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Before the

UNITED STATES POSTAL RATE COMMISSION

In the Matter of: SPECIAL SERVICES FEES AND
 CLASSIFICATIONS

Docket No. MC96-3

VOLUME 7

HEARING

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OFFICE OF THE SECRETARY

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BEFORE THE
POSTAL RATE COMMISSION

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In the Matter of: :
SPECIAL SERVICES FEES AND : Docket No. MC96-3
CLASSIFICATIONS :
- - - - - X

Third Floor Hearing Room
Postal Rate Commission
1333 H Street, N.W.
Washington, D.C. 20268

Volume 7
Wednesday, November 20, 1996

The above-entitled matter came on for hearing,
pursuant to notice, at 9:33 a.m.

BEFORE:

HON. EDWARD J. GLEIMAN, CHAIRMAN
HON. W.H. "TREY" LeBLANC, III, VICE CHAIRMAN
HON. H. EDWARD QUICK, JR., COMMISSIONER, PRESIDING
HON. GEORGE W. HALEY, COMMISSIONER

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1 C O N T E N T S

2 RULINGS BY THE PRESIDING OFFICER: PAGE

3 [None.]

4

5 WITNESS DIRECT CROSS REDIRECT RECROSS

6 ROGER SHERMAN

7 BY MR. COSTICH 2268

8 BY MR. ALVERNO 2418

9 BY MR. COSTICH 2494

10 BY MR. ALVERNO 2496

11

12 DOCUMENTS TRANSCRIBED INTO THE RECORD: PAGE

13 Direct Testimony of Roger Sherman, Exhibit No.

14 OCA-T-100 2270

15 Designation of Written Cross-examination of

16 Witness Sherman 2318

17

18 E X H I B I T S

19 EXHIBITS AND/OR TESTIMONY IDENTIFIED RECEIVED

20 Direct Testimony of Roger Sherman,

21 Exhibit No. OCA-T-100 2269

22 Designation of Written Cross-

23 examination of Witness

24 Sherman 2317

25

P R O C E E D I N G S

[9:33 a.m.]

COMMISSIONER QUICK: Good morning.

Today, we resume hearings in Docket MC96-3 to receive the direct cases of participants other than the Postal Service, including their rebuttal to the Postal Service.

Today we will receive testimony from the Office of the Consumer Advocate Witness Roger Sherman.

I just have one procedural matter to discuss. It has come to my attention that several parties did not receive service of Presiding Officer's Ruling Number 25. For that reason, I granted requests from the Office of the Consumer Advocate and Nashua, Mystic, Seattle to extend the date for submission of designations of institutional responses and other materials provided by the Postal Service until November 21. I want it to be clear that this extension applies to all parties.

Does any participant have a procedural matter to raise at this time?

[No response.]

COMMISSIONER QUICK: Mr. Costich, would you identify your witness so I can swear him in?

MR. COSTICH: Thank you, Commissioner Quick.

The OCA calls Roger Sherman.

1 Whereupon,

2 ROGER SHERMAN,

3 a witness, was called for examination by counsel for Office
4 of the Consumer Advocate and, having been first duly sworn,
5 was examined and testified as follows:

6 COMMISSIONER QUICK: Mr. Costich.

7 DIRECT EXAMINATION

8 BY MR. COSTICH:

9 Q Would you state your name for the record?

10 A Roger Sherman. Roger Sherman.

11 Q Do you have before you two copies of a document
12 identified as Exhibit OCA-T-100?

13 A Yes.

14 Q Can you identify that document?

15 A It's my testimony, my direct testimony.

16 COMMISSIONER LeBLANC: Mr. Sherman, would you pull
17 the mic a little closer, please? Just pull it to you a
18 little closer. Thank you.

19 BY MR. COSTICH:

20 Q Was that testimony prepared by you or under your
21 supervision?

22 A Yes.

23 Q Do you have any corrections to make to that
24 testimony?

25 A No.

1 Q If you were to testify orally today, would this be
2 your testimony?

3 A Yes.

4 MR. COSTICH: Commissioner Quick, I am going to
5 hand two copies of Exhibit OCA-T-100 to the reporter and I
6 move its admission into evidence.

7 COMMISSIONER QUICK: Are there any objections?

8 [No response.]

9 COMMISSIONER QUICK: Hearing none, Dr. Sherman's
10 testimony and exhibits are received into evidence. I direct
11 that it be accepted into evidence and be transcribed into
12 the record at this point.

13 [The Direct Testimony of Roger
14 Sherman, Exhibit No. OCA-T-100 was
15 received into evidence and
16 transcribed into the record.]

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OCA-T-100

Docket No. MC96-3

DIRECT TESTIMONY

OF

ROGER SHERMAN

ON BEHALF OF

THE OFFICE OF THE CONSUMER ADVOCATE

September 30, 1996

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1 DIRECT TESTIMONY OF

2 ROGER SHERMAN

3 STATEMENT OF QUALIFICATIONS

4

5 My Name is Roger Sherman. I am Brown-Forman Professor of
6 Economics at the University of Virginia. I was awarded the
7 M.B.A. degree by Harvard University and the M.S. and Ph.D.
8 degrees by Carnegie-Mellon University. I have been at the
9 University of Virginia since 1965 and served as Economics
10 Department chair from 1982 to 1990. I have published five
11 books, including an edited volume on postal issues, and over
12 80 articles, including 10 that can be related to postal
13 matters. I currently serve on the editorial boards of two
14 academic journals, including the Journal of Regulatory
15 Economics. In the past I have served as consultant to the
16 U.S. Postal Service and the Postal Rate Commission. My
17 curriculum vitae is attached.

1 I. PURPOSE OF TESTIMONY

2

3 The purpose of my testimony is to discuss pricing and
4 classification principles used by the Postal Service in Docket
5 No. MC96-3. Attention will be given to the market power of
6 the Postal Service and to evidence of competitive pressure,
7 and how such elements affect optimal pricing according to
8 accepted principles. Cost information is the crucial basis
9 for pricing in any circumstance, and the use of cost
10 information will be considered.

11

1 II. THE PIECE-MEAL APPROACH AND THE MARKETPLACE

2

3 The Postal Service proposal in Docket No. MC96-3 has
4 features that are unusual. First, it focuses on only a few
5 special services, rather than on all services. Second, it
6 gives attention to something called marketplace
7 considerations, and gives less than expected attention to
8 costs. Observations will be made about these features of the
9 case, and then the proposals will be taken up in turn.

10 This is an unusual proposal for making price increases on
11 a piece-meal basis rather than in context, as in an omnibus
12 rate case, where all rates for all services can be compared.
13 In setting out goals of the proposal, Witness Lyons (USPS-T-1)
14 says the first goal is to place services "on a more
15 economically rational, businesslike basis." (page 2) In
16 trying to give content to that vague statement he says the
17 proposals are designed "to reflect marketplace considerations,
18 as well as the costs of providing services." (page 2) He adds
19 that "Specific pricing reform objectives include more market-
20 based prices, more equitable contributions from the services
21 to institutional costs, and the realignment and streamlining
22 of certain special services offerings to make them more
23 commercially attractive." These may be nice-sounding
24 statements but they are still vague. It is not at all clear
25 what market-based prices are. They are not defined well

1 enough to be related to principles of optimal pricing. To
2 pursue equitable contributions to institutional costs calls
3 for an omnibus rate case, where comparisons across services
4 are possible. That goal is practically impossible to pursue
5 when only piece-meal proposals are made. And the recommended
6 realignment and streamlining sometimes seems aimed more at
7 raising revenue than at making offerings more commercially
8 attractive.

9 The second goal Mr. Lyons cites (USPS-T-1) is to make
10 improvements in services so "they are more useful to the
11 customer." (page 2) The only concrete example he gives is the
12 special fee that is proposed for postal cards, which will
13 raise the price by 2 cents per card; this would not seem to
14 make the postal card any more useful to customers. Another
15 improvement noted along this line is reducing the number of
16 fees for certain services. Of course the number of fees is
17 reduced by eliminating choices for consumers, which would
18 usually make a service less rather than more useful.
19 Eliminating a service is cited as another such improvement.
20 While eliminating a service may make good profit and loss
21 sense, it can hardly make the service more useful. The third
22 goal cited is to improve contributions, consistent with
23 overall financial policy objectives (USPS-T-1, page 3). This
24 goal seems to be served by practically every proposal that is
25 made.

1 The influence of the marketplace is described generally
2 in the testimony of Witness Steidtmann (USPS-T-2), who
3 rationalizes the Postal Service proposals as fitting a
4 retailer's procedures and point of view. In defense of the
5 piece-meal approach of selective pricing, he says that
6 "retailers will tend to adjust prices selectively," and "it
7 allows for greater analysis of those products that would most
8 benefit from adjustment." (page 1) Selections of services to
9 consider apparently were not made on that ground, however.
10 Money order and C.O.D. services currently appear to be priced
11 below their attributable costs, so they obviously are most in
12 need of adjustment, but they are not among the services being
13 adjusted. In any case, a retailer's way of looking at
14 revisions to services and prices would not ordinarily include
15 welfare considerations and so is not what is expected from the
16 Postal Service.

17 Witness Steidtmann's review of the proposals repeatedly
18 finds them consistent with sound retailing practice. In the
19 case of certified mail/return receipt service, for example, he
20 notes the certified mail price is to be increased and the
21 choice of return receipt service without address information
22 is to be eliminated. About eliminating the return receipt
23 choice he says that "it is sound retailing practice to
24 simplify a product offering." (page 5) About the price
25 increase in certified mail he says: "This increase in
26 certified mail price reflects the fact that comparable service

1 is currently offered at much higher prices. The certified
2 mail fee increases thus comports with retail industry
3 practices." (pages 5-6) Having alternative services available
4 only at higher prices means the Postal Service has market
5 power. The point has been made often: "...monopoly power is
6 present when a firm is sufficiently insulated from competitive
7 pressures to be able to raise prices...without concern for its
8 competitors' actions because its rivals cannot offer customers
9 reasonable alternatives."¹ That such monopoly power would be
10 exploited by a retailer is unsurprising. The fact that a
11 retailer would exploit monopoly advantage is also irrelevant
12 as far as pricing the services of the Postal Service is
13 concerned.

14 Marketplace considerations alone seem often to leave
15 great latitude for Postal Service prices. If alternative
16 services can be offered at prices not far from those of the
17 Postal Service, however, that emphasizes the importance of
18 cost information. Indeed, cost information is really more
19 important than competitive price information. For even when
20 informed about competitive prices, a provider of services must
21 know its own costs in order to judge where its services can
22 offer consumers the greatest advantage relative to
23 competitors. This is clearly true if technologies differ, so

¹ From F.M. Fisher, J.J. McGowan, and J.E. Greenwood, Folded, Spindled, and Mutilated: Economic Analysis of U.S. vs. IBM, Cambridge, Mass.: MIT Press, 1983, p. 99.

1 costs of different service features differ among providers,
2 because then advantage should be taken of one's own technology
3 to lower prices where costs are lower. That is how consumers
4 can benefit from the different technologies. If technologies
5 are similar and costs are similar among producers, information
6 about costs is still crucial. Then the provider who is better
7 informed about costs, and who prices based on costs, will win
8 the business where it has lower costs, leaving the less
9 profitable business for a less informed competitor. Cost
10 information in the Postal Service proposal is very limited,
11 however. There is often little cost information for detailed
12 offerings within broad service categories, making analysis of
13 specific pricing proposals impossible.

14 Of course cost information also is crucially important
15 for pricing in the absence of close competitors offering
16 alternative services. Optimal pricing theories often stress
17 relative prices—how prices relate to one another—or relative
18 contribution margins as in the case of Ramsey prices. And to
19 see the pattern of such relative price relationships it is
20 desirable to consider all prices at once, as in an omnibus
21 rate case. In addition, a price change in one service can
22 alter quantities of other services, through cross-price-
23 elasticity effects. This interrelationship among services
24 also makes it desirable to consider entire sets of prices
25 rather than to take them up in a piece-meal way, since in the
26 piece-meal approach it is difficult to deal with effects on

1 services that are not under consideration. Thus, to take
2 account of optimal pricing ideas and to reflect effects across
3 services, omnibus rate cases have great advantages.

4 It is still possible to consider effectively only a
5 subset of services, if added care is given to the subset and
6 effects of relations to other prices and services are
7 included. Only limited attention is given to such effects by
8 the Postal Service. For instance, in pricing post office
9 boxes no attention is given to possible delivery-cost savings
10 in the major mail classes due to post office box use. The
11 Commission has rejected this so called "cost avoidance" effect
12 in pricing post office boxes before (R77-1; R84-1; R87-1), but
13 it always had to do so for lack of sound information on what
14 the consequent delivery cost savings might be. This would be
15 an appropriate time to deal feasibly with the question. When
16 the subject came up in prior cases the Commission was
17 confronted with fairly extreme proposals to be accepted or
18 rejected, whereas here a reasoned analysis might have been
19 provided as an influence on post office box pricing.

20 If socially optimal pricing is a goal, some reference to
21 the relation between costs and prices across services is
22 needed. Otherwise one subclass, or a small group of
23 subclasses, could be out of line with others regarding
24 contribution made to institutional costs, yet this would not
25 be known. To pursue socially optimal prices, a piece-meal
26 approach has to include an explicit plan for future proposals,

1 so the intended pattern of price-cost relationships in effect
2 over time can be seen. Only then would it be possible to
3 estimate in an overall way which consumers benefit or which
4 bear added burdens under a proposal. The Postal Service
5 offers no such plan. Even though it would not be binding,
6 such a plan would still allow comparisons of effects across
7 services.

8 One goal of the Postal Service's proposal is to raise
9 greater revenue and increase the contribution to institutional
10 costs. It stands to reason that increased prices for only
11 some services will distort overall Ramsey price relationships
12 or any other form of relative relationship from whatever
13 existed before, unless attention is focused on services where
14 price-cost relationships have fallen out of line. But
15 attention clearly is not focused in that way, since two money-
16 losing special services, C.O.D. and money orders, are not
17 given any attention. By failing to cover their attributable
18 costs these two services fail to satisfy virtually any
19 guideline for optimal pricing. By failing to cover their
20 attributable costs they also are not in compliance with the
21 law, in the form of pricing requirements of the Act
22 (§ 3622(b)). In any consideration of increases in special
23 services prices they would therefore seem to deserve the
24 highest priority.

25 Thus, the new features of this case do not appear to
26 bring real advantages. The goals stated for them are vague

1 and not always descriptive of what is actually proposed.
2 Sound cost information is crucial, as always, but seems not to
3 have been given great attention relative to information on
4 alternative supplier's offerings. Where they are provided,
5 these marketplace considerations indicate mainly that few
6 alternatives are available at reasonable prices for Postal
7 Service customers. Such evidence of market power indicates
8 that optimal pricing principles are still important. But they
9 are not emphasized and are not easy to apply because only a
10 few services are under consideration.

11

1 III. SPECIFIC POSTAL SERVICE PROPOSALS

2 In turning to examine specific proposals for individual
3 services, we shall begin with proposals that are easy to judge
4 favorably, such as the proposal to eliminate special delivery
5 service. Its role is now being served by faster means of
6 expedited delivery and it can barely cover its attributable
7 cost, so it is reasonable to eliminate it. Raising indemnity
8 limits for insurance service is a desirable expansion of
9 offerings and should be adopted. No longer charging for
10 registry service based on declared value above \$100 when it is
11 uninsured—that is, when cost probably does not depend on
12 value—may be a step that should have been taken long ago. It
13 would be very simple to decide the question if cost
14 information were available, but lack of cost information is
15 serious. Adequate cost information is also lacking for
16 certified mail service, where a simple price increase is
17 proposed. Elimination of return receipt service that does not
18 include address information, which is shown to be preferred by
19 nine-tenths of users, seems misguided. Why force consumers to
20 choose the address service when they show so clearly by their
21 choices that they do not want it? Finally, proposals for post
22 office box and caller service prices in relation to estimated
23 costs seem crudely jumbled, and it is difficult to see how the
24 proposal can be acceptable when it is so lacking in
25 consistency.

1 A. Special Delivery

2 The introduction of alternative expedited mail services
3 has narrowed the role available for special delivery and
4 threatened its usefulness. For example, Postal Service
5 Express Mail service does two things: (1) it speeds movement
6 of the mail to the destination post office and (2) it then
7 accomplishes expedited delivery. By offering faster movement
8 to destination in addition to expedited delivery, Express Mail
9 dominates special delivery service. It might be desirable to
10 separate these two features of speed in movement to
11 destination post office and speed in delivery, so users could
12 choose only the latter when they wish. This might be
13 preferred when seeking faster delivery within the same city,
14 for example, where speed of movement to a distant post office
15 is not needed. But apparently because of competition from
16 courier services, the Postal Service is unable to offer that
17 service at a price much above attributable costs. The Postal
18 Service now proposes to eliminate special delivery service.
19 Based on the declining usage of special delivery and its
20 inability to contribute above its attributable costs, this
21 might be a wise course.

22

23 B. Insured Mail

24 Insured mail is the only service for which a genuine
25 improvement is proposed. Higher indemnity levels are to be

1 offered for domestic insured mail, which now has a limit of
2 \$600, and for Express Mail, which now has a limit of \$500.
3 Both limits are to be raised to \$5,000. Charges for these
4 greater indemnity levels will be made based on value, in \$100
5 increments. The current insured mail fee is \$0.75 for values
6 up to \$50, \$1.60 for values from \$50.01 to \$100, and an added
7 \$0.90 per \$100 in value up to \$600. The proposal will simply
8 continue that fee of \$0.90 per \$100 of value past \$600 up to
9 \$5000. For Express Mail, an indemnity level up to \$500 is
10 currently included in the service and will continue to be
11 included without additional fee. Should greater insurance be
12 desired it will be offered under the proposal at \$0.90 per
13 \$100 up to \$5,000.

14 Some evidence is provided by the Postal Service
15 indicating that users of insured mailing services want higher
16 indemnity levels and would rely more on Postal Service
17 services if they could obtain it. A survey of customers shows
18 that significant usage of the greater indemnity levels is
19 likely (USPS-LR-SSR-109, cited by Witness Needham, USPS-T-8,
20 page 8). Thus, there appears to be sufficient interest to
21 warrant offering the higher indemnity levels, and to try to
22 see what effect it might have on usage by the mailers of
23 valuable items. One drawback of the proposal is that it is
24 difficult to identify costs for the new levels of insurance
25 service.

1 Since this increase in indemnity limit would essentially
2 be a new Postal Service offering, provision should be made to
3 gather cost information as a basis for later adjustment of
4 these fees, should that be appropriate. And a procedural
5 change may be warranted—as described by Postal Service
6 Witness Needham (USPS-T-8, pages 28-29)—to reduce the
7 probability of claims at higher indemnity levels for insured
8 mail. The change should make the exposure of insured mail and
9 Express Mail comparable and therefore help to support equal
10 insurance charges.

11 The Postal Service also proposes to make an insurance
12 service offering less attractive. It proposes to lower the
13 indemnity limit for document reconstruction from the current
14 levels of \$50,000 per piece and \$500,000 per occurrence down
15 to 1/100th of these amounts, to \$500 per piece and \$5,000 per
16 occurrence. Although it is a very substantial reduction in
17 what has been offered, the \$50,000 limit per piece is probably
18 inappropriate at the present time, and the new offering seems
19 adequate.

20 21 C. Registered Mail

22 Registered mail offers high security and accountability
23 that is appropriate for the care of valuable items. Currently
24 the price for registered mail depends on its declared value,
25 starting with value categories \$0.00 to \$100, \$100.01 to \$500,

1 \$500.01 to \$1,000, and rising thereafter in \$1,000 increments
2 to \$15,000,000. Two options, with different prices, are now
3 available for every value category, one with insurance and one
4 without insurance. Without insurance the lowest value
5 category is charged \$4.85 and for each rising declared value
6 category thereafter the price rises by \$0.35. With insurance
7 the lowest value category is charged \$4.95 and for each rising
8 category thereafter the price rises by \$0.45. (For example,
9 under this fee structure an item with a declared value of
10 \$1,000,000 will be priced at \$355.20 without insurance and
11 \$455.40 with insurance.)

12 The proposed rate structure eliminates the option of
13 sending an item by registered mail without insurance if its
14 declared value exceeds \$100. An item in the first value
15 category of \$0.00 to \$100 can be sent without insurance, but
16 no item with a higher declared value can be sent without
17 insurance. The rates for insured registry mail will remain
18 unchanged, and are to continue as described above.

19 The question this proposal raises about the current rates
20 is: For mail that had no insurance, why were such significant
21 distinctions made in price in the current rates, based on
22 declared value? It would seem that, without insurance,
23 declared value would not greatly affect handling cost, and
24 thus should not greatly affect rates. David Popkin argued in
25 R94-1 (Initial Brief dated September 22, 1994) that accepting,
26 transporting, and delivering a registered item that is not

1 insured costs no more simply because it is more valuable. The
2 rate structure proposed by the Postal Service, which
3 essentially offers no rate distinction for uninsured items by
4 declared value, is consistent with his argument. Any major
5 cost difference that is based on value would seem to turn on
6 the insurance cost, which presumably does depend on value.
7 The Commission endorsed exploration of this question that
8 Popkin raised in R94-1, but lacked a record on which to
9 consider it at that time. It is possible the logic of Mr.
10 Popkin's argument would be supported with postal cost
11 information by value category, which could then justify the
12 proposed rate structure. But costs for insured or uninsured
13 registry items by declared value are not provided, so although
14 the proposal is appealing no basis is provided for evaluating
15 it.

16 There is some survey information from Postal Service
17 customers showing positive interest in the proposal (Witness
18 Needham, USPS-T-8, pages 6-15, and USPS-LR-SSR-108). Indirect
19 support for the proposed fee schedule comes from the pattern
20 of usage, which shows that 88 percent of registry mail without
21 insurance has declared value of \$100 or less and only 12
22 percent has declared value above \$100. It might be surprising
23 to find even 12 percent of the mailers of uninsured mail
24 declaring a value higher than \$100—doing so only entitles
25 them to pay a higher fee. After all, the existing fee
26 structure looks like a form of "value of service" pricing.

1 The November 1993 survey of high claim filers and mailers of
2 high value items shows that most do not object to eliminating
3 the no-insurance option above \$100 and those who do are not
4 heavy users of uninsured registry mail.

5 The Postal Service projects that enough current users of
6 uninsured registry mail valued above \$100 will switch to
7 insured so revenue per transaction will increase under the
8 proposal (USPS-5G, 5J. But see USPS-T-1, WP-E, page 2, where
9 revenue per transaction is unchanged.) Since the proposal
10 eliminates the uninsured option for declared values above
11 \$100, it is also possible that users of this service will send
12 items at the \$100 value rate rather than declare a higher
13 value and pay for unwanted insurance. So there actually could
14 be a decline in revenue per transaction. But the effect in
15 any case will not be enormous, since only about 4 percent of
16 registry business is affected.

17

18 D. Certified Mail

19 Certified mail was created to provide a service somewhat
20 like registry service, but at lower cost, for the portion of
21 registry mail that had no monetary value. It has grown
22 handsomely and continues to be well accepted by consumers.
23 The Postal Service proposes to raise the fee for certified
24 mail from \$1.10 to \$1.50. It is difficult to interpret how
25 the result of this price increase would relate to the overall

1 structure of rates, because costs and revenues are not
2 consistently presented. The cost report of Witness Patelunas
3 (USPS-5G, 5J) shows a cost coverage for certified mail at
4 current rates of 202.2 percent, and a cost coverage under
5 proposed rates of 271.0 percent. These are very high cost
6 coverages. Witness Needham reports (USPS-T-8, page 71) that
7 the Postal Service historically has included return receipt
8 revenue but not return receipt cost in the cost coverage
9 calculation for certified mail, but that it is not doing so in
10 this case. Perhaps Witness Patelunas used the historical
11 practice, because Witness Needham reports lower cost
12 coverages, claiming that certified mail cost coverage is only
13 107 percent under current rates and would be 146 percent under
14 proposed rates.

