportation discounts are
 11 shown in Table 13.

12 **Table 13: Breakdown of Non-Transportation Discounts for DBMC,**
 13 **DSCF, and DDU Entry into Per Piece and Per Pound**
 14 **Components**

Discount	Total Cents Per Piece Non-Transportation Discount	Cents per <u>Pound</u> Non- Transportation Discount Component	Cents per <u>Piece</u> Non- Transportation Discount Component
DBMC (off of intra-BMC rates)	28.2	0.341	26.4
DSCF (off of DBMC rates)	19.1	0.231	17.9
DDU (off of DBMC rates)	34.5	0.417	32.3

19 Source: Exhibit UPS-T-4G.

20 The workshared rates would be computed in the normal way, albeit
 21 with a new component. For example, DBMC rates would be computed as:

1 *DBMC Rate = Intra-BMC Rate - DBMC Non-Transportation Discount per Piece -*
 2 *DBMC Non-Transportation Discount per Pound - DBMC Transportation Discount.*

3 In principle, this breakdown into per piece and per pound components
 4 could be performed for all worksharing discounts. For simplicity, I suggest that the
 5 BMC presort and OBMC entry discounts not be broken into per piece and per
 6 pound components in order to allow these rates to be applied as a straightforward
 7 per piece discount.

8 **RECOMMENDED DISCOUNTS AND RATES USING**
 9 **100% VARIABILITY FOR MAIL PROCESSING**

10 I have also computed revised worksharing discounts assuming that
 11 mail processing labor costs are 100% volume variable. This required replicating
 12 Ms. Daniel's and Mr. Crum's models, with adjusted productivity rates and corrected
 13 piggyback factors supplied by Mr. Sellick, as well as making the corrections
 14 discussed above. See UPS-Luciani-WP-4.

15 In general, the non-transportation discounts are higher, since more
 16 mail processing costs are now attributed and therefore a greater amount of costs
 17 are avoided by workshared categories, as shown in Table 14. The transportation
 18 discounts are unchanged.

Table 14: Revised Parcel Post Worksharing Avoided Costs and Discounts with 100% Mail Processing Labor Variability
(cents per piece, unless noted)

Avoided Cost/Discount	Revised Avoided Cost	Discount with 77% Passthrough
DBMC Non-Transportation (off of Intra-BMC)	42.8	33.0
OBMC Non-Transportation (off of Inter-BMC)	58.2	44.8
BMC Presort Non-Transportation (off of Inter-BMC)	21.1	16.2
Prebarcoding	2.73	2.1
DSCF Non-Transportation (off of DBMC)	36.8	28.3
DSCF Transportation (off of DBMC Zone 1/2)	\$0.2670/c.f.	\$0.2056/c.f.
DDU Non-Transportation (off of DBMC)	71.8	55.3
DDU Transportation (off of DBMC Zone 1/2)	\$0.6475/c.f.	\$0.4986/c.f.

Source: UPS-Luciani-WP-4.

I have derived Parcel Post rates using Ms. Mayes' rate design model modified to incorporate the above changes. In addition, this derivation includes the impact of the costing and pricing changes recommended by Dr. Neels, Mr. Sellick, and Dr. Henderson. The results are contained in my Exhibit UPS-T-4H.

PRIORITY MAIL COSTING AND RATE DESIGN

A. Separate Rate Treatment for Parcels

In Docket No. MC95-1, the Commission found that it costs the Postal Service more to process Standard (A) parcels than Standard (A) flats. In light of this finding, we investigated whether there are also processing cost differences between Priority Mail parcels and Priority Mail flats.

1 As shown by Mr. Sellick in UPS-T-2, Priority Mail parcels cost 19.5
2 cents per piece more to process than do Priority Mail flats in the test year.³⁹ This
3 analysis does not consider the impact of the Priority Mail Processing Center
4 ("PMPC") contract. A review of the PMPC contract data produced by the Postal
5 Service shows that in the PMPC network there will also be a price difference
6 between what the Postal Service will pay for handling flats and what it will pay for
7 handling parcels. Tr. 4/2140-41. On cross-examination, Mr. Sharkey agreed that
8 this difference likely reflected cost differences. Tr. 4/2145-46.

9 The PMPC contract requires the contractor to separate flats from
10 parcels and deliver these different shapes back to the Postal Service in different
11 types of containers. Tr. 4/2143. It seems obvious that once received back into the
12 Postal Service's system, the Priority Mail in flat trays can be sorted more easily
13 (perhaps using a FSM 1000) than in the case of the laborious manual sorting of
14 parcels. Moreover, to assist the contractor, the Postal Service is requesting that its
15 retail units segregate Priority Mail by shape prior to transfer to the PMPC. Tr.
16 4/2086. Thus, the difference in costs between Priority Mail flats and Priority Mail
17 parcels that exists in the Postal Service's network also exists in the PMPC network.

18 There is a significant number of parcels in Priority Mail. In fact,
19 parcels represent 63% of Priority Mail volume.⁴⁰ The average weight of the Priority
20 Mail flats observed in IOCS was 1.02 pounds, and the average weight of the

39. The difference is 12.7 cents per piece using Mr. Bradley's recommended mail processing variabilities. UPS-Sellick-WP-1-III-A, p. 2.

40. UPS-T-2, p. 19, Table 5.

1 Priority Mail parcels observed in IOCS was 3.34 pounds.⁴¹ According to IOCS,
2 then, Priority Mail parcels weigh 2.32 pounds more on average than Priority Mail
3 flats. In the Priority Mail rate design, Priority Mail rates increase with weight. This
4 is because increased weight increases transportation costs. Since the 19.4 cents
5 per piece difference in cost between parcels and flats affects only the difference in
6 mail processing costs, the impact of increasing rates by weight for transportation
7 costs does not capture the mail processing cost difference between flats and
8 parcels.

9 The 2.0 cents per pound adder for non-transportation costs in the
10 Priority Mail rate design becomes 4.0 cents per pound with the contingency
11 allowance and the institutional cost markup included. USPS-33N. This adder
12 yields an additional 9.3 cents per piece in the rates charged for the average Priority
13 Mail parcel in comparison to the average Priority Mail flat (4.0 cents per pound
14 multiplied by the 2.32 pound weight difference between parcels and flats) . This
15 additional charge is significantly less than the 19.5 cents per piece mail processing
16 cost difference between flats and parcels.

17 I recommend that the Commission adopt a surcharge of ten cents per
18 piece (19.5 cent cost difference minus 9.3 cent non-transportation weight related
19 cost) for Priority Mail parcels. Use of a surcharge would encourage the Postal
20 Service to keep track in the future of the separate costs it incurs for parcels and for
21 flats. A parcel surcharge would also mitigate the mystifying crossover problem
22 between Parcel Post rates and Priority Mail rates. The crossover check would be

41. UPS-Sellick-WP-1-VI-A.

between Priority Mail rates including the parcel surcharge and Parcel Post rates. With the Priority Mail parcel surcharge, Parcel Post rates are less likely to exceed Priority Mail rates for the same rate cell.

B. Delivery Confirmation

All of the cost of Priority Mail electronic delivery confirmation, designed for large volume users, is included in the base cost of all Priority Mail. A portion of the cost of delivery confirmation incurred for single-piece Priority Mail users (*i.e.*, manual delivery confirmation service) is also included in Priority Mail base rates. This yields a cost coverage for Priority Mail delivery confirmation of 69%, as shown in Table 15.

Table 15: Delivery Confirmation Costs and Proposed Charges in Priority Mail
(thousands of dollars, unless noted)

	Manual Service	Electronic Service	Total
Test Year Volume (000)	59,440	7,047	66,487
Proposed Fee (cents/piece)	35.0	0.0	NA
Test Year Revenue	20,804	0	20,804
Test Year Non-Subsidized Cost	20,120	0	20,120
Test Year Subsidized Cost	8,924	1,058	9,982
Total Cost	29,044	1,058	30,102
Cost Coverage	72%	0%	69%

Sources: USPS-T-40, WP 5; USPS-33N.

Fairness requires that the cost of the delivery confirmation activity be borne solely by those who will use it. Stated differently, those who do not use the delivery confirmation service should not pay for the costs incurred in providing it.

1 The Postal Service does attribute delivery confirmation costs to those who use the
2 service in Standard (B), but not for Priority Mail.

3 Mr. Plunkett argues that offering delivery confirmation will attract new
4 customers and maintain the existing customer base.⁴² While this is a rationale for
5 offering a delivery confirmation service, it is not a defense for subsidizing it. The
6 attributable cost for Priority Mail electronic service is essentially equal to the
7 attributable cost of Standard (B) electronic delivery confirmation service. Tr.
8 3/1028-29. I recommend that the Commission impose a fee of 25 cents per
9 transaction for electronic Priority Mail delivery confirmation, which is the same fee
10 proposed by the Postal Service for electronic Standard (B) delivery confirmation.
11 Similarly, the fee for Priority Mail manual delivery confirmation service should be 60
12 cents per transaction, the same as for Standard (B) manual delivery confirmation.

13 With respect to the capital cost of the scanners to be used for delivery
14 confirmation, less than 0.5% finds its way to Priority Mail and Standard (B), as
15 shown in Table 16.

42. USPS-T-40, p. 19.

Table 16: Allocation of Costs of Scanners, TY 1998
(millions of dollars)

	Original Estimate		Revised Estimate	
	Cost	Percent of Total Cost	Cost	Percent of Total Cost
Priority Mail	0.4	0.2%	0.3	0.2%
Standard (B)	0.5	0.3%	0.4	0.2%
Other	51.1	27.6%	34.4	20.7%
Total Volume Variable	51.9	28.0%	35.1	21.0%
Non-Volume Variable	133.7	72.0%	131.1	79.0%
TOTAL	185.5	100.0%	166.2	100.0%

Sources: USPS-T-22, Worksheets C-1 and C-2, and Tr. 3/1254-57.

Mr. Treworgy argues that the scanners will be used for a multitude of purposes and thus their costs should be spread among all classes.⁴³ However, he has performed no analysis showing the relative value of these other purposes. The significant share of the scanner cost that is not volume variable can be viewed as reflecting the informational uses of the scanners.

It is clear that the onset of delivery confirmation precipitated the purchase of the scanners. As such, I recommend that the entire portion of the cost of the scanners that Mr. Treworgy finds to be volume variable be allocated to only Priority Mail and Standard (B) in proportion to revenue, as shown in Table 17. The use of revenue to allocate the volume variable costs between Priority Mail and Standard (B) takes into account both the higher volume of Priority Mail and its

43. One of those purposes applies only to Priority Mail and Standard (B) mail. Tr. 3/1312.

higher value (and the resulting greater likelihood that Priority Mail users will use delivery confirmation service).

**Table 17: Recommended Attributable Cost by Subclass for
Capital Cost of New Scanners**

(millions of dollars)

	TYBR Revenues	Percent of Revenues	Attributable Cost (Original)	Attributable Cost (Revised)
Priority Mail	3,979	70.9%	36.8	24.9
Parcel Post	738	13.1%	6.8	4.6
BPM	493	8.8%	4.6	3.1
Special Rate	353	6.3%	3.3	2.2
Library Rate	48	0.9%	0.5	0.3
Total	5,611	100.0%	51.9	35.1

Source: Exhibit USPS-30A.

ALASKA AIR

The Alaska air program has two components: (1) standard Parcel Post that travels by air only because ground transportation is not available in Alaska or is more expensive than air travel, and (2) "bypass" mail that is not handled by the Postal Service's clerks or mailhandlers. POIR No. 4-8. Bypass mail is a special program. Bypass mail is charged intra-BMC Parcel Post rates. Tr. 8/4059. It represents 58.8% of Alaska air non-preferential costs. POIR No. 4-8.

Since Docket No. R90-1, the Commission has allocated all Alaska non-preferential air costs between attributable and non-attributable costs on the basis of the cost that would have been incurred had the parcels been transported

1 via ground transportation. This results in about 20% of Alaska non-preferential air
2 costs being counted as attributable Parcel Post costs.

3 The Postal Service continues to treat nearly 100% of Alaska non-
4 preferential air costs as attributable to Parcel Post. Since these costs are incurred
5 to handle Parcel Post mail, Tr. 8/4228, 4259, they meet the definition of attributable
6 costs and should be attributed to Parcel Post. At the very least, all of the standard
7 non-bypass Parcel Post air expense (41.2% of total Alaska non-preferential air
8 costs) should be attributed. In this way, all of the non-bypass expenses associated
9 with standard Parcel Post would be attributed to Parcel Post.

10 CONCLUSIONS

12 The proposed rates for Parcel Post (1) are based on overstated
13 estimates of worksharing avoided costs, (2) reflect passthroughs that are too high,
14 (3) fail to follow Commission policy in deriving workshared rates, and (4) exhibit
15 rate anomalies resulting from the implementation of a new and imprecise
16 transportation costing analysis. I suggest appropriate corrections for each of these
17 problems.

18 In addition, the costs of processing Priority Mail parcels are
19 significantly higher than the costs of processing Priority Mail flats. This requires
20 separate rate treatment for Priority Mail parcels. Moreover, the proposed treatment
21 of delivery confirmation costs is inequitable and should be revised. Finally, all
22 Alaska air costs should be fully attributed; at a minimum, all non-bypass Alaska air
23 costs should be attributed.

**OUTGOING MAIL PROCESSING COSTS AT NON-BMC
FACILITIES AVOIDED BY DBMC PARCEL POST**

(Revised to Exclude Costs of Platform Acceptance and Mail Preparation Operations)

<u>A. Costs Avoided</u>		Source
1. FY 1996 Processing Costs	\$20,807,467	LR-UPS-Sellick-1-IV-A
2. Base Year 1996 Parcel Post Mail Processing "Piggyback" Factor	0.685	Library Reference H-77
3. Indirect Attributable Costs	\$14,253,115	Line 1 * Line 2
4. Total	\$35,060,582	Line 1 + Line 3
 <u>B. Volumes</u>		
1. FY 1996 Parcel Post volume entered upstream of BMC/ASF	112,738,479	USPS-T-28, Exhibit B, Line 11
 <u>C. Unit Costs</u>		
1. Unit Costs Avoided	\$0.311	Costs/Volume (Line A4/Line B1)
 <u>D. Test Year/Base Year Adjustment</u>		
1. TY/BY Wage Rate Adjustment Factor	1.053	Library Reference H-146
2. 1998 Estimated Test Year Costs Avoided	\$0.327	Line C1 * Line D1

Note: See USPS-T-28, Exhibit C, for the Postal Service exhibit upon which this exhibit is based.

**OUTGOING MAIL PROCESSING COSTS AT NON-BMC
FACILITIES AVOIDED BY DBMC PARCEL POST**

Revised to: (1) Exclude Costs of Platform Acceptance and Mail Preparation
Operations
(2) Remove ASF Outgoing Costs When ASF Acts as a BMC

<u>A. Costs Avoided</u>		Source
1. FY 1996 Processing Costs	\$20,807,467	LR-UPS-Sellick-1-IV-A
1A. FY 1996 ASF Outgoing Mail Processing Costs When ASF Acts as BMC	\$3,371,728	UPS-T-4, Exhibit B, page 2
1B. Corrected FY 1996 Processing Costs	\$17,435,740	Line 1 - Line 1A
2. Base Year 1996 Parcel Post Mail Processing "Piggyback" Factor	0.685	Library Reference H-77
3. Indirect Attributable Costs	\$11,943,482	Line 1B * Line 2
4. Total	\$29,379,222	Line 3 + Line 1B
 <u>B. Volumes</u>		
1. FY 1996 Parcel Post volume entered upstream of BMC/ASF	112,738,479	USPS-T-28, Exhibit B, Line 11
 <u>C. Unit Costs</u>		
1. Unit Costs Avoided	\$0.261	Costs/Volume (Line A4/Line B1)
 <u>D. Test Year/Base Year Adjustment</u>		
1. TY/BY Wage Rate Adjustment Factor	1.053	Library Reference H-146
2. 1998 Estimated Test Year Costs Avoided	\$0.274	Line C1 * Line D1

Note: See USPS-T-28, Exhibit C, for the Postal Service exhibit upon which this exhibit is based.

(1) Calculation of ASF Outgoing Costs When Operating as a BMC for Inter-BMC Volume

Machinable Outgoing Inter-BMC Costs at Origin BMC (\$/pc)	\$0.3408	[1]
Nonmachinable Outgoing Inter-BMC Costs at Origin BMC (\$/pc)	\$0.6429	[2]
Percent of Inter-BMC that is machinable	91.25%	[3]
Percent of Inter-BMC that is nonmachinable	8.75%	[4]
Average Inter-BMC Outgoing Costs at Origin BMC	\$0.3672	[5]
FY 1996 Inter-BMC Volume with ASF as Origin BMC	4,454,622	[6]
Total ASF Outgoing Costs When Operating as a BMC for Inter-BMC	\$1,635,745	[7]

(2) Calculation of ASF Outgoing Costs When Operating as a BMC for Intra-BMC Volume

Machinable Outgoing Intra-BMC ASF Costs at BMC (\$/pc)	\$0.2264	[8]
Nonmachinable Outgoing Intra-BMC ASF Costs at BMC (\$/pc)	\$0.4870	[9]
Percent of Intra-BMC that is machinable	91.30%	[10]
Percent of Intra-BMC that is nonmachinable	8.70%	[11]
Average Intra-BMC Outgoing ASF Costs at BMC	\$0.2490	[12]
FY 1996 Intra-BMC Volume with ASF as BMC	3,676,595	[13]
Total ASF Outgoing Costs When Operating as a BMC for Intra-BMC	\$915,649	[14]

(3) Calculation of ASF Outgoing Costs When Operating as a BMC for DBMC Volume

Machinable Outgoing DBMC ASF Costs at BMC (\$/pc)	\$0.1322	[15]
Nonmachinable Outgoing DBMC ASF Costs at BMC (\$/pc)	\$0.6695	[16]
Percent of Intra-BMC that is machinable	92.99%	[17]
Percent of Intra-BMC that is nonmachinable	7.01%	[18]
Average DBMC Outgoing ASF Costs at BMC	\$0.1698	[19]
FY 1996 DBMC Volume with ASF as BMC	4,830,403	[20]
Total ASF Outgoing Costs When Operating as a BMC for DBMC	\$820,333	[21]

(4) Total ASF Outgoing Costs When Operating as a BMC**\$3,371,728 [22]**

-
1. UPS-Luciani-WP-2, page 1, line 5
 2. UPS-Luciani-WP-2, page 1, line 6
 3. LR-H-135. 1996 GFY Total Machinable Inter-BMC Parcel Post (60,462,052)/Total Inter-BMC Parcel Post (66,257,981)
 4. LR-H-135. 1996 GFY Total Nonmachinable Inter-BMC Parcel Post (5,795,914)/Total Inter-BMC Parcel Post (66,257,981)
 5. (Row [3] * Row [1]) + (Row [4] * Row [2])
 6. UPS-Luciani-WP-2, page 5
 7. Row [5] * Row [6]
 8. UPS-Luciani-WP-2, page 1, line 5
 9. UPS-Luciani-WP-2, page 1, line 6
 10. LR-H-135. 1996 GFY Total Machinable Intra-BMC Parcel Post (41,992,369)/Total Intra-BMC Parcel Post (45,996,280)
 11. LR-H-135. 1996 GFY Total Nonmachinable Intra-BMC Parcel Post (4,003,921)/Total Intra-BMC Parcel Post (45,996,280)
 12. (Row [10] * Row [8]) + (Row [11] * Row [9])
 13. UPS-Luciani-WP-2, page 9
 14. Row [12] * Row [13]
 15. UPS-Luciani-WP-2, page 1, line 5
 16. UPS-Luciani-WP-2, page 1, line 6
 17. LR-H-135. 1996 GFY Total Machinable DBMC Parcel Post (89,624,307)/Total DBMC Parcel Post (96,381,277)
 18. LR-H-135. 1996 GFY Total Nonmachinable DBMC Parcel Post (6,756,973)/Total DBMC Parcel Post (96,381,277)
 19. (Row [17] * Row [15]) + (Row [18] * Row [16])
 20. UPS-Luciani-WP-2, page 13
 21. Row [19] * Row [20]
 22. Row [7] + Row [14] + Row [21]

Calculation of DSCF Savings with Modified Conversion Factor Assumptions

Proportion of DBMC Parcel Post	<u>Machinable</u> 93%	<u>Nonmachinable</u> 7%	<u>Total</u> 100%	
				[1]
(1) DBMC Mail Processing Costs Avoided by Parcel Post Deposited at DSCFs	\$0.275	\$0.544	\$0.294	[2]
(2) After-BMC Downstream Costs				
Postal Network	\$0.159	\$0.498	\$0.183	[3]
DSCF Mail	\$0.193	\$0.433	\$0.210	[4]
DSCF Costs avoided at the DSCF	(\$0.034)	\$0.065	(\$0.027)	[5]
(3) Total Savings for DSCF Dropship	\$0.241	\$0.609	\$0.266	[6]

