

ORIGINAL

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

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Special Services Fees and Classifications

POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY
Docket No. MC96-3

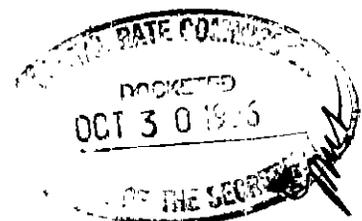
ANSWERS OF THE OFFICE OF THE CONSUMER ADVOCATE
TO INTERROGATORIES OF UNITED STATES POSTAL SERVICE
WITNESS: PAMELA A. THOMPSON (USPS/OCA-T200-1-9)
(OCTOBER 30, 1996)

The Office of the Consumer Advocate hereby submits the answers of Pamela A. Thompson to interrogatories USPS/OCA-T200-1-9, dated October 16, 1996. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

Emmett Rand Costich

EMMETT RAND COSTICH
Assistant Director
Office of the Consumer Advocate



ANSWERS OF OCA WITNESS PAMELA A. THOMPSON
TO INTERROGATORIES USPS/OCA-T200-1-9

USPS/OCA-T200-1.

(a) Please confirm that the Postal Service Board of Governors Resolution No. 95-9 does not limit the amount of net income to be earned by the Postal Service but rather states that net income may equal or exceed the cumulative prior years' loss recovery target prescribed by the Resolution. If you do not confirm, please explain what amount net income is limited to by the Resolution and how you determined the amount of the limit.

(b) Please confirm that the transcript of the Board of Governors meeting that you quote on page 9 of your testimony indicates that the Board was informed of the fact that Postal Service actual and planned net income exceeds the amount required by Board of Governors Resolution No. 95-9. If you cannot confirm, please explain why.

A. (a)-(b) Confirmed. Thus, the terms of the resolution will be met in both FY 96 and FY 97 without any rate increases.

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USPS/OCA-T200-2. On page 5 lines 10-12 of your testimony you state that "Docket No. MC96-3 abandons the earlier classification reform initiative goal of net revenue neutrality." On page 6, lines 8-12, you claim that "it is unfair and inequitable to depart from the earlier classification reform policy of net revenue neutrality by burdening special services alone with additional non-attributable net revenue requirements."

(a) In your opinion, would the proposals made by the Postal Service in this case have been more fair and equitable if Docket Nos. MC95-1 and MC96-2 had never been filed? Please explain your answer fully.

(b) In your opinion, must all future classification cases be based on the philosophy of net revenue neutrality espoused in Docket No. MC95-1? Please explain your answer fully.

A. (a) You appear to miss the point of my testimony. The Postal Service proposed classification reform principles and methodologies in Docket No. MC95-1.

In this Request, the Postal Service proposes to establish this framework as the basis for current and future classification reforms by restructuring the DMCS into four classes: Expedited Mail, First-Class Mail, Standard Mail, and Periodicals. (Emphasis added.)

Request of the United States Postal Service for Recommended Decisions on Classification Reform of First-, Second-, and Third-Class Mail, at 2. Prior to Docket No. MC96-3, the Postal Service proposed rates for the reformed subclasses that were designed to provide the same test year contribution to institutional costs as was projected by the Commission in Docket No. R94-1. Docket Nos. MC95-1 and MC96-2 used FY 95 as the test year. Docket No. MC96-3 does not; it uses FY 96 as the test year.

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CONTINUATION OF ANSWER TO USPS/OCA-T200-2:

The Docket No. MC96-3 Request of the United States Postal Service for a Recommended Decision on Special Service Changes, hereafter, Docket No. MC96-3 Request, proposes classification reform changes to a select few special services. In its Docket No. MC96-3 Request at 3, the Postal Service changes its own classification reform goal and states,

This filing is unusual in that it would have the effect of increasing net revenue for the Postal Service, outside of an omnibus rate proceeding.

The Postal Service's departure from the its own classification reform framework explicitly designed for current and future classification reforms in the midst of classification reform is discriminatory, arbitrary and capricious.