15 If there is a longstanding error in the way costs have
16 been evaluated for pricing certified mail service, that should
17 be demonstrated and new rates might be proposed based on
18 correct costs. At present the argument is not put explicitly
19 and the reason for the increase—cost increases or previously
20 incorrect costs—is not perfectly clear.

21 Evidence is provided from a survey of perceived certified
22 mail users, showing that alternative services are much more
23 costly to use. The average cost of an alternative service was
24 greater than the cost of Postal Service certified mail by
25 \$10.68. This difference applies whether return receipt, which
26 often accompanies certified mail service, was included or not

1 (Witness Needham, USPS-T-8, page 67, and USPS-LR-SSR-110).
2 Once again, this shows the great market power the Postal
3 Service has in the market for certified mail.
4

5 E. Return Receipt

6 Return receipt service gives proof of delivery. It is
7 available for mail matter sent C.O.D., insured at over \$50,
8 registered, certified, or Express Mail. For such mail
9 matter—which requires signature on receipt—even after it is
10 mailed it is possible to request the name of the person who
11 signed for it and the date it was delivered. But generally
12 the return receipt service is requested when the item is
13 mailed. Merchandise sent by First-Class Mail, Priority Mail,
14 and much of Standard Mail also qualifies for the return
15 receipt service, but only if requested at the time such items
16 are mailed. Currently the return receipt service for mail
17 matter after it has been mailed is available for a charge of
18 \$6.60, and no change in that rate is proposed. For mail
19 matter and merchandise there are now two levels of service,
20 one that provides the name of the recipient and the date
21 delivered, and another that provides those two facts plus the
22 address delivered to. For mail matter the first service is
23 available for a fee of \$1.10 and the second for a fee of
24 \$1.50. These same two levels of service are also available
25 for merchandise at fees of \$1.20 and \$1.65.

1 A reclassification is proposed to simplify the service
2 offerings by eliminating the choice of return receipt with
3 date and name of recipient only, and requiring that the
4 address information be chosen as well (the address will be
5 provided only when it is different from the original address).
6 The simplification would apply to return receipt use in both
7 mail matter and merchandise. Eliminating the lower price
8 option of choosing date and name only would have the effect of
9 forcing all users to the higher price service level that
10 includes address information, so it will effectively be a
11 price increase for those who had selected only date and name
12 information before. Since roughly 90 percent of the current
13 volume falls in the date and name category that is being
14 eliminated, the effect is essentially like a price increase,
15 and a substantial one. Currently the cost coverage for this
16 service is reported as 127 percent by Witness Needham and is
17 estimated to rise to 171 percent under the proposal (USPS-T-8,
18 page 92).

19 Witness Steidtmann uses the auto industry move to
20 offering option packages, rather than allowing complete
21 consumer choice of options, as a suggestive analogy (USPS-T-2,
22 page 5). In that auto case there was a great reduction in
23 cost as benefit to the consumer; no such benefit is provided
24 here in the return receipt case to justify the elimination of
25 consumer choice. Perhaps it is advantageous to the Postal
26 Service to have customers use the address service, so that

1 more addresses will be correct and fewer pieces of mail will
2 have to be forwarded because they were sent to the wrong
3 address. But if that is true the address service should be
4 offered at a lower price, not a higher one.

5 If the cost for providing the additional address
6 information in the present optional return receipt service is
7 very small, of course, a case might be made for including it
8 as part of a simpler, single-package return receipt service.
9 But the cost information that is given (USPS-T-1, WP-D at page
10 3) indicates an added cost for the address service of \$0.24,
11 which leads to a \$0.40 price difference with a cost coverage
12 of 167 percent. This cost difference thus seems sufficient to
13 warrant the existing \$0.40 price difference, and no argument
14 is offered to the contrary.

15 It is obvious from their present choices that consumers
16 want the no-address option, because nine-tenths of them choose
17 it in preference to the additional, more costly, address
18 information. The opportunity to have address information
19 might usefully be preserved as an extra-cost option for
20 consumers, since some consumers use it, especially recently
21 with merchandise, but the vast majority of consumers clearly
22 do not value it enough to pay the fee set for it. The fact
23 that nine-tenths of consumers now show by their choices that
24 they do not value the address information as much as they
25 would be charged for it is compelling evidence against the
26 proposal to force them to take it. Simplification is to be

1 considered in rate setting, but as the Commission has noted
2 before, it must be weighed against other effects (see, e.g.,
3 Recommended Decisions in Docket No. R77-1, page 434, and
4 Docket No. R80-1, page 583). Simplification is no
5 justification for forcing the vast majority of consumers to
6 buy the more expensive address service, which they demonstrate
7 overwhelmingly that they do not want. The choice of the lower
8 cost and lower price service their choices show they prefer
9 should not be taken away from them.

10

11 F. Stamped Card

12 The Postal Service proposes to add a \$0.02 fee to the
13 postal card to pay for its manufacture and for affixing a
14 stamp to it, to make the full price of the postal card \$0.22.
15 The rate for the private card is to remain at \$0.20. The
16 proposal would make the postal card analogous to the stamped
17 envelope, which requires a \$0.06 charge for the envelope and
18 for affixing the stamp (although it would depart from the
19 practice followed in Express Mail and Priority Mail of
20 providing envelopes, and even boxes, free). Pursuing this
21 analogy, the postal card would be renamed a stamped card. The
22 Postal Service estimates test-year volume for postal cards of
23 428,618,000 (USPS-T-1, WP-E, page 1) at current rates. This
24 volume would yield \$85,723,600 in revenue. The Postal Service
25 proposal assumes a very small decline in postal card volume in

1 response to the 10 percent price increase that the proposal
2 imposes, based on an assumed demand elasticity of only -0.17.
3 At the proposed new rate, volume is estimated at 421,302,000
4 (USPS-T-1, WP-D, page 10 and WP-E, page 1), which would yield
5 revenue of \$92,686,440. Thus there would be a net increase in
6 revenue of \$6,963,000. Postal Service forecasts of revenue
7 effects (USPS-T-1, Exhibit A and WP-E, page 2) show a larger
8 revenue gain of \$8,426,000, which is obtained by merely
9 multiplying the \$0.02 increase times the forecast volume at
10 the new rate. This calculation fails to take account of the
11 loss in postal card revenue (at \$.20 per card) due to the
12 decline in volume that the \$0.02 rate increase is assumed to
13 cause, so it overstates the net revenue gain that can be
14 expected. But even with that extra revenue loss accounted for
15 (see USPS-T-1, WP-E, page 1, line 4, column 5), the revenue
16 forecast may be far too optimistic because of the elasticity
17 assumptions that lie behind the volume forecast.

18 The main difficulty with this Postal Service proposal is
19 that it ignores the remarkable difference in processing cost
20 between postal cards and private cards, postal cards costing
21 at least \$0.08 per piece less to process than private cards
22 (USPS-T-5C at 10). Witness Patelunas' response to
23 interrogatory OCA/USPS-T5-11 notes plausible sources of this
24 cost difference, including greater compatibility of postal
25 cards with mechanization and automation due in part to their
26 uniform size and shape. They also may have cleaner addresses,

1 in part because private cards are more apt to be hand
2 addressed and sent, for example, from vacation spots. It is
3 unfortunate that costs are not provided, to show the effects
4 of these possible influences. But it surely is uneconomic to
5 raise the effective price of the postal card and thereby
6 discourage the use of a Postal Service offering that costs so
7 little to process, while at the same time encouraging the use
8 of a service that costs more to process. And these effects
9 may be stronger than is currently being assumed.

10 The newly created "stamped card" will be a very close
11 substitute for private cards. Past elasticity estimates have
12 not been based on changes in either the postal card or the
13 private card rate alone, and might have yielded a greater
14 elasticity estimate had such an estimate been possible. So
15 the extremely low elasticity of -0.17 that is being assumed
16 for a change in price of postal cards may be inappropriate.
17 Consideration should be given to the possibility that more of
18 the postal card volume will move to the very close—and now
19 lower priced—substitute, private cards. Should such
20 migration occur, the financial consequences could be
21 unfortunate. The reported contribution above attributable
22 cost (price minus attributable cost) is less than \$0.04 per
23 private card and roughly three times as great at \$0.12 per
24 postal card. To shift volume from the much more profitable
25 postal cards over to private cards in this situation by
26 raising the price of postal cards will lower the efficiency of

1 the mail stream. Indeed, the proposal may not even yield the
2 short-term profit contribution that can be calculated from the
3 proposal's optimistic assumptions about demand elasticities.

4 Thus, despite the apparent similarity with stamped
5 envelopes as a basis for charging for a card with a stamp
6 affixed to it, the stamped card proposal would discourage use
7 of an extremely efficient item in the mail stream. It is not
8 needed for consistency, since mailing materials are given free
9 with some other services. And the proposal could encourage
10 greater use of private cards that are less efficient to
11 process. The effects of this proposal could be worse than
12 projected by the Postal Service because these projections make
13 optimistic assumptions about cross elasticities of demand
14 between the two categories of card service.

15

16 G. Post Office Boxes and Caller Service

17 The Postal Service proposes price increases for post
18 office boxes and caller service (a decrease is also proposed
19 for box service in those few areas where carrier delivery is
20 not offered, from the nominal \$2 per year fee to provision of
21 box service at no charge). Difficulties arise in pricing post
22 office boxes with a single rate structure that must apply all
23 across the country. Costs can vary among urban areas and
24 between urban and rural areas. When areas are categorized and
25 prices are set to reflect average cost differences some of the

1 resulting prices may seem irrational, as when a suburban area
2 and a rural area are in close proximity and have essentially
3 the same costs, but have different rates. Proposed price
4 adjustments are intended to moderate disparities that exist
5 among delivery areas in the present rate structure. Costs
6 also are imputed to post office boxes by size and by location,
7 so rates can be compared with costs and adjusted to reflect
8 differences. A nonresident fee is also proposed, a charge of
9 \$36 per year to receive service in a post office box outside
10 the 5-digit ZIP Code area where the customer either resides or
11 has a business address.

12 The delivery areas that are now identified are: I-A, post
13 offices in high cost areas in New York City; I-B, post offices
14 in other parts of New York and in eight other large cities; I-
15 C, other city post offices; II, mainly rural post offices that
16 provide delivery service; and III, post offices that do not
17 provide delivery service. These categories are preserved
18 under the proposal, but rather than being called I-A, I-B, I-
19 C, II and III, they are to be renamed as delivery areas A, B,
20 C, D and E. Rates also vary by box size, which obviously
21 influences costs, and the same five box sizes that are now
22 offered are still to be offered. The smaller sizes tend to be
23 used more by individuals and small businesses, while the large
24 sizes are used more by large organizations such as
25 corporations.

1 There is a broad general problem in pricing post office
2 boxes that is not considered explicitly in the proposal. That
3 problem is that there may be a cost savings in delivery to a
4 post office box rather than to a business or residence. It is
5 interesting that two Postal Service post office box proposals,
6 having a fee for nonresident use of a post office box, or
7 providing post office boxes free of charge to mail recipients
8 who do not have delivery service, may both be consistent with
9 such delivery savings. In the latter case of no delivery to
10 mail recipients at their own locations, such delivery must be
11 so costly that it is more economical for the Postal Service to
12 use post office boxes instead, even when the boxes are given
13 away free. Such cost savings in delivery to parties that have
14 post office boxes might extend to other areas, and if so it
15 can warrant a reduction in the post office box fee to take
16 account of that effect. If fees are not lowered to reflect
17 any savings that post office boxes allow in delivery, then
18 post office box use might be discouraged, with the result that
19 total delivery costs will be higher.

20 Conceptually, the nonresident fee may also be consistent
21 with there being a cost saving when mail is delivered to a
22 post office box, rather than to a residence or place of
23 business. For when a post office box is provided to a party
24 living in, or at a business address in, another ZIP Code,
25 delivery at that other location may be more extensive than
26 when a box is obtained at the recipient's own post office. So

1 the full potential saving from delivery to a post office box
2 may not be realized for the nonresident post office box. If
3 the saving cannot be realized, it may be reasonable to charge
4 an extra fee for the post office box used by a nonresident.

5 Only minor administrative expenses, which might be traced
6 to nonresident mailboxes at some locations, have been offered
7 in an effort to justify the nonresident fee. Thus, in
8 principle, delivery cost savings—or rather the lack of it—is
9 the only cost justification for the nonresident fee, and it
10 has not been presented either. The nonresident fee is thus
11 unsupportable as presented, with no added cost information for
12 nonresident post office boxes to justify it. If post office
13 boxes are properly priced so they cover their costs they
14 should be provided wherever they are requested by consumers.
15 If the added delivery cost to nonresident boxes is significant
16 it should be estimated and offered as support for any proposed
17 nonresident fee.

18 Despite the failure to consider possible savings in
19 delivery cost explicitly, the proposed post office box fees
20 are not extremely high, so the degree of discouragement in
21 their use may not be great. There are significant differences
22 by delivery area and box size, however, that do not seem to be
23 justified by differences in costs. Average cost coverages are
24 presented below that were calculated from Witness Lion's cost
25 estimates (USPS-T-4, Table 18) and Witness Needham's revenue

information (USPS-T-7, Table 1). These estimates show a surprising reliance on

Delivery Area		Cost
<u>Old</u>	<u>New</u>	<u>Coverage</u>
I-A	A	148
I-B	B	149
I-C	C	194
II	D	73
III	E	0

high revenues from delivery area I-C, city areas outside the largest cities. There the cost coverage is 194 percent, whereas the next highest cost coverage (from large cities) averages 149 percent. The post office boxes in rural areas are priced below cost. Raising fees sufficiently to avoid pricing rural post office boxes below costs would require increases greater than 100 percent above current rates, because current rates are so low. But the absolute increases would be smaller than many other increases in the proposal, so they would not be unreasonable. Avoiding prices that are below cost would seem to be a compelling goal, and it requires higher fees for delivery area II, or proposed area D, post office boxes.

By box size, the highest average cost coverage is for the middle box size, at 153 percent, and coverages decline in moving either to smaller boxes, with a coverage of only 129 percent for the smallest box size, or to larger boxes, with a coverage of only 118 percent for the largest box size.

1		
2	Box	Cost
3	<u>Size</u>	<u>Coverage</u>
4	1	129
5	2	143
6	3	153
7	4	137
8	5	118

9
10 These substantial variations in cost coverages are not
11 justified by any facts or arguments that are presented. It is
12 claimed by Witness Needham that fees should be lower for
13 larger boxes. The main reason given is that users have a
14 tendency to choose boxes that are too small, which burdens the
15 Postal Service with costs from overflow mail problems. If
16 facts are known for such a pattern, it should be included as
17 an added cost of smaller boxes. Then there would be a basis,
18 in both principle and amount, for taking the effect into
19 account in setting prices.

20 The proposed rate structure now encourages the use of the
21 smallest boxes through lower cost coverages, as well as the
22 largest boxes, so the goal of encouraging use of larger boxes
23 is not consistently served by the proposed rates. Another
24 reason given for having lower rates for large boxes is that
25 those boxes are used by businesses. They sometimes have

1 alternative opportunities for service from commercial mail
2 receiving agents (CMRA's) and they may purchase other postal
3 services if the need to pick up mail gives them reason to be
4 in the post office. This latter point could be true but it is
5 speculative and is given no concrete support. The former
6 point about users of large boxes having alternative
7 opportunities is not itself persuasive. The large USPS post
8 office boxes are considerably larger than CMRA boxes. If
9 revenue obtainable from large boxes is so low, it might be
10 best for the Postal Service to allow those users to go
11 elsewhere for service so the large boxes could be converted
12 into smaller boxes to meet excess demand for them, or the
13 space might be devoted to other more productive uses.

14 The evidence about alternative services that is presented
15 is interpreted as showing that users would accept the proposed
16 increases in post office box rates (Witness Ellard, USPS-T-6).
17 Specifically, the rates for CMRA boxes are shown to be
18 substantially higher than USPS boxes (Witness Needham, USPS-T-
19 7, pages 12-13), and CMRA boxes tend on average to be smaller
20 (Witness Lion, USPS-T-4, page 23). Indeed, Postal Service
21 post office box size 4 is roughly twice as large as the
22 average for the largest CMRA box size, and of course Postal

1 Service box size 5 is even larger. Since the Postal Service
2 has economies of scope in providing post office box service,
3 and may even avoid some cost of delivery in doing so, there is
4 little doubt that alternative box services are more costly.
5 The Postal Service has market power, in other words, in the
6 market for post office boxes.

7 Caller service allows recipients of mail to call at the
8 post office to pick up mail. Slightly different fees exist
9 now for this service in delivery areas I-A, I-B, and I-C, and
10 the proposal calls for applying the highest semi-annual fee,
11 that of \$250 for New York City post offices in area I-A, to
12 the other delivery areas. The fee will rise 4 percent from
13 \$240 in delivery area I-B and 11 percent from \$225 in area I-
14 C. It is also proposed that this fee will apply to delivery
15 area II, where caller service is now available as a substitute
16 for a box when boxes are scarce, but where some broader demand
17 for caller service may develop. This service is currently
18 offered in post offices in delivery area II for the same price
19 as a large box, which is currently \$55 per year. For
20 consumers in this situation in rural delivery areas, the
21 increase in price for caller service from \$55 per year to \$500
22 per year will be slightly more than 800 percent. It is

1 difficult to consider this proposal to increase caller service
2 prices in the absence of information about how much it costs
3 to provide the service.

4 Thus the proposed post office box rates lack a coherent
5 rationale. Although implicitly consistent with proposals for
6 no fee in delivery area III and for the imposition of a
7 nonresident fee, the idea that delivery into a post office box
8 costs less than delivery to a remote location is not
9 explicitly considered. Cost coverages are very high for
10 cities that are not in the largest categories, and they are
11 actually negative for rural areas. Cost coverages are highest
12 for the middle size post office box, low for the smallest size
13 box, and exceptionally low for the largest size box that is
14 used mainly by larger businesses.

15 It is noted that proper pricing will motivate more
16 efficient decisions by the Postal Service about space
17 allocation to post office boxes (Witness Lyons, USPS-T-1, pages
18 18-19). But there is no evidence the proposed rates will
19 serve that end. Distortions across delivery areas make box
20 revenues actually lower than costs in some areas and well
21 above costs in other areas, so allocation by area will be
22 distorted. And some box sizes are much more profitable than

1 others, so allocation of space to boxes by size within post
2 offices will not be properly motivated either.

3

OCA-101

Docket No. MC96-3

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UNIVERSITY OF VIRGINIA COMMITTEES:

Department of Economics Financial Aid Committee (Chairman) (1973-74, 1978-79)
 Department of Economics Graduate Committee (Chairman) (1974-78)
 Department of Economics Self Study (Chairman) (1974)
 University Faculty Self Study (1974)
 University Center for Advanced Studies Grants Committee (1975-78)
 University Summer Grants Committee (1971-74, 1981-87) (Chairman 1973-74)
 University Small Grants Committee (1971-74, 1981-87) (Chairman 1973-74)
 University Research Policy Council (1972-83)
 Graduate Faculty of Arts and Sciences Program Committee (1976-81)
 Faculty of Arts and Sciences Academic Advisory Committee (1977-79)
 Faculty of Arts and Sciences Promotion and Tenure Committee (1977-79; 1993-94)
 Committee on the Role of Research in the University (Chairman) (1977-78)
 Danforth Foundation Selection Committee (1978-80)

College of Arts and Sciences Dean 's Advisory Committee (1978-80)
 Executive Director, Thomas Jefferson Center (1979-82)
 Director, Thomas Jefferson Center (1982-84)
 Presidential Fellowship Selection Committee (1979-80)
 Copyright Policy Review Committee (Chairman) (1980-81)
 Faculty of Arts and Sciences Nominating Committee (1988-90)
 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)
 Faculty of Arts and Sciences Ad Hoc Committee on Chaired Professorships
 (Chair) (1992-93)
 Faculty of Arts and Sciences Budget Committee (1992-93)

CONSULTING/ADVISING:

Civil Service Commission (1967, 1968)
 Council of Economic Advisors (1974)
 Postal Rate Commission (1975, 1994)
 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)
 Federal Trade Commission (1981-84)
 U.S. Postal Service (1982-84)
 McGuffey Arts Center Board Member (1986-92)
 Charlottesville Gas Advisory Board Member (1992-)

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1 COMMISSIONER QUICK: Dr. Sherman, have you had an
2 opportunity to examine the packet of designated written
3 cross-examination that was made available to you earlier
4 this morning?

5 THE WITNESS: Yes.

6 COMMISSIONER QUICK: If these questions were asked
7 of you today, would your answers be the same as those you
8 previously provided in writing?

9 THE WITNESS: Yes.

10 COMMISSIONER QUICK: Mr. Costich, do you have
11 copies for the reporter or does the reporter already have
12 copies of the --

13 MR. COSTICH: I put two copies on the Bench.

14 COMMISSIONER QUICK: These are the copies here.

15 Two copies of the corrected designated written
16 cross-examination of Witness Sherman have been given to the
17 reporter and I direct that it be accepted into evidence and
18 transcribed into the record at this point.

19 [The Designation of Written Cross-
20 examination of Witness Sherman was
21 received into evidence and
22 transcribed into the record.]

23

24

25

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Special Services Fees and Classifications

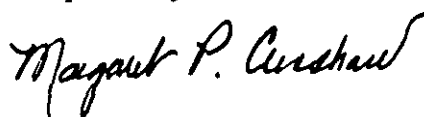
Docket No. MC96-3

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF THE OFFICE OF THE CONSUMER ADVOCATE
WITNESS SHERMAN
(OCA-T100)

The parties listed below have designated answers to interrogatories directed to witness Sherman as written cross-examination.

<u>Party</u>	<u>Answer To Interrogatories</u>
Douglas F. Carlson	USPS: Interrogatories T100-1-5, 6 (d)-36, 38-60, USPS: Interrogatories T300-27 (c)-(d) (redirected from witness Callow); USPS: Interrogatory T400-29 (redirected from witness Collins)
U. S. Postal Service	USPS: Interrogatories T100-1-4, 6-8, 10-14, 16, 19-22 (as revised 10/28/96), 23-27, 32-34, 36, 38-40, 41 (revised 11/14/96), 42-47, 51-52, 55-58, 60; USPS: Interrogatory T300-27 (redirected from witness Callow)

Respectfully submitted,



Margaret P. Crenshaw
Secretary

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

USPS/OCA-T100-1. Please refer to page 4 line 1 of your testimony.

- a. Please define "optimal pricing" or the principle of optimal pricing.
- b. Please identify all distinctions between "optimal pricing" and "market based pricing" as you understand those terms.