[1] Library Reference H-135

[2] USPS-T-28, Exhibit F, page 1

[3] USPS-T-28, Exhibit G, page 2

[4] UPS-T-4C, page 2

[5] Row [3] - [4]

[6] Row [2] + [5]

After BMC downstream costs of DSCF prepared parcel post

Test Year 1998 Wage Rate	\$	25.45	[1]
Platform Non-BMC Indirect Attributable Cost (Piggyback Factor)		1.844	[1]
Operation Productivities (pieces per hour)			

	<u>Machinable</u>	<u>Nonmachinable</u>	
	<u>Sacks</u>	<u>GPMC</u>	
Crossdock	12.6	12.6	[1]
Load	325.8	18.6	[1]
Unload	275.1	37.2	[1]
Dump	184.1		
Pieces per Container (Conversion Factor)	5.8	17.37	[2]
Sacks (Crossdock Only)	39.2		[1]
Cost per Handling			
Operation			
Crossdock at SCF	0.0953	0.2150	[3]
Load at SCF	0.0248	0.1454	[3]
Unload at Delivery Unit	0.0294	0.0726	[3]
Dump Sacks at Delivery Unit	0.0439		[3]
Total	0.1933	0.4330	[4]

Derivation of the GPMC Conversion Factor

[5]	[6]	[7]	[8]	[9]
Avg. % Container Fullness	Cubic feet per GPMC	Size of avg. NMO (in cubic ft)	Effective Cubic Capacity	Capacity at avg. fullness (in pieces)
88%	36.40	1.844	19.74	17.37

[1] USPS-T-28, Exhibit G, page 1

[2] USPS-T-29, Appendix V, page 17, UPS-T-4C, page 2, column [9]

[3] (Wage rate * piggyback factor)/(Conversion Factor * productivity)

[4] Sum [3]

[5] Average Container Fullness of a Gaylord used for OBM entry, USPS-T-29, Appendix V, page 17

[6] Library Reference H-133 (Container Methods), page 14

[7] USPS-T-29, Appendix V, page 17

[8] Column [6]/Column [7]

[9] Column [5] * Column [8]

**Adjustment to DSCF Dropship Savings to Account
for Postal Service Assistance in Unloading at the SCF**

DBMC Parcel Post							
Machinable	93%						[1]
Nonmachinable	7%						[1]
	<u>[A]</u>	<u>[B]</u>	<u>[C]</u>	<u>[D]</u>	<u>[E]</u>	<u>[F]</u>	
	<u># handlings</u>	<u>units/hr</u>	<u>conversion</u>	<u>piggyback</u>	<u>\$ per oper</u>	<u>\$ per facility</u>	
I. Machinable Parcel Post							
Unload Bedload Sacks at DSCF	1	275.1	5.8	1.844	\$ 0.0294	\$ 0.0294	[2]
Postal Service Share of Work						50%	[3]
DSCF Costs						\$ 0.0147	[4]
II. Nonmachinable Parcel Post							
Unload Containers	1	37.2	17.37	1.844	\$ 0.0726	\$ 0.0726	[5]
Postal Service Share of Work						100%	[6]
DSCF Costs						\$ 0.0726	[7]
III. Total Unloading Costs for Postal Assistance with DSCF Dropship Mail						\$ 0.0187	[8]
Test Year Wage Rate	\$25.445						[9]

[1] Library Reference H-135

[2.A] All machinable parcel post will arrive bedloaded in order to qualify for the DSCF discount.

[2.B] USPS-T-29, Appendix V, page 11

[2.C] USPS-T-29, Appendix V, page 11

[2.D] USPS-T-29, Appendix V, page 11

[3] It is assumed that the Postal Service's assistance in unloading sacks at the DSCF will amount to 50% of normal unloading costs.

[4] Row 2 * Row 3

[5.A] All nonmachinable parcel post will arrive in GPMCs in order to qualify for the DSCF discount.

[5.B] USPS-T-29, Appendix V, page 12

[5.C] UPS-T-4, Exhibit C

[5.D] USPS-T-29, Appendix V, page 12

[6] Per current policy, the Postal Service will unload all nonmachinable containers at SCFs.

[7] Row 5 * Row 6

[8] (Row 4 * Row 1) + (Row 7 * Row 1)

[9] Library Reference H-146

[E] (Row 9 * column [D]) / (Column [B] * column [C])

[F] Column [E] * column [A]

DDU Dropship Savings with Sack Shakeout Costs Removed
(\$ per piece)

USPS Witness Crum's Proposed DDU Dropship Discount **\$0.459** [1]

Postal Service using Daniel

Proportion	<u>Machinable</u> 93%	<u>Nonmachinable</u> 7%	<u>Total</u> 100%	
				[2]
Savings at BMC	\$0.275	\$0.544	\$0.294	[3]
Savings at DSCF	\$0.110	\$0.369	\$0.128	[4]
Savings at DDU				
Unload Bedload	\$0.008	\$0.046	\$0.010	[4]
Unload Loose in OTR	\$0.010	\$0.025	\$0.011	[4]
Unload OWC	\$0.005	\$0.013	\$0.005	[4]
Total Savings	\$0.407	\$0.996	\$0.448	[5]
Difference			\$0.011	[6]

[1] USPS-T-28, page 8. Mail processing costs avoided at the BMC (.294) + mail processing costs avoided at the DSCF and DDU (.165) totals .459

[2] Library Reference H-135

[3] USPS-T-28, Exhibit F, page 1

[4] USPS-T-29, Appendix V, pages 11 & 12, column 6

[5] Row [3] + Row [4]

[6] Row [1] - Row [5]

USPS WITNESS HATFIELD'S TEST YEAR PARCEL POST UNIT TRANSPORTATION COSTS
(dollars per cubic foot)

	Inter-BMC	Intra-BMC	DBMC (Non-DSCF)
Local	N/A	\$0.940	N/A
Zone 1/2	\$2.103	\$1.753	\$0.714
Zone 3	\$2.544	\$1.753	\$1.533
Zone 4	\$3.194	\$1.753	\$2.276
Zone 5	\$4.224	\$1.753	\$4.446
Zone 6	\$5.442	N/A	N/A
Zone 7	\$7.100	N/A	N/A
Zone 8	\$9.842	N/A	N/A

**PARCEL POST TEST YEAR UNIT TRANSPORTATION COSTS REVISED
TO REFLECT A CONSTANT DIFFERENCE BETWEEN INTER-BMC AND INTRA-BMC**
(dollars per cubic foot)

	Inter-BMC	Intra-BMC	DBMC (Non-DSCF)
Local	N/A	\$0.940	N/A
Zone 1/2	\$2.103	\$1.677	\$0.714
Zone 3	\$2.544	\$2.119	\$1.533
Zone 4	\$3.194	\$2.768	\$2.276
Zone 5	\$4.224	\$3.799	\$4.446
Zone 6	\$5.442	N/A	N/A
Zone 7	\$7.100	N/A	N/A
Zone 8	\$9.842	N/A	N/A

DIFFERENCE

	Inter-BMC	Intra-BMC	DBMC (Non-DSCF)
Local	N/A	(\$0.000)	N/A
Zone 1/2	(\$0.000)	(\$0.075)	\$0.000
Zone 3	(\$0.000)	\$0.366	(\$0.000)
Zone 4	\$0.000	\$1.016	(\$0.000)
Zone 5	\$0.000	\$2.046	(\$0.000)
Zone 6	\$0.000	N/A	N/A
Zone 7	\$0.000	N/A	N/A
Zone 8	\$0.000	N/A	N/A

Sources: USPS-T-16, Appendix III, pages 6 and 8 and UPS-T-4F, page 2.

Parcel Post Transportation Cost By Rate Category and Zone
Calculation of Intra-BMC Transportation Costs per Pound by Zone

Intra-BMC parcel transportation costs by function and distance relation

Local transportation costs incurred by Intra-BMC parcels (non-distance related)	1/	\$	17,828
Intermediate transportation costs incurred by Intra-BMC parcels (non-distance related)	2/	\$	21,355
Long distance transportation costs incurred by Intra-BMC parcels	3/	\$	-
Total Intra-BMC parcel transportation costs	4/	\$	39,182

	[1] Cubic Feet	[2] Average Local/ Intermediate Legs	[3] Average Cubic Foot Legs	[4] Percent	[5] Local Transportation Costs	[6] Intermediate Transportation Costs		
Local Zone	1,460,249	1	1,460,249	3.27%	487	699		
Non-local zone	21,572,870	2	43,145,740	96.73%	14,398	20,656		
Intra-city/box route adjustment 5/					2,942			
Total	23,033,119		44,605,989	100.00%	17,828	21,355		

Zone	[7] Local unit trans. costs (\$/cf)	[8] Intermediate unit trans. costs (\$/cf)	[9] Total Unit Trans. Costs (\$cf)	[10] Reconcile to total trans. costs (000)	[11] TY98 Cubic Feet by Zone	[12] Inter-BMC minus Intra BMC
Local	\$0.4615	\$0.4787	\$0.9402	\$1,373	1,460,249	
1-2	\$0.7952	\$0.8823	\$1.6774	\$31,344	18,685,824	\$0.4254
3	\$0.7952	\$1.3234	\$2.1186	\$5,050	2,383,554	\$0.4254
4	\$0.7952	\$1.9732	\$2.7684	\$1,336	482,631	\$0.4254
5	\$0.7952	\$3.0038	\$3.7989	\$79	20,861	\$0.4254
6	N/A	N/A	N/A	N/A	0	
7	N/A	N/A	N/A	N/A	0	
8	N/A	N/A	N/A	N/A	0	
Total				\$39,182	23,033,119	

Row 1/ USPS-T-16, Appendix I, page 13, row 19.

Row 2/ USPS-T-16, Appendix I, page 13, row 19.

Row 3/ USPS-T-16, Appendix I, page 13, row 19.

Row 4/ Row 1 + row 2 + row 3.

Row 5/ Row 1 * (1 - USPS-T-16, Appendix III, page 9, row 10).

Column [1]: USPS-T-16, Appendix II, page 9, column 2, intra-BMC cubic feet in the local zone and all other zones.

Column [2]: Local zone legs reflect half of the local parcels being held out at the AO. Non-local zone legs reflect typical intra-BMC parcel.

Column [3]: Column 1 * column 2.

Column [4]: Percentage of cubic foot legs from column 3.

Column [5]: (Row 1 - row 5) * column 4.

Column [6]: Row 2 * column 4.

Column [7]: Local zone unit cost = (local zone costs from column 5 / local zone cubic feet from column 1) + row 5 / total cubic feet.

Non-local zone unit cost = (non-local zone costs from column 5 / non-local zone cubic feet from column 1) + row 5 / total cubic feet.

Column [8]: Intra-BMC intermediate transportation costs were reallocated until the slope of total intra-BMC unit transportation costs matched that of total inter-BMC unit transportation costs. The local portion of intermediate transportation was not changed.

Column [9]: Column 7 + column 8.

Column [10]: Column 9 * column 11.

Column [11]: USPS-T-16, Appendix II, page 9, column 2 (intra-BMC cubic feet by zone).

Column [12]: USPS-T-16 Appendix III, page 6, column 11 (inter-BMC total unit transportation costs) - column 9.

Average TYBR Non-Transportation Cost per Piece
for Intra-BMC and Inter-BMC Parcel Post

		Source
[1] TYBR Non-Transportation Costs	\$411,492,180	USPS-T-37 WP I.I., page 2.
[2] DBMC NT Cost Saving per Piece	\$ 0.366	Table 11.
[3] DBMC Volume	136,730,338	USPS-T-37 WP I.A., page 1.
[4] DBMC Cost Savings	\$ 50,043,304	[2] * [3].
[5] DSCF NT Cost Saving per Piece	\$ 0.248	Table 11.
[6] DSCF Existing Volume	7,978,299	USPS-T-37 WP I.A., page 21-22.
[7] DSCF Cost Savings	\$ 1,978,618	[5] * [6].
[8] DDU NT Cost Saving per Piece	\$ 0.448	Table 11.
[9] DDU Existing Volume	958,192	USPS-T-37 WP I.A., page 23.
[10] DDU Cost Savings	\$ 429,270	[8] * [9].
[11] TOTAL DBMC/DSCF/DDU Cost Savings	\$ 52,451,192	[4] + [7] + [10].
[12] Adjusted TYBR NT Costs	\$463,943,372	[1] + [11].
[13] Parcel Post Volume	241,599,000	USPS-T-37 WP I.A., page 1.
[14] Average NT Cost per Piece	\$ 1.92030	[12] / [13].

Per Piece and Per Pound Components
for DBMC, DSCF, and DDU Non-Transportation

[1] \$0.02 * Contingency * Markup	\$ 0.02323	Contingency = 1.01, Markup Factor = USPS-T-37, WP I.I., page 2, Line 8.
[2] Average NT Cost per Piece	\$ 1.92030	From above.
[3] DBMC NT Discount	\$ 0.28200	Table 11.
[4] DBMC NT per Pound Component	\$ 0.00341	[(1) / (2)] * [3].
[5] DBMC NT per Piece Component	\$ 0.26440	[3] - ([4] * [12]).
[6] DSCF NT Discount	\$ 0.19100	Table 11.
[7] DSCF NT per Pound Component	\$ 0.00231	[(1) / (2)] * [6].
[8] DSCF NT per Piece Component	\$ 0.17908	[6] - ([7] * [12]).
[9] DDU NT Discount	\$ 0.34500	Table 11.
[10] DDU NT per Pound Component	\$ 0.00417	[(1) / (2)] * [9].
[11] DDU NT per Piece Component	\$ 0.32347	[9] - ([10] * [12]).
[12] Average Postal Pounds (Dropshipped)	5.15836	USPS-T-37 WP I.B., page 2 DBMC Total Postage Pounds / Total Volume.

Table 1
Parcel Post
Recommended Intra-BMC Rates
(Dollars)

Weight (Pounds)	Local	Zones 1 & 2	Zone 3	Zone 4	Zone 5
2	\$2.75	\$2.94	\$3.05	\$3.23	\$3.50
3	\$2.90	\$3.20	\$3.38	\$3.65	\$4.05
4	\$3.04	\$3.44	\$3.68	\$4.03	\$4.59
5	\$3.19	\$3.68	\$3.96	\$4.39	\$5.08
6	\$3.32	\$3.89	\$4.23	\$4.73	\$5.53
7	\$3.44	\$4.09	\$4.47	\$5.05	\$5.95
8	\$3.55	\$4.28	\$4.71	\$5.34	\$6.35
9	\$3.67	\$4.45	\$4.92	\$5.62	\$6.74
10	\$3.77	\$4.62	\$5.14	\$5.88	\$7.12
11	\$3.87	\$4.72	\$5.33	\$6.14	\$7.47
12	\$3.97	\$4.84	\$5.52	\$6.37	\$7.80
13	\$4.07	\$4.95	\$5.70	\$6.60	\$8.11
14	\$4.15	\$5.05	\$5.87	\$6.82	\$8.41
15	\$4.24	\$5.14	\$6.04	\$7.03	\$8.68
16	\$4.32	\$5.23	\$6.19	\$7.22	\$8.96
17	\$4.40	\$5.33	\$6.34	\$7.42	\$9.21
18	\$4.47	\$5.41	\$6.49	\$7.60	\$9.47
19	\$4.55	\$5.51	\$6.63	\$7.77	\$9.69
20	\$4.63	\$5.59	\$6.76	\$7.95	\$9.91
21	\$4.70	\$5.66	\$6.89	\$8.10	\$10.13
22	\$4.76	\$5.75	\$7.02	\$8.26	\$10.34
23	\$4.83	\$5.83	\$7.14	\$8.42	\$10.53
24	\$4.89	\$5.89	\$7.26	\$8.56	\$10.71
25	\$4.95	\$5.96	\$7.37	\$8.70	\$10.90
26	\$5.03	\$6.03	\$7.49	\$8.85	\$11.07
27	\$5.09	\$6.11	\$7.59	\$8.98	\$11.23
28	\$5.14	\$6.17	\$7.70	\$9.11	\$11.40
29	\$5.20	\$6.24	\$7.80	\$9.24	\$11.56
30	\$5.26	\$6.30	\$7.90	\$9.37	\$11.71
31	\$5.31	\$6.38	\$8.00	\$9.49	\$11.86
32	\$5.37	\$6.44	\$8.09	\$9.60	\$12.00
33	\$5.42	\$6.50	\$8.18	\$9.71	\$12.14
34	\$5.47	\$6.56	\$8.27	\$9.83	\$12.28
35	\$5.53	\$6.62	\$8.37	\$9.94	\$12.41
36	\$5.58	\$6.68	\$8.45	\$10.04	\$12.54
37	\$5.63	\$6.73	\$8.53	\$10.14	\$12.67
38	\$5.68	\$6.79	\$8.61	\$10.24	\$12.81
39	\$5.73	\$6.85	\$8.69	\$10.34	\$12.93
40	\$5.77	\$6.90	\$8.77	\$10.44	\$13.05
41	\$5.82	\$6.97	\$8.85	\$10.53	\$13.18
42	\$5.86	\$7.02	\$8.93	\$10.62	\$13.30
43	\$5.91	\$7.06	\$9.00	\$10.71	\$13.41
44	\$5.95	\$7.12	\$9.07	\$10.80	\$13.52
45	\$6.01	\$7.17	\$9.14	\$10.89	\$13.62
46	\$6.05	\$7.23	\$9.22	\$10.97	\$13.74
47	\$6.09	\$7.29	\$9.29	\$11.05	\$13.84
48	\$6.14	\$7.33	\$9.36	\$11.13	\$13.94
49	\$6.18	\$7.38	\$9.43	\$11.21	\$14.04

Table 1
Parcel Post
Recommended Intra-BMC Rates
(Dollars)

Weight (Pounds)	Local	Zones 1 & 2	Zone 3	Zone 4	Zone 5
50	\$6.22	\$7.42	\$9.49	\$11.29	\$14.15
51	\$6.26	\$7.48	\$9.56	\$11.37	\$14.24
52	\$6.30	\$7.52	\$9.62	\$11.44	\$14.34
53	\$6.34	\$7.57	\$9.68	\$11.52	\$14.43
54	\$6.38	\$7.61	\$9.74	\$11.59	\$14.52
55	\$6.42	\$7.66	\$9.80	\$11.66	\$14.61
56	\$6.46	\$7.72	\$9.87	\$11.74	\$14.70
57	\$6.50	\$7.76	\$9.92	\$11.80	\$14.78
58	\$6.54	\$7.81	\$9.98	\$11.87	\$14.87
59	\$6.58	\$7.85	\$10.03	\$11.94	\$14.95
60	\$6.62	\$7.90	\$10.09	\$12.00	\$15.03
61	\$6.65	\$7.96	\$10.14	\$12.06	\$15.12
62	\$6.69	\$8.00	\$10.20	\$12.13	\$15.19
63	\$6.72	\$8.03	\$10.25	\$12.19	\$15.27
64	\$6.76	\$8.08	\$10.31	\$12.26	\$15.35
65	\$6.80	\$8.12	\$10.36	\$12.32	\$15.42
66	\$6.83	\$8.18	\$10.41	\$12.38	\$15.49
67	\$6.87	\$8.22	\$10.46	\$12.44	\$15.57
68	\$6.90	\$8.25	\$10.51	\$12.49	\$15.64
69	\$6.94	\$8.30	\$10.56	\$12.55	\$15.71
70	\$6.98	\$8.34	\$10.61	\$12.61	\$15.78

Notes:

- 1 For prebarcoded mail, deduct \$0.02 per piece.
- 2 Pieces with combined length and girth exceeding 84 inches and weight under 15 pounds pay the applicable 15-pound rate.
- 3 Pieces exceeding 108 inches in combined length and girth pay the applicable 70-pound rate.
- 4 For each pickup stop, add \$8.25.
- 5 Add \$0.50 per piece for hazardous medical materials and \$1.00 per piece for other mailable hazardous materials.

