

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

POSTAL RATE AND FEE CHANGES, 2006 )

Docket No. R2006-1

RESPONSES OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND  
VALPAK DEALERS' ASSOCIATION, INC.

WITNESS ROBERT W. MITCHELL TO INTERROGATORIES OF  
THE UNITED STATES POSTAL SERVICE (USPS/VP-T1-28-31)

(October 12, 2006)

Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc.

("Valpak") hereby submit responses of witness Robert W. Mitchell to the following interrogatories of the United States Postal Service: USPS/VP-T1-28-31, filed on September 28, 2006. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

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**Response of Valpak Witness Mitchell  
to Interrogatory of the United States Postal Service**

**USPS/VP-T1-28.**

Please refer page 97 of your testimony where you discuss your proposed cost coverages and rate increases for Standard Mail.

- (a) Please confirm that your proposed rate increase for Standard Mail Regular is 17.6 percent, approximately 6.8 percentage points higher than the Postal Service's proposed rate increase for Standard Mail Regular and your proposed rate decrease for ECR is 8.5 percent, approximately 16.3 percentage points lower than the Postal Service's proposed rate change for ECR.
- (b) Please confirm that your testimony proposes no changes to cost coverages or rates proposed by the Postal Service for mail subclasses outside of Standard Mail.
- (c) Please confirm that under your proposals Standard Mail Regular and Nonprofit Regular will generate \$18.6 billion in revenue in the test year, and Standard Mail ECR and Nonprofit ECR will generate \$5.7 billion in revenue, for a total Standard Mail revenue of \$24.2 billion, and that this total revenue is approximately 30 percent of the Postal Service's revenue requirement in the test year.
- (d) Please state whether you considered how your proposed Standard Mail pricing should affect the pricing of mail classes and subclasses outside of Standard Mail, giving particular attention to First-Class Mail in your response.
- (e) If your response to part (d) is that there should be no impact on prices outside of Standard Mail, please explain your rationale fully.
- (f) If your response to part (d) is that there should be an impact, please explain why you did not propose alternate cost coverages and rate designs for other mail classes and subclasses, giving particular attention to First-Class Mail in your response.

Response:

- (a) Confirmed.
- (b) Confirmed.
- (c) Confirmed.
- (d) I considered First-Class, to some degree, as discussed in the section beginning on page 94 of my testimony. It is not easy to summarize the evolution of the

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Commission's preference for a cost coverage on Standard mail that is somewhat below the coverage on First-Class, and opinions might differ on how to do it.

Remembering that Standard was third class before Docket No. MC95-1, I believe it is fair to summarize it as follows: "It is understood that emphasis on economic efficiency would bring a coverage on third class that is considerably lower than the coverage on First-Class, because of the high elasticity of third class. However, First-Class is most strongly affected by the Private Express Statutes and by requirements that some materials *must* be sent First-Class. For reasons of national policy, including recognition of the Private Express Statutes, the Commission believes it best to set the cost coverage on third class only a little lower than the coverage on First-Class, not a lot lower." If this is a fair summary, it needs to be recognized that, since Docket No. R95-1, third class has been deaveraged and the elasticity of Standard Regular is just slightly below the elasticity of First-Class as estimated by Postal Service witness Thress.

- (e) My view is that the recommendation in Docket No. MC95-1 was to deaverage third class into Regular and ECR, to the point of creating two separate subclasses, and that an implication of deaveraging is that one coverage should increase and the other should decrease. In its simplest form, no other subclasses are necessarily involved. This general issue is discussed at some length in my testimony. *See* sections beginning on pages 26, 30, and 91, as well as the entire Introduction, beginning on page 6.

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- (f) My testimony is based on two presumptions: (1) that it is possible and reasonable to present testimony that analyzes the cost coverage of a subclass or a pair of subclasses and comes to conclusions on their cost coverage, without reviewing every other subclass and providing an overall analysis of financial breakeven for the Postal Service; and (2) that the Commission is highly proficient at assessing such testimony, along with testimony on other subclasses, and dealing in detail with the question of overall breakeven. The number of witnesses who have done just this in the past is very large. Also, I have not analyzed other subclasses.

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**USPS/VP-T1-29.**

Please confirm that your testimony and workpapers do not estimate the impacts of your pricing proposals on Standard Mail volumes or test year after rates revenues.

Response:

Confirmed. Note, however, that the difference between before-rates and after-rates cost coverage is usually very small.

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**USPS/VP-T1-30.**

Please refer page Charts 1 and 2 in your testimony where you show the percentage rate increases you are proposing for mailers of Standard Mail Regular and Nonprofit Regular flats.

- (a) Is it your view that at their current rates, Standard Mail Regular and Nonprofit Regular cover their volume variable costs? Please explain in detail any failure to confirm that these pieces cover their costs.
- (b) Please confirm that your proposals would require some commercial mailers of minimum-per-piece-rated flats to experience rate increases exceeding 50 percent?
- (c) Please confirm that your proposals would require some nonprofit mailers of minimum-per-piece-rated flats to experience rate increases exceeding 100 percent?
- (d) Please explain whether you examined the impacts that such large rate increases would have on mailers of lightweight flats and explain why you believe that these rate increases are appropriate regardless of their impact on mailers.

Response:

- (a) As I read the Domestic Mail Classification Schedule, “Standard Mail Regular” and “Nonprofit Regular” are separate subclasses. However, since separate costs are not available for them, we have no way of estimating whether they cover their costs. If combined and viewed as one subclass, of course, they do cover their costs, which, given the 60-percent rule, assures that “Standard Mail Regular,” at least, does cover its costs.

One way to look further at this question is to examine some of the costs for specific categories. As shown on the ‘Inputs’ sheet of my workpapers, the cost of a non-automation flat at the mixed ADC level is estimated to be 35.497 cents in the test year, including only mail processing and delivery costs. The current

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Nonprofit rate for such a piece is 19.5 cents. A similar result exists for the category of automation flats. Even at the 5-digit level, a misalignment exists. The suggestion is that, at least for flats, the current Nonprofit rates are pretty far below costs.

- (b) See my response to USPS/VP-T1-23. The two percentages that are marginally over 50 percent are due in part to deaveraging, consistent with that proposed by the Postal Service. The extent to which some mailers may send all of their mail in one category is unknown, but it is likely rather low.
- (c) According to Chart 2 in my testimony, page 194, one category, automation flats at the mixed ADC level, would be over 100 percent, at 102.6 percent. I do not know if any mailers send all of their pieces in this category, but such would not generally be expected. These are pieces that are now being rated substantially below their costs. See my response to part (a) of this question.
- (d) I understand the size of the increases. Questions of appropriateness are discussed in the section beginning on page 110 of my testimony. Issues of fairness are discussed in the section beginning on page 71. As discussed several places in my testimony, these changes have been needed for some time.

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**USPS/VP-T1-31.**

- (a) Please confirm that under your rate proposals an origin-entered minimum-per-piece rated Standard Mail Regular automation 5-digit letter would pay a rate of 21.8 cents per piece and that the same letter, if it qualified as an ECR Basic letter would pay 18.5 cents, a difference of 3.3 cents. Explain any failure to confirm.
- (b) Please explain how your revenue, volume and contribution projections treat the impacts that are likely to arise from Regular automation 5-digit letters migrating to ECR in response to the 3.3 cent lower rates in ECR.

Response:

- (a) Confirmed.
- (b) See my response to USPS/VP-T1-1(d-e).