A. a. "Optimal pricing" is pricing that serves an explicit goal. Often that goal is social welfare, and in that case pricing may be called "socially optimal pricing." Social welfare is often defined as consumer surplus plus producer surplus (usually consumer surplus represents the difference between what consumers are willing to pay and what they actually pay, and producer surplus is profit), and prices can be derived that will maximize that goal. For example, in simple circumstances, prices that equal marginal costs will maximize welfare. In cases where pricing at marginal cost would produce a deficit and the goal is to maximize welfare while having the enterprise breakeven, a situation that would seem to fit the Postal Service, optimal prices are Ramsey prices. If external diseconomies existed (such as pollution), optimal pricing would take them into account. The main point is that optimal pricing is the best pricing for a certain definite purpose.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

CONTINUATION OF ANSWER TO USPS/OCA-T100-1:

b. "Market-based pricing" is presumably based on pricing that is determined in markets. A host of market possibilities will yield market pricing, from virtual monopoly circumstances to fierce competition, and so the possibilities cover a wide range. Externalities normally are not reflected in market-based prices, so their effects would not ordinarily be remedied in market prices. So "market-based pricing" can cover a wide range of outcomes, whereas "optimal pricing" is pricing that best serves a specific goal.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

USPS/OCA-T100-2. Please refer to page 5 lines 10-13 and page 9 lines 15-22 of your testimony.

- a. You state that it appears that money orders are currently priced below attributable costs. Provide citations to the record to support this proposition.
- b. In what respect are money orders a money losing special service?
- c. How do money orders fail to cover their attributable costs?
- d. Is it your testimony that money orders fail to meet criterion (b)(3) of section 3622 of Title 39, United States Code?
- e. What type of characteristics would you expect the recipients of money orders to exhibit?
- f. What type of characteristics would you expect the recipients of COD service to exhibit?

A. a. The Direct Testimony of Richard Patelunas in MC96-3, USPS-T-5G, page 24, provides FY 96 Current Rates (with mix). For money orders it reports revenues of \$169.7 million and attributable costs of \$195.4 million. Revenue less attributable cost is reported as -\$25.8 million, a substantial negative amount. Revenue as a percent of attributable cost is reported as 86.8 percent.

b. If attributable cost exceeds revenue for a service, as reported in USPS-T-5G for money orders, that service not only fails to contribute to institutional costs but also is a financial drain on other services that must make up for the failure of the service to cover its attributable costs. In that respect the reported financial performance would make money orders a money losing service.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

CONTINUATION OF ANSWER TO USPS/OCA-T100-2:

c. I am not in a position to speculate as to how money orders fail to cover their attributable costs.

d. If the revenue/cost relationships reported in USPS-T-5G, page 24, are correct, the failure of money orders to cover their attributable cost would seem to prevent the USPS from meeting criterion (b)(3) of section 3622, "the requirement that each class or type of mail service bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type."

e. I am in no position to speculate about the characteristics exhibited by recipients of money orders. I have received a money order myself, but I don't know the characteristics of others who receive them.

f. I am in no position to speculate about the characteristics exhibited by recipients of COD service. I have received COD service myself, but I do not know the characteristics of others who have received it.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

USPS/OCA-T100-3. Please refer to page 6 lines 3-9 of your testimony.

- a. Please define your understanding of "market power."
- b. Please identify all quantitative means, measurements, or equations known to you by which market power or monopoly power may be evaluated.
- c. Please attach copies of pages 97-102 of F.M. Fisher et al., Folded, Spindled, and Mutilated: Economic Analysis of U.S. vs. IBM to your response to this interrogatory.

- A. a. "Market power" is quite generally accepted as being the power to have an influence on price.
- b. The subject of market power comprises an entire subfield of economics, called industrial organization, which is impossible to summarize briefly. Several measures of market power have been proposed. One of the earliest is due to the late economist, Abba Lerner, and is based on the ratio of the difference between price and marginal cost ($p - mc$) to price (p), or the ratio $(p - mc)/p$. It comes from the idea that a profit-maximizing monopoly will set price so that this ratio, sometimes called the "price-cost margin," will equal $1/e$, where e is the price-elasticity of demand. One crucial source of market power is an entry barrier, which will inhibit new firms from competing if the current price rises, and several methods have been proposed for estimating the level of entry barriers. Based on the

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

CONTINUATION OF ANSWER TO USPS/OCA-T100-3:

difficulty of raising capital, the capital needed to form an enterprise that can operate at the minimum efficient scale in an industry has been estimated, for example. The greater this figure, the more difficult is entry, since more capital will have to be raised in the capital market and then deployed effectively. Having a small number of firms is also thought to contribute to the market power of each, and various measures of "concentration" have been used to represent this conception. The simplest measure is the four-firm concentration ratio, which is the fraction of industry sales (or assets, or employment, or other measure) accounted for by the largest four firms in an industry. Another measure is the Herfindal index, which is the sum of all the squared market shares for firms in the industry. This number approaches one for monopoly and zero for competition. By themselves, these concentration measures are not thought to ensure that market power will exist, but they might give rise to it. Some significant form of entry barrier generally is thought to be needed. Product differentiation is another possible source of market power, sometimes based on a patent. And a cost advantage, also possibly protected by patent, can be a source of market power. Although various attempts have been made to measure what are seen as sources of market power, the ultimate

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

CONTINUATION OF ANSWER TO USPS/OCA-T100-3:

form that power takes is the capability to affect price.

c. See OCA-LR-4.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

USPS/OCA-T100-4. Please refer to page 13 lines 23-25 of your testimony. In reaching your conclusion that it is difficult to identify costs for the new levels of insurance service, did you consider Lyons WP A page 5 before your testimony was filed?

A. My remark about the difficulty of identifying cost was not a criticism of Lyons WP A, but rather was noting that without a record drawn from providing the service in the past, the estimation of cost would be more difficult.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

USPS/OCA-T100-5. Please refer to pages 15 line 19 to page 16 line 15 of your testimony.

- a. Please provide all information of which you were aware regarding Mr. Popkin's background and credentials at the time you drafted your testimony in this docket.
- b. Have you ever cited Mr. Popkin in any other publication or publicly available document?
- c. Are you familiar with Mr. Popkin's educational background and credentials? If so, please explain in full.
- d. Are your conclusions based on the belief that handling procedures and transportation methods for uninsured registry do not vary as value of the article increases?

A. a. I knew nothing of Mr. Popkin's background and credentials at the time I drafted my testimony.

b. No.

c. No.

d. I was unable to reach conclusions, except to say it is possible that Mr. Popkin's argument would be supported with postal cost information by value category if it was available. The Commission endorsed exploration of this question in R94-1 but lacked a record on which to consider it. The record is still lacking.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

USPS/OCA-T100-6. Please refer to page 18 line 15-18 of your testimony.

- a. Do you contend that witness Needham has not presented accurate proposed certified mail costs and revenues at Tr. 4/1073 for Docket Nos. R90, R94, and MC96-3?
- b. If your answer to (a) is anything but an unqualified no, please identify all inaccurate information at Tr. 4/1073, and explain how one would derive accurate information about costs and revenues for certified mail.
- c. What is your understanding of the after-rates cost coverage for certified mail in Docket Nos. R90 and R94? Please explain in detail.
- d. Do you contend that any past inaccuracies in the manner in which certified mail revenues, costs, and cost coverages were reported, which in fact contributed to pure certified mail cost coverages below 100 percent (see Tr. 4/1073), should preclude the Commission from taking remedial steps in this proceeding?

A. a.-c. Redirected to Witness Collins.

d. Of course I do not contend that past cost or revenue inaccuracies for certified mail would preclude the Commission from taking remedial steps in this proceeding. No reading of my testimony should suggest that I do.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

USPS/OCA-T100-7. Please refer to page 18 lines 23 to 26 of your testimony.

- a. Could an explanation for the fact that a product is much less costly than alternatives to that product be that the product is priced below cost?
- b. Could an explanation for the fact that a product is much less costly than alternatives to that product be that the product is priced below market price?
- c. Do you contend that it is irrational for a firm to attempt to raise prices of its products to be closer to prices of alternative products?

A. a. Yes, it is possible for a product to have a lower price than alternatives because it is priced below cost.

b. If a product is priced below alternatives it would not normally be said to be priced below market price, since its price would normally be part of the market price.

c. Of course it is not irrational for a private firm to attempt to raise the prices of its products to be closer to prices of alternative products. Profit seeking private retailers can be expected to do it at every opportunity. It may not be appropriate action, however, for a public enterprise that is to serve the public.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

USPS/OCA-T100-8. Please refer to page 20 lines 24-26 and page 21 lines 1-4 of your testimony.

- a. As a general matter, is a mailer better off sending a mailpiece with the correct or an incorrect address?
- b. What, in your opinion, do you think a mailer would prefer: sending a mailpiece with an incorrect address or sending a mailpiece with a correct address?
- c. Please identify all of the advantages that accrue to a mailer who uses a correct address versus one who uses an incorrect address?
- d. What do you understand to be all of the disadvantages, from the mailer's perspective, of using an incorrect address?
- e. Would you agree with the proposition that correct address information could aid a caller and telephone information operator in identifying a telephone customer, particularly when the listing sought is of a customer with a common first and last name, such as James Brown or David Smith? If not, why not?
- f. Isn't it true that a correct address could aid an individual in addressing a package sent via an alternative delivery carrier?
- g. Isn't it true that correct address information could aid an emergency assistance personnel such as fire or police services in promptly providing assistance, particularly when such services are requested by one individual on behalf of another person located elsewhere?

A. a. Of course a mailer is generally better off sending a mail piece with the correct address than with the incorrect address. It is up to the mailer to judge how great an effort to make to have correct addresses, however, as the mailer suffers the disadvantages of using an incorrect address. For example, suppose that 99 out of 100 of a mailer's addresses are correct, but the mailer does not know which address is incorrect. Then spending, say, an additional \$.40 for every item mailed in order

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

CONTINUATION OF ANSWER TO USPS/OCA-T100-8:

to obtain address information would result in an expenditure of \$40.00 (\$.40x100). This expenditure would only correct one incorrect address, and the exercise shows that a mailer's willingness to pay for improved addresses will depend on how high is the present quality of address information. The \$40.00 expenditure for one address correction in this example might easily be greater than the correct address would be worth to the mailer. That is why the choice about how much to spend to obtain correct addresses should be left to the mailer.

b. Of course a mailer would prefer sending a mail piece with a correct address rather than with an incorrect address. The question of interest is not whether a correct address is useful, but rather how much is obtaining the correct address worth?

c. I cannot enumerate all possible advantages that might follow from having a mail piece reach its intended destination. The main advantage of using a correct address is that the mail piece can reach its intended destination, which can have different value to different mailers. Each mailer has to weigh the advantages of correct addresses relative to their cost and decide how much to spend in seeking them. And mailers should

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

CONTINUATION OF ANSWER TO USPS/OCA-T100-8:

have a choice, as they do now, whether to employ the Postal Service to improve their address information.

d. Of course I cannot enumerate all possible disadvantages of a mail piece not reaching its intended destination. That is the main disadvantage of a mailer's using an incorrect address, and it can be expected to have different costs to different mailers. Again, each mailer may face different disadvantages, and so they may be willing to pay different amounts to obtain correct addresses.

e. Yes, a correct address can be useful. As explained in (a) above, the question is not whether a correct address is useful, but how great is the usefulness. On average, how much is a mailer willing to pay to obtain correct addresses? This is a question each mailer is in position to answer. At present almost 9 out of 10 mailers are unwilling to pay what the Postal Service charges for correct address information, which indicates that most mailers see no need for marginal improvement in address accuracy in view of its cost.

f. Yes, a correct address can be useful.

g. Yes, a correct address can be useful.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

USPS/OCA-T100-9. Please refer to page 21 lines 15-16 of your testimony.

- a. Do senders of articles having no value sent via Express Mail subsidize, directly or indirectly, the merchandise insurance coverage of Express Mail?
- b. Does the sender of an article having no value sent via Express Mail value the merchandise insurance feature of Express Mail?
- c. Is it fair to say that the proposal for return receipts is a combination of two proposals, one restructuring the classification for this service and proposing a fee for that service?

A. a. I should not expect that senders of articles having no value by Express Mail subsidize the merchandise insurance coverage of Express Mail, but I am in no position to answer the question.

b. I do not know whether the sender by Express Mail of an article having no value actually values the merchandise insurance feature of Express Mail.

c. No, it does not seem fair to say the proposal for return receipts is two proposals, one restructuring the classification and the other proposing a fee for the service. This would not even be a fair characterization if only the minor change in the address option was involved, without elimination of the no-address option, because the fee stays the same for that slightly changed service. The main feature of the return receipt

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

CONTINUATION OF INTERROGATORY USPS/OCA-T100-9:

proposal is that it would eliminate one of the choices that is presently offered. The restructuring produces no genuinely new service. Nor is there a new fee, since the fee for the address proposal will continue in force. But the no-address option will no longer be an option.

Presently the mailer has two return receipt options:

(1) to learn to whom and on what date the item was delivered, or
(2) to learn to whom, on what date, and to what address the item was delivered. The address option, (2), has a higher rate.

Under the proposal, the mailer must choose the address option, (2), (with the address to be provided only when it is different rather than in every case as it is presently) and will no longer be allowed to choose (1) because it will no longer be offered.

It is not fair to call it a restructuring based on the change in the address option, which is so minor, when the main feature of the proposal is elimination of the no-address option. And it is not fair to say the proposal will propose a new fee, since there is no new fee.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

USPS/OCA-T100-10. Please refer to page 23 line 2 of your testimony.

- a. Is it fair to say that a demand elasticity of -0.17 is relatively inelastic?
- b. What is the effect of a price increase on a product exhibiting relatively inelastic demand?

A. a. Yes, a demand elasticity of -0.17 is very inelastic.

b. When the demand for a product is inelastic, raising its price will decrease quantity sold but will also raise total revenue, because the percentage increase in price is greater than the percentage decrease in quantity.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-19

USPS/OCA-T100-11. Please refer to page 24 of your testimony.

- a. Are you aware that plain postcards may be purchased from private vendors? If your answer is affirmative, please explain.
- b. Assuming that postal cards were no longer sold by the Postal Service,
 - 1) is it fair to say that privately printed plain postcards would serve as an adequate substitute for them?
 - 2) isn't it fair to say that some of the lower cost characteristics exhibited by postal cards, such as the addressing techniques suggested by witness Patelunas, could also be exhibited by plain, privately printed post cards used by today's customers of postal cards? Please explain your response.
- c. What, in your opinion, would be the likely effect on attributable costs for the post card single-piece rate if more lower cost pieces were entered at that rate category?
- d. Isn't it true that all users of the postal and postcard subclass pay, to some degree, for the manufacturing costs of postal cards? If your answer is no, please explain.
- e. Do private postcard users pay, through postcard postage, for the stationery provided to postal card users? If your answer is anything other than an unqualified no, please explain.
- f. Do private postcard users value free stationery given to postal card users? If your answer is anything other than an unqualified no, please explain.
- g. Do postcard users receive any benefit from the free stationery provided to postal card users? If your answer is anything other than an unqualified no, please explain.

A. a. Yes, I am aware that plain postcards may be purchased from private vendors. I can see nothing in this affirmative answer that needs to be explained.

b.

1) Yes, it is fair to say that private cards would serve as an adequate substitute for postal cards if the latter were not available.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

CONTINUATION OF INTERROGATORY USPS/OCA-T100-11:

2) Yes, it seems fair to say that some of the lower cost characteristics exhibited by postal cards could also be exhibited by privately printed post cards used by today's customers of postal cards. At present, the customers have no incentive to generate such economies for the Postal Service.

c. If more lower cost pieces were entered in the post card mail stream I would expect that unit attributable costs for post cards would be reduced.

d. No, this claim that postcard mailers support the manufacturing costs of postal cards is wrong. The manufacturing costs of postal cards are attributed to postal cards, not to private cards. See testimony of OCA Witness Sheryda Collins, OCA-T-400 in this Docket, page 22. Her position that the manufacturing costs are attributed to postal cards is confirmed in answer of Witness Patelunas to OCA/USPS-T5-10 (Tr. 2/251) and answer of Witness Needham to OCA/USPS-T8-37 (Tr. 4/1119).

e. No. See answer to d.

f. I see no reason why private postcard users would value the stationery for postal cards, which is not given to postal card users--they pay for it.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

CONTINUATION OF ANSWER TO USPS/OCA-T100-11:

g. The stationery is not free to postal card users, since they pay for it. I suppose the same is true of envelopes for priority mail users and for express mail users, but I am not certain. I do not see any benefit to postcard users from the stationery in postal cards (or the envelopes in priority mail or in express mail).

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

USPS/OCA-T100-12. Please refer to page 5 line 15 of your testimony.

- a. Please define the term "welfare considerations."
- b. How do welfare considerations relate to the pricing criteria of the Postal Reorganization Act?

A. a. Welfare considerations would mean considerations having to do with the well being of the public and more specifically of consumers and producers. Consumer welfare might be represented by consumer surplus, the difference between what consumers are willing to pay and what they actually pay.

b. The requirement that rates be fair and equitable (criterion 1) is to protect the well being of consumers. Having the value of mail services influence rates (criterion 2) will further consumer welfare while at the same time enabling the Postal Service to cover institutional costs. It is consistent with Ramsey prices, which are derived from representations of consumer welfare. Ensuring that services cover costs (criterion 3) furthers welfare because consumers can always be benefitted by changing from any rate structure that allows the enterprise to break even but has some services priced below their costs. Considering the effect of rate increases on the general public (criterion 4) is clearly attending to public welfare. Considering available alternative means of sending and receiving letters

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

CONTINUATION OF ANSWER TO USPS/OCA-T100-12:

(criterion 5) is respecting the positions that consumers may be in and thereby promoting their welfare. Ramsey prices, which serve welfare, call for explicit attention to alternative services. The degree of preparation of mail (criterion 6) is like taking cost into account; it is required for fairness to mailers. Simplicity (criterion 7) acknowledges the cost to consumers of dealing with complex rate and service schedules and so reflects concern for public welfare. Educational, cultural, and scientific values (criterion 8) obviously relate to public welfare.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

USPS/OCA-T100-13. Please refer to page 27 lines 1-19 of your testimony.

- a. Other than circumstances in which post office box service is the only available means of postal delivery, isn't it true that post office box customers may receive "dual" delivery, i.e., at their residence or place of business and at the post office box?
- b. If post office box customers are in fact eligible for dual delivery and elect to receive mail at both their residence (or place of business) and their post office box, doesn't that have the effect of eliminating, or at least reducing, the delivery savings you claim attend the provision of post office box service?

A. a. Yes, "dual" delivery is possible, although the volume of mail delivered to an address would probably be lower if a post office box is also receiving some of the mail.

b. I do not claim delivery cost savings attend the provision of post office box service; I suggest that there may be a savings and if so they would be worth identifying. If such savings exist, they would probably be lower when there is "dual" delivery.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

USPS/OCA-T100-14. Please refer to page 6 line 15 through page 7 line 13 of your testimony.

- a. Please identify all the products for which you claim detailed cost information is needed to perform pricing analysis and draw comparisons to competitive products.
- b. For each product identified in (a), describe in detail the cost information that you claim has not been provided in the record in this proceeding or Docket No. R94-1.

A. a. As my testimony indicates (OCA-T-100, page 11), two services for which cost information is wanting are registry service and certified mail.

b. It would be useful to know whether or how declared value affects registry cost in cases where no insurance is carried. If the cost differences by value class are small, then the proposal to combine all groups of value declarations together into one pricing category would clearly be in order. In my testimony (OCA-T-100, page 17, line 18 to page 18, line 20) I explain how unambiguous cost information would aid in evaluating the certified mail pricing proposal.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-19

USPS/OCA-T100-15. Please refer to your testimony at page 7 line 21 to page 8 line 1.

- a. Please explain your definition of interrelatedness in economic terms.
- b. Is it your testimony that when one product is interrelated with another product, each can be a substitute of the other?
- c. For each product for which you claim information concerning its interrelationship with another product is lacking, please identify the product, all products with which it is interrelated (as that concept is defined in part (a)), and the information that you claim is lacking, either in this record or Docket No. R94-1.

A. a. An interrelationship exists between mail services if a change in the price of one service affects the quantity demanded of another service. In economic terms, the cross-elasticities of demand between such services are not zero.

b. No. When products are interrelated they can be either substitutes or complements.

c. I am not in position to show where information on demand interrelationships is lacking. I had no responsibility for identifying them and searching for where and whether they might exist in preparation for this case, so it is difficult for me to speculate about it now. However, it is reasonable to expect that a change in the price of postal cards will affect not only the demand for private cards, but also the demand for First-Class mail, a major service that is not included within the scope of this case. In connection with post office box service, it is

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

CONTINUATION OF ANSWER TO USPS/OCA-T100-15:

claimed by Postal Service Witness Needham USPS-T-7, page 20) that since businesses use the larger boxes, making rates lower for them is desirable, because their coming to post offices to pick up mail causes them to use other mail services, such as Express Mail, Priority Mail and Standard Mail. No evidence of this interrelationship with other mail services is shown, but it would involve services that are not within the scope of this case.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

USPS/OCA-T100-16. Please refer to your testimony at page 31, lines 17-18, and page 32, lines 1-4. Do you believe that the higher prices for CMRA boxes are based only on higher costs, compared to the Postal Service's costs? If not, what other factors might underlie the CMRA prices?

A. The higher prices for CMRA boxes than for Postal Service post office boxes may be due in part to other factors, in addition to higher cost. The difference in prices charged may be due to more services being provided by the CMRA's.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

USPS/OCA-T100-17. Please refer to Exhibit OCA-101. Please provide copies of the following articles:

- Roger Sherman & Robert Tollison, "Public Policy Toward Oligopoly," Antitrust Law and Economics Review, Vol. 4 (Summer 1971).
- Sherman, Roger, "Entry Barriers and the Growth of Firms," Southern Economic Journal, Vol. 38, (October 1971).
- Sherman, Roger, "The Rate-of-Return Regulated Public Utility Firm is Schizophrenic," Applied Economics, Vol. 4 (March 1972).
- Sherman, Roger & George, Anthony, "Second-Best Pricing for the U.S. Postal Service" Southern Economic Journal, Vol. 45 (January 1979).
- Sherman, Roger, "Pricing Inefficiency under Profit Regulation," Southern Economic Journal, Vol. 48 (October 1981).
- Sherman, Roger, "Pricing Behavior of the Budget Constrained Public Enterprise," Journal of Economic Behavior and Organization, Vol. 4 (1983).
- Sherman, Roger, "Institutional Design for Monopoly Regulation," European Journal of Political Economy, Vol. 5 (December 1989).
- Sherman, Roger, "Capital Waste in the Rate-of-Return Regulated Firm," Journal of Regulatory Economics, Vol. 4, (December 1992).
- Sherman, Roger, "Monopoly Regulation: From Legal Unrealism to Unreal Legalism and Beyond," Review of Industrial Organization.
- Sherman, Roger, "Should Ramsey-Price Markups Differ?" Journal of Regulatory Economics.

A. See OCA-LR-4.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-1-18

USPS/OCA-T100-18. Please refer to page 8 line 20 of your testimony. Please define "socially optimal pricing."

A. "Socially optimal pricing" is pricing that is desirable from society's standpoint. See answer to USPS/OCA-T100-1(a) above.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-19-22

USPS/OCA-T100-19. Please refer to page 4, line 2 of your testimony, where you refer to the pursuit of "equitable contributions to institutional costs."

a. Would you agree that, in postal ratemaking, the concepts of "fairness" and "equity" are essentially the same? If not, please explain fully.

b. In Docket No. R74-1, the Postal Service submitted the direct testimony of William Vickery, very recently announced as one of two winners of the 1996 Nobel Prize in Economics, in support of a Ramsey-type approach to pricing postal products. When asked if inverse elasticity pricing brings about a "fair distribution" of the revenue burden, Dr. Vickery responded:

Economists have no special expertise in deciding what is fair and what is not. For that you need a vicar, not a Vickery.