Source: UPS-Luciani-WP-3

Table 2
Parcel Post
Recommended Machinable Inter-BMC Rates
(Dollars)

Weight (Pounds)	Zones 1 & 2	Zone 3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8
2	\$3.60	\$3.73	\$3.94	\$4.26	\$4.40	\$4.40	\$4.40
3	\$3.97	\$4.20	\$4.51	\$5.01	\$5.61	\$5.89	\$5.89
4	\$4.28	\$4.62	\$5.04	\$5.71	\$6.50	\$7.38	\$7.38
5	\$4.43	\$5.00	\$5.53	\$6.34	\$7.30	\$8.62	\$8.87
6	\$4.57	\$5.29	\$5.96	\$6.91	\$8.04	\$9.58	\$11.85
7	\$4.71	\$5.53	\$6.37	\$7.46	\$8.72	\$10.46	\$13.33
8	\$4.86	\$5.74	\$6.75	\$7.95	\$9.36	\$11.28	\$14.44
9	\$4.96	\$5.95	\$7.10	\$8.40	\$9.94	\$12.02	\$15.47
10	\$5.10	\$6.14	\$7.43	\$8.82	\$10.48	\$12.72	\$16.42
11	\$5.20	\$6.33	\$7.73	\$9.22	\$10.98	\$13.37	\$17.31
12	\$5.32	\$6.51	\$8.02	\$9.59	\$11.45	\$13.97	\$18.14
13	\$5.42	\$6.66	\$8.28	\$9.94	\$11.89	\$14.53	\$18.92
14	\$5.53	\$6.84	\$8.54	\$10.26	\$12.30	\$15.06	\$19.64
15	\$5.62	\$6.99	\$8.77	\$10.57	\$12.69	\$15.57	\$20.33
16	\$5.71	\$7.14	\$9.00	\$10.86	\$13.05	\$16.04	\$20.96
17	\$5.81	\$7.27	\$9.21	\$11.13	\$13.39	\$16.47	\$21.82
18	\$5.89	\$7.41	\$9.42	\$11.39	\$13.72	\$16.89	\$22.40
19	\$5.99	\$7.54	\$9.61	\$11.63	\$14.03	\$17.29	\$23.25
20	\$6.06	\$7.66	\$9.79	\$11.87	\$14.32	\$17.66	\$23.84
21	\$6.14	\$7.79	\$9.97	\$12.09	\$14.60	\$18.02	\$24.41
22	\$6.23	\$7.90	\$10.13	\$12.30	\$14.86	\$18.35	\$24.96
23	\$6.30	\$8.03	\$10.28	\$12.50	\$15.12	\$18.68	\$25.47
24	\$6.36	\$8.14	\$10.44	\$12.70	\$15.36	\$18.99	\$25.97
25	\$6.44	\$8.24	\$10.58	\$12.88	\$15.59	\$19.28	\$26.45
26	\$6.51	\$8.34	\$10.72	\$13.05	\$15.81	\$19.56	\$26.91
27	\$6.59	\$8.45	\$10.86	\$13.22	\$16.01	\$19.82	\$27.34
28	\$6.65	\$8.55	\$10.98	\$13.38	\$16.22	\$20.08	\$27.77
29	\$6.72	\$8.66	\$11.10	\$13.53	\$16.41	\$20.33	\$28.17
30	\$6.78	\$8.75	\$11.22	\$13.69	\$16.60	\$20.56	\$28.57
31	\$6.85	\$8.82	\$11.34	\$13.83	\$16.77	\$20.78	\$28.94
32	\$6.91	\$8.93	\$11.45	\$13.96	\$16.94	\$21.00	\$29.30
33	\$6.97	\$9.01	\$11.55	\$14.09	\$17.11	\$21.20	\$29.66
34	\$7.03	\$9.09	\$11.65	\$14.23	\$17.27	\$21.41	\$30.00
35	\$7.09	\$9.18	\$11.76	\$14.35	\$17.41	\$21.60	\$30.33
36	\$7.15	\$9.25	\$11.85	\$14.47	\$17.57	\$21.78	\$30.64
37	\$7.21	\$9.33	\$11.94	\$14.58	\$17.70	\$21.96	\$30.94
38	\$7.27	\$9.42	\$12.03	\$14.70	\$17.84	\$22.12	\$31.24
39	\$7.33	\$9.49	\$12.11	\$14.80	\$17.98	\$22.29	\$31.53
40	\$7.38	\$9.57	\$12.19	\$14.90	\$18.10	\$22.45	\$31.81
41	\$7.45	\$9.66	\$12.28	\$15.00	\$18.22	\$22.60	\$32.07
42	\$7.49	\$9.71	\$12.36	\$15.10	\$18.33	\$22.75	\$32.33
43	\$7.54	\$9.79	\$12.44	\$15.20	\$18.46	\$22.89	\$32.58
44	\$7.60	\$9.85	\$12.51	\$15.28	\$18.56	\$23.02	\$32.83
45	\$7.64	\$9.92	\$12.58	\$15.37	\$18.67	\$23.15	\$33.06
46	\$7.70	\$10.00	\$12.65	\$15.45	\$18.77	\$23.29	\$33.30
47	\$7.76	\$10.06	\$12.73	\$15.55	\$18.87	\$23.41	\$33.52
48	\$7.81	\$10.13	\$12.79	\$15.62	\$18.97	\$23.53	\$33.73
49	\$7.85	\$10.19	\$12.85	\$15.70	\$19.06	\$23.64	\$33.95

Table 2
Parcel Post
Recommended Machinable Inter-BMC Rates
(Dollars)

Weight (Pounds)	Zones 1 & 2	Zone 3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8
50	\$7.90	\$10.25	\$12.92	\$15.78	\$19.15	\$23.76	\$34.15
51	\$7.96	\$10.31	\$12.98	\$15.85	\$19.24	\$23.86	\$34.35
52	\$8.00	\$10.39	\$13.03	\$15.92	\$19.32	\$23.97	\$34.54
53	\$8.05	\$10.44	\$13.09	\$15.99	\$19.41	\$24.07	\$34.74
54	\$8.09	\$10.50	\$13.16	\$16.06	\$19.49	\$24.17	\$34.92
55	\$8.14	\$10.55	\$13.21	\$16.13	\$19.57	\$24.27	\$35.10
56	\$8.20	\$10.62	\$13.27	\$16.19	\$19.65	\$24.36	\$35.27
57	\$8.24	\$10.68	\$13.32	\$16.25	\$19.72	\$24.44	\$35.44
58	\$8.28	\$10.73	\$13.37	\$16.31	\$19.79	\$24.53	\$35.60
59	\$8.33	\$10.79	\$13.42	\$16.37	\$19.87	\$24.65	\$35.76
60	\$8.37	\$10.85	\$13.47	\$16.43	\$19.93	\$24.75	\$35.92
61	\$8.43	\$10.91	\$13.51	\$16.48	\$20.00	\$24.86	\$36.07
62	\$8.48	\$10.95	\$13.56	\$16.55	\$20.06	\$24.97	\$36.22
63	\$8.51	\$11.01	\$13.61	\$16.60	\$20.12	\$25.06	\$36.37
64	\$8.55	\$11.06	\$13.66	\$16.65	\$20.18	\$25.18	\$36.50
65	\$8.60	\$11.12	\$13.70	\$16.70	\$20.24	\$25.27	\$36.64
66	\$8.66	\$11.18	\$13.75	\$16.75	\$20.30	\$25.36	\$36.77
67	\$8.70	\$11.22	\$13.79	\$16.80	\$20.36	\$25.46	\$36.91
68	\$8.73	\$11.26	\$13.83	\$16.84	\$20.42	\$25.54	\$37.04
69	\$8.78	\$11.31	\$13.87	\$16.89	\$20.47	\$25.65	\$37.15
70	\$8.82	\$11.38	\$13.91	\$16.94	\$20.52	\$25.73	\$37.28

Notes:

- 1 For nonmachinable inter-BMC parcels, add \$1.90 per piece.
- 2 For each pickup stop, add \$8.25.
- 3 For OBMC discount, deduct \$0.448 per piece.
- 4 For BMC presort, deduct \$0.162 per piece.
- 5 For prebarcoded mail, deduct \$0.02 per piece.
- 6 Pieces with combined length and girth exceeding 84 inches and weight under 15 pounds pay the applicable 15-pound rate.
- 7 Pieces exceeding 108 inches in combined length and girth pay the applicable 70-pound rate.
- 8 Add \$0.50 per piece for hazardous medical materials and \$1.00 per piece for other mailable hazardous materials.

Source: UPS-Luciani-WP-3

Table 3
Parcel Post
Recommended Destination BMC Rates
(Dollars)

Weight (Pounds)	Zones 1 & 2	Zone 3	Zone 4	Zone 5
2	\$2.47	\$2.72	\$2.90	\$3.17
3	\$2.63	\$3.05	\$3.32	\$3.72
4	\$2.80	\$3.35	\$3.70	\$4.26
5	\$2.96	\$3.63	\$4.06	\$4.75
6	\$3.09	\$3.90	\$4.40	\$5.20
7	\$3.23	\$4.14	\$4.72	\$5.62
8	\$3.36	\$4.38	\$5.01	\$6.02
9	\$3.47	\$4.59	\$5.29	\$6.41
10	\$3.58	\$4.81	\$5.55	\$6.79
11	\$3.70	\$4.99	\$5.81	\$7.14
12	\$3.80	\$5.18	\$6.04	\$7.47
13	\$3.89	\$5.35	\$6.27	\$7.78
14	\$3.99	\$5.53	\$6.49	\$8.08
15	\$4.08	\$5.68	\$6.70	\$8.35
16	\$4.16	\$5.82	\$6.89	\$8.63
17	\$4.25	\$5.97	\$7.09	\$8.88
18	\$4.32	\$6.11	\$7.27	\$9.14
19	\$4.40	\$6.25	\$7.44	\$9.36
20	\$4.48	\$6.37	\$7.62	\$9.58
21	\$4.54	\$6.50	\$7.77	\$9.80
22	\$4.62	\$6.62	\$7.93	\$10.01
23	\$4.69	\$6.73	\$8.09	\$10.20
24	\$4.76	\$6.84	\$8.23	\$10.38
25	\$4.82	\$6.96	\$8.37	\$10.57
26	\$4.88	\$7.06	\$8.52	\$10.74
27	\$4.94	\$7.16	\$8.65	\$10.90
28	\$5.00	\$7.26	\$8.78	\$11.07
29	\$5.07	\$7.35	\$8.91	\$11.23
30	\$5.13	\$7.45	\$9.04	\$11.38
31	\$5.17	\$7.54	\$9.16	\$11.53
32	\$5.23	\$7.62	\$9.27	\$11.67
33	\$5.28	\$7.71	\$9.38	\$11.81
34	\$5.33	\$7.79	\$9.50	\$11.95
35	\$5.39	\$7.87	\$9.61	\$12.08
36	\$5.44	\$7.96	\$9.71	\$12.21
37	\$5.48	\$8.03	\$9.81	\$12.34
38	\$5.54	\$8.10	\$9.91	\$12.48
39	\$5.58	\$8.18	\$10.01	\$12.60
40	\$5.63	\$8.25	\$10.11	\$12.72
41	\$5.67	\$8.31	\$10.20	\$12.85
42	\$5.72	\$8.40	\$10.29	\$12.97
43	\$5.76	\$8.46	\$10.38	\$13.08
44	\$5.81	\$8.53	\$10.47	\$13.19
45	\$5.85	\$8.59	\$10.56	\$13.29
46	\$5.89	\$8.65	\$10.64	\$13.41
47	\$5.93	\$8.72	\$10.72	\$13.51
48	\$5.97	\$8.77	\$10.80	\$13.61
49	\$6.02	\$8.83	\$10.88	\$13.71

Table 3
Parcel Post
Recommended Destination BMC Rates
(Dollars)

Weight (Pounds)	Zones 1 & 2	Zone 3	Zone 4	Zone 5
50	\$6.06	\$8.90	\$10.96	\$13.82
51	\$6.10	\$8.96	\$11.04	\$13.91
52	\$6.13	\$9.01	\$11.11	\$14.01
53	\$6.18	\$9.07	\$11.19	\$14.10
54	\$6.21	\$9.12	\$11.26	\$14.19
55	\$6.24	\$9.19	\$11.33	\$14.28
56	\$6.28	\$9.24	\$11.41	\$14.37
57	\$6.32	\$9.28	\$11.47	\$14.45
58	\$6.35	\$9.35	\$11.54	\$14.54
59	\$6.39	\$9.39	\$11.61	\$14.62
60	\$6.42	\$9.45	\$11.67	\$14.70
61	\$6.47	\$9.49	\$11.73	\$14.79
62	\$6.50	\$9.54	\$11.80	\$14.86
63	\$6.53	\$9.59	\$11.86	\$14.94
64	\$6.57	\$9.63	\$11.93	\$15.02
65	\$6.60	\$9.68	\$11.99	\$15.09
66	\$6.64	\$9.72	\$12.05	\$15.16
67	\$6.66	\$9.76	\$12.11	\$15.24
68	\$6.69	\$9.81	\$12.16	\$15.31
69	\$6.73	\$9.86	\$12.22	\$15.38
70	\$6.76	\$9.91	\$12.28	\$15.45

Notes:

- 1 For prebarcoded mail, deduct \$0.02 per piece.
- 2 Pieces with combined length and girth exceeding 84 inches and weight under 15 pounds pay the applicable 15-pound rate.
- 3 Pieces exceeding 108 inches in combined length and girth pay the applicable 70-pound rate.
- 4 Add \$0.50 per piece for hazardous medical materials and \$1.00 per piece for other mailable hazardous materials.

Source: UPS-Luciani-WP-3

Table 4
Parcel Post
Recommended Destination SCF and
Destination Delivery Unit Rates
(Dollars)

Weight (Pounds)	DSCF Rates	DDU Rates
2	\$2.12	\$1.77
3	\$2.25	\$1.85
4	\$2.39	\$1.93
5	\$2.51	\$2.01
6	\$2.61	\$2.07
7	\$2.72	\$2.14
8	\$2.83	\$2.21
9	\$2.91	\$2.25
10	\$3.00	\$2.31
11	\$3.10	\$2.37
12	\$3.17	\$2.43
13	\$3.24	\$2.47
14	\$3.32	\$2.53
15	\$3.40	\$2.57
16	\$3.45	\$2.61
17	\$3.53	\$2.66
18	\$3.58	\$2.69
19	\$3.65	\$2.73
20	\$3.71	\$2.78
21	\$3.76	\$2.80
22	\$3.83	\$2.84
23	\$3.87	\$2.89
24	\$3.93	\$2.92
25	\$3.98	\$2.96
26	\$4.03	\$2.98
27	\$4.08	\$3.02
28	\$4.13	\$3.05
29	\$4.19	\$3.10
30	\$4.24	\$3.13
31	\$4.26	\$3.15
32	\$4.31	\$3.18
33	\$4.36	\$3.21
34	\$4.39	\$3.23
35	\$4.44	\$3.28
36	\$4.48	\$3.30
37	\$4.52	\$3.32
38	\$4.56	\$3.36
39	\$4.60	\$3.38
40	\$4.64	\$3.41
41	\$4.67	\$3.43
42	\$4.71	\$3.46
43	\$4.74	\$3.48
44	\$4.79	\$3.52
45	\$4.81	\$3.53
46	\$4.85	\$3.56
47	\$4.88	\$3.58
48	\$4.92	\$3.61

Table 4
Parcel Post
Recommended Destination SCF and
Destination Delivery Unit Rates
(Dollars)

Weight (Pounds)	DSCF Rates	DDU Rates
49	\$4.95	\$3.64
50	\$4.99	\$3.67
51	\$5.03	\$3.69
52	\$5.05	\$3.70
53	\$5.09	\$3.74
54	\$5.11	\$3.75
55	\$5.14	\$3.77
56	\$5.17	\$3.79
57	\$5.20	\$3.82
58	\$5.23	\$3.83
59	\$5.26	\$3.86
60	\$5.28	\$3.88
61	\$5.33	\$3.92
62	\$5.35	\$3.93
63	\$5.38	\$3.95
64	\$5.41	\$3.97
65	\$5.44	\$4.00
66	\$5.47	\$4.02
67	\$5.48	\$4.02
68	\$5.51	\$4.05
69	\$5.54	\$4.07
70	\$5.57	\$4.09

Notes:

- 1 Pieces with combined length and girth exceeding 84 inches and weight under 15 pounds pay the applicable 15-pound rate.
- 2 Pieces exceeding 108 inches in combined length and girth pay the applicable 70-pound rate.
- 3 Add \$0.50 per piece for hazardous medical materials and \$1.00 per piece for other mailable hazardous materials.

Source: UPS-Luciani-WP-3

1 CHAIRMAN GLEIMAN: Mr. Luciani, have you had an
2 opportunity to examine the packet of designated written
3 cross-examination that was made available earlier today?

4 THE WITNESS: Yes, I did.

5 CHAIRMAN GLEIMAN: And if these questions were
6 asked of you today, would your answers be the same as those
7 you previously provided in writing?

8 THE WITNESS: Yes, they would.

9 CHAIRMAN GLEIMAN: That being the case, I am going
10 to provide two copies of the designated written
11 cross-examination of the witness to the reporter and direct
12 that they be accepted into evidence and transcribed into the
13 record at this point.

14 [Designation of Written
15 Cross-Examination of Ralph L.
16 Luciani, UPS-T-4, was received into
17 evidence and transcribed into the
18 record.]

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 1997

Docket No. R97-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED PARCEL SERVICE
WITNESS RALPH L. LUCIANI
(UPS-T4)

Party

Nashua Photo Inc., District Photo Inc.,
Mystic Color Lab, and Seattle
Filmworks, Inc.

Interrogatories

NDMS/UPS-T4-1
NDMS/UPS-T2-1 redirected to T4

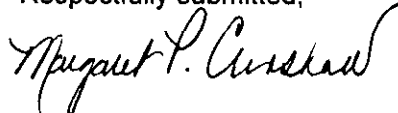
Parcel Shippers Association

PSA/UPS-T4-1-4

United States Postal Service

USPS/UPS-T4-1-26, 28-32, 34-53

Respectfully submitted,



Margaret P. Crenshaw
Secretary

INTERROGATORY RESPONSES OF
UNITED PARCEL SERVICE
WITNESS RALPH L. LUCIANI (T4)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory:

NDMS/UPS-T2-1 rd. to T4

NDMS/UPS-T4-1

PSA/UPS-T4-1

PSA/UPS-T4-2

PSA/UPS-T4-3

PSA/UPS-T4-4

USPS/UPS-T4-1

USPS/UPS-T4-2

USPS/UPS-T4-3

USPS/UPS-T4-4

USPS/UPS-T4-5

USPS/UPS-T4-6

USPS/UPS-T4-7

USPS/UPS-T4-8

USPS/UPS-T4-9

USPS/UPS-T4-10

USPS/UPS-T4-11

USPS/UPS-T4-12

USPS/UPS-T4-13

USPS/UPS-T4-14

USPS/UPS-T4-15

USPS/UPS-T4-16

USPS/UPS-T4-17

USPS/UPS-T4-18

USPS/UPS-T4-19

USPS/UPS-T4-20

Designating Parties:

NDMS

NDMS

PSA

PSA

PSA

PSA

USPS

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Interrogatory:

USPS/UPS-T4-53

Designating Parties:

USPS

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, AND SEATTLE FILMWORKS, INC.**

NDMS/UPS-T4-1. Please refer to the portion of your testimony proposing a surcharge on Priority Mail parcels (UPS-T-4, pages 42-45).

a. Where in your testimony do you describe which pieces of Priority Mail would be subject to UPS' proposed surcharge?

b. i. Are you proposing that the parcel surcharge apply in all Priority Mail rate categories, zoned and unzoned, at all weights?

ii. If so, please explain why it makes sense to impose a \$0.10 surcharge on, for example, a 50-, 60- or 70-pound Priority Mail parcel, given the fact that there are no 50-, 60- or 70-pound flats?

c. Did you consider the possibility of eliminating the 4-cents-per-pound charge built into the rate schedule (as discussed in your testimony at page 44) and instead imposing a 20 cent surcharge on all Priority Mail parcels?

i. If not, why not?

ii. If so, why did you not recommend it?

d. Would you agree that the 4-cents-per-pound charge fully compensates for the extra cost of parcels that weigh 5 pounds or more? Please explain fully any answer which is not unqualifiedly in the affirmative.

Response to NDMS/UPS-T4-1. (a) All Priority Mail parcels would be assessed the surcharge that I recommend.

(b) Yes. The surcharge is based on the fact that the parcel shape is more expensive to process than the flat shape. As such, it applies to all parcels regardless of other characteristics.

(c) I considered this possibility, but chose not to recommend it because it would require breaking with the traditional practice of assigning 2 cents per

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, AND SEATTLE FILMWORKS, INC.**

pound for non-transportation weighted related costs in Priority Mail, Parcel Post, Express Mail, and other subclasses.