(b) No, not all future classification cases must be net revenue neutral. However, the Postal Service must be consistent in the application of the framework used when it elects to approach classification reform initiatives on a piecemeal basis. If the Postal Service had wanted to use classification reform to generate revenues, it should have done so from the beginning. If an unforeseen need for new revenue in FY 97 arose in the midst of

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CONTINUATION OF ANSWER TO USPS/OCA-T200-2:

classification reform, the Postal Service should have filed a rate case and explained why it needed new revenue in FY 97. Sparing its largest customers rate increases in MC95-1 and MC96-3 under the cloaks of "revenue neutrality" and "adjustments ... previously deferred" has the appearance of favoritism.

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USPS/OCA-T200-3. Under the omnibus rate case scenarios you postulate on pages 12-13 of your testimony (where \$339.4 million of revenue requirement is spread over all classes of mail or all classes except First Class Mail), could the first two goals for this case articulated by witness Lyons on pages 2 and 3 of USPS-T-1 be accomplished for the special services which are the subject of this docket? If your answer is other than no, please explain how these goals could be accomplished.

A. To insure clarity, I will identify what I understand to be the first two goals articulated by witness Lyons on pages 2 and 3 of his testimony.

First, the pricing and classification proposals are designed to place the services and products on a more economically rational, businesslike basis. . . .

Second, we have reviewed the service offerings themselves to see what improvements could be made to make them more useful to the customer, and both easier to administer and understand.

I do not believe that either goal is precluded from being accomplished in an omnibus rate case. To my knowledge, there is no restriction on the classification changes requested in an omnibus rate case. The examples provided at pages 12-13 of my testimony are provided to illustrate what the magnitude of an average rate increase would be, if the Postal Service chose to recover the additional net revenues through an omnibus rate case. Postal Service witness Lyons states in his testimony at 6, the following:

In the interest of mitigating the impact of general increases on its customers, the Postal Service would like to moderate the pace toward the eventual

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CONTINUATION OF ANSWER TO USPS/OCA-T200-3:

need to increase overall revenues as a result of rising cost levels. . . . The infusion of revenues from these sources would contribute to the Postal Service's general financial policy goals, including the Board of Governors' concern for restoring equity. The same logic could also apply to future proposals for new products or classification that would create additions to total revenues, outside of an omnibus rate case, and that would expand contributions to institutional costs.

If the Postal Service needed \$339.4 million additional net revenues, I cannot think of a reason why an omnibus rate case could not be filed and still achieve witness Lyons' first two goals. However, in an omnibus rate case, it is less likely that one mail class or subclass would be targeted for a rate increase while other classes or subclasses of mail escaped with stable rates.

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USPS/OCA-T200-4. At the bottom of page 4 and the top of page 5 of your testimony, you quote selected portions of statements from the Postal Service's Request in Docket No. MC95-1 in order to characterize the intent of "classification reform." Please confirm that the statements of which you have quoted portions were limited in scope to clarifying the intent of the Request in Docket No. MC95-1, and did not purport to address generic "classification reform." If you cannot confirm, please explain fully.

A. Not confirmed. Please see the response to
OCA/USPS-T200-2(a).

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USPS/OCA-T200-5.

(a) Please confirm that most (if not all) classes of mail and types of services face some type of competition, in the sense that users usually have some alternatives available to perform the same function performed by the class of mail or type of service? If you cannot confirm, please explain fully.

(b) Please confirm that the relationships between a service and the potential alternatives provided by competitors, in terms of price, quality, convenience, effectiveness, etc., are generally considered relevant in pricing that service. If you cannot confirm, please explain fully.

(c) Please confirm that the relationship between a postal service and the potential alternatives provided by competitors are specifically relevant in postal ratemaking. If you cannot confirm, please explain fully, including why such factors should not be reflected in consideration of 39 U.S.C. §§ 3622(b)(2), (4), and (5).

(d) Please confirm that the relationships between postal services and the potential alternatives provided by competitors are not necessarily static, and that the pace of change in the markets for postal products may vary considerably across postal products. If you cannot confirm, please explain fully.