Docket No. R74-1, Vol. III (Part 1), pg. 77. Do you agree with these statements by Dr. Vickery? If not, please explain fully.

A. a. Yes, "fairness" and "equity" are very similar virtues.

Since both words appear in statutory guidelines, the statute's authors may have presumed some differences.

b. Very few persons can claim to be expert in rendering what is fair, and no absolute expertness can be claimed by a group, such as economists (or perhaps even vicars). Some principles have been articulated to define fairness, however, and economists may play an instrumental role in analyzing these representations of fairness and interpreting their application.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-19-22

USPS/OCA-T100-20. Please refer to page 3, lines 10-12 of your testimony, in which you state that this case presents "an unusual proposal for making price increases on a piece-meal basis rather than in context, as in an omnibus rate case, where all rates for all services can be compared," and lines 16-21 of page 7, in which you state that "to see the pattern" of relative price relationships (such as Ramsey) prices "it is desirable to consider all prices at once, as in an omnibus rate case."

a. Please confirm that it is possible to compare all rates for all services at any time, whether one is proposing to change all rates, many rates, few rates, or no rates. If you cannot confirm, please explain fully.

b. Please confirm that it is possible to compare existing relative price relationships with those suggested by a Ramsey model or, for example, a uniform markup model, whether one is proposing (or even contemplating) a change in all rates, many rates, few rates, or no rates. If you cannot confirm, please explain fully.

A. a. Yes, it is possible to compare all rates for all services at any time. When only some new rates are proposed, however, the consequences to services that are not being altered may not be included and then the evaluation will be incomplete.

As I noted in my testimony (OCA-T-100, p. 8, lines 4-7),

It is still possible to consider effectively only a subset of services, if added care is given to the subset and effects of relations to other prices and services are included.

The added care seems to be lacking in this case, care to show the interrelations with other services and to compare cost coverages

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-19-22

CONTINUATION OF ANSWER TO USPS/OCA-T100-20:

across all classes.

b. Confirmed. It is possible to compare existing relative price relationships, assuming all necessary data are available.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-19-22

USPS/OCA-T100-21. Please refer to page 9, lines 10-14 of your testimony, where you claim that it "stands to reason that increased prices for only some services will distort overall Ramsey price relationships or any other form of relative relationship from whatever existed before, unless attention is focused on services where price-cost relationships have fallen out of line."

a. Please confirm that this statement presupposes that, when rates were last changed, all rates were "in line" with Ramsey pricing or some other deliberate approach to establishing price-cost relationships. If you cannot confirm, please explain fully.

b. Would you agree that it may be possible to have a situation in which all rates were not "in line" at the time of the last rate change, and that rate changes "for only some services" may thus improve conformity rather than cause distortions? If you do not agree, please explain fully.

c. Would you agree, given a hypothetical situation in which price-cost relationships for a number of services are "out of line" (regardless of whether they were previously "in line" and fell out, or they were never "in line"), that it is better to move some (but not all) of those services in the direction of "in line" rather than leave them all where they are? Please explain your answer fully, discussing any factors that you believe might be relevant to qualify your response.

A. a. Confirmed. Presumably, with regard to price relationships, whatever existed before was approved and accepted.

b. I certainly agree that correcting those rates that have fallen out of line could improve conformity rather than cause distortions. That is essentially what is said in the sentence from page 9 of my testimony that is quoted at the beginning of this interrogatory. And in the next sentence I said:

But attention clearly is not focused in that way, since two money losing special services, C.O.D. and money orders, are not given any attention. (OCA-T-100, p. 9, lines 14-17).

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-19-22

CONTINUATION OF ANSWER TO USPS/OCA-T100-21:

Thus, although it is possible that rate changes for only some services could improve conformity with pricing aims, evidence suggests that is not the purpose here.

While it make no difference to the argument, it would seem more reasonable to assume that approved rate changes were not "out of line," but that some may have fallen out of line since then, due to cost or demand changes.

c. See answer to b. A hypothetical example is unnecessary since C.O.D. and money order services appear to be priced below their attributable costs at present. Raising rates for only these two services, C.O.D. and money order, would thus appear to improve conformity with the pricing requirements of the Act. But such changes were not proposed.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-19-22

USPS/OCA-T100-22. Please refer to the bottom of page 5 and the top of page 6 of your testimony, where you discuss the fee for certified mail and your views of the implications of the fact that competitors currently offer comparable service at much higher prices.

a. Your claim that the Postal Service has "market power" is supported by quotation of a statement that identifies conditions to test for the presence of "monopoly power." In your view, are "market power" and "monopoly power" the same? If not, which do you believe applies to certified mail? Please explain your answers fully.

b. Please confirm that, according to the criteria for "monopoly power" quoted at lines 5-9 of page 6, the competitors of the Postal Service that charge much higher prices for comparable service must have monopoly power in the market because they have raised their prices far above the fees for Certified Mail without concern for the reactions of the Postal Service. If you cannot confirm, please explain fully.

c. Please confirm that the Postal Service cannot be "exploiting" its market power if other service providers continue in the market charging higher prices than those of the Postal Service, and customers continue to patronize those service providers. If you cannot confirm, please explain fully.

d. If a firm has market or monopoly power, does the imposition of any price increase constitute "exploitation" of that market or monopoly power? Please explain fully (distinguishing between the two types of power to whatever extent you believe to be relevant). If not, how does one distinguish a price increase that would constitute "exploitation" from one that would not? Please explain fully.

e. Please confirm that if a firm can raise its rates without concern "because its rivals cannot offer customers reasonable alternatives," the service in question must have a high "value of service" to its customers, as that term is used in postal ratemaking. If you cannot confirm, please explain fully.

f. Is it your testimony that, all other things being equal, a fee increase for Certified Mail would be more defensible if comparable services offered by competitors were available at equivalent or lower prices, rather than at higher prices? Please explain fully.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-19-22

ANSWER TO USPS/OCA-T100-22:

A. a. The words, "market power" and "monopoly power" are often used to represent the power to raise price. "Market power" is generally used when there is clearly more than one seller. In this situation, "monopoly power" could be used because the Postal Service is the dominant seller. Alternatively, monopoly power may effectively exist because other sellers' prices are so far above the Postal Service's that it alone is in position to raise price.

b. Not confirmed. Alternative or "fringe" providers of service may be handicapped by higher costs, and barely able to survive at their cost disadvantage.

c. Not confirmed. Higher priced providers of a service may often exist on the fringe of a monopoly service, offering different features and attracting some customers despite serious cost disadvantages.

d. No, nothing as simple as a price increase can identify monopoly exploitation. Ordinarily, one would expect a legal private monopoly (a monopoly based, say, on a patent) to exploit its position by choosing profit maximizing prices. The monopoly position is revealed by the high level of prices in relation to

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-19-22

CONTINUATION OF ANSWER TO USPS/OCA-T100-22:

costs, not by changes in prices. A public enterprise with monopoly power may not fully use its power by setting profit maximizing price levels, because it is charged with serving the public. At any time it might be possible, however, for such an enterprise to exploit its monopoly situation in a particular market by raising its price there. Whether the price increase would be reasonable or exploitative would be determined by an evaluation of the overall pricing policies of the enterprise, which is most easily done, of course, in an omnibus rate case.

e. Not confirmed. To be able to raise price without concern for rivals' actions would indicate a value of service above some minimal level, but many postal services may occupy that value-of-service position. Just how great is the value of one service, relative to others, would be one of the questions raised about all rate increase in an omnibus rate case.

f. No, the problem in considering a fee increase for Certified Mail has little to do with the level of alternative prices. That they are high merely indicates that the Postal Service would seem to have market power that would permit it to

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-19-22

CONTINUATION OF ANSWER TO USPS/OCA-T100-22:

increase price for Certified Mail. Whether price should be increased depends on cost coverages and value of service for this service relative to others, and on other pricing criteria.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-23. At page 17, lines 5 through 9 of your testimony, you compare the revenue per transaction for registry in Exhibits USPS-T-1, WP-E, page 2.

- a. Is it your understanding that the revenue per transaction figures reported in Exhibits USPS-T-5G and J are comparable with those reported in USPS-T-1, WP-E, page 2? Please explain in detail.
- b. Please explain your understanding of what is included in the registry revenues reported in the Cost and Revenue Analysis Report?
- c. Please explain your understanding of what is included in the registry revenues reported in USPS-T-1, WP-E, page 2.

A. a. At page 17, lines 5-9 of my testimony I called attention to the fact that revenue per transaction for registry is projected to increase under the new rates, based on USPS-T-5G and J. I also noted, in parentheses, that in USPS-T-1, WP-E, page 2, revenue per transaction is the same for both before and after rates. My main point was that revenue per transaction might also fall rather than increase (or even stay the same). I pointed out, however, that the effect would probably not be great because only a small part of registry would be affected. I do not know the detailed differences that would make USPS-T-5G and J differ from USPS-T-1, WP-E, page 2.

b. I assume all appropriate registry revenues are included in the audited Cost and Revenue Analysis Report.

c. I assume an estimate of 1996 registry revenues, before and after new rates, is included in USPS-T-1, WP-E, page 2.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-24. At page 18, lines 7-10 of your testimony, you state your understanding "that the Postal Service historically has included return receipt revenue but not return receipt cost in the cost coverage calculation for certified mail, but that it is not doing so in this case." You then go on to state, "Perhaps Witness Patelunas used the historical practice."

- a. Please explain in detail your understanding of "the historical practice" referred to in the immediately preceding sentence.
- b. Is it your understanding that historically the Postal Service has included return receipt revenues in certified mail revenues? Please explain your understanding of what the Postal Service has historically included in certified mail revenues in detail.
- c. Is [sic] your understanding that historically the Postal Service has included return receipt costs in certified mail costs? Please explain your understanding of what the Postal Service has historically included in certified mail costs in detail.

A. a. As a fuller reading of my testimony should make clear, my understanding was drawn from Witness Needham's testimony. The first quote from my testimony that appears in the preamble to this interrogatory is part of a sentence from my page 18, lines 7-10, and the quoted part omits the source of my understanding. The whole sentence (beginning on line 6) reads: "Witness Needham reports (USPS-T-8, page 71) that the Postal Service historically has included return receipt revenue but not return receipt cost in the cost coverage calculation for certified mail, but that it is not doing so in this case." This sentence from my testimony is based on the following quote from Witness Needham (USPS-T-8, page

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

CONTINUATION OF ANSWER TO USPS/OCA-T100-24:

71): "In this proceeding, the Postal Service is changing the historic practice of including return receipt revenue but not return receipt costs in the certified mail cost coverage calculation." Including return receipt revenue but not return receipt costs would clearly appear to make the certified mail cost coverage larger, so departing from this historic practice can be expected to lower the cost coverage calculated for certified mail.

In the second quote from my testimony, only the beginning of my next sentence is provided: "Perhaps witness Patelunas used the historical practice." The full sentence from my testimony reads: "Perhaps Witness Patelunas used the historical practice, because Witness Needham reports lower cost coverages, claiming the certified mail cost coverage is only 107 percent under current rates and would be 146 percent under proposed rates." I had reported earlier on that page (lines 2-5): "The cost report of Witness Patelunas (USPS-5G, 5J) shows a cost coverage for certified mail at current rates of 202.2 percent, and a cost coverage under proposed rates of 271.0 percent."

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

CONTINUATION OF ANSWER TO USPS/OCA-T100-24:

b. See answer to a. My understanding comes from Witness Needham's testimony quoted there.

c. See answer to a. My understanding comes from Witness Needham's testimony, quoted in a., that return receipt revenues and costs were not consistently treated in historic certified mail cost coverage calculations.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-25. At page 18, lines 15-18 of your testimony, you state, "If there is a longstanding error in the way costs have been evaluated for pricing certified mail service, that should be demonstrated and new rates might be proposed based on correct costs."

- a. Please explain what you mean by "correct costs."
- b. Please explain in detail which costs are, in your view, incorrect in this docket.

A. a. Witness Needham's testimony (USPS-T-8, page 71) indicates that an inconsistent treatment of return receipt costs and revenues has led historically to faulty cost coverages for certified mail. Correct costs would match costs with revenues to yield cost coverage calculations for certified mail that would be correct.

b. Witness Needham testified that "the historic practice of including return receipt revenue but not return receipt costs in the certified mail cost calculation" is being changed in this docket. Witness Patelunas's cost coverages for certified mail are much higher than Witness Needham's, however, leading me to wonder whether he used what Witness Needham described as the historic practice. Cost coverages in Witness Patelunas's testimony are so high that accepting them as correct would make it very difficult to argue for any price increase in certified mail. Yet a price increase has been proposed. This leads one to wonder whether the change in treatment of cost coverages is a reason for proposing a change in the certified mail rate.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-26. At page 18, lines 18-20 of your testimony, you state, "At present the argument is not put explicitly and the reason for the increase -- cost increases or previously incorrect costs -- is not clear."

- a. What "argument is not put explicitly?" Please explain in detail.
- b. Please explain in detail the "cost increases" to which you are referring. Over what period of time have these "cost increases" occurred? Is it your testimony that certified mail unit costs have increased? If so, please cite the source for your conclusion.
- c. Please explain in detail the "previously incorrect costs" to which you are referring. Is it your testimony that certified mail costs have been incorrect previously? How have they been "incorrect?" For what previous periods of time have they been "incorrect?"

A. a. Changing from the historic practice of including return receipt revenue but not return receipt costs in certified mail cost coverage calculations, as described by Witness Needham (see answer to USPS/OCA-T100-24-a. above), can be expected to lower the cost coverage for certified mail. The corrected cost coverage might be a basis for requesting a price increase for certified mail. But no argument along these lines is explicitly made, showing the previous practice and why and how it is being corrected.

b. It is not clear why the Postal Service is requesting an increase in the certified mail rate. Increases in costs are often given as a reason for rate increases, usually because a revenue requirement must be greater to cover increased costs. My quoted

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

CONTINUATION OF ANSWER TO USPS/OCA-T100-26:

testimony noted that the reason for a rate increase is not clear and raises the question whether cost increases are the reason or whether the new and corrected basis for calculating cost coverage is the reason.

c. See answer to USPS/OCA-T100-24, part a., above. The incorrectness is in the cost coverage calculation which Witness Needham described merely as "historic."

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-27. At page 23, lines 18-22 of your testimony, you refer to the "remarkable difference in processing cost between postal cards and private cards" with postal cards being "at least \$0.08 per piece less" than private cards. You cite to Exhibit USPS-T-5C at 10 for this conclusion. Is it your testimony that Exhibit USPS-T-5C at 10 reflects only processing costs? Please explain in detail.

A. I intended no special narrow meaning for the word, "processing," when I referred to the "remarkable difference in processing cost between postal cards and private cards." The attributable costs are simply much lower for postal cards, and that is the observation I intended to make.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-28. At page 23, line 22 - page 24, line 2, you discuss what you term "plausible sources" of the cost difference between postal cards and private cards mentioned in Witness Patelunas's response to interrogatory OCA/USPS-T5-11, Tr. 2/252-53. You cite to "greater compatibility of postal cards with mechanization and automation due in part to their uniform size and shape." You also mention cleaner addresses.

- a. Please confirm that in his response to interrogatory OCA/USPS-T5-11, Tr. 2/252-53, Witness Patelunas also states that it is possible "that postal cards are misidentified as private cards during data collection." If you do not confirm, please explain in detail.
- b. Do you have any basis to dispute witness Patelunas's statement that it is possible "that postal cards are misidentified as private cards during data collection." If so, please explain in detail.

A. a.-b. I did not include misidentification in the explanation I discussed because it did not seem to be a revealing explanation and can always be offered to explain peculiar results. However, if the kind of "misidentification" described by witness Patelunas is actually occurring, then the reported difference in unit costs for postal and private cards is understated, not overstated. Specifically, if data collectors are misclassifying postal cards as private cards in both the cost estimating systems and the volume estimating systems, then the reported unit cost for postal cards is basically undistorted, but the reported unit cost for private cards is too low. The only way reported unit costs for private cards could be too high and for postal cards too low is if there were inconsistent

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

CONTINUATION OF ANSWER TO USPS/OCA-T100-28:

misidentification by data collectors, such as assigning costs to private cards and volumes to postal cards. This seems unlikely.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-29. At page 24, lines 3-5 of your testimony, you state, "It is unfortunate that costs are not provided, to show the effects of these possible influences."

- a. By "possible influences" do you mean the uniform size and shape of postal cards?
- b. By "possible influences" do you mean the cleaner addresses of postal cards as compared to private cards?
- c. By "possible influences" do you mean the possibility of data collection misidentification?
- d. To what other "possible influences" are you referring?
- e. How would costs be "provided to show the effects of these possible influences?" Please explain in detail.
- f. Would showing "the effects of these possible influences" also include an assessment of possible data collection misidentification? If not, please explain in detail why not.

A. a. Yes, it would be useful to know how the sizes and shapes of cards would affect their costs.

b. Yes, it would be useful to know how the address quality of cards would affect their costs.

c. I did not refer specifically to data collection misidentification, but information on how it might affect costs would be useful.

d. All the possible influences I mentioned in my testimony have been noted already, so there is no other to be expected.

e. Some separate cost collection would be needed, at least on a sample basis, to determine these costs. Costs could be

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

CONTINUATION OF ANSWER TO USPS/OCA-T100-29:

collected by size category and by address quality, perhaps with only two categories in each case.

f. Of course it would be useful to know how significant is data collection misidentification and what is its effect on costs.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-30. At page 24, lines 8-9 of your testimony, you state, "And these effects may be stronger than is currently being assumed."

- a. By "these effects" do you mean the uniform size and shape of postal cards as compared to private cards?
- b. By "these effects" do you mean the cleaner addresses of postal cards as compared to private cards?
- c. By "these effects" do you mean the possibility of data collection misidentification.
- d. To what other "effects" are you referring?
- e. Upon what evidence do you base your statement that the effects "may be stronger than is currently being assumed?" Please explain in detail.
- f. What is your understanding of what is being "assumed?" Please explain in detail.
- g. Is it your testimony that "these effects" are currently reflected in the unit cost difference between postal cards and private cards? If not, please explain in detail. If so, how could the effects "be stronger than is currently being assumed?" Would not any "stronger" influence also be reflected in the unit cost difference between postal cards and private cards?

A. a.-d. No. The sentence immediately preceding the sentence from my testimony that is quoted in the preamble to this interrogatory is: "But it surely is uneconomic to raise the effective price of the postal card and thereby discourage the use of a Postal Service offering that costs so little to process, while at the same time encouraging the use of a service that costs more to process." It is the effects on quantities of postal and private cards noted in this immediately preceding sentence that are the "effects" of the quoted sentence, which ends a paragraph. The following paragraph explains why the effect of encouraging use of high-cost cards may be stronger than assumed.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

CONTINUATION OF ANSWER TO USPS/OCA-T100-30:

e. I base my statement that effects on postal versus private card volumes "may be stronger than is currently being assumed" on the lack of new evidence presented as to elasticities of demand for postal cards or cross-elasticities of demand between postal and private cards. (See discussion immediately following the quote in this interrogatory, from line 10 on page 24 to line 14 on page 25 of my testimony.) The response to raising the price of postal cards 10 percent to \$.22 is estimated using the extremely low elasticity of -0.17 that has been estimated for all cards as a group. It is as if that estimate was obtained when both postal and private cards experienced the same rate increase, which of course is what happened in the past. Once postal cards are separated in price from private cards it should be realized that private cards are a very close substitute, and raising the postal card price but not the private card price may lead to a greater decline in postal card volume. The demand for postal cards may be more elastic. And that would make the effects on postal versus private card volumes stronger than is currently being assumed.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

CONTINUATION OF ANSWER TO USPS/OCA-T100-30:

f. A price elasticity of demand for postal cards of -0.17 is being assumed.

g. The effects are explained in my answer to a. They concern volume responses to price changes. They can seriously affect contributions to overhead costs because of cost differences between postal and private cards. A greater decline in postal card volume than is assumed can worsen that contribution because postal cards have low attributable cost, and there may be a greater volume of private cards than is assumed, which would also worsen that contribution because private cards have higher attributable cost.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-31. At page 24, lines 17-19, you state "the possibility that more of the postal card volume will move to the very close -- and now lower priced -- substitute, private cards.

- a. What do you mean by "lower priced?" Please quantify.
- b. In making the above statement, did you take into account the cost of a [sic] purchasing a private card? Please explain in detail.
- c. What is the current average purchase price of a private card?
- d. Assume that the average purchase price of a private card is 5 cents. With postage, the total cost of purchasing and mailing a private card is 25 cents, correct?

A. a. Private cards and postal cards now bear the same price: \$.20. Under the stamped card proposal, postal cards will have a price of \$.22, while private cards will remain at the lower price of \$.20. That is what I mean when I describe private cards under the proposal as "now lower priced."

b. I take into account the changed price in postal cards, which changes the price relationship between postal and private cards. There will be a cost of buying the private card, but that has been present in the past and appears unlikely to change as a result of the stamped card proposed.

c. I have no basis for estimating the current average purchase price of a private card, but it appears unlikely to change as a result of the stamped card proposal. For anticipating changes in volumes what is important is the change in relative prices.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

CONTINUATION OF ANSWER TO USPS/OCA-T100-31:

d. I can obtain index cards that could serve as private cards for about 2 cents per card in a store. On that basis, the cost of purchasing and mailing a private card would be 22 cents. But these costs of mailing a private card will not change because of the stamped card proposal. The price of postal cards, relative to the price of private cards, will increase under the stamped card proposal, and that is what can be expected to bring about volume changes.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-32. At page 27, lines 1-4 of your testimony, you indicate that the Postal Service's post office box pricing proposal did not "explicitly" consider "that there may be a cost savings in delivery to a post office box rather than to a business or residence."

- a. Is it your testimony that the Postal Service's post office box pricing proposal implicitly considered a possible cost savings in delivery to a post office box rather than to a business or residence? If so, please explain in detail.
- b. In making the statement contained in the preamble to this question, did you review and/or consider Appendix B to USPS-T-5? If so, what is your understanding of the results of Appendix B? If not, why not?
- c. Please explain in detail your understanding of the types of costs included under post office box attributable costs in the Cost and Revenue Analysis Report.
- d. In making the statement contained in the preamble to this question, did you review Exhibit USPS-T-5A? If so, what is your understanding of the types of costs included under post office box attributable costs in the Cost Segments and Components Report? If not, why not?
- e. In making the statement contained in the preamble to this question, did you review pages 34-35 of USPS-T-4? If so, what is your understanding of the types of costs included in Witness Lion's allocation of post office box attributable costs? If not, why not?
- f. In making the statement contained in the preamble to this question, did you review and/or consider the Commission's Distribution of PO Box Cost Adjustment contained in PRC-LR-2? If so, what is your understanding of the results of the Commission's Distribution of PO Box Cost Adjustment? If not, why not?
- g. If you did not review and/or consider the Commission's cost methodology as set forth in PRC-LR-1 and 2, why did you need an extension of time from September 25, 1996 to September 30, 1996 to prepare and file your testimony?