(d) No. The 10.2 cent difference between the parcel shape and the flat shape that I identify already takes into account the impact of the non-transportation weight-related charge. With the surcharge taken into account, the weight-related non-transportation charge assigned to any particular parcel or any particular flat would be solely due to weight.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, AND SEATTLE FILMWORKS, INC.**

NDMS/UPS-T2-1. Please refer to your testimony concerning Priority Mail cost differences by shape (UPS-T-2, starting at page 18, line 4).

a. Please confirm that, if a surcharge were imposed on Priority Mail parcels, the purported "extra cost" of handling parcels would be subtracted from the total nontransportation cost when calculating the base unit cost, leading to a lower base unit cost for all Priority Mail. If you do not confirm, please explain how these "extra costs" could be simultaneously (i) passed through in the form of a surcharge on parcels and (ii) included in the base unit cost for all Priority Mail, including parcels.

b. i. Please confirm that, using the Postal Service attribution of mail processing costs, the estimated cost differential between flats and parcels is \$0.1265 (after piggyback and wage adjustments, see Workpaper UPS-Sellick-1-III-A, p. 1). If you do not confirm, please explain.

ii. Please confirm that subtracting the difference in the average weight-related nontransportation costs for flats and parcels (\$0.0928) (UPS-T-4, p. 44) results in a supposed unaccounted-for cost differential between flats and parcels of \$0.0337. If you do not confirm, please explain.

c. For the following questions, assume that a parcel surcharge is imposed based on the purported unaccounted-for differential between flats and parcels of \$0.0337:

i. Please confirm that since the costs passed through the parcel surcharge would no longer be included in the base unit cost calculation, the resulting base unit cost for non-parcel Priority Mail would be less than the base unit cost if the surcharge was not imposed. If you do not confirm, please explain.

ii. Please confirm that the resulting per-piece cost for Priority Mail parcels (the base per-piece cost plus the parcel surcharge) would be less than \$0.0337

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, AND SEATTLE FILMWORKS, INC.**

greater than the Priority Mail per-piece transportation cost without a surcharge. If you do not confirm, please explain.

d. i. Please confirm that, historically, Priority Mail rates have been rounded to the nearest nickel. If you do not confirm, please explain.

ii. In view of this rounding, if the Postal Service costs are adopted, please explain why the Commission should adopt a parcel surcharge.

Response to NDMS/UPS-T2-1 (Redirected from witness Sellick). (a) Not confirmed. The non-transportation cost per piece (including markup and contingency) for Priority Mail in aggregate would be unchanged. Using the volume shares for parcels and flats in Priority Mail, the non-transportation cost per piece (including markup and contingency) for parcels and for flats would be derived. Based on my recommendation, the non-transportation cost per piece for parcels would be 10 cents higher than that for flats. The non-transportation cost per piece (including markup and contingency) for flats would then be used to design Priority Mail rates. All parcels would receive a 10 cents per piece surcharge.

(b)(i) Confirmed.

(ii) Not confirmed. To perform the calculation in this manner, one should remove the contingency and mark-up (which are artifacts of the rate design process) from the non-transportation weight-related cost. This would leave 8.01 cents per piece in unaccounted for costs.

(c)(i) Confirmed. See my response to (a).

(ii) The transportation costs for Priority Mail range from \$0.374 per pound to \$1.129 per pound, according to USPS-330. Without further specification of weight and zone, I am unable to say one way or the other how the transportation cost for any particular piece compares to the per piece cost.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, AND SEATTLE FILMWORKS, INC.**

If the word transportation was not meant to be in the question, then the answer is not confirmed. The cost per piece for parcels would be 3.37 cents per piece above that of non-parcel shaped Priority Mail after the adjustment.

(d)(i) Confirmed.

(ii) If the Postal Service's costs are adopted, then I recommend that the surcharge be set at five cents per piece by rounding the surcharge to the nearest nickel. This would also better reflect that there are 8.01 cents of unaccounted for cost differences between Priority Mail parcels and Priority Mail flats.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T4-1. On pages 22 and 23 of your testimony you criticize the Postal Service's proposed passthrough of 98% to 100% of the estimated mail processing costs savings in its proposed discounts, citing to the fact that in Docket No. R90-1 and Docket R94-1, the PRC only allowed a passthrough of 77% of the identified DBMC nontransportation cost savings. You ascribe the Commission's reasoning to the uncertainties surrounding the cost savings and state on page 23 that "the uncertainty surrounding the worksharing program has not diminished." Please document your statement that the uncertainty of DBMC cost savings has not diminished from the inception of the DBMC program.

Response to PSA/UPS-T4-1. See my response to USPS/UPS-T4-11(a).

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE PARCEL SHIPPERS ASSOCIATION**

14365

PSA/UPS-T4-2. In your Table 14 on page 22 of your testimony, where you list your revised parcel post worksharing avoided costs and discounts, you have assumed a 100% mail processing labor cost variability, but have only passed through 77% of the avoided cost to compute your discount. Please explain how a particular mail processing labor cost, if it is 100% variable with volume, will not be avoided 100% if that labor is not performed on a parcel that bypasses that function.

Response to PSA/UPS-T4-2. Table 14 is on page 42 of my testimony. The passthrough percentage is always applied to the attributed cost that has been identified as avoided. This is true whether mail processing variabilities are assumed to be 100% or not. The revised avoided costs contained in Table 7 on page 31 of my testimony and the revised avoided costs contained in Table 14 are attributed costs. Application of a passthrough percentage to these attributed costs is standard Commission practice.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE PARCEL SHIPPERS ASSOCIATION**

14366

PSA/UPS-T4-3. On page 24 of your testimony you dispute that the overall parcel post increase is 10.2%, claiming, rather, that it is 8.5% when the new rate discounts are taken into consideration. Please confirm that a mailer who receives a 20% rate discount for new worksharing and dropshipping, but who then must incur an additional 30% increase in costs for mail preparation and transportation, will have effectively received a 10% increase in postal rates. If you cannot confirm, please explain why you disagree with the statement for reasons other than the fact that you may disbelieve the hypotheses.

Response to PSA/UPS-T4-3. I am unable to confirm. A 20% decrease followed by a 30% increase yields a net increase of 4% $[(1 - 20\%) * (1 + 30\%)]$. The revenue per piece figures shown on Table 8 of my testimony are the total revenues per piece by rate category before and after the proposed rate increase. For example, the DSCF rate category will have a total revenue per piece decrease of 20.3% under the Postal Service's proposal. This includes both the impact of the new worksharing discount and all other changes to Parcel Post costs.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE PARCEL SHIPPERS ASSOCIATION**

14367

PSA/UPS-T4-4. On page 25 of your testimony, you state that "96% of the volume that will qualify for the prebarcode discount is already being prebarcoded." Please supply any studies UPS has conducted to document your 96% claim, or cite to any studies that have been admitted into evidence in this proceeding if you are relying on studies or data produced by someone other than United Parcel Service.

Response to PSA/UPS-T4-4. I am not a lawyer and cannot address whether documents have been "admitted into evidence in this proceeding." However, I have used only that data which has been presented and relied upon by Postal Service witnesses. The 96% figure was used by Ms. Mayes in her workpapers to derive Parcel Post rates. She obtained the 96% figure from LR-H-163, "Fourth Class Market Research Study."

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-1. Please refer to your testimony at pages 6-7. Please explain your rationale for excluding mail preparation costs from the pool of outgoing mail processing costs that DBMC avoids.

Response to USPS/UPS-T4-1. The exclusion is based on the testimony of Mr. Acheson in Docket No. R90-1. The Postal Service has not explained what, if anything, has changed that would make this exclusion appropriate in Docket No. R90-1 (and in Docket No. MC97-2), but not in this proceeding. Moreover, it is likely that outgoing mail preparation costs at non-BMCs are associated with local intra-BMC parcels that do not travel to the BMC. Such costs would not be part of the difference in processing costs between a parcel that travels on the origin legs to the BMC and a DBMC parcel that is entered at the BMC.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-2. Please refer to your testimony at page 7. Please explain exactly how you believe "window and acceptance costs" are overstated or double-counted because of the decision not to exclude platform acceptance from the pool of outgoing mail processing dollars that DBMC avoids. Please state the level of this suggested overstatement in cents.

Response to USPS/UPS-T4-2. My testimony states that avoided window and acceptance cost savings are double-counted. The acceptance cost savings for DBMC parcels were computed by Mr. Crum in USPS-T-28, Exhibit A, by taking into account the difference in the cost of platform acceptance (i.e., Accepting Mail from Patron on Platform, Library Reference H-1) between DBMC parcels and non-DBMC parcels. This completely captures the platform acceptance cost savings for DBMC parcels. In light of Mr. Crum's Exhibit A calculations, the platform acceptance operation must be excluded from the DBMC mail processing cost savings calculation, as Mr. Acheson did in Docket No. R90-1 and as Mr. Crum did in Docket No. MC97-2. To subsequently include platform acceptance costs for non-DBMC parcels as part of the mail processing costs avoided by DBMC mail, as Mr. Crum does in USPS-T-28, Exhibit C, is a clear double count. I have not separately computed the impact of the double-count; correcting the platform acceptance double count along with excluding the mail preparation costs from the pool of avoided costs results in a reduction in the DBMC discount of 5.0 cents per piece.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-3. Please refer to pages 8-10. Please confirm that you have excluded ASF costs from the pool that DBMC avoids. Please confirm that you have not excluded ASF volumes in the associated calculation and that this treatment is inconsistent with Commission precedent. (See Docket No. R90-1, Tr. 32/16574.) Please explain the logic behind this apparent inconsistency.

Response to USPS/UPS-T4-3. Confirmed that I have excluded outgoing costs at ASFs when the ASF acts as a BMC from the pool that DBMC avoids. This is the exact amount of ASF costs that DBMC parcels do not avoid. Excluding only these ASF costs, and not all ASF costs, avoids the need to take ASF volumes into account in the calculation. Previously, the Commission did not have available the portion of ASF costs that were outgoing costs in which the ASF acts as a BMC, and thus the Commission had to remove all ASF costs and volumes from the calculation in order not to allow ASF data to distort the amount of the discount. My calculation is consistent with the Commission's objective in making the original ASF adjustment and takes into account the fact that the exact ASF cost data needed can now be estimated because of the availability of Ms. Daniel's study.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-4. Please refer to pages 12-14 of your testimony.

(a) Please confirm that the calculations in witness Crum's testimony for deriving the non-transportation costs avoided by DSCF entry are based on *average* quantities per container.

(b) Assume that the Postal Service adopts implementing regulations setting *minimums* for DSCF eligibility at 10 machinable pieces per sack and 25 nonmachinable pieces per GPMC. Would you agree that if these minimums are required, the shortfall of 4.8 cents per piece that you calculate in this section of your testimony would be avoided?

Response to USPS/UPS-T4-4.

(a) Confirmed. Based on the testimony of Ms. Daniel, the actual average number of machinable parcels per sack is 5.8, which is the figure I use in my correction of Mr. Crum's calculations.

(b) Mr. Crum's analysis was based simply on an assumption regarding pieces per container. There was no suggestion that there would be minimums proscribed, and none is contained in the Postal Service's proposed classification schedule language. It is highly doubtful that such minimums could be required without seriously impacting volumes and increasing uncertainty about the estimated savings and revenue losses from the discount, since, as I show in UPS-T-4C, no more than 20 average non-machinable parcels will fit in a GPMC. If the minimums above are proscribed and

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

enforced as to all sacks, (including for the "last sack" in each shipment), despite the probable loss in volume, then the shortfall would be avoided.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-5. Please confirm your understanding that DSCF parcel post is not currently a functioning rate category.

Response to USPS/UPS-T4-5. Confirmed, although postal survey data indicate that significant numbers of parcels are currently being dropshipped at the DSCF.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-6. Have you conducted any study or analysis to suggest that future DDU mailers will containerize their parcels in sacks? If so, please provide the results of that study.

Response to USPS/UPS-T4-6. Neither I nor the Postal Service have conducted such a study. We do know that the Postal Service "containerizes" in sacks 27% of the machinable parcels that arrive at the DDU. See USPS-T-29, Appendix V, page 3 of 17. We also know that the Postal Service containerizes in sacks 23% of the machinable parcels that arrive at the DSCF. Id. We also know that 100% of the machinable parcels dropshipped at the DSCF will be containerized in sacks. USPS-T-28 at page 5.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-7. Please refer to your testimony at lines 4 and 5 of page 5. There you refer to the Commission's determination in Docket Nos. R90-1 and R94-1 of 11.3 cents and 13.4 cents per piece, respectively, for the estimated mail processing costs avoided by DMBC entry. Please confirm that the avoided costs developed in Docket No. R94-1 represented simply the application of the same percent change to the avoided costs as to the rates, and not the results of an updated cost study. If not confirmed, please explain fully, and provide reference to the Commission's analysis and methodological approach to updating the avoided mail processing costs in Docket No. R94-1.

Response to USPS/UPS-T4-7. Confirmed.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-8. Please refer to your testimony at line 6 on page 14 where you refer to "DBMC entry mail – which includes DSCF entry mail – is significantly less dense than Parcel Post as a whole." [footnote omitted]

(a) Please provide the basis for your statement that DSCF entry mail is subsumed by DBMC entry mail.

(b) Please provide all evidence available to you to indicate the density of DSCF mail.

Response to USPS/UPS-T4-8.

(a) - (b) My statement is intended to indicate that Mr. Hatfield's data for DBMC entry mail includes DSCF entry mail. Mr. Hatfield in Appendix II, page 9 of 9, of his testimony (USPS-T-16) notes that the sum of "DSCF Cubic Feet" and "Regular DBMC Cubic Feet" totals "Total DBMC Cubic Feet." On Appendix I, page 13 of 13, of USPS-T-16, he notes that 7.11 percent of DBMC parcels are entered at the DSCF. On Exhibit USPS-16A, he asserts that the local transportation costs for DSCF are the same as those for DBMC. In her Workpaper I.E., Ms. Mayes (USPS-T-37) computes the transportation costs for DSCF using the cube per piece by weight for DBMC.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-9. Please refer to your statement at lines 7 and 8 on page 14 that a sack of DSCF parcels will contain fewer pieces than a sack of regular Parcel Post. Please define "regular Parcel Post."

Response to USPS/UPS-T4-9. The term "regular Parcel Post" is meant to indicate all Parcel Post in the aggregate.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-10. Please refer to your testimony at line 16 of page 14.

Confirm that you intended to refer to DSCF and not DBMC.

Response to USPS/UPS-T4-10. Confirmed.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-11. Please refer to your testimony at page 23 lines 6 and

7.

(a) Please state the basis for your statement that "the uncertainty surrounding this worksharing program [DBMC] has not diminished."

(b) Please confirm that DBMC parcels represent more than 45 percent of total Parcel Post volume in the base year 1996. If not confirmed, please explain.

(c) Please confirm that DBMC discounts have been available to Parcel Post mailers since 1991. If not confirmed, please explain fully.

Response to USPS/UPS-T4-11.

(a) Of the nine uncertainties identified in my testimony beginning on page 26, five apply to the DBMC avoided cost calculation. Mr. Crum's calculation of the mail processing portion of the DBMC discount is simply a recalculation of Mr. Acheson's "top down" methodology from Docket No. R90-1. The methodology relies only on data observed where DBMC parcels are not handled rather than measuring the cost of handling DBMC parcels. As a result, institution of the DBMC discount does not necessarily make the Acheson method more accurate. No effort was made to derive the DBMC discount using the operational work flow costing approach of Ms. Daniel, which could have addressed a number of the key uncertainties that I identified. Thus, there continues to be significant uncertainty surrounding the estimated DBMC cost savings.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

(b) Confirmed.

(c) Confirmed.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-12. Please refer to your testimony at page 23, lines 10 through 19.

(a) Please confirm that Docket No. R90-1 was the first occasion upon which the Commission was introduced to the idea of DSCF and DDU dropship discounts.

(b) Please confirm that the Postal Service has accumulated approximately 8 years of experience with DSCF and DDU discounts with Standard Mail (A) (formerly third-class).

(c) Please confirm that there may be rate design issues aside from uncertainty regarding the basis of a discount for passing through less than 100 percent of the measured savings. If not confirmed, please explain.

Response to USPS/UPS-T4-12.

(a) Confirmed that such discounts were first adopted in Docket No. R90-1 (but not for Parcel Post). With the information I have available to me, I cannot confirm that this was the first occasion the Commission was introduced to the idea.

(b) Confirmed.

(c) Confirmed that there might be. The impact on non-worksharing mailers would be another reason, as mentioned on page 24 of my testimony.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-13. Please refer to your testimony at page 24 at lines 19 and 22. Please provide the basis for your calculation of the TYAR revenue per piece, including citations to the sources of volume and revenue figures. Please also provide the basis for your calculation of the overall percentage increases, including citations to the sources of volumes and revenues.

Response to USPS/UPS-T4-13. See UPS-Luciani-WP-1 for the detailed support for the data provided in Table 8.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-14. Please refer to your testimony from line 23 of page 24 to line 4 of page 25, where you state: "In fact, the rates for many large mailers would decrease significantly. The large increases for single piece and small volume mailers result from the fact that all of the proposed new discounts yield revenue losses significantly in excess of the additional cost savings that would be realized because many shippers are already performing these same worksharing activities in the absence of a discount."

(a) Please confirm that any cost savings accruing as a result of shippers' already performing worksharing in the absence of a discount will help maintain lower rates for all of the mailers in the subclass or rate category, regardless of whether they have performed those worksharing activities. If not confirmed, please explain.

(b) If you have confirmed part a, please comment on the fairness of permitting the worksharing activities of one group of mailers to result in lower rates for a group of mailers who did not perform such activities.

(c) Please confirm that establishing lower rates for the activities performed by the mailer to create a lower-cost mailpiece will result in rates that more closely tie to the costs to the Postal Service of handling that mail. If not confirmed, please explain.

(d) Please confirm that, under the circumstances described in part c above, one result of rate de-averaging may be that some mailers of higher-cost mail will pay

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

higher rates more closely aligned with the cost to the Postal Service of handling that mail. If not confirmed, please explain.

Response to USPS/UPS-T4-14.

(a) Confirmed, all else equal, if no discount is offered. Otherwise, not confirmed.

(b) Those entities performing the worksharing without a specific rate incentive are doing so for other reasons, including, for example, the activity may lower their total costs, or the activity may yield better service (e.g., faster transit times). Those entities have deemed it beneficial to themselves in the absence of a discount to perform the activity. In such a situation, introducing a discount provides no additional cost savings for the Postal Service, and unless the revenue lost from the discount is recovered from non-workshared mail, there is less contribution to institutional costs. It is a question left to the Commission's judgment whether it is more fair to lower the rate to an entity for performing a worksharing activity for which the entity already receives more benefits than costs in the absence of the discount, or to maintain lower rates for all. In consideration of this issue and others identified in my testimony, I recommend a 77 percent passthrough for the proposed Parcel Post discounts.

(c) Confirmed. See my response to part (b), above.

(d) Confirmed. See my response to part (b), above.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-15. Please refer to your testimony at page 29, lines 10 through 13. Please provide any and all information available to you, including field studies, indicating that the DDU entry mail "could very well arrive in containers that are more costly to handle in the manual parcel sortation area than Parcel Post arriving from the DSCF or the DBMC."

Response to USPS/UPS-T4-15. Since the Postal Service did not perform a containerization study for DDU entry mail, it is highly likely -- in fact, it is almost a certainty -- that DDU mail will have a container profile different from that now on the postal network. For example, according to Ms. Daniel's study, sacks are more costly to handle at the DDU after unloading than are other containers. Each container in Ms. Daniel's study has different efficiencies associated with its handling. Clearly, there would be different efficiencies for different types of containers when handled at the DDU. Neither I nor the Postal Service have performed any field studies on this issue.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-16. Please refer to your testimony at page 33, lines 6 through 9 where you state, "Mr. Hatfield, in deriving the cost of DDU transportation, implicitly assumes that DDU has the same density profile as DSCF and DBMC, since he uses the local transportation costs for the DSCF and DBMC categories to derive the DDU transportation cost avoidance." [footnote omitted]

(a) Please identify the portion(s) of Mr. Hatfield's testimony from which you have derived the conclusion.

(b) Please provide a citation to the portion of Mr. Hatfield's testimony or workpapers in which he uses the density profile of DSCF or DBMC to develop DDU cost avoidances.

(c) Have you performed an analysis, using something other than the DBMC or DSCF density profile, to develop alternative estimates of the DDU cost avoidance? If so, please provide both the methodology used and the results.

Response to USPS/UPS-T4-16.

(a) - (b) Mr. Hatfield does not use density profiles to develop the DDU cost avoidance. The reference in my testimony relates to Mr. Hatfield's statement on page 1 of his testimony (USPS-T-16) that he "estimates the potential difference in transportation costs between DBMC parcel post entered at a destination P&DC and a new rate category of parcel post entered at a destination delivery unit (DDU)." There is no reason to compute the transportation cost difference between DBMC and DDU mail

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

under the rate design technique used by Ms. Mayes. Instead, the transportation cost difference between intra-BMC local and DDU mail would be computed. Throughout his testimony, Mr. Hatfield, quite logically, refers to DBMC, DSCF and DDU parcel post as related (see page 24 and Appendix III, page 5 of 9). I interpreted Mr. Hatfield's discussion as support for the logical notion that DBMC, DSCF, and DDU mail pieces would have the same transportation cost for those legs on which they all travel. Having the same transportation cost -- in dollars, not just dollars per cubic foot --- for those legs on which the pieces travel would require that they have a similar density profile.

(c) No. The only techniques considered were the method used by Ms. Mayes and the method I recommend.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-17. Please refer to your testimony at page 38, lines 5 through 8.

(a) Please confirm that you have examined the workpapers of Postal Service witness Mayes in this docket. If not confirmed, please provide the basis upon which you have reached your conclusions.