(e) Please confirm that developments in the market for a particular postal product, independent of any general cost level increases or any specific changes in attributable costs for that product, may justify adjustments in the rates or fees for that product, under circumstances in which no omnibus rate changes are required. (Adjustments can be thought of as "justified" if, had the market developments in question occurred prior to the last general rate case and been considered during such a case, the result would or could have been different rates than those recommended.) If you cannot confirm, please explain fully.

A. (a) and (d) I cannot confirm. I have not conducted any market analysis, nor am I aware of any published Postal Service analyses that examine the interrelationships existing between postal products or between postal products and potential alternatives. However, your hypothetical is possible.

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CONTINUATION OF ANSWER TO USPS/OCA-T200-5:

(b)-(c) Confirmed.

(e) The scenario you present was not necessary for me to consider for purposes of my testimony, and I do not believe it is pertinent. If the additional information you hypothesize had been available in a prior general rate case, then all rates would likely have been different. In any event, I would expect the net revenue consequences of such adjustments to be minuscule. Otherwise, a general rate case would be in order. For example, if Priority rates were adjusted on the basis of new information so as to forgo \$1 billion of net revenue, I would expect the Postal Service to seek other adjustments as well. However, if single-piece third class were brought up to 100 percent cost coverage, I would not expect to see any other adjustments.

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USPS/OCA-T200-6. Please consider the following hypothetical. A new analysis conducted by the Postal Service shows that, in light of a variety of market considerations, users of one particular postal service are getting an extraordinarily "good deal," and that higher rates for that service could be implemented that would be fully in accord with the ratemaking factors of the Act. Assume that is not open to question that the higher **rate levels** suggested by the analysis comport with all factors of the Act, including fairness and equity. Because the Postal Service does not plan to file a general rate case in the immediate future, however, it has two options. Option One is to act immediately to bring the rates for this product in line with demand by filing a case seeking rate increases limited to that product. Option Two is to leave the rates unchanged until the next general rate case, at which time the rates will be increased in light of the new analysis.

(a) Please confirm that, under this hypothetical, the users of the service have done nothing to entitle them to continuation of this "good deal." If you cannot confirm, please explain fully.

(b) Please confirm that continuation of the "good deal" deprives users of all other services of a potential increased contribution to net revenue that could be provided by users of the service in question. If you cannot confirm, please explain fully.

(c) In your opinion, under this hypothetical, should the Postal Service be allowed to pursue Option One -- selective, but justified, price adjustments? Please explain your answer fully.

(d) Further assume that the new market analysis probably could have been conducted at the time of the last general rate increase if attention had been focused in that direction, but was not. Would this additional assumption change your answer to any of the previous subparts? Please explain any necessary changes fully.

A. (a)-(b) Not confirmed. This hypothetical is not plausible. A determination of fairness and equity requires a comparison of all relative cost coverages. You have assumed that such a comparison will not reveal any other rates that need

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CONTINUATION OF ANSWER TO USPS/OCA-T200-6:

adjusting. In addition, your hypothetical only states that "users of one particular postal service are getting an extraordinarily 'good deal,'" It says nothing about whether or not users of the service have done anything to entitle them to the continuation of this "good deal."

For purposes of illustration, the following scenario is provided. As Postal Service radio advertisements have stated, First-Class mailstream users get an extremely "good deal" on the price of a \$0.32 First-Class stamp especially when compared to the cost of similar service in other countries. It does not follow, however, that First-Class mailstream users have done nothing to entitle them to the "good deal."

In your hypothetical, users may indeed be getting an extraordinarily "good deal," although in my view it is those whose rates are near or below cost who are getting the best deal. However, your interrogatory implies that all postal products should pay profit-maximizing prices. Otherwise, some users would always be "deprived" of potential increased contributions to net revenue. Specifically, in this case, certain special services are being deprived of the contribution that might be available if

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CONTINUATION OF ANSWER TO USPS/OCA-T200-6:

First Class's "good deal" were eliminated.