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

ANSWER TO USPS/OCA-T100-32:

A. a. In setting prices for post office boxes there does not appear to be any explicit consideration of savings that might be realized by delivery through post office boxes. I know of no implicit consideration either.

b. My understanding is that Appendix B to USPS-T-5 traces consequences of the post office box rate increases. It is not a determinant of the proposed price increases, however, and I did not consider it for that reason.

c.-d. I did not use the post office box attributable costs in the Cost and Revenue Analysis Report or in the Cost Segments and Components Report (USPS-T-5A). I do not know in detail the types of costs that are included. I relied on the testimony of Witness Lion (USPS-T-4), whom I trust relied in turn on proper cost records.

e. Yes, I reviewed pages 34-35 of Witness Lion's testimony in USPS-T-4. He includes "space support," "space provision," and "all other" categories of cost, which are defined on the referenced pages. "Space provision" costs include rents, interest, and depreciation expenses, while "space support" costs include custodial and building services and supplies, maintenance (including elevators, heating and cooling), fuel, power and water,

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

CONTINUATION OF ANSWER TO USPS/OCA-T100-32:

and protection activities. The "all other" category includes labor for sorting mail to boxes and supervisory activities.

f. No. I attended to Postal Service testimony and assumed it complied with Postal Rate Commission requirements.

g. I was unaware of any extension of time until early October.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-33. Please refer to page 32, lines 3-4 of your testimony, where you assert "there is little doubt that alternative box services are more costly" [than post office boxes].

- a. Please explain the basis for this assertion.
- b. Assuming the existence of "economies of scope" is the reason for your assertion, please define this term and explain how it should be measured in this case.
- c. In your opinion, is there a significant difference in labor costs between CMRA employees and Postal Service employees? Please explain, in quantitative terms if possible.
- d. If labor costs at CMRAs are significantly lower, would that affect your conclusion? Please explain.

A. a. The Postal Service can deliver mail straight into post office boxes and can blend post office box services in with other postal services. CMRA's have to set up boxes at a separate location, which one would expect to be more costly. Evidence shows that CMRA's are more costly. See, for example, Witness Lion, USPS-T-4, page 22, Table 11, for CMRA rates that may be compared with proposed Postal Service rates. Witness Needham provides an explicit comparison in USPS-T-7, page 12, Table IV, which shows CMRA rates to be substantially higher than Postal Service rates.

b. Economies of scope are economies that attend the production of more than one service in a single firm. Consider a two-product example. If the cost of producing the two products is lower when they are both produced in a single firm than when each product is produced in a separate, specialized, firm, then

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

CONTINUATION OF ANSWER TO USPS/OCA-T100-33:

economies of scope are said to exist. Measuring costs in these circumstances can be difficult. Essentially, what is needed in an ideal case is a reference point cost for producing only one service. Then the incremental cost of adding the second service might be estimated. Comparing that incremental cost with the cost of independently providing the second service through another firm would give an indication of the significance of economies of scope. In the Postal Service setting, one would attempt to determine the cost that the Postal Service would experience if it offered no post office boxes, versus the incremental cost of providing post office box service. The advantage this cost offers over provision by independent service providers would be a measure of economies of scope.

c. I do not know how labor costs compare between CMRA employees and Postal Service employees.

d. No. My conclusion is based largely on the evidence in testimony referred to in my answer to part a. above, not on a comparison of labor costs.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-34. At page 33, lines 7-9 of your testimony, you state that "the idea that delivery into a post office box costs less than delivery to a remote location is not explicitly considered."

- a. How should the Commission consider this under the criteria of the Postal Reorganization Act? Please explain in detail.
- b. How should cost of delivery to a post office box versus cost of delivery to "a remote location" be accounted for under 39 U.S.C. § 3622(b)(3)? Please explain in detail.
- c. Is it your testimony that the cost of delivery to a post office box versus the cost of delivery to "a remote location" should be accounted for under one of the non-cost criteria of the Postal Reorganization Act? If so, please specify which criterion or criteria and explain your rationale in detail.

A. a. Suppose data were presented to show that post office box delivery cost less than other means of delivery. That saving in delivery cost would essentially mean there is a lower cost of providing service through a post office box than would be calculated if that effect on delivery cost were ignored. Once the savings was converted into a reduction in post office box cost, to achieve a true rendering of that cost, pricing criteria under the Postal Reorganization Act would be applied as in any other case.

b. See answer to part a. The effect should be traced to the cost of post office box service and then the criteria can be applied.

c. No. There is no need for non-cost criteria to deal with this matter. The question involves the determination of a

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

CONTINUATION OF ANSWER TO USPS/OCA-T100-34:

service's true cost. If a customer's use of a post office box lowers the cost of delivering mail, that cost savings should be taken into account in setting the post office box rate.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-35. In your response to USPS/OCA-T100-11(d), you indicate that private card mailers do not "support the manufacturing costs of postal cards." Please confirm that the manufacturing costs of postal cards are covered by the 20-cent postage paid by users of the cards subclass as a whole. If you do not confirm, please explain in detail.

A. Not confirmed. For a detailed explanation, see Witness Collins' answer to USPS/OCA-T400-13, part a.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-36. In your response to USPS/OCA-T100-13, you state, "I do not claim delivery cost savings attend the provision of post office box service; I suggest that there may be a savings and if so they would be worth identifying." Is it your testimony that Appendix B to USPS-T-5 does not identify delivery cost savings due to use of post office boxes? Please explain in detail.

A. I do not think Appendix B to USPS-T-5 identifies delivery cost savings in a form that can be readily converted into cost savings from post office box service in order to affect the price of that service. The savings must be imputed to the post office box units to determine effects on prices for them, and data are not presented for that pricing purpose.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-38. At page 24, lines 21-23 of your testimony, you state, "The reported contribution above attributable cost (price minus attributable cost) is less than \$0.04 per private card and roughly three times as great at \$0.12 per postal card."

- a. Please confirm that these figures are derived by subtracting the Postal Service's unit attributable costs for private cards and postal cards as reflected in Exhibit USPS-T-5C, page 10, from the 20 cent postage rate. If you do not confirm, please explain in detail.
- b. Please confirm that the 20-cent rate for private and postal cards is based on a markup of costs that reflects the Commission's cost methodology as reflected in its recommended decision in Docket No. R94-1 on Reconsideration. If you do not confirm, please explain in detail.
- c. Please confirm that the unit attributable costs for private and postal cards are different under the Commission's cost methodology as reflected in PRC-LR-1 and 2 in this docket than under the Postal Service's cost methodology. If you do not confirm, please explain in detail.
- d. Please confirm that the "contribution above attributable cost (price minus attributable cost)" is less for both private and postal cards under the Commission's cost methodology than under the Postal Service's cost methodology. If you do not confirm, please explain in detail.
- e. Please confirm that the "reported contribution above attributable cost (price minus attributable cost)" is actually 3.3 times or 230 percent larger for postal cards than for private cards using the Postal Service's cost methodology. If you do not confirm, please explain in detail.
- f. Please confirm that the "reported contribution above attributable cost (price minus attributable cost)" is 2.8 times or 180 percent larger for postal cards than for private cards using the Commission's cost methodology. If you do not confirm, please explain in detail.
- g. Did you review and/or consider the Commission's cost methodology as set forth in PRC-LR-1 and 2 in preparing the stamped card portion of your testimony? If so, how did you use the Commission's methodology? If not, why not?

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

ANSWER TO USPS/OCA-T100-38:

A. a. Not confirmed. The figures were derived as described, but the source was USPS-T-5G, page 15.

b. I presume that the 20-cent rate for private and postal cards results from a proper and approved markup of costs resulting from the Commission's recommended decision in Docket No. R94-1. I am not aware of the origins of the costing methodology and consequently I cannot confirm the offered statement.

c.-f. See my answer to part b. above.

g. I relied on cost and revenue presentations offered by Postal Service witnesses in MC96-3 and did not consult PRC-LR-1 and 2, which were not available to me when I prepared my testimony.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-39. Please refer to your testimony at page 13, lines 14-17. From the perspective of a mailer of merchandise valued above \$600, could an increase in the indemnity limit for insured mail from \$600 to \$5000 represent an improvement in service for that customer? Please explain your response.

A. An increase in the indemnity limit for insured mail from \$600 to \$5000 certainly represents an improvement in service for the customer mailing merchandise valued above \$600. That is in part why I said at page 12, lines 24 and 25: "Insured mail is the only service for which a genuine improvement is proposed."

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-40. Assume that a firm offers a product for a price less than its marginal cost and that the firm has market power. What are the economic consequences of not changing the price, both from the firm's perspective and from society's perspective?

A. From the standpoint of the firm that has market power but prices a product below its marginal cost, the firm will probably lose money on that product overall (it need not lose money if marginal cost is rising with output, because average cost would then be below marginal cost and so could be below price) and will certainly be losing money on the last few (marginal) units produced. From the standpoint of society, welfare could be improved by raising price because resources that go into the production of this product now cost more than the value consumers place on them (the product price).

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ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-41. Please refer to page 28, lines 12-14 of your testimony, where you state that "[i]f post office boxes are properly priced so they cover their costs they should be provided wherever they are requested by consumers."

- a. What should the Postal Service do to provide boxes when they are requested by customers at offices in which all boxes are in use, if the fees are not sufficiently high to justify the expansion of the box service section?
- b. Does it make economic sense for the Postal Service to reduce fees at such offices?

A. a. If fees are not sufficiently high to justify expansion of box service, it would appear that post office boxes are not properly priced. When it can be properly done, the Postal Service should request higher prices in this situation, in part because prices may not cover costs and so may not be in compliance with pricing statutes of the Postal Reorganization Act. As the quoted statement points out, proper pricing will avoid such a situation.

b. I can see no reason for reduced box fees at such an office.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-42. Please refer to your response to USPS/OCA-T100-1. You state that "[i]n cases where pricing at marginal cost would produce a deficit and the goal is to maximize welfare while having the enterprise breakeven, a situation that would seem to fit the Postal Service, optimal prices are Ramsey prices."

- a. Is it fair to say that adoption of marginal cost pricing in the context of the Postal Service would cause the Postal Service to fall below break-even if that pricing method were applied to all Postal Service products?
 - b. In the case of the Postal Service, should the institutional costs of the Postal Service be borne by all postal products subject to evaluation by the Commission? If your answer is anything other than an unqualified "yes," please identify the products that you believe should not make contributions toward the institutional costs of the Postal Service and provide reasons for your opinions.
 - c. Please confirm that if the institutional costs of the Postal Service are not recovered in full, the Postal Service will incur deficits.
 - d. Nonprofit, overseas voters, and free mail for the blind categories notwithstanding, in the absence of any other congressional appropriation, please confirm that the only means by which the institutional costs of the Postal Service may be recovered is through marking up prices on products.
- A.
- a. Yes.
 - b. Yes.
 - c. Yes, if all costs are not covered by revenues the Postal Service will have a deficit.
 - d. Yes, prices have to exceed marginal costs for the Postal Service to cover its institutional costs.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-43. Please refer to your response to USPS/OCA-T100-3.

- a. Is it your testimony that post office box service is a monopoly product? Please explain your response.
- b. Does the Postal Service face competition in the box service market? Please explain.
- c. Are there barriers that have prevented Postal Service competitors from entering the box service market? Please explain.
- d. Could low prices for Postal Service box service serve as a barrier to entry in the box service market?

A. a. I cannot say that the Postal Service's post office box service is a monopoly product. That is too simple, given the existence of alternative services. But the Postal Service has great advantages in offering such service, since it can sort directly to the box as part of a mailing service already paid for by the mailer. Thus there is an economy of scope for the Postal Service in offering post office box service while also offering mail service. To the extent this actually saves delivery cost for the Postal Service, there is an added economy that will give the Postal Service further cost advantage. An alternative supplier of the box service must receive delivery at another location and place it in the box holder's box, without its being part of other postal activities.

b. Yes, there are alternative providers of post office box service but their charges tend to be considerably higher than the

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

CONTINUATION OF ANSWER TO USPS/OCA-T100-43:

Postal Service's (see USPS-T-7, Table IV, page 12), probably because their costs are higher.

c. Alternative providers of post office service must attract customers by offering services that the Postal Service does not offer or does not offer well, or by having a location that is more convenient than the Postal Service location—at least for some customers. As their prices will almost certainly be higher than Postal Service prices, their services must be important to customers if the alternative providers are to win any of those customers.

d. Yes, low prices for Postal Service post office box services could discourage entry into the box service market.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-44. Please refer to your response to USPS/OCA-T100-16. You state that higher prices for CMRA boxes may be "due in part to other factors, in addition to higher cost." You state that one such factor is that CMRAs may provide more services than the Postal Service. Please identify all other noncost factors that may contribute to higher prices for CMRA boxes. Are demand characteristics an example of such noncost factors? Please explain.

A. CRMA boxes may be in locations that are preferred by at least some customers. To obtain box service at these locations the customers may be willing to pay the higher costs that such premium locations require. It may seem difficult to say location is a "noncost factor" because, as in this example, costs may be higher and demand also may be higher. The main point is that, as in the case of other services such as copying, although costs are higher the result is a preferred service for a few customers who are willing to pay substantially more for it.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-45. Please refer to page 4 lines 1-4 of your testimony where you state "[t]o pursue equitable contributions to institutional costs calls for an omnibus rate case, where comparisons across services are possible."

- a. Please define the term "equitable" as you have used it here.
- b. Is it possible to arrive at equitable contributions outside of an omnibus rate case? If your answer is other than yes, please explain why this result would not be possible.
- c. Are rates that are recommended by the Commission pursuant to an omnibus rate case always equitable? Please explain your response.

A. a. By "equitable contributions" I only mean fair or balanced contributions that allow similarly situated parties to make similar contributions. Identifying equitable contributions can be easier in the context of an omnibus case, where actual comparisons across services would be possible along with proposed actions.

b. All services are not acted upon outside of an omnibus case. Without an omnibus case, some imbalances in relative markups, for example, can be expected to persist that might have been corrected in an omnibus case. Changes made in a piecemeal case affect only some services and simply do not afford the comparisons across all services that are appropriate.

With care and planning, it may be possible to achieve reasonably equitable contributions outside of an omnibus rate

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

CONTINUATION OF ANSWER TO USPS/OCA-T100-45:

case and across a series of cases. In my testimony from page 8, line 4 to page 9, line 24, I indicate this possibility but point out that appropriate steps have not been taken in this case to achieve such an aim.

c. Yes, it is reasonable to presume that rates recommended by the Commission pursuant to an omnibus rate case are equitable. The Commission is responsible for identifying fair and equitable rates that comply with the Postal Reorganization Act.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-46. On page 4, lines 7 and 8 of your testimony, you state that the Postal Service's proposal seems "aimed more at raising revenue than at making offerings more commercially attractive." Please provide your definition of "commercially attractive."

A. The words, "commercially attractive," were used by Witness Lyons when he included as an objective of the Postal Service proposal "the realignment and streamlining of certain special service offerings to make them more commercially attractive" (USPS-T-1, page 2, lines 7 and 8). I take the words to mean that offerings are to be made more attractive to customers. Thus, the increase in indemnity limit for insured mail is a change that would make the insurance feature and perhaps the mail itself more commercially attractive by Postal Service proposals. Special Delivery is to be eliminated as a service, certified mail and the stamped card essentially are to have their prices increased, a most popular option in return receipt service is essentially to be eliminated, and post office box rates are effectively to be raised. This combination of reduced services and increased prices in the proposal is what prompted the quoted passage from my testimony.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-47. Please refer to your response to USPS/OCA-T100-14. Is it your testimony that an economically rational firm would always be better off doing nothing in the absence of the information you claim is lacking than attempting to adjust prices with the information that it does have available? Please explain your response.

A. An economically rational firm would develop cost information for its products and services as a basis for rational product design and pricing. Doing so is especially appropriate for a public enterprise that must act responsibly in the interest of the public. Whether the firm is better off acting without adequate information is not possible to answer in the abstract, nor is it really the issue in this case. The question is whether all those who are to consider and evaluate the Postal Service proposal can do so properly with the information that is provided.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-48. On page 25, lines 24-25, and page 26, lines 1-3, you state:

when areas are categorized and prices are set to reflect average cost differences some of the resulting prices may seem irrational, as when a suburban area and a rural area are in close proximity and have essentially the same costs, but have different rates.

- a. In the context of post office boxes, are you aware of any other circumstances in which these prices may seem "irrational?"
- b. Isn't it true that under the Postal Service proposal, the differential between fees for post office boxes in suburban areas and nearby rural areas would be decreased, assuming the former is currently Group IC and the latter is Group II?

A. a. No, but since rates differ substantially by delivery group, it is possible that at group boundaries other similar cases will arise.

b. No, this claim is wrong. It is not true that under the Postal Service proposal the differential between fees for post office boxes in suburban areas (Group IC) and nearby rural areas (Group II) would generally be decreased. The fee differential would be decreased for box sizes 4 and 5, but it would be increased for box sizes 1, 2, and 3 (see USPS-T-7, Table I, pages 3 and 4).

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-49. On page 28, line 5 of your testimony you state. [sic] "[o]nly minor administrative expenses, which might be traced to non-resident mailboxes at some locations, have been offered in an attempt to justify the nonresident fee." Is it your testimony that the Postal Service has not attempted to support its nonresident fee proposal through testimony demonstrating the value of service that non-residential box customers receive? If you do not confirm please explain.

A. The Postal Service has not provided cost testimony to support its nonresident fee proposal by showing how much more costly such service is to provide. Nor has it provided persuasive testimony, supported for instance by demand elasticity information, as to the value of the service, compared with other services, to motivate a greater markup over costs.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-50. On page 33 of your testimony you state that witness Lyons notes that proper pricing will motivate more efficient decisions by the Postal Service about space allocation to post office boxes[,]. . . [b]ut there is no evidence that proposed rates will serve that end".[sic] Assuming all other variables equal, would a rational decisionmaker be more likely to increase output if net revenue per unit were increased?

A. Yes, assuming all other things equal, a rational decisionmaker would be more likely to increase output if net revenue per unit increased. But post office prices might not motivate increases in post office boxes where they are most needed because the relation between cost and price is so inconsistent.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-51. On page 33, line 19 you state that "[d]istortions across delivery areas make box revenues actually lower than costs in some areas and well above costs in other areas, so allocation by area will be distorted". Please identify all areas of which you are aware where box revenues would be below cost under the Postal Service's proposed fees and those where box revenues would be above cost. Please explain how you determined that revenue to cost relationships would be "distorted" in those areas.

A. By combining attributable costs per box from Witness Lion (USPS-T-4, Table 18, page 44) and revenues per box from Witness Needham (USPS-T-7, Table 1, pages 3 and 4), it is possible to compare revenues and costs for Delivery Groups and box sizes. Revenues do not come close to covering costs for any box size in Group II, with the poorest cost coverage of 0.53 coming for box size 5. Other Delivery Groups cover costs but some just barely, such as box size 5 in Group IA (cost coverage 1.022) and in Group IB (cost coverage 1.040). On the other hand, revenues from box sizes 2 and 3 in Group IC are more than twice their costs. Thus, there is an incentive to expand the number of box sizes 2 and 3 in Group IC rather than in Group II, which leads to misallocation.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-52. Please refer to your testimony at page 18, lines 15-20. Is your statement that there has been "a longstanding error in the way costs have been evaluated for pricing certified mail service" referring to issues that were not discussed by witness Lyons at Tr. 2/153-54 and by witness Needham at USPS-T-8 p.71 lines 5-12 and 16-21 and Tr. 4/1062, 1072-75, and 1196-1201? If your response is negative, please explain.

A. No. The basis for my statement is stated in my answer to interrogatory USPS/OCA-T100-24.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-53. Please refer to your testimony at page 24, lines 4-8. Mail processing costs notwithstanding, does a mailer receive greater value by purchasing a 20 cent postal card as opposed to purchasing a 20 cent stamp for postcard postage? Please explain.

A. My statement at lines 4-8 of page 24 of my testimony was concerned with effects on costs of encouraging greater use of a less efficient mail stream, namely private cards, by lowering its price relative to postal cards. I am in no position to tell whether a mailer receives "greater value" by purchasing a 20 cent postal card as opposed to purchasing a 20 cent stamp for postcard postage. The postal card does include a card on which to write a message, but the postal card is also narrow or inflexible, and may not include the information, such as a picture for example, that the mailer wishes to mail. One notable difference is that postal cards seem much less costly for the Postal Service to process.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-54. Please refer to your testimony at page 24, lines 17-19.

- a. In order to mail a private post card, isn't it true that the mailer usually affixes postage to those cards, either through affixing a stamp to the card or printing a meter or permit imprint indicium on it? Please explain your response.
- b. Isn't it true that large volume mailers of postcard size pieces must incur labor and/or capital costs to affix evidence of postage to private post card pieces? Please explain any negative response.
- c. Is it your testimony that the cost of a private post card plus the cost of labor and/or capital used in affixing postage to that piece amounts to less than two cents per card? Please explain your response.

A. a. Yes, a private card requires a stamp.

b. Yes, large volume mailers must affix postage. However, they can do so at low cost. And they have great flexibility to choose card size, design, color, and printing. Mailers can also affix addresses which, because they differ, are probably more difficult to affix than postage.

c. No, I have prepared no cost estimate for affixing postage to a card. It might cost two cents per card, but I do not know. For studying the stamped card proposal, however, it really does not matter. What is important is the change from what is presently done, and the change is that, compared with private cards, postal cards will cost relatively more than they have before. This can be expected to reduce volume in the postal card mail stream relative to the private card mail stream, which

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

CONTINUATION OF ANSWER TO USPS/OCA-T100-54:

is unfortunate because the postal card is processed at much lower cost.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-55. Please refer to your response to USPS/OCA-T100-3(b).

- a. Please confirm that a profit maximizing monopoly applying the Lerner index would set price by solving for the variable p using the following formula, where " p " is price, " mc " is marginal cost, and " e " is elasticity of demand:

$$\frac{p-mc}{p} = -\frac{1}{e}$$

- Please explain any negative response.
- b. For a product whose elasticity equals -0.25 , what would the relationship between the product's marginal cost and price be if the firm intends to exercise monopoly power and maximize profits?
- c. Does a profit-maximizing monopoly operate on the inelastic portion of the demand curve? Please explain your response.
- d. Is it possible to use the Lerner index of monopoly power to solve for price if demand for a product is inelastic?
- i. If your answer is affirmative, please explain how a profit-maximizing monopoly would set the price of certified mail. Please show all calculations. For purposes of your response, please assume the equivalence between attributable costs and marginal costs.
 - ii. If your answer is negative, please identify any other quantitative means and equations by which market power or monopoly power may be evaluated when demand for a product is inelastic.

A. a. The Lerner index is an early and crude measure of monopoly power, the ratio of price minus marginal cost divided by price. This interrogatory presents the monopoly pricing rule, which has that ratio equal to the reciprocal of the elasticity of demand (in absolute value) when the profit maximizing monopoly has settled on its optimal price.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

CONTINUATION OF ANSWER TO USPS/OCA-T100-55:

b.-c. As is well known, a monopoly never wishes to operate in the inelastic region of demand, as this question proposes. With an inelastic demand, such as -0.25 , the monopoly firm should raise price because revenue will increase while quantity, and therefore cost, can only decrease. That is, profit improves by raising price if demand is inelastic. And the monopoly firm will continue to want to raise price until demand is no longer inelastic, since only then can it satisfy the rule discussed in part a.

d. No.

i. Not Applicable.

ii. This raises the general problem of representing market power and my answer to interrogatory USPS/OCA-T100-3, part b. is relevant. It is also possible, as noted in the answer to part b. above, that the time periods over which demand elasticities are estimated may differ.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-56. Please refer to your response to USPS/OCA-T100-8(a). Assuming adoption of the Postal Service's proposal, would you agree that if a return receipt does not bear address information, the mailer receives *de facto* confirmation that a mailpiece for which a return receipt was purchased was correctly addressed?

