

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

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

**RESPONSES OF POSTAL SERVICE WITNESS KIEFER
TO INTERROGATORIES OF UNITED PARCEL SERVICE
(UPS/USPS-T37-1 - 3(a)-(c), (e), 4-5, 7-8)**

The United States Postal Service hereby provides the responses of witness Kiefer to the following interrogatories of United Parcel Service, filed on June 20, 2006: UPS/USPS-T37-1 - 3(a)-(c), (e), 4-5, 7-8. Interrogatory UPS/USPS-T37-3(d) was redirected to witness Page and interrogatory UPS/USPS-T37-6 was redirected to witness Coombs.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking

Scott L. Reiter

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2999, Fax -5402
scott.l.reiter@usps.gov
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UPS/USPS-T37-1. Provide the back-up calculations for each of the rate increase figures cited on page 22 of USPS-T-37 in Section VII., Financial Impact of Rates.

RESPONSE

The calculations supporting the overall percentage change in line 3 are in WP-PP-37. Calculations for the remaining percentage changes by rate category can be found in the two attached workbooks, UPS-USPS-T37-1 WORKSHEET-A.xls and UPS-USPS-T37-1 WORKSHEET-B.xls in the sheets with the tab titles "Rate Class Increases" and "Constant Mix Increases." The "A" version of the worksheet assumes migration of pieces from Priority Mail to avoid dim weight pricing; the "B" version assumes no migration. The original calculations supporting the percentage changes on page 22 of my testimony were developed before I made some small corrections to the workpapers. These corrections were cited in my testimony in footnote 10 on page 19. The attached workbooks therefore were updated to contain those corrections, plus several further minor corrections made in response to POIR 3. In addition, I discovered and corrected an inconsistency in WP-PP-13 in the PRS Adjusted Revenue. In WP-PP-13 (Adjusted TYBR Revenue) the PRS revenue was multiplied by the Parcel Select revenue adjustment factor, whereas in WP-PP-36 the TYAR PRS revenue was not multiplied by the same factor. In the attached workbooks, neither calculation applies the Parcel Select revenue adjustment factor since I am not persuaded that this adjustment is appropriate for PRS pieces. As a result of my corrections to the original (i.e. pre-filing) workpapers, several of the percentage changes reported in my testimony on page 22 change slightly. The 13.2 percent figure in line 10 should become 13.3 percent; the 14.0 percent figure in line 11 should become 14.1 percent; and the 13.1 percent figure in line 18 should become 14.0 percent.

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UPS/USPS-T37-2. Refer to library reference USPS-LR-L-82, WP-PP-1, in this docket, and Docket No. R2001-1, USPS-T-33, WP-PP-1. Confirm that OMAS volume is no longer being separately identified for inter-BMC parcels in the R2006-1 Parcel Post rate design. If confirmed, explain the reason and explain how OMAS volume is being treated in Postal Service rates. If not confirmed, explain in detail.

RESPONSE

Confirmed that OMAS volume is no longer separately identified in the Inter-BMC rate design. OMAS volume is no longer separately reported in the RPW or billing determinants data. OMAS volume is combined with private sector volume, so that, for example, the Inter-BMC volumes, revenues and weights that are reported contain data for both private sector and OMAS pieces. Inter-BMC OMAS pieces pay the applicable Inter-BMC rates, so that all volume or revenue figures that are reported for the Inter-BMC category either in RPW or in my workpapers are composites of private and OMAS pieces.

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UPS/USPS-T37-3. Refer to library reference USPS-LR-L-82, WP-PP-1 and WP-PP-20.

(a) Confirm that the cost of no-additional-fee electronic Delivery Confirmation for Parcel Select is used to arrive at the \$0.107 per piece “Additional Parcel Select Per-Piece Charge” in line [y] of WP-PP-20 via the following steps:

1. Electronic Delivery Confirmation Unit Cost of \$0.1073 per piece;
2. multiplied by 286,738,488 Parcel Select TYBR pieces;
3. multiplied by 80%, the “Share of Parcel Select Using No-Fee Delivery Confirmation;”
4. multiplied by 124.2% Gross Markup Factor (including contingency);
5. divided by 286,738,488 Parcel Select TYBR pieces.

If any step is not confirmed, explain in detail.

(b) Confirm that the source listed on WP-PP-1 for the Electronic Delivery Confirmation Unit Cost of \$0.1073 per piece on line [17k] is “Estimated value.” If not confirmed, explain in detail.