(b) If you confirmed part a, please confirm that in workpaper WP I.K., pages 7 and 8 of USPS-T-37, some cells in Zones 1 and 2 of intra-BMC are shown to have required increases exceeding 62 percent before being constrained to a lower increase. If not confirmed, please explain.

(c) If you confirmed part a, please confirm that in workpaper WP I.K., pages 9 and 10 of USPS-T-37, the unconstrained rate for a two-pound piece of inter-BMC Parcel Post with a Zone 8 destination would have increased more than 77 percent, had the rate increase not been constrained. If not confirmed, please explain.

(d) If you confirmed part a, please confirm that in workpaper WP I.K., pages 9 and 10 of USPS-T-37, some cells in Zones 1 and 2 of inter-BMC would have increased more than 75 percent, had the rate increases not been constrained. If not confirmed, please explain.

(e) If you confirmed part b, please confirm that in WP I.L and WP I.M. of USPS-T-37, the revenue losses associated with the constraint of rate increases in

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

Zones 1 & 2 of intra-BMC were recovered in the form of an additional markup on all unconstrained cells, including DBMC rate cells. If not confirmed, please explain.

(f) If you confirmed part c or part d, please confirm that in WP I.L and WP I.M. of USPS-T-37, the revenue losses associated with the constraint of rate increases in inter-BMC were recovered in the form of an additional markup on all unconstrained cells, including DBMC rate cells. If not confirmed, please explain.

(g) Please confirm that at pages 24, 30 and 36 of workpaper WP I.L., USPS-T-37, the revenue loss associated with constraining DBMC is significantly less than the revenue loss associated with constraining the rate cells in either intra-BMC or inter-BMC. If not confirmed, please explain.

(h) Please confirm that at pages 22, 28 and 34 of workpaper WP I.M., USPS-T-37, the revenue loss associated with constraining DBMC is significantly less than the revenue loss associated with constraining the rate cells in either intra-BMC or inter-BMC. If not confirmed, please explain.

(i) Please identify the revenue loss you have identified at page 38 associated with capping the DBMC rates.

Response to USPS/UPS-T4-17.

- (a) Confirmed.
- (b) - (d) Confirmed, using the Postal Service's input assumptions.
- (e) - (f) Confirmed.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

(g) - (h) Confirmed, using the Postal Service's input assumptions.

Correcting the Postal Service's overstatements of the destination entry discounts would change these figures.

(I) Without modifying Ms. Mayes model, I cannot identify the amount of lost revenue that results from using the Postal Service's input assumptions since the final iteration of her model includes constraints other than capping the DBMC rates.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-18. Please refer to your testimony at pages 39 and 40.

Please explain why the 2 cents per pound charge should be the same for inter-BMC and intra-BMC when intra-BMC receives fewer handlings in the postal system.

Response to USPS/UPS-T4-18. Historically, the discount between inter-BMC and intra-BMC has been solely on a per piece basis, and a different non-transportation related charge would require a different discount at all weights. Thus, I chose at this time not to propose a different per pound charge for intra-BMC and inter-BMC. The charge could differ between inter-BMC and intra-BMC, and my methodology could be easily modified to do so. My suggested approach, with or without this modification, is preferable to the current approach.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-19. On page 28 of your testimony, you present testimony and data regarding inbound and outbound postal highway movements. Consider the following truck routing: BMC to SCF1 to SCF2 to BMC.

- (a) Which of these legs do you regard as inbound?
- (b) Which of these legs do you regard as outbound?

Response to USPS/UPS-T4-19. (a)-(b) I assume that the BMC at the beginning and the end of the route is the same BMC, and that this is an intra-BMC contract.

According to Ms. Nieto's response to FGfSA/USPS-T2-10 (Tr. 7/3256), highway contract routes generally have multiple trips specified within them. According to Ms. Nieto, the BMC to SCF1 to SCF2 movement on an intra-BMC contract would be one route trip, and the movement from SCF2 to the BMC would be a separate route trip (Tr.7/3454). Ms. Nieto noted that when the last stop on a route trip is a BMC, the movement is inbound; otherwise, it is outbound (Tr. 7/3456). As such, the first and second legs in the round trip identified above would be defined as outbound, and the last leg would be defined as inbound.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-20. Have you studied postal highway capacity utilization as it operated prior to dropship discounts? If so, please provide any such studies and any results.

Response to USPS/UPS-T4-20. No.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-21. Please provide all estimates you have of the percent of inbound space utilized on intra-SCF and inter-SCF vehicles prior to the introduction of dropshipping.

Response to USPS/UPS-T4-21. I assume the question means prior to the introduction of dropship discounts. See my response to USPS/UPS-T4-20.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-22. Please refer to pages 16 and 17 of UPS-T-4.

a. Please assume that DSCF mailings will contain pieces destinating within the service area of a delivery unit that is co-located with the DSCF. Confirm that under these conditions, witness Hatfield has not overstated DSCF transportation costs by 12.3%, but by some amount less than 12.3%. If not confirmed, please explain.

b. Please assume that 12.3% of DSCF mail will destinate within the service area of a delivery unit that is co-located with the DSCF. Confirm that under these conditions, witness Hatfield has not overstated DSCF costs at all.

Response to USPS/UPS-T4-22. (a) I assume the question is meant to read that witness Hatfield has not understated DSCF transportation costs. According to the Postal Service (Tr. 19/9555), those 5-digit presort sacks and containers destinating to the co-located DDU would qualify for the DDU discount. Thus, this must be a combined DSCF/DDU mailing. Those pieces that get the DSCF discount, and not the DDU discount, will travel to a non-co-located DDU. This means that Mr. Hatfield has understated the DSCF transportation costs (above the level of the delivery unit) by 12.3%.

If I assume (contrary to the Postal Service's stated intentions) that those 5-digit presort sacks and containers destinating to the co-located DDU do not receive the DDU discount, there would be two effects. First, the DSCF transportation costs would not have been understated by Mr. Hatfield by 12.3%, but by some lesser amount. Second, the 31.4 cents per piece of processing costs avoided by DSCF entry estimated by Mr. Crum would have to be reduced.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

Mr. Crum computes the costs avoided by DSCF entry against a base that assumes that 100% of parcels are unloaded and crossdocked at the DSCF and subsequently unloaded again at the DDU (See USPS-T-28, Exhibit G). Mr. Crum deliberately overrode Ms. Daniel's model, which only had 87.7% of parcels unloaded and crossdocked at the DSCF under base conditions (Id.). Clearly, Mr. Crum's assumption would have to be modified if the 5-digit presort sacks and containers destinating to the co-located DDU do not receive the DDU discount. Thus, if Mr. Hatfield is right, then Mr. Crum is wrong; they cannot both be right. Regardless of the assumption used, the costs avoided by DSCF entry have been overstated by the Postal Service.

(b) Not confirmed. See my response to part (a).

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-23. Please refer to pages 16 and 17 of UPS-T-4.

a. Please confirm that your proposed \$0.0468 increase in DSCF transportation costs would lead to a corresponding \$330,908 increase in revenues recovered for DSCF transportation costs (based on DSCF cubic feet of 7,066,584). If not confirmed, please explain.

b. In order to ensure that unit transportation cost estimates recover only test year transportation costs, wouldn't it be necessary to lower the non-DSCF DBMC transportation costs by \$330,908? Please explain your answer other than an unqualified 'yes'.

Response to USPS/UPS-T4-23. (a) Confirmed that there would be an increase in revenues. I calculate \$330,716.

(b) No. To take this revenue into account, the analysis in USPS-T-16, Appendix I, page 13, would need to be redone taking into account the number of local legs by type. The end result would be slightly lower transportation costs for intra-BMC, inter-BMC and non-DSCF DBMC parcels. Going through the calculation would also lower the DSCF transportation cost (i.e., DSCF transportation cost would continue to be 12.3% higher than the cost of local transportation for DBMC mail above the level of the delivery unit). In the rate design process, a slightly higher markup would then be applied to all of these slightly lower transportation costs to yield the overall cost coverage required. Thus, correcting for this difference would be complex and likely would yield little material difference in the rates.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-24. Please refer to pages 30 and 31 of UPS-T-4.

- a. Please provide any quantitative evidence to support your statement on lines 16-18 that "taking into account these other eight flowpaths would likely lower Inter-BMC and Intra-BMC transportation costs, and increase DBMC transportation costs."
- b. Please confirm that higher degrees of "skipping around" within a particular rate category of Parcel Post would be evidenced by a greater share of inter-SCF transportation costs and a smaller share of intra-BMC and/or inter-BMC transportation costs. If not confirmed, please explain.
- c. Please confirm that witness Hatfield has allocated an equal share of inter-SCF transportation costs to each rate category of Parcel Post based on cubic foot legs. If not confirmed, please explain.
- d. Based on your responses to parts (a) - (c) of this question, please confirm that explicitly accounting for inter-SCF transportation flows in Mr. Hatfield's analysis would have the following effects on his current results: (1) movement of inter-SCF transportation costs from DBMC to non-DBMC rate categories and (2) movement of intra-BMC and/or inter-BMC transportation costs from non-DBMC rate categories to DBMC. If not confirmed, please explain.
- e. Based on the fact that explicitly accounting for inter-SCF flows in Mr. Hatfield's analysis would lead to both the addition and removal of costs from the DBMC rate category, please justify your claim that DBMC costs will increase without having performed any quantitative analysis.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

Response to USPS/UPS-T4-24. (a) The quantitative evidence is based on the probability of there being a skip around the simplified transportation path model of Mr. Hatfield. According to Mr. Acheson, there are eight alternative paths through which an intra-BMC or inter-BMC piece can skip one or more transportation legs of Mr. Hatfield's simplified model. Only one of these eight alternative paths identified by Mr. Acheson can be taken by DBMC parcels. Thus, by default, there must be more opportunity for intra-BMC and inter-BMC parcels to skip legs of transportation and thereby lower their relative transportation costs in relation to DBMC parcels.

(b) Confirmed. Skipping around also would lead to a decrease in intra-SCF transportation costs. Since only two of the eight alternative paths that lead to skipping of transportation legs are inter-SCF transportation paths, skipping around does not necessarily result in inter-SCF transportation costs being incurred.

(c) I am not familiar with the term cubic foot legs. However, I agree that inter-SCF transportation costs are allocated equally per cubic foot for the average number of legs assumed by Mr. Hatfield to be traveled by rate category. However, the number of legs assumed by Mr. Hatfield to be traveled by rate category did not take into account the probability of a skip resulting from traveling on alternative paths.

(d) Confirmed. Intra-SCF costs also would be transferred from non-DBMC categories to DBMC.

(e) While the inter-SCF transportation costs for the inter-BMC and intra-BMC rate categories likely would increase, the intra-BMC and intra-SCF transportation costs would likely decrease much more. This is because of the disproportionate number of transportation legs that would be skipped by the inter-BMC and intra-BMC rate categories. The ultimate proportion of transportation costs by rate category cannot be

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

determined in the absence of a study similar to that performed by Mr. Acheson in Docket No. R90-1 for Third Class mail. The Postal Service has not conducted such a study for Parcel Post. This leads to uncertainty surrounding the avoided cost estimates for DBMC entry.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-25. Refer to lines 6-8 on pages 33 of UPS-T-4 where you state, "Mr. Hatfield, in deriving the cost of DDU transportation, implicitly assumes that DDU has the same density profile as DSCF and DBMC."

a. Please verify that according to witness Hatfield's methodology, the transportation cost associated with exactly 1.0 legs of local transportation for a given rate category would be calculated as follows: $\text{Local Costs} / (\text{Total Test Year Cubic Feet} \times \text{Average Number of Local Legs})$. If not confirmed, please explain.

b. Please verify that the result of the calculation described in part (a) is 0.3997 \$/cubic foot, and that this result is the same for inter-BMC, intra-BMC, and DBMC. For example, for inter-BMC the calculation is: $\$26,934,000 / \$34,466.346 \times 1.96$. If not verified, please explain.

c. Based on your response to part (b), please confirm that according to witness Hatfield's methodology, the average local transportation cost per cubic foot for mail that travels exactly one local leg is the same across all three rate categories. If not confirmed, please explain.

d. Please confirm that the average density within each category of parcel post is different. If not confirmed, please explain.

e. Based on your response to parts (c) and (d), please confirm that local transportation costs per cubic foot for parcels that travel exactly one local leg do not depend on density. If not confirmed, please explain.

Response to USPS/UPS-T4-25. (a) - (e) Confirmed. See my response to USPS/UPS-T4-16.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-26. Please refer to pages 34-38 of UPS-T-4.

- a. Please confirm that witness Hatfield allocates distance related costs to zone based on cubic foot miles.
- b. Please confirm that witness Hatfield allocates non-distance related costs to zone based on cubic feet.
- c. Please confirm that if a particular grouping of costs were to be split into distance and non-distance related components, it would be logical to allocate costs to zone based on both cubic feet and cubic feet miles according to the methodology presented in witness Hatfield's testimony.
- d. In UPS-T-4, you claim that intra-BMC intermediate transportation costs are partially distance related and partially non-distance related. Please explain why you have not allocated the non-distance related portion using cubic feet and the distance related portion using cubic foot miles.
- e. Please provide any analyses or data to support your claim that the difference in transportation costs per cubic foot between intra-BMC and inter-BMC remains constant across zones.

Response to USPS/UPS-T4-26. (a) - (b) Confirmed.

(c) Confirmed that the approach used by Mr. Hatfield with respect to distance and non-distance related components is logical.

(d) - (e) As noted in my testimony, I recommend for rate design purposes that the transportation costs by zone for intra-BMC Parcel Post be set to be an equal amount (in dollars per cubic foot) below the corresponding total of inter-BMC transportation costs by zone. This yields a more understandable relationship between intra-BMC rates and

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

inter-BMC rates. Given the absence of any reliable data regarding the distance and non-distance related share of intra-BMC intermediate transportation costs, in my view the rate design objective for comprehensible rates overrides the technical objective cited in the question. Implementing the technical objective as suggested in the question would not necessarily yield rates that are more accurate, and the resulting rates themselves likely would be less comprehensible.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-28. Please confirm that for Priority Mail, when the IOCS observed average weight per piece by shape is multiplied by the ODIS average daily volume by shape and aggregated across shapes, the resulting weight exceeds BY96 weight by more than 55%, e.g. 1.02 pounds per flat (p.43)* 1,197,156 flats per day (UPS-Sellick-1-III-a, p.2)* 302 days per year + 3.34 pounds per parcel (p.44)*2,049,308 IPPs and parcels per day (UPS-Sellick-1-III-a, p.2)* 302 days = 2,435,868 thousand pounds, compared to 1,562,801 thousand pounds reported by RPW. If not confirmed, please explain fully.

Response to USPS/UPS-T4-28. Confirmed that the calculations above are correct. Taking these calculations at face value, it could be that the weight differential between Priority Mail flats and parcels is lower than the figure I used to derive the surcharge for Priority Mail parcels. This would result in an increase in my recommended surcharge.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-29. Suppose the average revenue of the Priority Mail flats observed in IOCS is \$4.23, and the average revenue of the Priority Mail IPPs and parcels observed in IOCS is \$5.09. Please confirm that this \$0.86 difference in revenue might offset the \$0.13 difference in cost per piece shown in workpapers UPS-Sellick-1-III-A, p.2. If not confirmed, please explain fully.

Response to USPS/UPS-T4-29. Not confirmed. Revenues are driven by the rate schedule. The Priority Mail rate schedule currently is designed to reflect only differences in transportation costs and non-transportation weight-related costs. The rate schedule includes a markup on these differences. There is no reflection in the rates for the difference in cost caused by shape.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-30. Please refer to your testimony on page 45, lines 22-23 where you state: "Fairness requires that the cost of the delivery confirmation activity be borne solely by those who will use it." Do you propose that this is the only definition of fairness that is consistent with the ratemaking criteria established in the Act?

Response to USPS/UPS-T4-30. The cited statement does not contain a definition of fairness. Fairness as used here simply means that rates should reflect costs. I believe this to be consistent with the ratemaking criteria in the Act.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-31. Did the relative cost coverages of Standard (B) and Priority Mail inform your conclusions regarding the appropriateness of the Delivery Confirmation fees proposed in the testimony of witness Plunkett (USPS-T-40)? Please comment.

Response to USPS/UPS-T4-31. No, nor do I believe that they should. The much higher cost coverage for Priority Mail is long-standing and obviously predates the availability of delivery confirmation. It is meant to reflect non-cost considerations. Under the Postal Service's proposal, Priority Mail users that do not use delivery confirmation will be charged rates that include costs attributable to delivery confirmation service. They will also pay rates that yield higher cost coverages than would otherwise be the case. These users should not be forced to pay higher rates as a result of a service that they do not use and for costs that they do not cause.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-32. Please explain the basis of your statement "delivery confirmation precipitated the purchase of the scanners." (Page 47, lines 15-16).

Response to USPS/UPS-T4-32. While Mr. Treworgy outlined several uses for the scanners (Tr. 3/1312), the timing of the May 6, 1997, decision to purchase the scanners (Tr. 3/1225) was likely driven by the need to have a more effective delivery confirmation process in place for Priority Mail. The delivery confirmation process outlined by Mr. Treworgy in Docket No. MC97-2 for Standard B Mail involved the use of peel-off labels and ultimately placing these labels on various forms (Tr. 3/1214). Mr. Treworgy noted that the new scanners are largely for the benefit of the mailers for whom the peel-off labels would be difficult — primarily the bulk mailers using electronic delivery confirmation (Tr. 3/1292). I do not disagree that the scanners ultimately may be used for a number of purposes; however, of those purposes, it appears that the need to have these scanners in place for Priority Mail and Parcel Post dictated the timing of the purchase.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-34. Please confirm that your proposed Priority Mail parcel surcharge will result in increased Priority Mail revenue. Please indicate where a corresponding decrease in revenue occurs in order to meet the breakeven criterion.

Response to USPS/UPS-T4-34. Confirmed, all else equal. I have not formed a recommendation regarding how the revenues from the surcharge should be treated. In practice, the implementation of the surcharge could be handled by lowering the base Priority Mail rates exclusive of the surcharge.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-35. Please indicate which other shipping companies have a shape-based surcharge for two- or three-day delivery of parcel-shaped mail.

Response to USPS/UPS-T4-35. I do not know.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-36. Based on your experience, do parcel- and flat-shaped mail have different price elasticities? If yes, please explain.

Response to USPS/UPS-T4-36. I have not examined this issue. To my knowledge, Dr. Tolley does not estimate different elasticities for Priority Mail parcels and Priority Mail flats.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-37. Please refer to page 15, lines 5-6 of your testimony.

Is it your understanding that witness Crum testified that the Postal Service currently has dropshipment procedures for DSCF or DDU parcel post? Please explain fully.

Response to USPS/UPS-T4-37. The cited statement refers to Mr. Crum's testimony regarding Postal Service DSCF dropshipment procedures. Mr. Crum testified that there are current guidelines regarding dropshipment mail at DSCFs (Tr. 5/2283). Parcel Post is currently dropshipped at the DSCF (USPS-T-16, Appendix I, page 13). Thus, there are current guidelines in effect for Parcel Post dropped at the DSCF. The Postal Service also has guidelines in effect for DDU entry (Tr. 5/2310). Ms. Mayes assumes that currently there are significant numbers of Parcel Post pieces dropped at the DDU (Tr. 8/4171).

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-38. Please refer to page 15, line 14 and page 19, line 4 of your testimony as well as Tr. 5/2283, 2299, and 2301. Please provide the basis for your assumptions regarding "Postal Service policy."

Response to USPS/UPS-T4-38. My reference is to Tr. 5/2400, but similar guidelines also appear at 5/2310. When the guidelines and operating procedures are in published form (and, for example, posted on the walls at Postal Service facilities), I believe it fair to refer to them as "Postal Service policy."

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-39. Please refer to page 5 of your testimony. Please provide the "pre-passthrough" acceptance savings determined by the Commission in Docket No. R90-1.

Response to USPS/UPS-T4-39. The pre-passthrough window and acceptance savings were 9.8 cents per piece in Docket No. R90-1 (PRC-LR-7, DBMC Calculations, p. 1). This is very close to the 9.2 cents per piece estimated by Mr. Crum in Docket No R97-1. The window and acceptance savings have not changed in the same inexplicable manner as the mail processing savings have.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-40. Please refer to page 9, lines 10-13 of your testimony.

a. Is it your testimony that DBMC parcel post avoids no outgoing costs at BMCs? If your answer is yes, please explain and provide any evidence you might have to support that claim.

b. Please confirm that page 2 of your Exhibit UPS-T-4B could be used to show that DBMC avoids 7.9 cents per piece of outgoing costs at BMCs compared to Intra-BMC (line 12 - line 19). Please fully explain any negative or partially negative response.

c. Please refer to page 9 of your testimony, and to USPS-T-29, Appendix V, page 16. Is it your understanding that destinating BMCs will feed barcoded destinating mail unfiltered to the secondary parcel sorting machine? Is it your testimony that these pieces receive outgoing costs? If so, please provide any supporting evidence you have.