A. Yes, I presume that is the way the address-if-different service is to function. And I agreed that a correct address is better than an incorrect address. The important question is: how much better is it, or how much is the correct address information worth to a mailer?

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-57. Please refer to your response to USPS/OCA-T100-9(c).

- a. As compared to basic return receipt service (signature and date service), does the addition of the address (if different) feature create a better and/or enhanced service? If your response is negative, please explain.
- b. Does the proposed \$1.50 fee for a signature, date, and address (if different) represent a new fee over the \$1.10 fee for return receipt with signature and date?
- c. Does a proposal to combine a signature and date return receipt service with a signature, date, and address return receipt service to make a signature, date, and address (if different) return receipt service alter the makeup of the signature and date option? Does the proposal alter the makeup of the signature, date, and address option?

A. a. No new service is created. Two services are already available, a basic signature-and-date service, and service with an added address feature. The service with the address feature costs more. Customers clearly prefer (by about a 9 to 1 margin) the basic, no-address service. They say that the enhanced service is not worth its added cost to them.

b. No, not as I understand the offerings. The signature, date, and address (if different) offering is virtually the same as the present signature, date, and address option, which has a fee of \$1.50 that will not change. The \$1.10 fee applies to the overwhelmingly more popular signature and date option which will no longer be offered.

c. The proposal should not really be described as one to combine the signature and date return receipt option with the

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

CONTINUATION OF ANSWER TO USPS/OCA-T100-57:

signature, date, and address option. The signature and date option is simply being eliminated. It is being taken away. Consumers will have to take the added address feature, and they will be forced to pay for it. Despite the fact that almost 90 percent of users choose and thus prefer the service that provides just signature and date, the Postal Service is proposing to eliminate that service option.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-58. Please refer to your response to USPS/OCA-T100-11. Are you aware of any vendors of private postcards? Please identify them by name and location.

A. Perhaps I misunderstand this question, but I am of course aware of vendors of private postcards. They are everywhere. Just in the city of Charlottesville, Virginia, they are on many street corners. There may be too many just in Charlottesville for me to identify by name and location in the time I have to complete interrogatories, and I would have to list many more to comply entirely with this request. I can only assume that the request is for some other matter that I do not understand.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-59. Please refer to your response to USPS/OCA-T100-11(f) and (g).

- a. Please confirm that a postal card customer receives both postage and stationery for 20 cents, whereas a mailer of a private single-piece postcard must pay 20 cents for a postage stamp (or other indicium for 20 cents) for which no stationery is provided. If you are unable to confirm, please explain.
- b. Since mailers of postcard size pieces can choose between paying 20 cents for a single-piece postcard postage stamp (or other indicium) or paying 20 cents for a postal card, would mailers be likely to perceive the stationery provided with a postal card to be offered for free? If no, please explain.
- c. Do customers primarily use Priority Mail and Express Mail envelopes as stationery for correspondence? If yes, please explain.

A. a. Confirmed. The postal card customer has stationery provided, but the size, color, and composition of the stationery is chosen by someone else, whereas the private card mailer purchases a stamp to be used with a piece of stationery that mailer chooses.

b. There now is no added charge for the stationery part of the postal card, that is true, but neither is the postage flexible and usable on other stationery items. Thus, the mailer may perceive the added stationery as "free," but also constraining, since it limits the way the included postage may be used. Since the stationery is also limiting, it may not be seen as "free." And of course the mailer actually is paying for the stationery.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

CONTINUATION OF ANSWER TO USPS/OCA-T100-59:

c. Customers generally do not use envelopes of any kind as stationery. Postal Service Witness Needham rationalized the stamped card proposal by analogy to the stamped envelope, however, which is offered for an extra fee (USPS-T-8, page 95, lines 4-9). It is thus appropriate to point out that fees are not consistently imposed by the Postal Service for envelopes, since no fee is charged for Priority Mail or Express Mail envelopes. The analogy between envelope charges and stamped card charges therefore is not compelling.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

USPS/OCA-T100-60. Please refer to your response to USPS/OCA-T100-22. You state that, "[t]he words 'market power' and 'monopoly power' are often used to represent the power to raise price."

- a. Is your statement intended to be consistent with the statement of Fisher et al. at page 20 of *Folded, Spindled, and Mutilated* that "[m]onopoly power is the ability to raise prices above competitive levels or to market inferior products while excluding competition"? Please explain any negative response.
- b. Do you agree that the statement in subpart (a) is the economist's version of the law's definition of monopoly? Please explain any negative response.
- c. Do you agree with the statement of Fisher et al. at page 99 of *Folded, Spindled, and Mutilated* that "[m]onopoly power is not present when a firm can keep its business only by means of lower prices or better products than its competitors'" Please explain any negative response.
- d. Do you agree that monopoly power can be analyzed by examining the ease with which buyers can turn to other sellers and substitute products and the readiness with which competitors will expand output if the monopolist appears to be reaping monopoly profits? Please explain any negative response.
- e. Do you agree with the statement of Fisher et al. at page 108 of *Folded, Spindled, and Mutilated* that "the touchstone question in using market share as any kind of indicator of monopoly power is whether an attempt to exploit customers would lead to a sharp reduction in market share"? Please explain any negative response.
- f. Is it your testimony that if the USPS proposed fee for certified mail is implemented,
 - i) such fee would be higher than the prices of competitors' offerings?
 - ii) it would not be easy for Postal Service customers to substitute other competitors' products for certified mail?
 - iii) it would not be easy for Postal Service competitors to increase their output of competing products?
 - iv) it would not be easy for competitors of the Postal Service to enter the market for products competing with certified mail?

Please explain your response.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

ANSWER TO USPS/OCA-T100-60:

- g. Is it your testimony that if the USPS proposed fees for post office boxes are implemented,
- i) such fees would be higher than the prices of competitors' offerings
 - ii) it would not be easy for the Postal Service's customers to substitute other competitors' products for post office boxes?
 - iii) it would not be easy for Postal Service competitors to increase their output of competing products?
 - iv) it would not be easy for competitors of the Postal Service to enter the market for those products?

A. a. Yes, the statements are not the same but they are consistent with each other.

b. I prefer the statement quoted in my testimony as a way to convey the effect of monopoly power. For the quoted statement in part a., it would be better to add the sentence in the book that precedes it. ("A firm has monopoly power when it is sufficiently insulated from competitive pressures to be able to raise its prices or withhold the introduction of new technology, either in product innovations or in process (cost-reducing) innovations, without concern about the actions of its competitors and with relative impunity because its customers lack reasonable alternatives to which to turn." From F.M. Fisher , J.J. McGowan, and J.F. Greenwood, *Folded, Spindled, and Mutilated*, page 20.)

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

CONTINUATION OF ANSWER TO USPS/OCA-T100-60:

Yes, this is a reasonable effort to give an economist's version of the law's definition of monopoly, meaning that it is an attempt to provide a more useful version.

c. Yes, this quote on page 99 is recognizing the role of "superior skill, foresight, and industry," as opposed to monopoly power, and the same distinction is also made in the discussion at page 20.

d. I do not agree totally. If a monopolist is reaping monopoly profits it would seem to have some monopoly power.

e. Yes. The quote occurs in the context of the market share of IBM.

f. i) No.

ii) At present it does not appear to be easy for customers to substitute other competitors' products for certified mail. As an example, certified mail is available as a complementary feature with First Class Mail, which is a monopoly service that has no close substitute.

iii) I have no knowledge of how easily alternative providers could increase their outputs but I would not expect that they would have difficulty doing it. They also face the problem of selling any increased output.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-38-60

CONTINUATION OF ANSWER TO USPS/OCA-T100-60:

iv) It is already difficult for alternative providers who are unable even to offer many of the services with which the Postal Service can combine certified mail service. So I expect entry will continue to be difficult for alternative providers.

g. i) No. There is evidence that CMRA boxes will have higher prices (see USPS-T-7, Table IV, page 12).

ii) The price difference alone suggests that it would not be easy to do so.

iii) I have no knowledge of how easily alternative providers of boxes could expand their supply of boxes but I would not expect it to be difficult. They also face the problem of selling any increased output.

iv) Alternative providers of box service must serve customers' very special needs, since they must charge much higher rates than the Postal Service. I have no way of knowing how difficult it might be to fashion the location and service mixture that will attract users at such a relative price disadvantage.

ANSWER OF OCA WITNESS ROGER SHERMAN
TO REDIRECTED INTERROGATORY USPS/OCA-T300-27

USPS/OCA-T300-27. On page 15, line 21- page 16, line 2 of your testimony, you state that "The Postal Service's discriminatory treatment of non-resident boxholders through the proposed non-resident surcharge is unfair and inequitable".

c. Do you consider the higher charges imposed on Metro riders in the Washington, D.C. area during rush hours to be unfair and inequitable? Please explain why or why not.

d. With respect to Metro, please assume that the cost per rider is not higher during rush hour than at other times. How would that assumption affect your view about the fairness and equity of higher rush hour fares?

A. c. No. There is not enough information to discuss fairness or equity of Metro fares. In any case, the difference between rush-hour and non-rush-hour charges would very likely be caused by differences in costs, with expansion of rush-hour travel requiring additions to capacity and thus higher costs. It is also possible that rush-hour and non-rush-hour travelers may share capacity, so expanding usage by either group would require more capacity, and then their combined willingness to pay for capacity would affect fares. In that case, though, the higher rush-hour demand would lead to a higher rush-hour fare because capacity would be filled at rush hour with a higher fare.

d. Even with equal costs, which could be claimed in the second case of sharing capacity in question c. above, the optimal sharing rule could still lead to higher prices at the rush hour. To say more would require information about the different customer groups that is not available to us in this case.

ANSWER OF OCA WITNESS ROGER SHERMAN
TO REDIRECTED INTERROGATORY USPS/OCA-T400-29

USPS/OCA-T400-29. At page 22, lines 21 - page 23, line 14 of your testimony, you discuss witness Patelunas's "speculative reasons" for the cost difference between postal cards and private cards cited in his response to OCA/USPS-T5-11, Tr. 2/252-53. You state that postal cards "are more compatible with postal processing equipment than post cards." You also state that "[a]ddress hygiene may be better."

- a. Please confirm that in his response to interrogatory OCA/USPS-T5-11, Tr. 2/252-53, witness Patelunas also states that it is possible "that postal cards are misidentified as private cards during data collection." If you do not confirm, please explain in detail.
- b. Do you have any basis to dispute witness Patelunas's statement that it is possible "that postal cards are misidentified as private cards during data collection?" If so, please explain in detail.

A. a.-b. Please see my response to USPS/OCA-T100-28.

1 COMMISSIONER QUICK: Does any participant have
2 additional written cross-examination for Witness Sherman?

3 [No response.]

4 COMMISSIONER QUICK: Only one participant, the
5 United States Postal Service, has requested oral cross-
6 examination of Witness Sherman. Does any other participant
7 have oral cross-examination for Witness Sherman?

8 [No response.]

9 COMMISSIONER QUICK: Mr. Alverno, would you please
10 begin?

11 MR. ALVERNO: Thank you, Mr. Presiding Officer.

12 CROSS EXAMINATION

13 BY MR. ALVERNO:

14 Q Good morning, Dr. Sherman. I am Anthony Alverno
15 and I will be conducting cross-examination on behalf of the
16 United States Postal Service.

17 A Good morning.

18 Q How are you today?

19 A Fine, thanks. How are you?

20 Q Could you please turn to your response to
21 Interrogatory 8A of the Postal Service.

22 A I have it, yes.

23 Q Now, in that response to the interrogatory, you
24 criticize the Postal Service's proposal for return receipts
25 and you offer an example of a mailer who has 100 addresses

1 to which he would -- to whom he would like to send a mail
2 piece and 99 of which are correct. Now, if the mailer used
3 a return receipt to send mail pieces to each of those 100
4 addressees, you claim that the mailer would incur an
5 expenditure of \$40 in order to obtain information about one
6 correct address. Is that a fair characterization of what
7 your *response*.

8 A Yes.

9 Q Now, in the example you give, is it fair to say
10 that your analysis assumes that the Postal Service's
11 proposed change in fee for return receipts, that is the
12 change in the basic service fee from \$1.10 to \$1.50 is
13 motivated entirely by the classification change that would
14 provide the sender with the address, if different, in
15 addition to the signature and date?

16 A Yes, this illustration assumes the present
17 situation where there is a choice between the address option
18 and the no-address option.

19 Q Is it assuming the Postal Service's proposed
20 service for return receipts; that is, that it would provide
21 the date, signature and address if different?

22 A That would be certainly -- whether -- the main
23 point would be that there is an address option that is being
24 provided.

25 Q Now, is it your testimony that the Postal Service

1 provided testimony justifying the fee increase for return
2 receipts on the basis of the classification change alone;
3 that is, the change of classification for the basic service
4 to provide not just date and signature, but also date,
5 signature and address if different?

6 A Well, the way -- it appears to me the -- a small
7 -- there are now two options: name and date or name, date
8 and address. A small change is being made in the address
9 choice so that you get the address if it's different rather
10 than simply the address. I regard that as a small change.

11 The other option is being removed, so that's just
12 being taken away. The new service is name, date and address
13 if different.

14 Q Now, in the example you give, you claim the mailer
15 is paying \$40 for a single correct address; is that right?

16 A Yes. In this example.

17 Q Yes.

18 Now, under the Postal Service's proposal for
19 return receipts, customers would receive the address to
20 which the piece is delivered, it would be printed on the
21 piece itself, that is the return receipt, if it differs from
22 the address on the mail piece, right?

23 A Right.

24 Q So if the mailer receives a return receipt without
25 an address on it, the mailer has in essence received de

1 facto confirmation that the address which was printed on the
2 mail piece was correct.

3 A Yes.

4 Q So it's true, then, that if the proposed new
5 service is implemented, whether or not there is address
6 information on the return receipt, the mailer still receives
7 the benefit of information about the addressee's address for
8 each return receipt.

9 A Yes. In fact, the mailer is forced to receive
10 that information. My point here is it might not be worth
11 \$40 to the mailer and under the available options today, the
12 mailer can reject this address information if it's not worth
13 \$40. Under the new proposal, the mailer won't be able to
14 reject it. The mailer will have to pay the \$40.

15 Q Okay. Could you please turn to your response to
16 interrogatory 6A of the Postal Service.

17 A I have it.

18 Q Pardon me. 6D.

19 A I have that.

20 Q Now, you state that you do not contend that past
21 cost or revenue inaccuracies for certified mail would
22 preclude the Commission from taking remedial steps in this
23 proceeding; is that correct?

24 A Yes.

25 Q Now, assume that there have been past inaccuracies

1 in certified mail revenues that have resulted in cost
2 coverages for certified mail in prior omnibus rate
3 proceedings that led the Commission to believe that the
4 certified mail cost coverage was higher than it actually
5 was. Let's further assume that if the Commission had been
6 given the correct, that is the pure, unadulterated cost
7 coverage for certified mail in prior dockets, that coverage
8 would have been below 100 percent. Would you agree that it
9 would be appropriate for the Commission in this docket to
10 consider recommending a substantial increase in the fee for
11 certified mail to compensate for the longstanding error in
12 the certified mail cost coverage methodology that resulted
13 in cost coverages essentially being below 100 percent?

14 A Setting aside the problem of whether there should
15 be piecemeal cases that just look at a few rates and so on,
16 and on the assumption that an explanation along these lines
17 was provided with appropriate details, I think I would agree
18 with that.

19 Q A substantial increase?

20 A Well, whatever increase would be appropriate given
21 the correct costs.

22 Q And you think it's proper that the Commission
23 consider test years in past dockets where the cost coverage
24 was below 100 percent?

25 A Well, if it's revealed that the basis for

1 decisions in the past were faulty because costs were wrong,
2 then it seems entirely appropriate to take remedial steps.
3 I see no reason not to consider repairing a faulty decision
4 in the past based on faulty costs.

5 Q Could you please turn to your response to
6 interrogatory USPS OCA T100-14.

7 A I have it.

8 Q Okay. Now, in your response to Part A of that
9 interrogatory, you state that two services for which cost
10 information is lacking are registry and certified mail; is
11 that correct?

12 A Yes.

13 Q Now, in Part B to that interrogatory, you state
14 that, with respect to registry, you state that it would be
15 useful to know whether or ~~now~~^{not} declared value affects
16 registry costs in cases where no insurance is carried. If
17 the cost differences by value class are small, then the
18 proposal to combine all groups of value declaration together
19 into one pricing category would clearly be in order.

20 Now, could you please tell me what participant in
21 this docket has proposed that uninsured registry value
22 levels be combined together into one pricing category?

23 A What I mean by that is you pay one fee for values
24 up to \$100 and for values higher than that you must accept
25 insurance. It's as if the category -- suppose I had

1 something worth \$110. I could declare that now and mail it
2 without insurance. I will no longer have that option under
3 the proposal.

4 It would be interesting to know what added costs
5 there might be in such service.

6 Q As I read your response, you're referring to
7 circumstances in which there is no insurance offered with
8 the registry service.

9 A Right.

10 Q So there is no proposal on the record right now to
11 collapse uninsured registry into one composite category;
12 there is simply a proposal on the record to permit customers
13 who have items valued between zero and \$100 to have no
14 insurance as an option.

15 A Right. At the present, if they have an item
16 that's valued at more than \$100, they are permitted to
17 declare that value and send the item without insurance. As
18 I understand the proposal, they will now be asked to take
19 insurance if they declare that higher value.

20 I think a very small fraction of items are in this
21 category, perhaps because it doesn't seem that a mailer
22 would want to declare a value a little above \$100 simply for
23 the right to pay a higher fee if they don't seek insurance.
24 They might just declare \$100.

25 Q Okay. I simply don't see, you know, what proposal

1 there is to combine all groups of value declarations. I
2 mean, there really isn't a proposal in the record of that
3 sort.

4 So maybe you were intending to refer to the zero
5 to \$100 category alone.

6 A Yes.

7 Q In which case there is one value increment, in
8 which case there is no reason to consider the variances in
9 costs depending on value.

10 A It would be interesting to know whether an item
11 valued at \$500 and mailed today without insurance costs more
12 than an item valued at say \$50.

13 Q I'm sorry, that carries insurance or that does
14 not?

15 A That does not carry insurance. It would be --
16 this difference is now being eliminated.

17 Q Right. I agree with you that there are lots of
18 interesting questions that we would all like to consider,
19 but frankly, in relation to the proposals that are on the
20 record right now in this proceeding, this isn't relevant, is
21 it?

22 A Well, I think it is because there exists now a
23 rate structure that has gradations of fees by value.
24 Presumably there's a cost difference; otherwise why would
25 there be a fee difference? It would be interesting to know

1 if that cost difference is significant, at least it seems to
2 me of interest.

3 Q Now in the next sentence in your response to
4 Interrogatory 14B, you state that cost information about
5 certified mail is also lacking in this docket. You state
6 that you would like some unambiguous cost information about
7 the certified mail proposal.

8 Could you please identify for me what specific
9 cost information you claim is lacking regarding the
10 certified mail proposal in this docket?

11 A I may have to go back to my testimony for that.
12 My main difficulty was that Witness Needham described cost
13 coverages which differed from Witness Patelunas' cost
14 coverages. They were not consistent.

15 There was an exchange of interrogatories that left
16 me, I must admit, a little baffled about what the two costs
17 for certified mail are.

18 Q Okay. Now, could you please distinguish for me
19 the terms "cost" and "cost coverage"?

20 A Cost I would think of as attributable costs to a
21 mail service and cost coverage would be the revenue for that
22 service divided by that cost.

23 THE REPORTER: Divided by that cost?

24 ~~DR. SHERMAN:~~

~~MR. OLSON:~~ By that cost.

25 BY MR. ALVERNO:

1 Q Let's look at your testimony now at page 18,
2 starting at line 6. You state that "Witness Needham reports
3 that the Postal Service historically included return receipt
4 revenue but not return receipt cost in the cost coverage
5 calculation for certified mail, but that it is not doing so
6 in this case."

7 What is the effect on the cost coverage if
8 revenues are overstated by the presence of ancillary service
9 revenues and certified mail revenues?

10 A Well, that would be overstated. It would be high.

11 Q The cost coverage would be higher than what it
12 really is?

13 A Yes.

14 Q So, if ancillary service revenues historically
15 included in certified mail revenues run up the cost^{Coverage}, then
16 historically cost coverages for certified mail would then be
17 higher than what they really were if you considered
18 certified mail in isolation?

19 A Yes.

20 Q Let's look down now at line 15.

21 A Yes.

22 Q You state that if there has been a longstanding
23 error in the way costs have been evaluated for pricing
24 certified mail service, that should be demonstrated and new
25 rates might be proposed based on correct costs.

1 At present, the argument is not put explicitly and
2 the reason for the increase, cost increases are previously
3 incorrect costs, is not perfectly clear. By longstanding,
4 what do you mean?

5 A I use Witness Needham's word, historical.

6 Q Where do you draw the conclusion that there's been
7 a longstanding error in costs?

8 A Well, it's cost coverage.

9 Q Okay, so on page 18, line 15, that should read,
10 "If there has been a longstanding error in the way cost
11 coverages have been evaluated for pricing certified mail
12 service, that should be demonstrated and new rates might be
13 proposed based on correct coverages."

14 A That's correct. That's right.

15 Q The next sentence would read, if corrected, "At
16 present, the argument is not put explicitly and the reason
17 for the cost increases or previously incorrect cost
18 coverages is not perfectly clear."

19 A I think that's improved it, yes.

20 Q Let's now turn to your response to Interrogatory
21 25-A of the Postal Service.

22 A I have it.

23 Q Now you state that witness Needham's testimony
24 indicates that an inconsistent treatment of return receipt
25 costs and revenues had led historically to faulty cost

1 coverages for Certified Mail; correct costs would match
2 costs with revenues to yield a cost coverage calculation for
3 Certified Mail that would be correct.

4 Okay. Here your reference to correct costs is not
5 a challenge to the costs that have been presented for
6 Certified Mail, is that right?

7 A I don't think I'm challenging the costs. In
8 witness Needham's testimony there was a reference to cost
9 coverage. There was not detailed information about costs.

10 Q Okay. Is that a criticism^{or} is it simply a
11 statement of fact?

12 A I guess a little of each. If the change in the
13 connection between revenue and cost to alter this historical
14 practice is the basis for the rate increase it would be nice
15 to have this laid out to explain how the calculation used to
16 be made, how it ought to be made, what the consequences are,
17 and present it as a basis for a rate increase, which is what
18 the Certified Mail proposal is.

19 Q So in other words if I think I understand your
20 criticism correctly, you would say that we should be
21 consistent in calculating cost coverages so that we have
22 pure, unadulterated Certified Mail revenues divided by pure,
23 unadulterated Certified Mail costs, not tainted by any
24 ancillary service revenues, is that correct?

25 A If that is the sound way to price Certified Mail

1 I'd say it's correct.

2 It sounds sensible. It would be gratifying to me
3 to see a case made on some basis like that for what the rate
4 ought to be.

5 Q That seems to be what you are saying in your
6 response to Interrogatory 24C, if you could just take a look
7 at that.

8 A [Reviewing document.]

9 Q As I understand that response, you are simply
10 stating that -- your reference to the inconsistent treatment
11 of historic Certified Mail cost coverage calculations has to
12 do with whether or not ancillary service revenues were
13 included in the Certified Mail revenues.