(c) No. See the response to USPS/OCA-T200-6(a-b).

(d) No. Omnibus rate cases allow all evidence and testimony to be presented and examined. Rates are based upon the testimony and evidence presented. If one party fails to focus on an area during the omnibus rate case, then it elected to do so. Therefore, the party must accept the consequences of its actions, or initiate a new omnibus rate case so that all evidence and testimony can be presented, examined, and rates re-evaluated. To do otherwise, would effectively allow one party to pick and choose what evidence is presented; when the evidence is presented; and what rates are manipulated.

Consider recent history. The Postal Service requested an across-the-board rate increase in R94-1. As a result, certain cost coverages that were "out of line" did not get adjusted. The Postal Service then created a principle of "net revenue neutrality" in MC95-1. As a result, certain cost coverages that were still "out of line" did not get adjusted. Finally, the Postal Service abandoned the recently created principle of "net

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CONTINUATION OF ANSWER TO USPS/OCA-T200-6:

revenue neutrality" in a severely restricted "classification" case, MC96-3. As a result, certain "out of line" cost coverages remain unadjusted. The potential for arbitrary and discriminatory ratemaking is enormous under the assumptions of your question.

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USPS/OCA-T-200-7. Please refer to page 14 of your testimony.

(a) Would it be fair to equate your testimony on this page with a "sporting" theory of postal ratemaking, in which parties participate in a designated "game" known as an omnibus rate case, and it is thus "unsporting" of the Postal Service to try to alter the results of that game to the detriment of some of the "winners," whether they deserved to win or not? Please explain your answer fully.

(b) Is your objection to what you refer to as "divide-and-conquer ratemaking" based on a perceived inability of the Commission to distinguish between "justified" selective interim rate adjustments and "unjustified" ones? Please explain your answer fully.

(c) In your view, whose interests would be served by a ratemaking process in which beneficial interim rate adjustments could be identified, but could not be implemented under the theory that either they should have been proposed in the last omnibus rate case, or they should wait until the next omnibus rate case? Please explain your answer fully. In particular, please identify any objectives of regulation (e.g., the objective stated by Prof. Baumol -- Docket No. R84-1, USPS-T-5, pgs. 8-11 -- and many others, such as Alfred Kahn in this 1970 treatise The Economics of Regulation at page 17, that regulation should act as a surrogate for the free market forces) that you believe would or would not be enhanced by such a constraint.

A. (a)-(c) It seems disrespectful of Congress to liken the postal ratemaking process to either a "sport" or a "game." My testimony at 14 points out that the Postal Service established a classification reform framework in MC95-1. In its Docket No. MC95-1 Request, the Postal Service stated that the classification reform guidelines were for the current and future classification reform initiatives. See my response to USPS/OCA-T200-2(a). Prior to completion of the classification reform initiative, the

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CONTINUATION OF ANSWER TO USPS/OCA-T200-7:

Postal Service altered the framework, which fostered inequitable treatment of mail classes and subclasses. Not all mail classes and subclasses are being treated to the same goal of net revenue neutrality. The Postal Service's actions are discriminatory and unexplained.

Apparently, you misinterpret my use of the phrase "divide-and-conquer ratemaking." I am referring to the Postal Service's presenting limited rate cases with the purpose of selectively targeting a mail class or subclass for a rate increase, in the expectation that non-targeted mailers will leave well enough alone. The Postal Service's actions allow it effectively to pick and chose who is at risk of rate increases and who benefits from stable rates. Recent history would suggest that the Postal Service believes that selecting mail categories for "justified selective" rate increases is a "management decision," and that the Commission has no business second-guessing the Postal Service on what is "justified" or "unjustified."

Finally, my understanding of the efficiency rationale for regulation is that it is supposed to produce competitive market outcomes, not profit-maximizing outcomes. See response of OCA witness Sherman to USPS/OCA-T100-7(c).