(c) Confirm that the source listed on WP-PP-1 for the “Share of Parcel Select Using No-Fee Delivery Confirmation” on line [13] is “Assumption.” If not confirmed, explain in detail.

(d) Refer to library reference USPS-LR-L-59, Attachment 4D and Attachment 14A, page 3.

- i. Confirm that the cost of no-additional-fee electronic Delivery Confirmation for Package Services applied in the final adjustments process is \$0.1467 per piece per Attachment 4D, “Volume Variable Costs Summary – Delivery Confirmation TY 2008(BR).” If not confirmed, explain in detail.
- ii. Confirm that in the final adjustment process in Attachment 14A, “Shift Other Special Services Cost to Respective Subclass,” this cost of \$0.1467 per piece is applied to 100% of the Parcel Select volume. If not confirmed, explain in detail.

(e) Confirm that if the cost of electronic Delivery Confirmation is \$0.1467 per piece and is applied to 100% of the Parcel Select volume, then the “Additional Parcel Select Per-Piece Charge” in WP-PP-20 would increase from \$0.107 per piece to \$0.1822 per piece, all else equal. If not confirmed, explain in detail.

RESPONSE

- a. Confirmed.
- b. Confirmed.
- c. Confirmed.

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- d. Redirected to witness Page (USPS-T-23).
- e. Confirmed.

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UPS/USPS-T37-4. Refer to library reference USPS-LR-L-82, WP-PP-33 and WP-PP-34.

(a) Confirm that 33% of the Priority Mail volume lost due to the commencement of dimensional weight pricing is assumed to migrate to Inter-BMC Parcel Post. If confirmed, provide the source for this assumption. If not confirmed, explain in detail.

(b) Confirm that 877,033 Priority Mail pieces are assumed to migrate to Inter-BMC Parcel Post in the TYAR, yielding additional Parcel Post revenue of \$9,976,403. If not confirmed, explain in detail.

(c) Refer to library reference USPS-LR-L-59, Attachment 14A, page 18. Confirm that the migrating pieces yield \$17,337,698 of additional Parcel Post costs in the TYAR. If not confirmed, explain in detail.

(d) Provide and describe in detail all studies and analyses regarding the likely loss of Priority Mail volume due to the commencement of dimensional weight pricing, the likely migration of this volume to Parcel Post, or the likely migration of this volume to other Postal Service services or to Postal Service competitors.

RESPONSE

- a. Confirmed. The source for this assumption is a judgment, made in consultation with witness Scherer (USPS-T-33), that a not insignificant amount of the volume leaving Priority Mail will migrate to Parcel Post (despite the loss in service standard), if only owing to the convenience of continuing to be able to tender a parcel at the post office retail window. On the other hand, I understand from witness Scherer that Priority Mail without dim-weighting is significantly lower-priced than the dim-weighted 2- and 3-day air competition. This has no doubt caused Priority Mail — and the Postal Service — to attract many parcels that it otherwise would not have attracted. Once Priority Mail dim weight pricing is implemented it is reasonable to believe that many of these parcels are susceptible to leaving the Postal Service altogether. Hence I am assuming that 33 percent would migrate to Parcel Post with 67 percent going elsewhere. For Parcel Post, the assumption was made that 100 percent of the migrating volume would

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pay Inter-BMC rates because Priority Mail dim-weighting will apply only in Zones 5 - 8, where there is very little Intra-BMC Parcel Post volume.

- b. I can confirm the volume estimate. Due to minor corrections to my workpapers (cited in footnote 10 to my testimony) the prices in the workpapers differ in a few cells from the Inter-BMC prices that I am proposing. Using the proposed prices (rather than the prices in the workbook), the migrating pieces are estimated to generate additional revenue of \$9,975,465.
- c. I can confirm that this figure appeared in USPS-LR-L-59. Due to a correction in my workpapers in response to POIR 3, my best estimate of the additional cost is now \$17,303,502.
- d. The likely loss of Priority Mail volume due to the implementation of dimensional weight pricing is documented in witness Scherer's USPS-LR-L-120. No study has been conducted on where this volume may migrate. Instead, I made the assumption discussed in subpart (a) above.

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UPS/USPS-T37-5. Refer to library reference USPS-LR-L-82.