14 A Yes.

15 Q Okay. Could you please turn to page 9, line 16,
16 of your testimony?

17 A Page 9?

18 Q Yes, page 9, line 16.

19 A Yes, have it.

20 Q Excuse me, lines 15 and 16. You describe money
21 orders as a money-losing special service, is that correct?

22 A Yes.

23 Q Now are you aware that witness Lyons filed an
24 interrogatory response on this subject where he stated that
25 if one considered the addition of revenues resulting from

1 money order float and money orders taken into revenue the
2 cost coverage for money orders would be expected to push the
3 cost coverage for money orders above 100 percent.

4 A I learned later that there was such testimony. If
5 that's true it seems that it should be included in the
6 witness Patelunas's cost calculation -- cost and revenue
7 calculation.

8 Q Can you identify for me whether or not or tell me
9 whether or not they were included in FY 1995, money order
10 revenues and costs -- excuse me, revenues?

11 A Well, I -- offhand I can't.

12 Q Okay.

13 A You mean the float element?

14 Q Right. Yes.

15 A I can't.

16 Q Could you please turn to your response to USPS OCA
17 T100-33A of the Postal Service?

18 A I have it.

19 Q Now, you state that evidence shows that CMRAs are
20 more costly and CMRA refers to commercial mail receiving
21 agencies, correct?

22 A Uh-huh.

23 Q Now, by more costly, do you intend to say that the
24 cost to a CMRA of providing box service is higher than the
25 cost to the Postal Service of providing post office box

1 service?

2 A The evidence I refer to is price evidence. I
3 would expect if the prices are higher, the costs are higher.
4 There are reasons why I think costs would be higher.

5 Q Well, we'll get to that.

6 What are the elements of the costs of providing
7 box service for a CMRA?

8 A Well, the space, the rental cost, the services
9 that go with space, and then sorting and so on, plus any
10 other services they may provide like copying or staying open
11 late at night, whatever.

12 Q And your support for the proposition that CMRA is
13 more costly is Witness Lyons' testimony at page 22, table
14 11, correct?

15 A Right, and Witness Needham's comparison in her
16 testimony.

17 Q Okay. Let's take a look at Witness Lyons'
18 testimony at page 22 for a second.

19 MR. COSTICH: Commissioner Quick, could I ask if
20 counsel has copies of that for the witness and counsel?

21 MR. ALVERNO: I don't have a copy.

22 Do you have a copy? Anybody?

23 COMMISSIONER QUICK: Copy? Copy?

24 BY MR. ALVERNO:

25 Q Well, we'll do this from the basis of your

1 recollection of what that page has on it. That page is
2 strictly a compilation of information about prices --

3 A For CMRA.

4 Q -- of post office boxes, correct?

5 A I thought it was CMRAs.

6 Q Excuse me. CMRA's --

7 A Right.

8 Q -- box service, correct?

9 A I think so.

10 Q It doesn't contain anything about space rental
11 costs, --

12 A True.

13 Q -- services that go with space, sorting.

14 A True. Strictly rates.

15 Q So how do you draw conclusions about the costs to
16 CMRAs of providing box service on the basis of the prices
17 that they charge their customers?

18 A Well, I'm presuming there is some competition in
19 the provision of such services, that if there were enormous
20 profit in these higher prices, more people would be trying
21 to provide the services. And so I expect the prices they
22 can ask for the service are roughly in line with what it
23 costs to provide them.

24 I'm also thinking that for the Postal Service to
25 deliver into a box, the Postal Service is already receiving

1 payment from a mailer that includes, presumably, the cost of
2 delivering the piece into a mailbox, so they're already --
3 they have an advantage in that the fee paid to them includes
4 this cost, whereas a CMRA has to set up a space, take the
5 mail from the Post Office and install it in the box. It's
6 added costs. I just would expect it to be more expensive,
7 although that's, I must admit, speculation.

8 Q Is it fair to say that the only circumstance in
9 which one can draw conclusions about CMRA costs on the basis
10 of the prices that they charge for box service is when the
11 box market is in long run equilibrium?

12 A I suppose, yes.

13 Q And isn't it also true that one can draw
14 conclusions about demand from prices and quantities sold of
15 boxes?

16 A That could be trickier. You can observe one
17 point, but if you -- you don't know what the shape of that
18 might be like, the shape of the demand curve might be like.

19 Q But one can use those elements to determine
20 demand.

21 A What elements?

22 Q Quantity sold and prices.

23 A If you observe a price and a quantity sold, you
24 can observe a point on this demand curve, but you don't know
25 the shape of --

1 Q In other words, if you vary prices and you vary
2 quantity sold --

3 A Then you can make a stab at it, yes.

4 Q Could you please turn to your response to
5 Interrogatory 43B of the Postal Service.

6 A I have it.

7 Q Now, in your response, you refer to alternative
8 providers of box service, and you state that their charges
9 tend to be considerably higher than the Postal Service's,
10 probably because their costs are higher.

11 Now, by alternative providers of post office box
12 service, you're talking about CMRAs, correct?

13 A Yes.

14 Q And I trust that the evidence you cite in support
15 of that proposition is Witness ^{Lion's} ~~Byrne's~~ testimony at page 22?

16 A I think it's actually Witness Needham's.

17 Q Witness Needham's testimony?

18 A Testimony.

19 Q And do you know exactly what you're referring to
20 in her testimony?

21 A A table that listed Postal Service box fees and
22 CMRA fees.

23 Q Okay. Let's turn now to Part C of Interrogatory
24 33 of the Postal Service.

25 A I have it.

1 Q Now, there you state that you do not know how
2 labor costs compare between CMRA employees and Postal
3 Service employees, correct?

4 A Correct.

5 Q Now, isn't it true that within the Postal Service,
6 clerks and/or mailhandlers generally deliver box mail?

7 A I will accept that.

8 Q Subject to check.

9 A Yes.

10 Q Okay. And those types of employees generally are
11 bargaining unit employees, correct?

12 A I accept that.

13 Q Are you aware of the extent to which CMRA
14 employees are unionized?

15 A No.

16 Q And would you generally accept the
17 characterization of CMRAs as storefront operations, small
18 businesses?

19 A I would suspect so, yes.

20 Q And would it be reasonable to expect that few CMRA
21 employees are unionized?

22 A Now, that, I have no idea.

23 Q Would it be reasonable to expect that?

24 A I suppose. I suppose.

25 Q And would it also be fair to say that bargaining

1 unit employees are generally paid higher wages than non-
2 bargaining unit employees for the same type of work
3 performed?

4 A That is possible.

5 Q And do you know how rental costs might compare
6 between Postal Service facilities and CMRAs that provide box
7 service?

8 A I don't. It seems to me the CMRA locations would
9 have to have some value and advantage to some mailers in
10 order for them to win any business, which might mean the
11 space is costly.

12 Q Could you please turn to page 7, lines 21 to 23,
13 of your testimony?

14 A I have it.

15 Q Okay. Now, you state that a price change in one
16 service can alter quantities of other services through cross
17 price elasticity effects.

18 Now, is it fair to say you're referring to cross
19 price elasticity of demand --

20 A Yes.

21 Q -- in your testimony?

22 A Yes.

23 Q Now, could you turn to your response to
24 Interrogatory 49 of the Postal Service.

25 A I have it.

1 Q In the last sentence there, you state that the
2 Postal Service might have supported a price increase for
3 post office boxes by demand elasticity information as to the
4 value of service compared with other services to motivate a
5 greater mark-up over costs.

6 A Oh, excuse me. I have number 49. Is -- are you
7 reading from my answer to 49?

8 Q Yes.

9 A Oh, that must be --

10 Q This is T1 -- there might be a redirect question.
11 I'm not sure.

12 MR. COSTICH: No, I think it's -- it's the second
13 sentence of the answer. There was just a -- the word "it" I
14 think was replaced with "Postal Service" when counsel asked
15 the question.

16 MR. ALVERNO: I wasn't quoting exactly. I
17 apologize.

18 THE WITNESS: This has to do with non-resident
19 mailbox fees?

20 MR. ALVERNO: Yes.

21 THE WITNESS: Okay. Okay. I was in the wrong
22 sentence. I'm sorry.

23 MR. ALVERNO: Okay.

24 THE WITNESS: It's the last sentence of my answer
25 that you're --

1 MR. ALVERNO: Right.

2 THE WITNESS: Okay.

3 MR. ALVERNO: I'll re-read the question so that
4 you have it.

5 THE WITNESS: Thank you.

6 BY MR. ALVERNO:

7 Q The Postal Service might have supported a price
8 increase for post office boxes by demand elasticity
9 information as to the value of the service compared with
10 other services to motivate a greater mark-up over costs; is
11 that right?

12 A Yes.

13 Q So when one takes account of cross price and own
14 price elasticities of demand in setting rates, isn't one in
15 essence applying market-based demand factors in pricing?

16 A Well, I would describe them as the Ramsey
17 Principles. It's really -- or value of service principles.
18 The aim of such calculations is to raise revenue to cover
19 fixed institutional costs in a fair way and demand
20 elasticity reflects the value of service to the consumer.
21 It's an empirical measure of willingness to pay and value of
22 service, and it's used for that purpose.

23 Cross elasticities reflect alternative services
24 available and play a role in this kind of welfare maximizing
25 pricing. Full-fledged Ramsey prices take demand elasticity

1 and cross elasticities into account.

2 Q So in a Ramsey pricing model, demand
3 considerations should be taken into account in ratesetting,
4 isn't that right?

5 A Yes, and I wouldn't call them market-based because
6 there may be a complete monopoly service. There's not a
7 competitive -- there may be no competitive process and yet
8 these demand considerations would play an appropriate role.

9 Q You are saying that demand elasticity information
10 can be used in determining prices?

11 A Yes.

12 Q Let's turn now to your response to ^{USPS}~~USPS~~/OCA
13 T-100-1.

14 COMMISSIONER QUICK: Mr. Alverno, is your mike on?

15 MR. ALVERNO: It is on.

16 COMMISSIONER QUICK: Could you pull it a little
17 closer?

18 MR. ALVERNO: Yes.

19 MR. COSTICH: Excuse me, Commissioner Quick.

20 Could I have that citation again?

21 MR. ALVERNO: Yes, certainly. ^{USPS}~~USPS~~/OCA T-100-1.

22 THE WITNESS: I have it.

23 BY MR. ALVERNO:

24 Q Now, in the second to last sentence, you state
25 that "For the Postal Service, optimal prices are Ramsey

1 prices," correct?

2 A In this setting, in this case, yes.

3 Q And can you just explain for us how Ramsey pricing
4 would be applied in a postal context?

5 A Well, this has been presented in rate case
6 testimony before. There is some known revenue and cost
7 circumstance by service and there is also an institutional
8 cost to be covered.

9 It is possible, in principle, to set up a
10 representation of consumer welfare like consumer surplus and
11 maximize it. The implication of such a procedure is Ramsey
12 prices which, if there are no cross-elasticities, would set
13 markups above, in our setting, attributable costs in inverse
14 proportion to demand elasticities.

15 If there are cross-elasticities that are not zero,
16 it gets a little more complicated, but they can be drawn
17 into the calculation.

18 What these prices serve to do is make the
19 contribution to institutional costs greater from services
20 that have less elastic demands and less for services that
21 have more elastic demand.

22 The presumption behind all this is that the
23 services are monopoly services.

24 Q The presumption is that they are monopoly
25 services?

1 A Yes. You're trying to set optimal rates for an
2 enterprise that you want to have break even. You don't want
3 it to make a lot of money. It's a public enterprise.

4 Q How does price relate to value when adopts a
5 price, or Ramsey pricing model?

6 A You mean value of service?

7 Q Yes.

8 A Price -- markup above attributable costs would be
9 greater where the value of service is seen to be greater.
10 In this case, value of service would be represented by a
11 lower elasticity of demand.

12 I might mention that to do this, it's desirable to
13 have all services available at the same time so these
14 comparisons can be made across all services.

15 Q Would one consider cross-price elasticities
16 between a regulated firm's products and a competitor's
17 products in a Ramsey pricing model?

18 A Yes.

19 Q Let's turn now to page 7, line 23.

20 A I have it.

21 Q Of your testimony?

22 A Yes.

23 Q Now, you state that this interrelationship -- I'm
24 not getting this mic right. Okay.

25 I'm given to understand if I turn to read your

1 testimony I can't be heard. Let me try this again.

2 This interrelationship among services also makes
3 it desirable to consider entire sets of prices rather than
4 to take them up in a piecemeal way since, in the piecemeal
5 approach, it is difficult to deal with effects on services
6 that are not under consideration; is that right?

7 A Yes.

8 Q Now, turning now to your response to Interrogatory
9 USPS-OCA-T-100-15C --

10 A Number 15?

11 Q Yes.

12 A Yes, I have it.

13 Q Now, in your response to 15C you state that no
14 evidence of the interrelationship between Post Office boxes
15 and Express, Priority and Standard Mail is shown on the
16 record; is that right?

17 A I don't see that explicit statement.

18 Q Okay, I see -- I wasn't quoting again, but I was
19 paraphrasing your last sentence.

20 A In Part C?

21 Q Yes.

22 A I think that has to do with the claim that
23 business customers should be encouraged to use boxes because
24 when they come in they ask for Express, Priority and
25 Standard Mail. So I guess -- I guess you're right. I'm --

1 I'm claiming that there is an alleged connection to those
2 three services.

3 Q Okay, I think when you gave your response, you --
4 you might have mixed the words around just a little bit.

5 When customers come to the Post Office to retrieve
6 their box mail, they may also purchase services like Express
7 Mail, Priority Mail and Standard Mail, and that sort of
8 thing?

9 A Right, right.

10 Q Okay.

11 Now, can you tell me when, in any prior omnibus
12 rate case the Commission has taken into account the cross-
13 price elasticities between Post Office box service and other
14 services like Express, Priority, First Class Mail?

15 A As far as I know, it's never been done. I just
16 note that it is claimed in this case, that connection.
17 There is no evidence provided but the claim is made.

18 Q Has the Commission ever considered information
19 about elasticities across boxes or fees?

20 A I don't know. I would doubt it.

21 Q To your knowledge, has the Commission ever
22 considered a cross-price or own-price elasticity for Post
23 Office boxes in determining Post Office box prices?

24 A No, not that I know of.

25 Q And yet, in your response to Interrogatory 45C --

1 A Yes, I have it.

2 Q You do state that it's reasonable to presume that
3 the rates recommended by the Commission meet the criteria of
4 the Postal Reorganization Act, correct?

5 A Yes. They have no -- would have had no evidence
6 of these cross-price elasticities on which to act.

7 Q Let's turn now to your response to Interrogatory
8 41 of the Postal Service.

9 A I have it.

10 Q Now you state that if fees for post office boxes
11 are not sufficiently high to justify expansion of box
12 service, it would appear that post office boxes are not
13 properly priced.

14 Does this imply that fees for post office boxes
15 should cover their actual costs of providing post office box
16 service?

17 A I think fees should cover their actual costs to
18 comply with the statute, the Postal Reorganization Act.

19 It also would lead to better decisions about
20 whether to provide service, box services.

21 Q Let's now turn to your response to USPS/OCA T-
22 100-22(b) .

23 A I have it.

24 Q Now you were asked in the interrogatory to confirm
25 whether competitors of the Certified Mail product have

1 monopoly power and in your response you didn't confirm but
2 instead indicated that "Alternative or fringe providers of
3 service may be handicapped by higher costs and barely able
4 to survive at their cost disadvantage."

5 Now your statement is limited to providers of
6 alternatives to Certified Mail, is that right?

7 A Yes.

8 Q And --

9 A I think the answer I give is a general answer but
10 I intended it for the setting, for this context.

11 Q Okay. Does your view of alternative providers of
12 Certified Mail would not hold true in the context of
13 alternative providers of post office box service or box
14 service, excuse me?

15 A I think there is a similarity there.

16 The providers of the -- the CRMAs operate, they
17 offer smaller boxes at higher prices and they are, I would
18 regard them as fringe providers.

19 Q Where do you draw your conclusions from?

20 A Just the testimony, just the comparisons of rates
21 charged. It seems to me they would have to be well located
22 and provide attractive services in order to win any
23 business.

24 Q Again we're talking about witness ^{Lion's}~~Lyons~~ testimony
25 at page 22 and witness Needham's table that you referred to

1 earlier.

2 A Yes. I think it is witness Needham's table that
3 provides the explicit comparison of rates.

4 Q Getting back now to alternative providers of
5 Certified Mail, where do you draw your conclusion that
6 alternative providers of Certified Mail -- alternatives to
7 Certified Mail may be handicapped by higher costs and barely
8 able to survive at their disadvantage?

9 A Well, one thing, the prices of these services are
10 ten-plus dollars higher -- the prices are much higher.
11 Certified Mail can be attached to services the Postal
12 Service offers, which is a great advantage.

13 Some of these services are monopoly services or
14 virtually monopoly services, so an alternative provider I
15 think is handicapped.

16 Q Do you know what customers in the Certified Mail
17 study identified as alternatives to Certified Mail?

18 A I don't recall.

19 Q What -- what do you consider the alternatives to
20 Certified Mail?

21 A Well, a courier, for instance.

22 Q Any others?

23 A I suppose Express Mail would be a substitute, a
24 little costly. Could be certified. I don't know what the
25 competing services or alternative services would be.

1 Q Are there any others?

2 A I suspect there are but I don't know them.

3 Q So you have drawn a conclusion about alternative
4 providers on Certified Mail on the basis or -- you have
5 identified them as things like Express Mail, couriers and
6 from that you draw the conclusion that they are fringe
7 providers?

8 A Yes, plus the fact that their price is so much
9 higher, the fact that they don't -- they can't be combined
10 with Postal Service services.

11 I think these alternatives were -- some of them
12 were described in Witness Needham's testimony; I just don't
13 recall.

14 Q Could you please turn now to your response to
15 Interrogatory 60A of the Postal Service?

16 A Yes, I have it.

17 Q Now, you were asked in that subpart to the
18 interrogatory if your statement that the words "market
19 power" --

20 A Which subpart?

21 Q Sorry, subpart A.

22 A Oh, yes. Yes? Yes?

23 Q You were asked in the interrogatory in subpart A
24 with reference to your statement that the words "market
25 power" and "monopoly power" are often used to represent the

1 power to raise price, you were asked if your statement was
2 consistent with the statement in the book Folded, Spindled
3 and Mutilated, that monopoly power is the ability to raise
4 prices above competitive levels.

5 Now, in your response, you stated that your
6 statement and the statement in the book Folded, Spindled and
7 Mutilated, are not the same but they are consistent with
8 each other; is that right?

9 A Yes. They are not literally the same but they are
10 the same spirit, of the same spirit.

11 Q Is it your testimony that monopoly power is
12 exhibited when a firm has the power to raise price or is it
13 rather that monopoly power is exhibited when a firm has the
14 power to raise price above competitive levels?

15 A Above competitive levels would be preferable, more
16 exact.

17 Q Now, isn't it true that in a competitive market,
18 prices account for both demand and supply factors?

19 A Yes.

20 Q Isn't it also true that the price paid for a
21 product is the reflection of the minimum value of the
22 product to the user?

23 A I am not sure what -- exactly what "minimum value"
24 might convey but the price in a classic case would be
25 determined by the intersection of a supply and a demand

1 function.

2 Q And would you also agree with the proposition that
3 if a product is priced above or below competitive levels,
4 that would contribute to the inefficient allocation of
5 resources?

6 A Generally, yes.

7 Q And is it possible for a firm to acquire
8 information about the value customers place on a type of
9 product based on information showing what customers are
10 willing to pay for such products when they are offered by
11 competitors?

12 A I missed the start of that.

13 Q Sure. Is it possible for a firm to acquire
14 information about the value customers place on a type of
15 product based on information showing what customers are
16 willing and able to pay for such product when they are
17 offered by the firm's competitors?

18 A I think that's possible, yes.

19 Q So isn't it also true that market-based prices are
20 a reflection of value for the product?

21 A I'm not sure what market-based prices mean in this
22 case. You mean the competitive price?

23 Q Yes.

24 A A competitive price, I think, would convey some
25 notion of both the marginal valuation consumers place on the

1 product and also what adding more of the product would cost
2 society. It reflects those two factors which coincide.

3 Q Could you please now turn to your response to
4 Interrogatory 27 of the Postal Service -- excuse me, this is
5 T-300-27 which was redirected from Witness Callow.

6 A Yes, I have that.

7 Q Now, in the second sentence, you state "The
8 difference between rush hour and nonrush hour charges," and
9 you were talking about --

10 A This is Part C.

11 Q Excuse me, yes, Part C. The context here is Metro
12 fares and the rush-hour versus non-rush-hour charges varying
13 with the rush-hour charges obviously being higher?

14 A Yes.

15 Q In your discussion there, you say, "The difference
16 between rush-hour and non-rush-hour charges would very
17 likely be caused by differences in cost, with expansion of
18 rush-hour travel requiring additions to capacity and thus
19 higher costs."

20 Further down in that same subpart, you state,
21 "Higher rush-hour demand would lead to a higher rush-hour
22 fare because capacity would be filled at rush hour with a
23 higher fare," right?

24 A Right. That sentence applies to the sentence in
25 between those two that talks about sharing capacity. It's

1 the example where capacity might be needed even at the off-
2 peak time, even at the non-rush hour time and the level of
3 capacity -- capacity would be full at both times but the
4 rate would be higher at the rush hour.

5 Q Reading your response, is it fair to say that the
6 differences in rush hour versus non-rush hour Metro fares is
7 motivated both by differences in cost and demand
8 characteristics of rush hour versus non-rush hour riders?

9 A Yes.

10 Q Would you also agree that generally rush-hour
11 users of public transportation have a lower elasticity of
12 demand than non-rush hour users?

13 A That doesn't necessarily follow. I think there is
14 some evidence for that among electricity demands, but
15 everybody hasn't found it there. I don't know of a study of
16 it by rush and non-rush hour travelers offhand, but it makes
17 some sense.

18 Q Is it reasonable to expect that?

19 A Yes.

20 Q It's reasonable to expect that rush-hour users of
21 public transportation have lower elasticity of demand than
22 non-rush hour users?

23 A Probably, yes.

24 Q Could you please turn now to your response to
25 Interrogatory 20B of the Postal Service.

1 A Yes, I have it.

2 Q Now, in Interrogatory 20B, you were asked whether
3 it's possible to compare existing relative price
4 relationships with those suggested by a Ramsey model or a
5 uniform mark-up model, whether one is proposing a change in
6 all, many, few or no rates.

7 Now, your response confirmed the propriety of this
8 approach --

9 A It confirms the -- I agree with the statement that
10 it is possible, yes.

11 Q Okay. And you say that it's possible to compare
12 existing relative price relationships assuming all data are
13 available -- excuse me -- necessary data are available.

14 A Yes.

15 Q Now, let's take certified mail as just an example.
16 Could you give me an example of the necessary data that the
17 Commission would need to evaluate price relationships for
18 certified mail in this docket?

19 A That's a little different from the context of this
20 question, which is would want sound attributable cost for
21 every service and would need to know institutional cost that
22 need to be covered and demand elasticities everywhere in
23 order to turn out something like Ramsey prices for all
24 services. Among those services could be certified mail
25 where sound attributable costs would be needed as for

1 everything else, and elasticity information.

2 Q And do you know whether attributable costs for
3 certified mail are on the record in this docket?

4 A Well, I'm not sure. There are -- I think there
5 are attributable costs for certified mail. I find that
6 there are too many of them.