Response to USPS/UPS-T4-40. (a) No. This issue has not been examined by the Postal Service. For example, with respect to platform acceptance and central mail markup, there are likely additional costs incurred by DBMC parcels subsequent to their arrival at the BMC. Ms. Daniel noted that the DBMC outgoing costs she did identify were only for the purposes of deriving the proportional adjustment factor (USPS-T-29, Appendix V, p. 11). To the extent that certain costs at the BMC incurred by DBMC parcels were not part of Ms. Daniel's analysis, I have underestimated in this exhibit the impact of removing the costs at the ASF when the ASF acts as a BMC.

(b) Confirmed for those outgoing costs identified. See my response to part (a).

Moreover, it would be inconsistent to use Ms. Daniel's results only to compute some of

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

the avoided costs at the BMC, without using a similar analysis for processing costs at the AO and origin SCF. For example, Ms. Daniel shows only 7.6 cents in processing costs at the origin SCF for intra-BMC machinable parcels and 17.7 cents per piece for non-machinable intra-BMC parcels, for a weighted average of only 8.5 cents per piece (USPS-T-29, Appendix V, pages 8-9). Yet, Mr. Crum calculates that 37.7 cents per piece of processing costs are avoided by DBMC prior to the BMC.

(c) Yes, for approximately one-half of inter-BMC parcels (see USPS-T-29, page 17, lines 17-20). Inter-BMC parcels do not incur outgoing costs at the destination BMC (LR-H-49, Appendix B, page 144).

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-41. Please refer to page 28, lines 3-4. Is it your testimony that no non-DBMC mail is verified by Postal Service clerks at the mailer's plant? Please provide evidence to support any affirmative response.

Response to USPS/UPS-T4-41. No. However, common sense suggests that the verification is for large-volume mailers. Such mailers are significant users of DBMC entry.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-42.

a. Please confirm that in Exhibit UPS-T-4B, you are assuming that ASFs are acting as BMCs (i.e. processing the pieces) and not merely passing the volume to the parent BMC for sortation and transport. Please fully explain any negative response.

b. If you confirm part (a), please refer to the attachment, which shows current outgoing parcel splits for five ASFs. If you were aware of these plans, would you have made an assumption other than the one you made. Please explain your answer.

Response to USPS/UPS-T4-42. (a) - (b) Confirmed that I have performed the calculation assuming all ASF volume is processed at the ASF at the highly efficient cost of a BMC. Not confirmed that I assume that all ASFs will process all volumes. I have reviewed the testimony of Mr. Byrne in Docket No. R84-1 (USPS-T-14), which makes clear that the handling of parcels by the various ASFs can vary depending on operational circumstances. In my view, using the highly efficient cost of the BMC to cost all ASF service provides a conservative estimate of the average outgoing costs incurred at ASFs when the ASF acts as a BMC. For example, Mr. Byrne computed that the processing costs for machinable parcels was 14.3 cents per piece for intra-BMC Parcel Post and 19.1 cents per piece for intra-ASF Parcel Post. For non-machinable parcels, Mr. Byrne computed 30.7 cents per piece for intra-BMC and 40.1 cents per piece for intra-ASF (See USPS-14V, Docket No. R84-1). Reviewing the attachment provides me no further insight than I was able to determine from the testimony of Mr. Byrne and based on the attachment, I would not change my approach.

Auxiliary Service Facilities Outgoing Parcel Splits

Auxiliary Service Facility (ASF)	Parent BMC	Other Outgoing Splits (BMCs and ASFs)
Buffalo	Pittsburgh	Springfield BMC
Fargo	Minneapolis	Billings ASF, Sioux Falls ASF
Oklahoma City	Dallas	Denver BMC, Kansas City BMC, Memphis BMC, St Louis BMC
Salt Lake City	Denver	Los Angeles BMC, Phoenix ASF, San Francisco BMC, Seattle BMC
Sioux Falls	Des Moines	Denver BMC, Fargo ASF, Minneapolis BMC

Auxiliary Service Facilities Outgoing Parcel Splits

Auxiliary Service Facility (ASF)	Parent BMC	Other Outgoing Splits (BMCs and ASFs)
Buffalo	Pittsburgh	Springfield BMC
Fargo	Minneapolis	Billings ASF, Sioux Falls ASF
Oklahoma City	Dallas	Denver BMC, Kansas City BMC, Memphis BMC, St Louis BMC
Salt Lake City	Denver	Los Angeles BMC, Phoenix ASF, San Francisco BMC, Seattle BMC
Sioux Falls	Des Moines	Denver BMC, Fargo ASF, Minneapolis BMC

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-43. Please refer to page 21 of your testimony. After describing many problems with barcodes, you stated that "there is no difference in these respects between Postal Service barcoded pieces and mailer prebarcoded pieces."

a. Please confirm that if a mailer's barcode is printed directly onto a parcel it cannot fall off.

b. Please confirm that if a mailer's barcode shows through a plastic window, it cannot fall off.

c. Please confirm that if the Postal Service requires prebarcodes to meet readability and accuracy standards before the mailer can receive the prebarcode discount, this will reduce the chance of the barcode falling off, being incorrect, or being obstructed or otherwise unreadable.

d. Please confirm that if the mailer's barcode is examined by the Postal Service before it is accepted, this will reduce the chance of the barcode falling off, being incorrect, or being obstructed or otherwise unreadable.

e. Please confirm that mailer's list-generated barcodes are more likely to be accurate than human applied barcodes.

Response to USPS/UPS-T4-43. (a) Confirmed, it cannot fall off. However, it could lead to additional scanning errors, depending on how and where the printing is done on the parcel.

(b) Confirmed as a general proposition; however, much depends on how the window is attached to the parcel.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

(c) Confirmed that this should reduce the chance, if the requirements are enforced, although not necessarily to the same level as the barcodes applied by the Postal Service.

(d) Confirmed that this should reduce the chance, although it appears that the extra cost incurred through this examination has not been taken into account in Ms. Daniel's analysis of the prebarcoding avoided costs.

(e) Confirmed. Whether this matters to any degree depends on the rate of keying error, for which I have seen no data.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-44. Refer to Table 14 on page 42 of your testimony.

- a. Please provide an exact citation to UPS-Luciani-WP-4 where the Prebarcoding Revised Avoided Cost with 100% MP Labor Variability can be found.
- b. Please confirm that the difference in the model cost of PSM key and scan on page 13 of 63 of UPS-Luciani-WP-4 is \$0.0223.
- c. Please confirm that adding the \$0.005 cost per ribbon to the difference in the model cost of PSM key and scan on page 13 of 63 of UPS-Luciani-WP-4 is \$0.0273. If confirmed, please reconcile this figure with the 2.66 figure shown in Table 14.

Response to USPS/UPS-T4-44. (a) The relevant figures are contained on page 13 of 63 of UPS-Luciani-WP-4.

(b) Confirmed.

(c) Confirmed. Table 14 should be corrected to read 2.73 cents per piece rather than 2.66 cents per piece for prebarcoding. With a 77% passthrough, the discount is 2.1 cents per piece.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-45. Please refer to page 43 of 63 of your WP-4.

a. Please confirm that the outgoing mail processing cost difference you show between barcoded and nonbarcoded mail is \$0.0295.

b. Please confirm this cost difference does not include the \$0.005 ribbon and label costs incurred by nonbarcoded mail.

c. Why isn't the Avoided Cost/Discount for Prebarcoding shown in Table 14 on page 42 of your testimony not 3.45 cents?

Response to USPS/UPS-T4-45. (a) Confirmed. These total costs follow the methodology of Ms. Daniel and include the proportional multiplier as applied across a broad spectrum of activities

(b) Confirmed.

(c) For the reasons contained on pages 20-21 of my testimony, when looking solely at the difference in the operation that drives the difference between pre-barcoded and barcoded mail, the proportional multiplier should not be included. For computational ease, the proportional multiplier was applied to the total costs of barcoded and nonbarcoded mail separately. Application of the proportional multiplier subsequent to the combination of the barcoded and nonbarcoded mail costs would have yielded no difference in my calculations.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-46. Refer to Table 14 on page 42 of your testimony.

a. Please provide an exact citation to UPS-Luciani-WP-4 where the BMC Presort Non-Transportation (off of Inter-BMC) Revised Avoided Cost with 100% MP Labor Variability of 21.1 can be found.

b. Please confirm that on page 31 of 63 of UPS-Luciani-WP-4 and the Summary Sheet the cost avoidance for OBMC BMC Presort Savings is \$0.155 but BMC Presort Non-Transportation (off of Inter-BMC) Revised Avoided Cost with 100% MP Labor Variability in Table 14 is 22.1. If confirmed, please reconcile the difference.

Response to USPS/UPS-T4-46. (a) Refer to UPS-Luciani-WP-4, page 35 of 63.

(b) I assume the question means to say 21.1, rather than 22.1. If so, confirmed. This simply follows the methodology of Witness Crum in his Exhibit D. The OBMC presort savings refers to the presort savings that take place only at the BMC.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-47. Please refer to Table 14 on page 42 of your testimony.

a. Please confirm that on page 31 of 63 of UPS-Luciani-WP-4 and the Summary Sheet the cost avoidance for DSCF Discount is \$0.368 but is 36.7 in Table 14. If confirmed, please reconcile the difference.

b. Please confirm that on page 31 of 63 of UPS-Luciani-WP-4 and the Summary Sheet the cost avoidance for DDU Discount is \$0.718 but is 71.7 in Table 14. If confirmed, please reconcile the difference.

Response to USPS/UPS-T4-47. (a) Confirmed. Table 14 should be corrected to read 36.8 cents per piece for the DSCF non-transportation discount instead of 36.7 cents per piece. After rounding, the discount with a 77% passthrough applied remains unchanged at 28.3 cents per piece.

(b) Confirmed. Table 14 should be corrected to read 71.8 cents per piece for the DDU non-transportation discount instead of 71.7 cents per piece. After rounding, the discount with a 77% passthrough applied changes to 55.3 cents per piece.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-48. Why are the piggyback factors used on page 29 of 63 of UPS-Luciani-WP-4 derived by multiplying the piggyback factors from LR-H-77 by 0.9302 instead of using the piggyback factors calculated in LR-H-318?

Response to USPS/UPS-T4-48. I had not received LR-H-318 by the time my testimony was filed. The notice that LR-H-318 was filed was received on December 29, 1997. In the absence of LR-H-318, Mr. Sellick estimated that the original piggyback factors would be multiplied by a factor of 0.9302 on average. While the individual piggyback factors applied using Mr. Sellick's estimate are different from those contained in LR-H-318 in aggregate, I have confirmed that there would be immaterial differences to my results using our estimated piggyback factors as opposed to the piggyback factors contained in LR-H-318.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-49. Please refer to page 10 of your testimony where you state "parcel sorting productivity at ASFs is almost certainly lower."

a. Please confirm that the costs (\$0.208) incurred to support a mechanized environment shown on page 44 of 63 of WP-4 such as dumping into a PSM (\$0.095), sack sorter (\$0.005), sack shakeout (\$0.023) and sweeping runouts (\$0.089) would not be incurred in a simplified manual environment like those found at ASFs.

b. Please confirm ASFs would have fewer outgoing separations to make than BMCs if they did not sort to every other BMC.

c. Please confirm that manual sorting productivities should be higher if there are fewer separations, all else equal.

d. Do you think it is possible that the productivity for manual sorts with 1-5 separations could be faster than a mechanized sort with at least 21 separations?

e. Do you think that the cost of an outgoing sort of primarily machinable parcels to only a few BMCs would be cheaper than the \$0.179 cost of the manually sorted incoming 3-Digit nonmachinable parcel to 5-Digits you show on page 25 of 63 of WP-4?

Response to USPS/UPS-T4-49. Confirmed that costs at the ASF in the absence of these specific machine costs would be different. However, they would be replaced by other costs, such as the 26.5 cents for move costs at the SCF for the manual sort contained on page 25 of 63.

(b) Confirmed.

(c) Confirmed that the fewer the separations, the higher the manual productivity is likely to be, all else equal.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

(d) It is possible. In the absence of any data, I would regard it as unlikely that a manual sortation of parcels (which generally requires tossing the parcels one at a time into an array of hampers) would be nearly as efficient as the mechanized sort at the BMC. Also, see my response to USPS/UPS-T4-42.

(e) Manual sorting of primarily machinable parcels likely would be more efficient, but it is unlikely to be as low as the 3.7 cents to 5.9 cents I conservatively use on pages 43 and 44 for sortation at the ASF.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-50. Please refer to your WP-4 page 6 of 63.

- a. Why did you assume all DSCF sacks will arrive bedloaded?
- b. Why did you not assume DSCF sacks may come in rolling stock or some mix of bedloading and rolling stock?
- c. Would the costs incurred by USPS as a result of assisting with unloading be lower if sacks were also in rolling stock? Please explain.

Response to USPS/UPS-T4-50. (a)-(b) Mr. Crum treats the machinable DSCF sacks as bedloaded throughout his analysis. I accepted his assumption for purposes of computing the cost of assistance in unloading.

(c) It might. It would depend on the container used. The Postal Service's share of the work would increase from 50% to 100%, as described on page 15 of my testimony. Moreover, costs elsewhere in the Postal Service's processing stream would change after take into account the rolling containers.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-51. Please refer to your WP-4 page 6 of 63.

- a. If USPS allowed mailers to assist unloading wheeled containers, would the same 50% share of the work made with regard to sacks be a reasonable assumption?
- b. If your answer to part (a) is no, please explain in detail.
- c. If your answer to part (a) is yes, please recompute your adjustment assuming the 50% USPS assistance.

Response to USPS/UPS-T4-51. (a) - (c) Yes, although allowing mailers to assist with this type of unloading is in violation of Postal Service procedures. The costs for Postal Service assistance on WP-4, page 6 of 63, would change to 2.85 cents per piece.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-52. Please provide citations to the figures used on your SP-4 page 40 of 63.

Response to USPS/UPS-T4-52. Page 40 of UPS-Luciani-WP-4 is a modified version of page 3 of Mr. Crum's Exhibit G (USPS-T-28). The figures \$0.279 and \$0.919 can be found on page 39 of WP-4. The figures (\$0.338) and (\$0.760) should have their parentheses removed and can be found on page 38 of WP-4.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS LUCIANI TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T4-53. Why do you consider the destinating NMO sort to 3-Digit incurred by intra-BMC and DBMC parcels "outgoing" costs on pages 50 and 54 of 63 in your WP-4?

Response to USPS/UPS-T4-53. The IOCS handbook states that the primary (first) sort is part of the Outgoing basic function for DBMC and intra-BMC mail (LR-H-49, Appendix B, page 144).

1 CHAIRMAN GLEIMAN: Does any participant have
2 additional written cross-examination for Witness Luciani in
3 his capacity as USPS Witness T-2?

4 [No response.]

5 CHAIRMAN GLEIMAN: Before we move on to oral
6 cross-examination, Mr. McKeever, would you like to move the
7 supplemental testimony at this point?

8 MR. McKEEVER: Yes, Mr. Chairman.

9 BY MR. McKEEVER:

10 Q Mr. Luciani, I have handed you a copy of a
11 document entitled "Supplemental Testimony of Ralph L.
12 Luciani on Behalf of United Parcel Service Concerning Mail
13 Processing Costs Derived Pursuant to Order No. 1203" and
14 marked as UPS-ST-4. Was that document prepared by you or
15 under your direction and supervision?

16 A Yes, it was.

17 Q And if you were to testify orally here today,
18 would your testimony be as set forth in that document?

19 A Yes, it would.

20 MR. McKEEVER: Mr. Chairman, I have two copies for
21 the reporter. I move the "Supplemental Testimony of Ralph
22 L. Luciani on Behalf of United Parcel Service Concerning
23 Mail Processing Costs Derived Pursuant to Order No. 1203"
24 and marked as UPS-ST-4 be admitted into evidence and
25 transcribed into the record.

1 CHAIRMAN GLEIMAN: Are there any objections?

2 [No response.]

3 CHAIRMAN GLEIMAN: Hearing none, Mr. Luciani's
4 testimony and exhibits are received into evidence and I
5 direct that they be transcribed into the record at this
6 point.

7 [Supplemental Testimony and
8 Exhibits of Ralph L. Luciani,
9 UPS-ST-4, was received into
10 evidence and transcribed into the
11 record.]

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UPS-ST-4

BEFORE THE
POSTAL RATE COMMISSION

POSTAL RATE AND FEE CHANGES, 1997

DOCKET NO. R97-1

SUPPLEMENTAL TESTIMONY OF
RALPH L. LUCIANI ON BEHALF
OF UNITED PARCEL SERVICE
CONCERNING MAIL PROCESSING
COSTS DERIVED PURSUANT TO
ORDER NO. 1203

BEFORE THE
POSTAL RATE COMMISSION

POSTAL RATE AND FEE CHANGES, 1997

DOCKET NO. R97-1

SUPPLEMENTAL TESTIMONY OF
RALPH L. LUCIANI ON BEHALF
OF UNITED PARCEL SERVICE
CONCERNING MAIL PROCESSING
COSTS DERIVED PURSUANT TO
ORDER NO. 1203

1 My name is Ralph L. Luciani. I am submitting this Supplemental
2 Testimony at the request of United Parcel Service.

3 Since the filing of my direct testimony (UPS-T-4) on December 30, 1997, I
4 have had the opportunity to review the Postal Service's responses to interrogatories
5 OCA/USPS-71 through OCA/USPS-76, received on December 29, 1997, and its
6 responses to interrogatories UPS/USPS-T28-42 - 46, filed February 4, 1998. In those
7 interrogatory answers, the Postal Service, in response to Order No. 1203, provided
8 costs resulting from the Postal Service's attempt to apply the "established variability
9 analysis" from Docket No. R94-1 to its proposals in this case. As part of its responses,
10 the Postal Service provided Library References H-315 through H-328. Library
11 References H-326 and H-327 contain the Postal Service's estimate of Parcel Post non-
12 transportation worksharing avoided costs pursuant to Order No. 1203.

1 My review of Library Reference H-327 indicates that Postal Service
2 witness Crum made a number of errors in his derivation of Parcel Post worksharing
3 avoided costs pursuant to Order No. 1203. The errors contained in H-327 are outlined
4 below. These errors are separate and distinct from those issues regarding Mr. Crum's
5 estimates of worksharing avoided costs that I identify in my direct testimony, UPS-T-4.

6 1. In Exhibit D of H-327, Mr. Crum failed to include the cost of
7 bedloading activities at the origin SCF in the derivation of the origin SCF loading costs
8 for nonpresorted machinable Parcel Post. Mr. Crum did include these bedloading costs
9 in Exhibit D of his original direct testimony, USPS-T-28.

10 2. In Exhibit G of H-327, Mr. Crum did not change the platform non-
11 BMC piggyback factor to the 1.719 figure found in Library Reference H-318, which
12 contains the piggyback factors for the Order No. 1203 scenario. Similarly, he did not
13 change the piggyback factor for non-machinable manual sorting at the SCF to the 1.49
14 figure found in Library Reference H-318. In addition, Mr. Crum used a productivity
15 figure for unloading bedloaded sacks at the destination SCF for machinable Parcel
16 Post of 275.1, rather than the 145.8 shown in the Order No. 1203 version of USPS-T-
17 29, Appendix V, provided in Library Reference H-326.

18 3. In Exhibit J of H-327, Mr. Crum did not change the piggyback
19 factors used to those provided in Library Reference H-318. In addition, the
20 productivities used to calculate the costs of the load gaylord activity at the origin BMC
21 and the unload gaylord activity at the destination BMC were switched. Finally, the
22 wrong productivity was used for crossdocking pallets, per Appendix V in Library
23 Reference H-326.

24 4. In Exhibit C of H-327, Mr. Crum relied on an incorrect figure for
25 outgoing mail processing costs avoided by DBMC Parcel Post. The source of the
26 figure is Table 1 of Library Reference H-323. A comparison of Library Reference H-

1 315 and Library Reference H-323 indicates that the Postal Service put a number of
2 cost pool figures in the wrong location in column 10 of Table 1 in H-323. Certain
3 figures are off by a factor of 10, others by more than a factor of 100. These
4 transposition errors yield an incorrect estimate of outgoing mail processing costs
5 avoided by DBMC Parcel Post in Table 1 of H-323. Using the data provided in H-315, I
6 have recalculated the outgoing mail processing costs avoided by DBMC to correct
7 these transposition errors.

8 Shown in column A of Table S1 below are the Parcel Post non-
9 transportation worksharing avoided cost estimates contained in H-326 and H-327.
10 Shown in column B are those avoided cost estimates as revised only for the errors
11 outlined above. Shown in column C are those avoided cost estimates revised to reflect
12 the impact of the issues identified in my direct testimony. Column D shows the avoided
13 cost estimates contained in my direct testimony, UPS-T-4.