(a) Confirm that in the Parcel Post rate design you have applied a 100% passthrough for DBMC-entry, DSCF-entry, and DDU-entry worksharing savings. If confirmed, explain why a 100% passthrough was selected. If not confirmed, explain in detail, provide the passthrough(s) that you have applied, and explain why you selected these passthrough(s).

(b) Confirm that, assuming a 100% passthrough of worksharing savings, the contribution per piece for workshared categories of Parcel Post in the preliminary rates should be the same as that of the non-workshared categories from which the workshared categories' preliminary rates are derived. If not confirmed, explain in detail.

RESPONSE

- a. I can confirm that my rate design passes through 100 percent of the non-transportation cost differentials for DBMC, DSCF and DDU rate categories in developing the preliminary rates for these rate categories. Since this portion of my rate design was focused on developing preliminary rates, I saw no need to alter the full passthrough of the cost differentials. Later adjustments were made to the preliminary rates to achieve the final proposed rates. These adjustments were made to the rates themselves, and not to components like the cost differentials. I do not have comparable "worksharing savings" figures for transportation costs, so transportation costs were not treated in the same way.
- b. Please see my response to UPS/USPS-T33-27 in Docket No. R2001-1. The reasoning, which in that response applied to DDU Parcel Select, also applies to DSCF and DBMC Parcel Select as well.

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UPS/USPS-T37-6. Describe in detail all differences in the processing and delivery of Priority Mail pieces and Parcel Post pieces upon reaching the DDU.

RESPONSE

Redirected to witness Coombs (USPS-T-44).

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UPS/USPS-T37-7. Refer to library reference USPS-LR-L-82.

(a) Confirm that the “pound charges” by rate category derived in workpaper WP-PP-21 include the transportation charges by rate category derived in workpaper WP-PP-15. If not confirmed, explain in detail.

(b) Confirm that the pound charges derived in workpaper WP-PP-21 include a markup, through application of a markup factor of 123%, to the underlying costs. If not confirmed, explain in detail.

(c) Confirm that DBMC destination-entry parcels, DSCF destination-entry parcels, and DDU destination-entry parcels represent workshared rate categories of Parcel Post. If not confirmed, explain in detail.

(d) Confirm that it is standard Postal Rate Commission practice in deriving worksharing category rates to deduct the passed-through worksharing cost savings from the rate assigned to the non-workshared rate category. If not confirmed, explain in detail and provide references to where the Commission in its Opinions and Recommended Decisions has accepted alternative practices.

(e) Confirm that deriving preliminary rates by marking up the underlying transportation costs for each individual non-workshared rate category and each workshared rate category results in transportation worksharing cost avoidances being marked up. If not confirmed, explain in detail.

(f) Confirm that the Commission explicitly stated in its Opinion and Recommended Decision in Docket No. R97-1, at 489, that Parcel Post transportation worksharing cost differences should not be marked up in deriving Parcel Post rates. If not confirmed, explain in detail.

(g) Explain in detail why you have chosen to markup transportation worksharing cost avoidances in your derivation of Parcel Post rates.

(h) Confirm that deriving preliminary rates by marking up the underlying transportation costs for each individual non-workshared rate category and each workshared rate category results in contributions per piece for workshared rate categories that are less than the contributions per piece for non-workshared rate categories.

RESPONSE

- a. I can confirm that the preliminary pound charges derived in WP-PP-21 include the transportation charges by rate category derived in WP-PP-15.
- b. Confirmed for the preliminary pound charges in workpaper WP-PP-21.
- c. Confirmed.
- d. Please see my responses to UPS/USPS-T33-17 subparts (d) and (h) in Docket No. R2001-1.

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- e. Please see my response to UPS/USPS-T33-17 subpart (f) in Docket No. R2001-1. If by “being marked up” the question means applying markup that is equivalent to the markup that would be applied to unit costs if a wholly top-down rate setting approach were used, then the statement is not confirmed. Please see my response to UPS/USPS-T33-17 subpart (e) in Docket No. R2001-1. I can confirm that the approach I have followed does result in transportation costs for different rate categories receiving a markup, thereby resulting in the cost differences between the rate categories also being marked up.
- f. Please see my response to UPS/USPS-T33-17 subpart (g) in Docket No. R2001-1.
- g. Please see my response to UPS/USPS-T33-17 subpart (h) in Docket No. R2001-1. It should be borne in mind that these markup calculations are performed to achieve the preliminary charges, and that this is just the starting point for developing the final proposed rates. Please see also my responses to UPS/USPS-T33-42 subpart (c) and UPS/USPS-T33-41, both in Docket No. R2001-1.
- h. Not confirmed. Please see my response to PSA/USPS-T37-10 in this docket. Since CRA costs for Parcel Post are measured only at the subclass level, all costs below the subclass level are assigned, using reasonable methodologies, for the purpose of developing rates. As I pointed out in my response to the PSA question, I do not know how precisely these assigned costs correspond to actual costs on a rate category basis. For this reason, I do not know the rate category level unit contributions actually produced by my preliminary rates, and I cannot confirm that the unit contributions for the Inter-BMC and Intra-BMC rate categories are higher than the unit