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USPS/OCA-T200-8. Please refer to page 15, lines 8-12, where you state:

If a classification initiative is filed and the revenues generated by the class or subclass of mail undergoing reform fail to cover costs, then rate increase may be appropriate. The rate increases should be designed to be contribution neutral.

(a) Please confirm that if a subclass has costs exceeding revenues (i.e., negative contribution), any rate increase designed to correct that situation cannot be contribution neutral. If you cannot confirm, please explain fully.

(b) Was it your intent to suggest that the rate increases should be designed to yield the contribution target for the subclass initially set in the last general rate case? If not, please explain fully.

A. (a) Not confirmed. Going from negative contribution to zero contribution obviously represents an increase in net income. However, in any given year, there are likely to be categories of mail whose cost coverage is too high relative to the Commission's most recent recommendation. Such categories could receive rate reductions designed to neutralize the net revenue effect of any necessary rate increases. For example: If COD rates are below costs and money order rates recover more than was recommended by the Commission in Docket No. R94-1, then a classification case could be designed to bring both rates "in line" and be contribution neutral. COD rates could be raised so that revenues equaled costs. Money order rates could be lowered to bring its rates more "in line" with the Commission's Docket No. R94-1

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CONTINUATION OF ANSWER TO USPS/OCA-T200-8:

recommendation. The overall effect could be contribution neutral - no change in the net contribution.

(b) No. Docket No. R94-1 was an unusual omnibus rate case in that it requested an across-the-board rate increase and cost coverages were based upon a FY 95 test year. Docket No. MC96-3 uses FY 96 as its test year. Therefore, it is inappropriate to assume that the cost coverages established in Docket No. R94-1 are appropriate for Docket No. MC96-3. Even if R94-1 cost coverages need to be attained in FY 96, that is not what the Service is doing in MC96-3. There are more egregious situations crying out for adjustment than the special services targeted in MC96-3. This contradicts any claim by the Postal Service that it is merely making needed adjustments in cost coverages.

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USPS/OCA-T200-9. Please refer to page 12 of your testimony, where you claim that the "choice of a few special services as the source of additional revenue was entirely coincidental and thus capricious."

(a) Is it your testimony that, out of all the classes of mail and types of services, the special services which are the subject of this case were chosen entirely at random? If not, what do you mean by the phrase "entirely coincidental." Please explain your answers fully.

(b) Is it your testimony that the determination to seek additional net revenue in this filing was made **before** any analysis of which special service could be improved and thus should be included within the scope of the request for a recommended decision? If so, what is the basis for this testimony? If not, would you agree that such analysis makes the statement quoted above inapposite? Please explain your answers fully.

A. (a)-(b) No. My point is precisely the opposite. Extra revenue is being sought solely from those special services that had the bad luck to be ready for reclassification. That is not a rational basis for choosing how to allocate a new revenue burden. (Of course, the new revenue burden is also entirely coincidental, being the accidental result of raising rates for the bad luck special services, rather than the result of a rational process that explained why the Service needed \$340 million.)

If Docket No. MC96-3 is really a classification case for a few special services, then raising rates only for those special services is opportunistic revenue enhancement for the benefit of other subclasses, whose cost coverages for FY 96 are permitted to remain below Docket No. R94-1 recommendations. If this case is instead a case for fixing cost coverages that have fallen out of

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CONTINUATION OF ANSWER TO USPS/OCA-T200-9:

line, then why hasn't the Postal Service proposed fixing
Priority, Single Piece Third, Bound Printed Matter, Special Rate
Fourth, Cash on Delivery (COD), and Money Orders?

DECLARATION

I, Pamela A. Thompson, declare under penalty of perjury that the answers to interrogatories USPS/OCA-T200-1-9 of the United States Postal Service are true and correct, to the best of my knowledge, information and belief.

Executed October 30, 1996

Pamela A. Thompson

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document upon all participants of record in this proceeding in accordance with section 3.B(3) of the special rules of practice.


EMMETT RAND COSTICH
Attorney

Washington, DC 20268-0001
October 30, 1996