Table S1
 Order No. 1203 Parcel Post Worksharing Avoided Costs, Revised
 (cents per piece)

Parcel Post Worksharing Activity	A USPS Order No. 1203 Case As Filed	B USPS Order No. 1203 Case Revised	C USPS Order No. 1203 Case Revised to Reflect UPS-T- 4 issues	D UPS-T-4 (Table 14) ¹
DBMC Non-Transportation	63.8	54.9	42.7	42.8
OBMC Non-Transportation	76.8	71.7	59.5	58.2
BMC Presort Non-Transportation	16.5	22.3	22.3	21.1
Prebarcoding	3.66	3.66	2.76	2.73
DSCF Non-Transportation	48.3	48.7	37.0	36.8
DDU Non-Transportation	74.0	74.0	72.1	71.8

As noted in my direct testimony, a 77% passthrough should be applied to the selected avoided cost estimates.

¹. Reflects corrections noted in USPS/UPS-T4-44 and 47.

1 CHAIRMAN GLEIMAN: There was no designated written
2 cross-examination associated with this supplemental
3 testimony. That moves us along to oral cross-examination.

4 Four participants requested oral cross-examination
5 of Witness Luciani regarding his UPS-T-2 testimony. There
6 were no requests for cross-examination with regard to the
7 supplemental testimony, although Mr. McKeever indicates that
8 he would not object to cross-examination on that bit of
9 testimony also.

10 The four parties are CTC Distribution Services;
11 Nashua District, Mystic, Seattle; Parcel Shippers
12 Association; and the United States Postal Service. Does any
13 other party wish to cross-examine the witness?

14 [No response.]

15 CHAIRMAN GLEIMAN: If not, then Mr. Miles, or
16 whoever is going to cross on behalf of CTC.

17 MR. MILES: Mr. Chairman and members of the
18 Commission, John Miles appearing on behalf of CTC
19 Distribution Services. With me is John Callender, associate
20 from our office.

21 CHAIRMAN GLEIMAN: Mr. Callender is a veteran up
22 here now. He has been through the wars at least once.

23 CROSS-EXAMINATION

24 BY MR. MILES:

25 Q Mr. Luciani, I represent CTC Distribution Services

1 in this proceeding. Are you familiar with the company?

2 A Not specifically.

3 Q Have you heard of it?

4 A Just through their testimony?

5 Q Have you had occasion to read the testimony, the
6 direct testimony of Mr. John Clark, who is the president?

7 A I did read through that, quickly though.

8 Q Are you aware that CTC supports the parcel post
9 work-sharing program proposed by the Postal Service in this
10 case?

11 A I am generally aware of that.

12 Q These questions pertain to your direct testimony
13 in this case relative to the proposed 77 percent
14 pass-through that you testified about.

15 A Yes.

16 Q In your direct testimony, with respect to parcel
17 post, and, specifically, pages 22 through 31, you set forth
18 your disagreement with the 98 to 100 percent pass-through
19 recommended by the Postal Service with respect to costs
20 avoided by drop shipment to OBMC, DBMC, DSCF and DDU, as
21 well as the presort BMC and BMC pre-bar-code discounts,
22 correct?

23 A That is correct.

24 Q As I understand your testimony, the pass-through
25 should be 77 percent and not the higher pass-through

1 recommended by the Postal Service?

2 A My recommendation is 77 percent, correct.

3 Q And a principal reason for that is that you feel
4 that the costs -- the estimate of costs, of avoided costs,
5 made by the Postal Service is uncertain?

6 A Yes, there is significant uncertainty surrounding
7 these estimates for parcel post.

8 Q If the Commission felt that those uncertainties
9 were cured, would you feel confident in recommending the 98
10 to 100 percent that the Postal Service has proposed?

11 A If there was no uncertainty, yes, I think a higher
12 pass-through might be merited.

13 Q As I understand your testimony, Mr. Luciani, a
14 principal reason in support of your 77 percent
15 recommendation is that this, such a pass-through, would be
16 consistent with the Commission's Decision, or Opinion and
17 Recommended Decision in Docket R90-1?

18 A Yes, that's one of the reasons I have laid out in
19 my testimony.

20 Q In preparing your testimony, did you read through
21 that decision, the relevant portions of it, with respect to
22 that decision of the Commission?

23 A Yes, I read through the R90-1 decision and the
24 R94-1 decision.

25 Q Did you -- do you recall who -- you actually were

1 involved in R90-1, were you not?

2 A I didn't hear the first word of that.

3 Q You were actually involved in that proceeding,
4 were you not, R90-1?

5 A I assisted Dr. Hall in that proceeding.

6 Q Did you have occasion, in preparing your testimony
7 in this case, to read through Dr. Hall's testimony?

8 A I did not.

9 Q Do you recall it?

10 A It has been a number of years now, but I recall it
11 to the extent -- in a general sense.

12 Q You recall probably the essence of it?

13 A Yes.

14 Q And you have not read it recently?

15 A It has been a number of years.

16 Q Do you recall, was the 77 percent pass-through
17 that the Commission arrived at in R90-1 consistent with the
18 Postal Service's recommendation for a pass-through in that
19 case?

20 A That I don't recall.

21 Q Did you not address that in this case? Did you
22 not address that idea in this case and say that it was
23 consistent?

24 A I believe I said that it was consistent with the
25 Commission's decision in R90-1.

1 Q But you don't know if it was consistent with the
2 Postal Service's recommendation?

3 A I did not -- I do not know, as I sit here.

4 Q Did UPS -- you worked for UPS in connection with
5 R90-1, did you not? You were a consultant hired by UPS?

6 A That's correct.

7 Q Did UPS support a 77 percent passthrough in Docket
8 Number R90-1 for parcel post?

9 A I don't recall.

10 Q Do you recall that, in fact, UPS urged that the
11 entire destination BMC rate structure be rejected?

12 A I believe there were recommendations that the DBMC
13 program not be incorporated. I believe that was one of many
14 suggestions about the DBMC program.

15 Q Do you recall Dr. Hall's testimony or did you have
16 a hand perhaps in writing any of the testimony relative to
17 the volume projections that Dr. Hall made?

18 A I don't recall that specifically.

19 Q Do you recall any testimony in Dr. Hall's
20 submission relative to an imaginary volume created by the
21 Postal Service relative to DBMC?

22 A I have a vague recollection that there was some
23 uncertainty associated with the volume estimates in that
24 proceeding.

25 Q Do you recall that the Commission accepted the

1 Postal Service's volume estimates as conservative?

2 A I don't recall that specifically.

3 Q Do you recall what those volume estimates were?

4 A No, I do not.

5 Q Mr. Luciani, do you know if UPS has forecasted
6 volumes for parcel post relative to this case?

7 A I am not aware of that.

8 Q Are you aware of any study conducted by UPS or
9 others that would indicate the effect on UPS if the parcel
10 post proposals submitted by the Postal Service in this case
11 were recommended and adopted?

12 A I am not aware of any such study.

13 Q Would you agree, Mr. Luciani, that the proposed
14 parcel post work-sharing discounts, if recommended and
15 adopted, would cause parcel post volume to increase
16 significantly?

17 A The very first part of that question again? If
18 adopted as recommended by the Postal Service?

19 Q By the Postal Service, yes.

20 A Okay. Could you repeat, then, the second part?

21 Q Yes. Would you agree that if the Postal Service's
22 recommendations were recommended by the Commission,
23 recommendations with respect to parcel post¹ work-sharing
24 ~~and discounts~~, that that would cause parcel post volume to
25 increase significantly?

1 A I don't know about significantly. I believe that
2 there is a significant volume that would use the new
3 discounts, but there are at least some indications that a
4 lot of that volume is already performing that work-sharing.
5 So I don't know whether its additional volume is
6 significant. I believe there is some.

7 Q Do you agree that the DBMC drop ship discount
8 program that has been in effect since 1990 has been a major
9 factor in revitalizing parcel post, which had been lagging
10 seriously prior to that?

11 A I have not examined it from that perspective. I
12 do agree that there is significant DBMC volume.

13 Q Would you agree that the BMC parcel post
14 work-sharing program again that's been in effect since 1990
15 can be fairly described as extremely successful for the
16 Postal Service?

17 A I haven't examined it from that perspective and
18 really can't say.

19 Q You have no opinion about that?

20 A No.

21 Q Do you have any opinion about whether it's been in
22 any way adverse to UPS?

23 A No.

24 Q Do you have any opinion about whether that
25 program, again the parcel post program, has been successful

1 for the nation as a whole?

2 A No.

3 Q Would you agree that the parcel post market is a
4 growing segment of the economy?

5 A I have not examined that.

6 MR. MILES: I have nothing further. Thank you.

7 CHAIRMAN GLEIMAN: Nashua District, Mystic,
8 Seattle?

9 MR. CALLENDER: Thank you very much, Mr. Chairman.

10 CROSS-EXAMINATION

11 BY MR. CALLENDER:

12 Q My name is Jack Callender. I'm here on behalf of
13 Nashua, Mystic, District and Seattle.

14 Mr. Luciani, yesterday I asked Dr. Henderson a few
15 questions about several different features of priority mail
16 as compared with UPS second-day air and three-day select,
17 and he said that you might be a better witness to answer my
18 questions.

19 First, I asked Dr. Henderson about how often
20 priority mail and these two UPS products meet their delivery
21 standards. Just based on what you know about UPS, including
22 its money-back guarantee for packages not delivered on time,
23 do you think UPS second-day air and three-day select perform
24 better or worse than priority mail?

25 MR. MCKEEVER: Mr. Chairman, I'm going to object.

1 It's really beyond the scope of Mr. Luciani's testimony. He
2 hasn't testified in any way, shape or form on anything like
3 that.

4 MR. CALLENDER: Well, Dr. Henderson referred Mr.
5 Luciani -- referred these questions to Mr. Luciani.

6 MR. MCKEEVER: No, I don't believe that's correct.
7 I think what happened was that Mr. Callender asked Mr.
8 Henderson if he knew anybody, any other UPS witness who
9 might know and Dr. Henderson said, well, Mr. Luciani has
10 worked with UPS for a number of years, maybe he would know.
11 That doesn't mean it's within the scope of Mr. Luciani's
12 direct testimony.

13 CHAIRMAN GLEIMAN: Well, I agree with you that
14 it's not within the scope of Mr. Luciani's direct testimony,
15 but if he does have a sense of it, it certainly wouldn't
16 hurt the record to have him respond.

17 So Mr. Luciani, if you want to take a shot at
18 answering the question?

19 THE WITNESS: May I ask that the question be
20 repeated, Mr. Chairman?

21 CHAIRMAN GLEIMAN: Certainly.

22 BY MR. CALLENDER:

23 Q Well, based on what you know about UPS, including
24 the money-back guarantee, do you think UPS second-day air
25 and three-day select perform better or worse than priority

1 mail?

2 A I have not examined that and I do not know.

3 Q Okay. And I also asked Dr. Henderson about
4 insurance included in the basic price for priority mail, UPS
5 second-day air and UPS three-day select. Are you aware of
6 any insurance provided as part of the basic rate for
7 priority mail?

8 A I am not specifically aware.

9 Q How about for UPS second-day air and three-day
10 select?

11 A I do not know.

12 Q Okay. I also asked Dr. Henderson about billing
13 and payment options. Did you know that the Postal Service
14 requires the sender to pre-pay postage for priority mail?

15 A Could you repeat that?

16 Q Did you know that the Postal Service requires the
17 sender to pre-pay postage for priority mail?

18 A And again, I do not know specifically about that.

19 Q Are you aware of payment arrangements that can be
20 made by users of UPS second-day air and UPS three-day
21 select?

22 A I do not.

23 Q Do you know if a business could set up an account
24 with UPS?

25 A I do not.

1 Q Okay. I also asked him about discounts available.
2 Are you aware of any discounts based on volume or on any
3 other basis available for users of priority mail?

4 MR. McKEEVER: Mr. Chairman, I maintain my
5 objection, but I'm assuming that I have an objection to this
6 continuing line of questions and that the objection has been
7 overruled. My point in interjecting is I just want to make
8 sure that my failure to object doesn't mean that I do not
9 have an objection.

10 CHAIRMAN GLEIMAN: We understand that, I believe.

11 MR. McKEEVER: Thank you.

12 THE WITNESS: Could you repeat the question?

13 MR. CALLENDER: Sure.

14 BY MR. CALLENDER:

15 Q Are you aware that the -- are you aware of any
16 volume discounts or other -- discounts based on other
17 factors, are you aware of any of these discounts available
18 for users of priority mail?

19 A Yes. I do believe there is a presort discount for
20 priority mail which is suggested that it will be
21 discontinued by Mr. Sharkey.

22 Q Are you aware of any individually negotiated
23 discounts?

24 A No, I'm not aware of any of those.

25 Q Are you aware of any individually negotiated

1 discounts available to users of UPS second-day air and
2 three-day select?

3 A I do not know.

4 MR. CALLENDER: Thank you. I have no further
5 questions.

6 CHAIRMAN GLEIMAN: Parcel Shippers Association?

7 CROSS-EXAMINATION

8 BY MR. MAY:

9 Q Good to see you again, Mr. Luciani.

10 A Yes.

11 Q Just a few questions. If you would examine your
12 response to the Postal Service's Interrogatory 11(a), in
13 that response you explain your claim that, quote, "The
14 uncertainty surrounding this work sharing program" --
15 meaning DBMC -- "has not diminished" -- you explain that in
16 part by assigning as a reason the fact that the Postal
17 Service continues to use Mr. Acheson's top-down, quote,
18 "top-down" methodology from R90 to calculate the cost
19 avoidance, correct?

20 A That's correct.

21 Q Is it not the case that more often than not, for
22 example in the case of presort First Class mail, utilization
23 of the top-down methodology invented by Mr. Acheson for
24 calculating the costs of presorted mail tends to overstate
25 the actual cost of such mail rather than understate it?

1 A I am not aware of any bias one way or another
2 based on the top-down method.

3 I merely note here the uncertainty associated with
4 it.

5 Q Are you familiar with this Commission's decision
6 followed in several rate proceedings with respect to presort
7 First Class mail to use a separate Commission designed
8 methodology for calculating the actual cost avoidance of
9 presorted First Class mail because the top-down methodology
10 failed to calculate all of the efficiencies of that type of
11 mail?

12 Are you familiar with that decision?

13 A I am not specifically aware of the presort First
14 Class rate design issues.

15 Q And you don't know anything about the Commission's
16 treatment of that and their own -- creation of their own
17 methodology for determining the cost avoidance for presort
18 First Class?

19 A With respect to First Class presort, no.

20 Q Would you have reference to your response to
21 Postal Service Question 29?

22 A Yes.

23 Q Now in that question the Postal Service asked you
24 to confirm that an average revenue for Priority Mail
25 parcels, the average revenue being \$5.09, which was 86 cents

1 more than the average revenue for Priority Mail flats, asked
2 you to confirm whether that difference, that 86 cents more
3 revenue, might not offset the asserted cost difference
4 between Priority Mail parcels and flats of 13 cents.

5 Your response was that revenues are a function of
6 the rate schedule and that the schedule was designed only to
7 reflect differences in transportation costs and
8 non-transportation weight related costs but not shape, is
9 that correct?

10 A That's correct.

11 Q Now irrespective of what the rate schedule was
12 intended to reflect, is it not the case that within the same
13 Priority Mail subclass a Priority Mail piece that generates
14 86 cents more revenue than a Priority Mail piece that costs
15 only 13 cents more -- less is a substantially more
16 profitable, if I could use the word "profitable" in not
17 meaning actual profits but a more profitable in that
18 sense Priority Mail piece for the Postal Service?

19 MR. McKEEVER: Objection, Mr. Chairman. I am not
20 sure which question Mr. May wants Mr. Luciani to ask -- he
21 said more and then he said less in the same question and I
22 am not sure which he wants and I take it he is assuming that
23 the only difference is 13 cents.

24 MR. MAY: Mr. Chairman, counsel well knows that
25 the question was less, but let me repeat the question.

1 I don't want this witness to misunderstand.

2 CHAIRMAN GLEIMAN: Well, it is helpful for the
3 bench to understand too, and I did hear you say more and
4 then less, and I assumed it was less --

5 MR. MAY: Yes.

6 CHAIRMAN GLEIMAN: -- but I don't know that for
7 sure, so let's clarify and make sure we are all on the same
8 wavelength here.

9 MR. MAY: Yes.

10 BY MR. MAY:

11 Q The question you were asked is you have a Priority
12 Mail piece, parcels, presumed -- average revenue from that
13 being \$5.06 -- \$5.09, excuse me, \$5.09 and that is 86 cents
14 more per piece revenue than the average flat piece.

15 Are we okay so far?

16 A Yes.

17 Q Now they asked you and I am asking you, isn't it
18 the case, quite apart from what rates are intended to
19 reflect, that such a piece, a parcel that produces 59
20 cents -- excuse me, 86 cents more revenue is a more
21 profitable parcel to the Postal Service even though it may
22 cost 13 cents more to process than a flat that produces 86
23 cents less revenue?

24 MR. McKEEVER: Objection to the use of the term
25 "profitable" --

1 MR. MAY: Mr. Chairman, I did define the term
2 "profitable" to mean a more generous return to the Postal
3 Service.

4 MR. McKEEVER: A larger contribution to
5 institutional costs is the way I interpret that, Mr.
6 Chairman.

7 MR. MAY: That is fine with me, Mr. Chairman.

8 CHAIRMAN GLEIMAN: Okay. That is what you
9 intended to mean?

10 MR. MAY: Indeed it is.

11 CHAIRMAN GLEIMAN: Thank you, sir. Can you answer
12 the question now?

13 THE WITNESS: Yes, I can.

14 I don't believe it has a higher contribution per
15 piece on a percentage basis.

16 The rates were derived with a consistent markup
17 across all rate cells.

18 On a per piece basis it would have more
19 contribution buried in that particular rate, but on a
20 percentage basis as a markup, it would not.

21 BY MR. MAY:

22 Q Well, I mean if we want to look at it that way,
23 you might actually say that in terms of -- that Parcel Post
24 might actually be contributing more dollars than First
25 Class, for example.

1 We are not talking about percentage.

2 The question was on a per piece basis. That was
3 the question.

4 I take it that you agree that, yes, the parcel,
5 the Priority Mail parcel, does in that case return more to
6 institutional costs than the flat, is that correct?

7 A No, I don't agree. Within the rate subclass in
8 and of itself, each rate cell is designed to have a
9 consistent markup percentage and therefore it has consistent
10 percentage profitability within that rate cell, within that
11 rate subclass.

12 On a contribution per piece, yes, I would agree
13 with you.

14 Q That was the question -- on a contribution per
15 piece.

16 Now if you will look at your answer to PSA
17 Question Number 3.

18 A Yes.

19 Q In that question you were asked to confirm that a
20 mailer who receives a 20 percent rate discount from a new
21 work sharing proceeding -- for example, a proposal in this
22 rate case -- for a 20 percent discount that you are talking
23 about in your testimony, you were asked to confirm that such
24 a mailer who receives a 20 percent discount but in turn then
25 has to lay out 30 percent more of his own money to do mail

1 prep and transportation, whether or not that was an
2 effective 10 percent increase for that mailer, and your
3 response was no, he found that it was only 4 percent.

4 Perhaps we had a misunderstanding in the way the
5 question was phrased. Let me re-do it again.

6 The mailer is paying a dollar per package. Under
7 the discount, he gets a 20 percent discount that you are
8 talking about in your case, so now he is paying 80 cents.

9 He has to pay, however, 30 percent of the dollar
10 he used to pay in additional transportation and mail prep
11 costs. Okay? That is 30 cents, is it not?

12 A I want to understand. This mail preparation and
13 transportation cost this mailer is incurring are not rates
14 paid to the Postal Service?

15 Q That's correct. These are his own costs, but
16 costs he didn't have before but costs that he has to incur
17 in order to meet the mail prep and drop shipment
18 requirements for this 20 cent discount that your testimony
19 speaks of.

20 MR. McKEEVER: Mr. Chairman, I don't believe there
21 is a question pending.

22 MR. MAY: The witness asked me to clarify a
23 question, Mr. Chairman, and I did.

24 BY MR. MAY:

25 Q You understand the question now?

1 A I understand your clarification --

2 Q Okay. Now under that circumstance, this 30
3 percent increase on the dollar is 30 cents, is it not?

4 A It depends on what starting point you want to talk
5 about.

6 Q Thirty cents of the dollar. He was paying a
7 dollar. He has got a 30 percent increase of the dollar to
8 do mail prep and transportation, but he is getting a 20
9 percent reduction in what he has to pay the post office.

10 MR. MCKEEVER: Mr. Chairman, is Mr. May asking the
11 witness to assume that his clients would do work sharing and
12 pay \$1.10 to the Postal Service instead of not doing work
13 sharing and pay a dollar to the Postal Service?