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contributions for the Parcel Select rate categories. In any event, the preliminary rates are not the final rates, and differences or lack of differences between rate category unit contributions in the preliminary rates are likely to change between the preliminary rates and the rates that are ultimately proposed. To illustrate the danger of trying to infer actual unit contributions by performing calculations on my assigned costs, please see PSA/USPS-T37-10, subpart (a) as well as my response. Based on assigned costs, PSA has inferred that the “average unit contribution of Intra-BMC parcels is 3 cents.” While I do not confirm that amount, consider that statement in conjunction with UPS’s assertion in this question that my methodology will lead to the circumstance where “contributions per piece for workshared rate categories ... are less than the contributions per piece for non-workshared rate categories.” If UPS’s and PSA’s assertions were both true, then the unit contributions for all of Parcel Select (as well as Intra-BMC Parcel Post) would be less than three cents per piece. The TYAR volume for all of these pieces is 290 million pieces, or more than 78 percent of Parcel Post subclass mail. Multiplied by three cents per piece the total “contribution” from Intra-BMC plus Parcel Select would be less than \$9 million. What, then, accounts for the remaining \$181 million in Parcel Post contribution? It is unrealistic to conclude that Inter-BMC rate pieces (78 million in TYAR) pay on average \$2.31 per piece in contribution (\$181 million divided by 78 million pieces) while all the other rate categories contribute less than three cents per piece. I can only conclude that PSA’s and UPS’s attempts to infer unit contributions at the rate category level run the risk of producing seriously misleading results.

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UPS/USPS-T37-8. Refer to library reference USPS-LR-L-82, WP-PP-19 and WP-PP-20.

(a) Explain in detail your reasoning for deducting each of the following items in deriving the per piece charge:

- i. Other Revenue – Alaska Bypass Revenue;
- ii. Other Revenue – Combination Enclosure Revenue;
- iii. Other Revenue – Pickup Revenue; and
- iv. Excess Costs of Oversized and Balloon Parcels.

(b) Explain why the unit costs for the Non-Machinable surcharges were used to arrive at the “Surcharges” to deduct in the calculation of the per piece charge.

- i. Explain why the proposed rates for the Non-Machinable surcharges were not used to arrive at the “Surcharges” to deduct.
- ii. Confirm that using the unit costs is a change from the Postal Service’s methodology used in Docket No. R2000-1. If confirmed, explain why the change was made. If not confirmed, explain in detail.

RESPONSE

a. The per piece charge is the basic charge per piece for the benchmark piece, a non-workshared Inter-BMC machinable piece that is not a balloon or oversized piece. The excess costs of balloon and oversized pieces is covered by the “extra” charges for these pieces and so is not included in developing the basic charge per piece. Similarly the other revenue sources are deducted because they are separately recovered and so should not be part of the basic charge per piece (otherwise they would be double-recovered).

b. (i) In general, my approach views the development of the preliminary rates as reflecting the rates that would obtain before any mitigation or policy adjustments are made. For this reason I use the cost differences (i.e. assume a 100 percent passthrough), rather than impose an *a priori* passthrough adjustment, when I develop the preliminary rates. This puts all of the revenue shifts caused by rate change mitigation and other policy

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adjustments (such as, maintaining the Priority Mail / Inter-BMC and DBMC-Intra-BMC rate differentials) on the same footing when the preliminary rates are adjusted to obtain the final proposed rates.

(ii) I can confirm that a different approach was followed in Docket No. R2000-1. Unless one knows in advance whether, or to what degree, the nonmachinable costs will be mitigated in the final rates, I think my preferred approach is better for the reasons I cited in subpart (i), above.