14 MR. MAY: Mr. Chairman, I didn't ask the witness
15 to assume anything other than what I put to the witness,
16 which was to ask the witness to assume his own talk about a
17 20 cent discount.

18 I asked the witness, and I repeat, if this mailer
19 who is getting this 20 percent discount, if that same mailer
20 also has to pay out of his pocket an additional 30 percent
21 to do mail prep and transportation, I am asking what is the
22 net result to this mailer?

23 BY MR. MAY:

24 Q And I asked you is it not the case that whereas
25 the mailer was paying before a dollar, he now paying \$1.10.

1 He is paying 80 cents to the post office and he is paying
2 another 30 cents for more labor to do mail prep and for
3 transportation.

4 Now is that what that result is? That is an
5 effective 10 percent increase in the cost of making a
6 mailing for that mailer, is it not?

7 A For that particular mailer, as you have laid out
8 the cost assumptions, it would be an increase if they chose
9 to participate in that work sharing program. It seems
10 unlikely if given a 20 cent discount but they have to incur
11 30 cents in cost to do it whether they would do so.

12 Q Well, suppose the alternative, the alternative the
13 Postal Service is giving is to pay a 20 percent increase in
14 rates if he doesn't do this additional preparation and
15 discounting?

16 A In that particular instance they may go ahead and
17 participate in the work sharing program, but the data
18 indicates that most of these work sharing programs that are
19 being proposed by the Postal Service, much of the volume is
20 already participating in the work sharing program.

21 Q I do intend to ask you about that, but you are
22 also familiar with the fact, are you not -- I guess you know
23 enough about these proposals to know that there are a number
24 of mailers, parcel mailers, who are going to have to pay 20
25 percent increases if they don't qualify for these discounts,

1 is that not the case?

2 A Yes. I believe I laid out the rate increases for
3 various rate categories within Parcel Post. I don't know
4 which ones of those, these particular mailers you are
5 talking about, would incur but there are various percentage
6 increases for the various rate categories. Yes.

7 Q So it's really not a far-fetched example, is it,
8 to suppose that someone might actually do the work-sharing
9 and drop-shipping even though they have to pay 30 cents in
10 order to get the 20-cent discount? That's not that
11 far-fetched under these circumstances, is it?

12 A There might be a particular mailer faced with
13 those circumstances.

14 Q Now if you would turn to your response to PSA-4.
15 In that question you were asked to document your
16 claim that 96 percent of the volume that will qualify for
17 the pre-bar code discounts is already being pre-bar coded.
18 You preface your response by stating that not being a lawyer
19 you are unable to address whether documents have been,
20 quote, admitted into evidence in this proceeding, close
21 quote. That's your answer.

22 Now you state that you rely on Ms. Mayes' work
23 papers, which state that this figure comes from Library
24 Reference H-163 captioned Fourth Class Market Research
25 Study.

1 Now, Mr. Luciani, I'm going to ask you to assume,
2 for purposes of this question I'm going to ask you, that
3 this study that you reference is not in evidence in this
4 proceeding. I'm going to ask you to assume that.

5 On the basis of that assumption, is it the case
6 that you have no study that you conducted that would
7 document your 96-percent figure, and that you know of no
8 evidence in the record of this proceeding that would support
9 your claim? Isn't that the case?

10 MR. McKEEVER: Mr. Chairman, I'll object to asking
11 the witness to make a legal assumption. I have no problem
12 with Mr. May's basic question. I think he doesn't need the
13 assumption that he wants the witness to make in order to ask
14 his question. And if he just eliminates the assumption and
15 asks him the question, I would have no objection to it.

16 MR. MAY: Mr. Chairman, I am perfectly entitled to
17 ask this question to assume that a particular document is
18 not in evidence. I'm perfectly -- there's nothing wrong
19 with that hypothetical. I'm asking this witness to tell us
20 if that isn't in evidence, is there anything else that he
21 knows of that is in evidence or any study he did that can
22 confirm his 96-percent figure?

23 MR. McKEEVER: Once again I object, Mr. Chairman,
24 because he asked him if it's in evidence. If he just would
25 drop that part of the question, I think he could get an

1 answer very easily.

2 CHAIRMAN GLEIMAN: Mr. May, I think that you can
3 get the same result by asking the witness whether he has
4 done any studies or is aware of any studies other than any
5 that may have been done by Ms. Mayes, and then I won't have
6 to try and sort through and figure out how to rule.

7 MR. MAY: Well, that's fine.

8 BY MR. MAY:

9 Q Do you know of any other support for your
10 contention other than that which you cited to?

11 A The only support I have is what Ms. Mayes used to
12 derive her rates. Her rates cannot be derived without use
13 of that study.

14 MR. MAY: Mr. Chairman, I ask that the Commission
15 take official notice of the fact and that the record reflect
16 that LRH-163 was never sponsored by any witness in this
17 proceeding and is therefore not in evidence in this
18 proceeding.

19 MR. McKEEVER: Mr. Chairman, I believe there's a
20 procedure to ask the Commission to take official notice of
21 something.

22 CHAIRMAN GLEIMAN: I'll ask you to put your
23 request in writing, Mr. May, and just as I didn't want any
24 other parties to be prejudiced earlier on, I'm perfectly
25 prepared to schedule proceedings to receive in evidence any

1 documents which anybody thinks need to be in evidence but
2 which aren't in evidence in this proceeding in order that we
3 have a full and complete record so that we can make a
4 decision based on the views of all of the experts that have
5 presented testimony under oath and/or participated in
6 developing library references which may have escaped the net
7 that was cast earlier on.

8 MR. MAY: Well, I understand -- Mr. Chairman,
9 there must be some end to this. We went through this again
10 and again with everybody having every possible chance to ask
11 the Post Office to supply witnesses for every conceivable
12 study. Now here we are almost at the end of the hearings
13 and now yet there's another opportunity for somebody to try
14 to sponsor an unsponsored study that heretofore no one in
15 this proceeding ever asked for. I object to that.

16 CHAIRMAN GLEIMAN: Well, put your request for
17 judicial notice and your objection in writing. All I can
18 say is that I and my colleagues are tasked with reviewing
19 all the materials and trying to make some -- provide some
20 thoughtful and well-based recommendations. And to the
21 extent that there's information out there that is useful for
22 that purpose, I think that it is poor public policy not to
23 allow that information to be made available to the record so
24 that we can make a thoughtful, considered decision.

25 Now when I see your arguments in writing, I may

1 conclude otherwise, because I know how articulate you are
2 and well-versed in the law, and I will not rule on it now,
3 but I don't want to preclude myself and my colleagues from
4 the opportunity to make a decision based on the best
5 available evidence or information. But --

6 MR. MAY: As long, Mr. Chairman, as your comments
7 do not presume that there's any evidentiary quality to this
8 study --

9 CHAIRMAN GLEIMAN: I don't.

10 MR. MAY: Which no one has vouched for up to this
11 point.

12 CHAIRMAN GLEIMAN: I don't presume anything at
13 all, unlike a lot of people. I presume everybody is here
14 seeking out truth, virtue, and the American way. I
15 recognize that everybody has a position that they espouse
16 which probably reflects an attempt to better themselves
17 relative to others. I don't think there's any party here
18 that doesn't intend to try and better their position in the
19 overall scheme of things. I just think that if there is
20 information available to us, that we shouldn't be denied the
21 information and make decisions based on a less-than-complete
22 record.

23 But, you know, put your arguments in writing. You
24 have convinced me in the past of the error of my ways, and
25 I'm sure that you're quite capable of doing that again.

1 MR. MAY: Well, I'm not suggesting any error at
2 this point --

3 CHAIRMAN GLEIMAN: No, no --

4 MR. MAY: I'm not suggesting -- I'm simply
5 pointing out the fact, and it is a fact, that something is
6 not in evidence. I do not intend to offer it into evidence,
7 and the Postal Service evidently did not either, since it's
8 their study. Why would I -- I have no way of knowing of any
9 quality of this study. I'm certainly not going to offer it
10 into evidence.

11 CHAIRMAN GLEIMAN: Well, Mr. May, if somebody
12 wants to make a motion to move it into evidence, if it
13 becomes crucial to their case, I'm going to entertain a
14 motion from that party or those parties, and the pressure
15 that I'm putting on is the pressure that we're putting on
16 ourselves and the staff here at the Commission, because the
17 time is dwindling. If someone wants -- you make a motion
18 regarding us taking notice of something that's not in
19 evidence, and we'll receive that and give it our full
20 consideration and thought, and if somebody else wants to
21 make any other motions, it's perfectly within their purview
22 to do so.

23 BY MR. MAY:

24 Q Mr. Luciani, just one more question. If you'll
25 look at your response to PSA-2, that question asked you if a

1 particular mail-processing function which is 100-percent
2 variable is avoided why 100 percent of the cost would also
3 not be avoided, and your response was that it is standard
4 Commission practice to pass through only a certain
5 percentage of avoided costs in the form of a discount.

6 Now while that response is of course correct, it
7 avoids answering the question, which I repeat. If a cost is
8 100 percent a variable, and the work-sharing avoids that
9 cost, is it not the case that 100 percent of that cost will
10 be avoided?

11 A I can answer that without the qualification that
12 it be 100-percent variable, because the way the avoided
13 costs are identified, that consists solely of attributable
14 cost, and if you're absolutely certain about the amount of
15 costs that are avoided, yes, it would be avoided by
16 bypassing those operations.

17 Q Well, I'm talking about the cost that you, United
18 Parcel Service, has contended in this case are 100-percent
19 variable. I'm talking about those costs.

20 A If you're referring to the discounts I have
21 identified when 100 percent volume variability is associated
22 with mail-processing costs, I went ahead and recalculated
23 the avoided costs, those particular ones. Is that what
24 you're referring to?

25 Q No. If you are correct that a particular cost is

1 100-percent variable and that cost is avoided because of the
2 work-sharing, then is it not the case that 100 percent of
3 that particular cost is avoided, even though you are arguing
4 that only 77 percent of it should be passed through in the
5 form of a discount?

6 MR. MCKEEVER: I believe, Mr. Chairman, Mr.
7 Luciani answered that question, but I have no objection to
8 him answering it again.

9 CHAIRMAN GLEIMAN: If you have no objection to him
10 answering it again, let's let him answer it again.

11 THE WITNESS: Regardless of whether mail
12 processing costs are 100-percent volume-variable or not, the
13 identified avoided costs, if one is certain that those are
14 the avoided costs, would be fully avoided if you bypass
15 those operations.

16 BY MR. MAY:

17 Q Okay. Now -- by the way, has the Commission in
18 the past allowed a 100-percent passthrough of claimed
19 avoided costs from presorting and work-sharing?

20 A You qualified it with presorting and work-sharing.

21 Q Well, as a form of work-sharing.

22 A I do not know specifically. It would not surprise
23 me if they have allowed up to 100 percent in certain
24 instances.

25 MR. MAY: That's all, Mr. Chairman.

1 CHAIRMAN GLEIMAN: Thank you, Mr. May.
2 Mr. Reiter.

3 MR. REITER: Thank you, Mr. Chairman.

4 CROSS-EXAMINATION

5 BY MR. REITER:

6 Q Good afternoon, Mr. Luciani.

7 A Good afternoon.

8 Q Would you turn to your response to Postal Service
9 Interrogatory 38, please?

10 A Yes.

11 Q You make a reference there to two items in
12 transcript volume 5, do you not?

13 A Yes, I do.

14 Q Do you happen to have that volume with you?

15 A I do not have the full volume. I do have the
16 particular pages that I cited.

17 Q Do you recall what those two items were that you
18 cited?

19 A I believe there was a placard that was posted when
20 I toured the Bulk Mail Center in Washington that indicated
21 the guidelines for drop-shipping mail at DBMCs, SCFs, and
22 delivery units. That was the first guideline.

23 And the second were guidelines I believe supplied
24 by Mr. Crum as part of an interrogatory response.

25 Q Do you recall whether those were called the

1 plant-verified drop-ship -- I'm sorry -- plant-verified
2 drop-shipment guidelines?

3 A The page I have has PVDS guidelines, so that's
4 probably correct.

5 Q You just have that one page that you cited; is
6 that right?

7 A I do.

8 Q I'd like to show you another page from that same
9 transcript.

10 A Okay.

11 Q This appears at transcript page 2301, which is
12 several pages earlier than the one page you did cite there

13 Do you recall seeing this page before?

14 A I'm certain that I at least skimmed through this
15 page, yes.

16 Q And this is labelled the introduction to the plant
17 verified drop shipment guidelines -- you recall seeing that
18 in that context?

19 A That's correct.

20 Q I direct your attention to the last paragraph,
21 which says, "Our primary intent is to help postal personnel
22 accept plant verified drop shipments transported by mailers
23 to destination postal facilities. In the event of any
24 ambiguity or discrepancy the regulations in the DMM and
25 official postal directives must be followed."

1 Do you see that?

2 A I see that.

3 Q Would that suggest to you that these guidelines
4 are of lesser force than postal regulations or other
5 official postal directives?

6 A It wouldn't necessarily suggest that to me -- only
7 that it may not be as complete as other sources.

8 Q Doesn't it say that the DMM and official postal
9 directives must be followed, as opposed to these guidelines
10 in the event of ambiguity --

11 A I'm sorry?

12 Q I'm sorry, in the event of ambiguity or
13 discrepancy.

14 A That is correct.

15 Q And would you not interpret that to mean that
16 those other sources, the DMM and official postal directives,
17 have supremacy over anything that it says in here in those
18 cases?

19 A As a general proposition, yes. I think it might
20 be meant more towards that there might be errors in this
21 particular document, but yes.

22 Q So you are agreeing with me that they would
23 supersede this document if -- in certain cases at least?

24 A If there is ambiguity or discrepancy, yes.

25 Q The other item that you cited in your response to

1 Interrogatory 38 I believe you said was a sign that was
2 posted at a postal facility you visited?

3 A Yes, it was I believe a cross-examination of Mr.
4 Crum that used that sign that had been posted, or a copy of
5 the sign that had been posted at the Washington BMC as part
6 of that cross-examination.

7 Q Do you remember whether it was actually in the
8 Washington BMC or the Southern Maryland P&DC, processing and
9 distribution center that adjoins it?

10 A I believe it was at the Washington BMC.

11 Q You have been to other postal facilities also,
12 haven't you?

13 A Yes, I have.

14 Q Have you seen the same sign in any of those?

15 A I did not see that placard at the Merrifield SCF
16 that I visited.

17 We did ask the plant manager with respect to his
18 procedures to be followed when drop ship mail arrived at the
19 SCF and he noted that their procedures were consistent with
20 what was in the placard and what are on these PVDS
21 guidelines.

22 Q But you neither saw the same sign nor asked the
23 same question with respect to other BMCs or P&DCs, is that
24 correct?

25 A I did not see the placard at the SCF and did not

1 ask others that question.

2 Q May I ask you now to look at your response to
3 Postal Service Interrogatory 3, please.

4 A Yes.

5 Q At the same time, would you also look at your
6 Exhibit 4B?

7 A A particular page of 4B?

8 Q I'm sorry, page 2.

9 A Yes.

10 Q In line numbers 5, 6, and 7 there you first
11 estimate unit inter-BMC outgoing costs at the origin BMC; is
12 that correct?

13 A Yes, those are taken from Ms. Daniel's testimony.

14 Q And then to get total outgoing ASF costs when
15 operating as a BMC, you've multiplied those unit costs by
16 volumes; is that correct?

17 A Yes.

18 Q Would you agree that for -- to get total costs for
19 ASFs acting as a BMC, both the unit costs and the volumes
20 have to be when the ASF acts as a BMC?

21 A That would be the intent; yes.

22 Q And in your response to interrogatory 3, you
23 stated, confirmed that I have excluded outgoing costs at
24 ASFs when the ASF acts as a BMC; is that correct?

25 A That's correct.

1 Q Could you explain how you isolated when the ASF
2 acts as a BMC?

3 A What I did was estimate, use the outgoing cost at
4 the BMC to estimate the costs at the ASF when acting as a
5 BMC. I had information supplied by Ms. Mayes' interrogatory
6 response which indicated the origin and destination by ASF
7 and/or BMC, and I used that as the volume, and applied the
8 outgoing costs at each BMC as estimated by Ms. Daniel,
9 multiplied those two figures, to come up with the amount of
10 costs incurred at the ASF when acting as a BMC.

11 Q I'd like to ask you a couple of questions about
12 Priority Mail. Are you aware of whether other shippers in
13 that market impose a surcharge on parcel-shaped pieces?

14 A I believe I answered an interrogatory on that, but
15 the answer was I do not know.

16 Q Do you know whether there are any differences in
17 mail-processing operations in handling Priority Mail based
18 on the shape of the mail piece?

19 A Could you repeat that question?

20 Q You've observed mail-processing operations; am I
21 correct?

22 A Yes, I have.

23 Q Are you aware of whether there are any differences
24 in handling Priority Mail pieces based on their shape?

25 A I'm aware of those differences by shape in the new

1 PMPC contract.

2 Q Differences in handling?

3 A That's my understanding. They must be
4 containerized in different types of containers under the
5 PMPC contract.

6 MR. REITER: That's all I have.

7 Thank you, Mr. Luciani. Thank you, Mr. Chairman.

8 CHAIRMAN GLEIMAN: Is there any followup?

9 Questions from the bench?

10 Commissioner LeBlanc.

11 COMMISSIONER LeBLANC: Mr. Luciani, I just need
12 one clarification, if you can. When you appeared before us,
13 we didn't take all that you had brought out last time, but
14 parcel post has been growing pretty substantially ever
15 since, and you talk about a lot of the uncertainties in the
16 77 percent pass-through. Did you look at, when you looked
17 at the 77 percent pass-through, did you look at any kind of
18 special difference between parcel sizes as well as shapes?

19 THE WITNESS: That is one thing that I think was
20 not done by the Postal Service. I did point that out as one
21 of my key uncertainties associated with DBMC discount, in
22 that the Postal Service did not take into account the much
23 lower density of DBMC, which, in general, means it will be
24 larger sized pieces.

25 COMMISSIONER LeBLANC: Correct.

1 THE WITNESS: Fewer would fit in a particular
2 container. And I believe that has to be taken into account
3 when you want to derive the amount of avoided costs for
4 DBMC.

5 COMMISSIONER LeBLANC: But bear with me, we have
6 had a lot of paper, and you may have had it in here and I
7 missed it. Did you show that in your rate anywhere?

8 THE WITNESS: I was unable to determine the impact
9 of that -- of that lower density.

10 COMMISSIONER LeBLANC: Okay. That's --

11 THE WITNESS: And so, as a result, I recommend a
12 77 percent pass-through, one of the reasons for the 77
13 percent pass-through to reflect that type of uncertainty.

14 COMMISSIONER LeBLANC: Okay. That's what I
15 thought. Thank you very much.

16 Thank you, Mr. Chairman.

17 CHAIRMAN GLEIMAN: Any other questions? Follow-up
18 as a result of questions from the bench?

19 [No response.]

20 CHAIRMAN GLEIMAN: If not, that brings us to
21 redirect. How would you like to have 10 minutes with your
22 witness? We will come back at 20 of the hour.

23 MR. McKEEVER: Mr. Chairman, we have no redirect.

24 CHAIRMAN GLEIMAN: In that case, you don't get 10
25 minutes.

1 [Laughter.]

2 CHAIRMAN GLEIMAN: We want to be equally unfair to
3 everyone here.

4 If that is the case, Mr. Luciani, I want to thank
5 you. We appreciate your appearance here today and your
6 contributions to the record. And if there is nothing
7 further, you are excused from these proceedings on the
8 assumption that we will not receive a notice from someone
9 that they want to cross-examine you on the 3rd regarding
10 your supplemental testimony.

11 [Witness excused.]

12 CHAIRMAN GLEIMAN: We will convene tomorrow, the
13 26th, at 9:30. We are scheduled to hear testimony from
14 Alliance of Independent Store Owners and Professionals,
15 Witness Otuteye; Magazine Publishers of America, Witnesses
16 Little and Glick; Newspaper Association of America, Witness
17 Donlan; McGraw-Hill, Witness Hehir, Newspaper -- National
18 Newspaper Association, Witnesses Heath and Speights;
19 National Association of Presort Mailer, Witness MacHarg; and
20 ValPak Direct Marketer Systems, ValPak Dealers Association,
21 Carol Wright, Witness Haldi; and also we will hear from
22 Advertising Mail Marketing Association, Witness Schick, who
23 has been scheduled -- rescheduled yet again, to appear at
24 the end of the day tomorrow. Testimony of Witness Monastro
25 representing the Recording Industry of America was withdraw

1 yesterday and, therefore, his appearance has been cancelled.

2 I want to thank you all and I look forward to
3 receiving all your notices and motions. Thank you. Have a
4 lovely afternoon.

5 [Whereupon, at 2:29 p.m., the hearing was
6 recessed, to reconvene at 9:30 a.m., Thursday, February 26,
7 1998.]

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