7 Q Where is there more than one?

8 A Well, between -- Needham, who really deals in
9 terms of cost coverages, and Patelunas in her initial
10 testimony were inconsistent. There has been --

11 Q Inconsistent in regard to costs?

12 A Cost coverages.

13 Q Cost coverages. So there's no inconsistency with
14 regard to costs?

15 A Well, if the rates they're speaking about are the
16 same and the cost coverages differ, the costs must differ.

17 Q So you're saying that rates -- or that costs vary
18 by the rate charged?

19 A No. Witness Needham and Witness Patelunas had
20 different cost coverage features for before and after
21 circumstances in connection with the proposal. I assume
22 they are both dealing with the same rates since they are the
23 proposed Postal Service rates. If the cost coverages
24 differ, the costs must differ. It's just an inference.

25 Q I don't see how one can draw that conclusion,

1 quite frankly. That the cost coverage differs could be a
2 result of the revenues differing; isn't that correct?

3 A Yes.

4 Q That's what Witness Needham said was being changed
5 in this docket, correct, that ancillary service revenues
6 were being removed from --

7 A Yes.

8 Q -- certified mail revenues to produce a pure
9 unadulterated --

10 A That's right.

11 Q -- certified mail revenue.

12 A Yes.

13 Q So your inference that costs are somehow
14 inconsistent in this docket has no basis in Witness
15 Needham's testimony or Witness Patelunas's testimony; isn't
16 that correct?

17 A What was your -- what was your statement again?

18 Q Yes. Your statement that costs are inconsistent
19 in this docket, okay, is -- cannot be -- there's no source
20 for that proposition either in Witness Needham's testimony
21 or in Witness Patelunas' testimony; isn't that correct?

22 A Okay. It's the -- I don't really know the answer,
23 but the main problem is the inconsistent handling of
24 revenue, I presume, the difference in how revenue is
25 handled.

1 Q You didn't identify revenues as one of the
2 elements of necessary data that's needed to evaluate the
3 proposal, but now you're saying that revenues are --

4 A Yes.

5 Q -- necessary as well?

6 A Yes. This historical practice needs to be
7 altered, yes.

8 Q Okay. So is it -- are you comfortable with the
9 attributable costs that have been presented in this docket
10 or not for certified mail?

11 A I'm not the ideal person to answer that question.
12 I suppose I could say I could find some attributable costs
13 that would be all right. I'm confused by the testimony, the
14 original testimony. My confusion --

15 Q Regarding cost coverages or costs for certified
16 mail?

17 A Regarding cost coverages.

18 Q Cost coverages.

19 A Yes.

20 Q So you're not claiming that there is an absence of
21 necessary data regarding attributable costs for certified
22 mail; is that right?

23 A I can't make that claim, no. I would have liked
24 to have had a presentation of how it used to be done and how
25 it's being proposed now and what the attributable costs are

1 and what the revenues are. That is of central importance to
2 the proposal and I didn't find that.

3 Q Okay. The next element you identified for this
4 necessary data to evaluate the certified mail proposal was,
5 I believe it was contribution to institutional costs?

6 A Right.

7 Q What data do you need in that regard?

8 A Well, again, we're going to back to the context
9 here where we're trying to think about producing a set of
10 prices for everything across the board. In order to do
11 that, we would have to know in total how much institutional
12 costs must be covered by our total revenues. We would need
13 something like a revenue requirement.

14 Q Are you saying that on this record, there is no
15 evidence concerning the total institutional cost to the
16 Postal Service?

17 A There isn't a record, I don't think, to prepare
18 Ramsey prices for all services.

19 Q I didn't ask that. I asked if the total
20 institutional cost to the Postal Service are not in the
21 record in this docket.

22 A Well, they would be there. There would be some
23 basis for them.

24 Q Okay. You also identified demand elasticities as
25 one of the necessary data needed to evaluate the certified

1 mail fee proposal.

2 Now, do you know that there is evidence on the
3 record concerning the owned price elasticity of certified
4 mail in this docket?

5 A Okay. I would accept that. I don't know --

6 Q Assume it's there.

7 A Yes.

8 Q That's in Witness Needham's testimony, if you're
9 curious.

10 You identified then, I guess, four things that we
11 needed to have on this docket to evaluate the certified mail
12 fee proposal: attributable costs, revenues, total
13 institutional costs and demand elasticities. And I submit
14 to you that they're all there.

15 A The problem would be in estimating the certified
16 mail, the appropriate mark-up, say Ramsey mark-up for
17 certified mail in the context of mark-ups for all other
18 services. That's what we don't have.

19 Q Why can't the existing mark-ups, unchanged,
20 unadulterated, be the mark-ups that the Postal Service and
21 the governors believe are appropriate?

22 A To cover institutional costs?

23 Q Yes.

24 A They may not be the same. That is, institutional
25 cost, whatever they are, may not be covered with a mark-up.

1 If you start with a mark-up and apply it, you may come up
2 with a contribution to an institutional cost that is not
3 consistent with the total amount of institutional costs.
4 What you want to do is --

5 Q You're presuming that there's been tinkering with
6 the markups in the categories or subclasses that aren't part
7 of this proposal, isn't that right?

8 A I would assume there is a change since the last
9 rate case, yes, but I -- the procedure would be to know what
10 the institutional costs are and to solve for what the
11 markups ought to be and I don't think we are in a position
12 to do that.

13 We would have to be doing price adjustments for
14 all services in order to do that.

15 Q Can a presumption be attached to each rate that is
16 not being affected that it's making a fair contribution to
17 institutional costs?

18 A I don't know. That's a big question. I don't
19 know the answer to that.

20 Q Can it be done?

21 A Can what be done?

22 Q Can one presume there is no need to change markups
23 for categories that are unaffected?

24 A I don't think so. I think there might be greater
25 needs for change in other services than in the one we might

1 be focusing on.

2 Q So every time the Postal Service has a minor
3 classification change or has an adjustment in a single rate
4 we would have to look at every single rate, is that your
5 testimony?

6 A There would certainly be great advantages in doing
7 so, yes.

8 Q There may be great advantages but do you believe
9 that is required?

10 A I think it's possible to work around that severe
11 requirement. It just takes a lot of care in planning where
12 you would work out an arrangement under which certain rates
13 could be examined and others would not be but over a series
14 of time all rates would be considered -- in other words some
15 planned, careful, thoughtful way to deal with less than all
16 the rates in any one case.

17 Q So with regard to the Certified Mail proposal, you
18 are suggesting that increasing the fee and its relative
19 contribution to institutional costs, that decision can't be
20 informed unless we also know what every other category or
21 subclass --

22 A In principle, yes. In order to decide what is
23 fair and equitable, in order to decide what the markup
24 should be in this class of mail, this service, we should
25 compare it with others.

1 Q Every single one?

2 A Yes. That's the advantage of a complete case.

3 Q Do you suppose the Commission has done that in
4 past cases which have not been omnibus rate cases?

5 A Most rate cases that I know of have been omnibus
6 cases. I don't know of, I don't have knowledge of piecemeal
7 cases.

8 Q So you don't know whether or not the Commission
9 has recommended rates or classifications to the Governors
10 with or without reviewing every single rate category?

11 A Well, I know there have been classification cases
12 that were aimed at being revenue-neutral that didn't
13 consider every case -- every service.

14 Q So they exist?

15 A They do exist.

16 Q And it's again reasonable to presume, as you have
17 stated, that the rates recommended by the Commission are
18 fair and equitable, right?

19 A Yes.

20 Q And they have been able to do that in cases where
21 they haven't looked at every single rare category, right?

22 A Right. There was agreement on what the aims were
23 in those cases. They were classification cases that
24 involved no revenue change.

25 MR. ALVERNO: Mr. Presiding Officer, I am about to

1 move on to another topic. I don't know if this is a
2 suitable time for a break.

3 COMMISSIONER QUICK: Yes. I was just going to ask
4 you if you were going to have a natural break here. That
5 would be fine.

6 We'll come back at 5 after 11:00.

7 [Recess.]

8 COMMISSIONER QUICK: Mr. Alverno, would you like
9 to proceed?

10 MR. ALVERNO: Thank you, Mr. Presiding Officer.

11 BY MR. ALVERNO:

12 Q Dr. Sherman, could you please turn to your
13 response to USPS-OCA-T-100-32.

14 A I have that.

15 Q Now, your response to part B, your response to
16 part B of that interrogatory states that appendix B to USPS-
17 T-5 traces consequences of the Post Office box rate
18 increases. Do you have a copy of that appendix with you
19 right now?

20 A No, I don't. Sorry.

21 Q Well, I do have some copies here. I presume that
22 you have looked at it previously?

23 A Yes. Not carefully but, yes.

24 MR. ALVERNO: Mr. Presiding Officer, I would like
25 to approach the witness, please, with a copy of USPS-T-5

1 Appendix B.

2 COMMISSIONER QUICK: Certainly, you may approach
3 the witness.

4 BY MR. ALVERNO:

5 Q Could you please turn to page 4 of 7 of that
6 appendix?

7 A Okay.

8 MR. COSTICH: Excuse me, Commissioner Quick --

9 MR. ALVERNO: It seems to be missing from my copy,
10 too.

11 MR. COSTICH: I don't seem to have page 4 in my
12 copy.

13 COMMISSIONER QUICK: Page 4 of 7?

14 MR. ALVERNO: I'm sorry, some of them must have --
15 some of them are two-sided, some of them are not, so I guess
16 we will identify who is missing a copy.

17 COMMISSIONER QUICK: Did you say 4 of 7?

18 MR. ALVERNO: Yes.

19 COMMISSIONER QUICK: It looks like this and it is
20 labeled 4 of 7.

21 MR. ALVERNO: Yes, some copies have it and some
22 don't, but it's two-sided.

23 CHAIRMAN GLEIMAN: Well, I have two copies of
24 whatever you handed out and neither of them have a page 4.

25 COMMISSIONER LeBLANC: Does this read "cost

1 adjustments, proposed Post Office box rates" on the top?

2 MR. ALVERNO: Yes.

3 COMMISSIONER LeBLANC: USPS-T-5, Appendix B.

4 CHAIRMAN GLEIMAN: George, have it?

5 MR. ALVERNO: We'll get some copies made.

6 Do you have it, Dr. Sherman?

7 THE WITNESS: Yes.

8 COMMISSIONER QUICK: We'll go off the record here
9 for a couple of minutes.

10 [Discussion off the record.]

11 COMMISSIONER QUICK: Thank you very much. I think
12 we can proceed now. I think everybody has a copy of the
13 two-sided page.

14 MR. ALVERNO: Yes. I apologize for that
15 oversight.

16 BY MR. ALVERNO:

17 Q Do you have a copy of page four?

18 A Yes.

19 Q Looking at page four, that shows the unit costs by
20 class of mail for post office box delivery and street
21 delivery for FY 1994 and the test year after rates, 1996, is
22 that correct?

23 A Okay.

24 Q Yes?

25 A Yes.

1 Q What's your understanding of what these costs
2 represent?

3 A They would be the difference between delivering to
4 box and delivering otherwise, I presume.

5 Q Is it your understanding that these costs
6 represent or include post office box attributable costs?

7 A I would think they would. I don't know
8 absolutely.

9 Q Don't they represent labor costs attributable to
10 the category of mail being handled either at a post office
11 box or for street delivery?

12 A I should think so, yes.

13 Q Are all the costs attributable to the category of
14 mail being handled reflected in these calculations?

15 A That, I don't know. I assume -- I'm prepared to
16 accept that they are.

17 Q And are the unit cost differences a reasonable
18 method to measure the labor cost differences between post
19 office box and street delivery?

20 A I'm prepared to accept that they are but it's not
21 -- I haven't gone through these costs, so I can't be
22 entirely comfortable with them, with saying that.

23 Q Lets now switch to post office box attributable
24 costs. Looking at your response to USPC/OCA T-100-32,
25 Subparts C and D or C-D, your response there states that you

1 relied on the testimony of Witness Lion, "whom I trust
2 relied in turn on proper cost records."

3 In your response to Subpart E, you indicate that
4 you think you understand the types of costs included in
5 Witness Lion's allocation of post office box attributable
6 costs of space support, space provision and all other,"
7 correct?

8 A Yes.

9 Q Are you aware that Witness Lion filed an errata to
10 his testimony which revised page 35, lines 1 to 3 of his
11 testimony?

12 A I don't think so. I don't think I have that.

13 Q I do have a copy. Perhaps I could show it to you
14 and you can offer an opinion on whether or not that, in
15 fact, does replace the pages you might have relied on.

16 A I don't have Witness Lion in front of me, so it's
17 hard.

18 MR. ALVERNO: May I approach the witness, please?

19 COMMISSIONER QUICK: Yes, sir.

20 MR. ALVERNO: I hope that all pages are here.

21 BY MR. ALVERNO:

22 Q Now, if you note, on page 35, concerning what's
23 included in the "all other" category of Post Office box
24 attributable costs, okay, what does that -- that beginning
25 sentence say, starting with line 1?

1 A All other costs are primarily labor costs for
2 window -- I'm sorry.

3 All other costs are primarily labor costs for
4 window services and related supervisory activities.

5 Is that what you meant?

6 Q And would you conclude that all costs attributable
7 to Post Office boxes reflected in the three categories of
8 space support, space provision and all other?

9 A It sounds like they are the complete set of
10 categories.

11 Q Okay. Let's turn now to your response to USPS-
12 OCA-T-100-34. In subpart A, you state, suppose data were
13 presented to show that Post Office box delivery costs less
14 than other means of delivery. That savings in delivery cost
15 would essentially mean there is a lower cost to providing
16 service through a Post Office box than would be calculated
17 if that effect on delivery cost were ignored.

18 Do you know whether those data were presented in
19 Appendix B to USPS-T-5?

20 A It looks like you could estimate these differences
21 from this appendix, yes.

22 Q That's a yes?

23 A Yes.

24 Q Is the measure of how much the Post Office box
25 delivery costs less than other means of delivery captured in

1 Appendix B to USPS-T-5?

2 A I think the answer's yes.

3 Q At subpart A to Interrogatory 34, you indicate
4 that you believe that the attributable costs for Post Office
5 boxes are overstated because they do not reflect the cost
6 savings of delivering to a Post Office box rather than to a
7 business or residence; is that right?

8 A Yes.

9 Q So what costs are overstated, space support, space
10 provision or all other?

11 A When they are all added up, that number can be
12 compared with the cost of delivering by other means, like
13 carrier delivery, and if there is a savings from providing a
14 box, that should lower the cost of the box service, should
15 be a reduction in the cost of providing Post Office boxes.

16 Q Well, in the base year 1995, all expenses are
17 booked therefore they can't change. So if cost savings are
18 to be reflected in the cost of Post Office boxes by
19 decreasing Post Office box costs, from which of the three
20 categories of Post Office box costs should the savings be
21 subtracted from?

22 MR. COSTICH: Commissioner Quick, as counsel noted
23 in his question, FY '95 costs are booked, there is not going
24 to be any reallocation and there is not going to be any
25 change in Post Office box rates that would cause any need to

1 reallocate costs so I am not sure that we have a logically
2 consistent hypothetical here.

3 MR. ALVERNO: I think that's the answer I am
4 looking for, so nice coaching of the witness but I need an
5 answer from the witness, not Mr. Costich.

6 COMMISSIONER QUICK: Do you want to restate your
7 question?

8 MR. ALVERNO: Yes.

9 BY MR. ALVERNO:

10 Q In terms of base year 1995, total expenses are
11 booked and therefore they can't change so if the cost
12 savings are to be reflected in the cost of Post Office boxes
13 by decreasing Post Office box costs, from which of the three
14 categories of Post Office box costs should the savings be
15 subtracted from? I mean, space support, space provision or
16 all other?

17 A I don't understand why the pieces would be
18 separated out. If there is a difference in cost traceable
19 to the provision of Post Office boxes, that difference in
20 principle should be subtracted from the Post Office box cost
21 and the attributable cost and the attributable cost to boxes
22 and prices would be based on the lower costs.

23 Q So insofar as the cost methodology reflects volume
24 variability, does the roll-forward in this docket reflect
25 the changes in both volume of mail and the number of boxes

1 in use from what they were in the base year?

2 A Well, I'm not sure.

3 Q Well, do you know what is missing from the roll-
4 forward that would provide your true rendering of costs, as
5 you described in subpart (a) to Interrogatory 34?

6 A I presume the comparison of the delivery cost
7 differences, whether it is to a post office box or by some
8 other means.

9 Q Okay. Let's turn now to your response to subpart
10 (c) of Interrogatory 34, the last sentence.

11 A Yes.

12 Q If a customer's use of a post office box lowers
13 the cost of delivering mail, that cost savings should be
14 taken into account in setting the post office box rate. Is
15 that correct?

16 A Yes.

17 Q So what costs discussed above, that is,
18 attributable post office box costs or the cost of delivering
19 the mail or both, have not been taken into account in
20 setting the post office box rate?

21 A I may be wrong but my understanding is the -- any
22 difference between the cost of delivering to the box and
23 delivering to a resident, say, carrier delivery, isn't
24 reflected in the post office box attributable cost.

25 That is the cost that I am urging be considered.

1 Q Assuming that there is an identifiable per piece
2 cost savings associated with delivery to a post office box
3 as opposed to delivery to a business or residence, then why
4 should the post office boxholder receive the benefit of
5 those cost savings?

6 A Well, the boxholder is making them possible by
7 renting the box.

8 Q Making what possible?

9 A The cost savings, the delivery cost savings, if
10 they exist, as we are hypothesizing here.

11 Q Let's turn now to your response to Interrogatory
12 36 to the Postal Service.

13 [Pause.]

14 BY MR. ALVERNO:

15 Q Do you have it?

16 A Yes, I have it. Sorry.

17 Q Would it be fair to summarize your response as
18 saving that you do not believe that Appendix B to USPS-T-5
19 identifies the cost savings of delivering to a post office
20 box rather than a business or residence in a form that can
21 be imputed to the post office box units?

22 A Yes. I think it's possible, but it's not
23 presently in that form.

24 Q Well, how would you identify the delivery cost
25 savings?

1 A By some added work that would require information
2 on the classes of mail that are delivered to boxes and
3 impute an average perhaps of the savings available because
4 of delivery into a box per box.

5 These are savings by mail class. You would have
6 to convert that over to a savings per box.

7 Q So you'd impute those savings to post office box
8 units?

9 A Yes.

10 Q How would that be done?

11 A It would require information on the mail
12 categories that go into boxes, perhaps even by box size, and
13 from that you can make up the savings by those separate
14 classes and average them together by -- so that you would
15 convert it to a difference per box.

16 If there are so many letters a year that go into a
17 box and there's so much savings per letter, you could
18 calculate out how much ought to be reduced from the cost of
19 offering the box.

20 Q Okay. Let's turn now to your response to USPS/OCA
21 T-400 11D.

22 MR. COSTICH: Excuse me, Commissioner Quick. Did
23 counsel say T-400?

24 MR. ALVERNO: T-400, 11D.

25 MR. COSTICH: Is that a redirected response?

1 MR. ALVERNO: Excuse me, T-100, 11D. It's been a
2 long week.

3 THE WITNESS: I have it.

4 BY MR. ALVERNO:

5 Q Okay. Now you state in your response that this
6 claim that post card mailers support the manufacturing costs
7 of postal cards is wrong -- the manufacturing cost of postal
8 cards are attributed to postal cards, not to private cards.

9 Is that right?

10 A Right.

11 Q Now since you say that the manufacturing costs of
12 postal cards are attributed to postal cards, is it fair to
13 say that a hypothetical increase or decrease in the
14 manufacturing costs of postal cards would be unrelated to
15 the postage rates paid by users of private postcards?

16 A How is that again, that a change in the
17 manufacturing costs --

18 Q I'll say it again -- yes. Is it fair to say that
19 a hypothetical increase or decrease in the manufacturing
20 costs of postal cards would be unrelated to the postage
21 rates paid by users of private postcards?

22 A And this presumes that there would be some rate
23 case in the future where the effects of these manufacturing
24 cost changes would be part of the record, part of the basis
25 for rates?

1 Q Sure.

2 A I suppose those changes could affect the postage
3 for postcards.

4 Q For private post card users?

5 A Because they are tied together, yes.

6 Q So you are saying that the rates of postage for
7 private post cards vary with the postal card manufacturing
8 costs, is that correct?

9 A That is possible.

10 Q Is it correct or not?

11 A I'd say it's correct. The costs are still
12 separately identified, so they can be traced to the
13 manufacturing costs of the postal card.

14 Q And for ratesetting purposes, isn't it true that
15 the Commission has not distinguished between postal cards
16 and private cards, is that correct?

17 A I think that's correct.

18 Q Postal cards are not considered in isolation for
19 ratesetting purposes, isn't that right?

20 A That's right.

21 Q So the manufacturing costs of postal cards are
22 included in the attributable costs of the post and postal
23 card subclass, isn't that correct?

24 A The combined, yes, the combined set.

25 Q You still have the view that post card mailers

1 don't support manufacturing costs of postal cards?

2 A Well, I'm mainly focusing on the contribution to
3 institutional costs from these two distinguishable parts of
4 the postal card plus post card business and those
5 contributions can be separately identified and in
6 calculating the one for the postal card, all the
7 manufacturing costs are counted.

8 Q If I have a substantial increase in manufacturing
9 costs of postal cards, I, as a private post card user, may
10 pay more for my postage, isn't that right?

11 A That is true.

12 Q So I'm paying more for manufacturing costs as a
13 private post card user, that's possible, right?

14 A That's possible.

15 Q I, as a private post card user, could be
16 supporting the manufacturing costs of postal cards, is that
17 right?

18 A It's possible, yes.

19 Q Yes?

20 A Yes.

21 Q So is your claim that post card mailers support
22 the manufacturing costs of postal cards is wrong wrong?

23 A It may be too strong.

24 CHAIRMAN GLEIMAN: Excuse me for interrupting. I
25 had difficulty hearing one of your answers. A moment ago,

1 you were asked about private post card users using --
2 supporting the manufacturing costs of the postal cards and I
3 thought at first you said -- and I couldn't hear you --
4 possibly yes or was your answer yes?

5 THE WITNESS: It's possibly yes.

6 CHAIRMAN GLEIMAN: I wasn't sure whether I heard
7 the possibly at the front end or not. I couldn't tell.

8 MR. ALVERNO: I heard a yes after that.

9 CHAIRMAN GLEIMAN: Well, it was the way the
10 question was asked again.

11 THE WITNESS: Yes.

12 MR. ALVERNO: I'll let the record speak for
13 itself.

14 CHAIRMAN GLEIMAN: Thank you.

15 BY MR. ALVERNO:

16 Q Let's turn now to your response to Interrogatory
17 59-B of the Postal Service.

18 A I have it.

19 Q All right. You state in the last sentence, "The
20 mailer actually is paying for the stationery." We're
21 talking about postal cards here. Who is the mailer?

22 A I'm thinking of the postal card mailer.

23 Q So are you saying that does or does not include a
24 private post card user?

25 A Suppose the proposal goes into effect, that there

1 is a stamped card at 22 cents and post cards at 20 cents,
2 the mailer will be paying for the stationery based on the
3 existing way costs are allocated -- the mailer of a postal
4 card.

5 Q Just the mailer of a postal card?

6 A Yes.

7 Q Not too long ago, we had an exchange where we did
8 conclude that sometimes private post card users are
9 supporting the manufacturing costs of postal cards so they
10 are also paying for the stationery, aren't they?

11 A I just set up an example where the proposal is in
12 effect, the postal card is offered at 22 cents, the postcard
13 is at 20 cents, the mailer of a postal card in that case
14 will pay for the stationery because the accounting presently
15 counts it toward postal card, the accounting as it is
16 presently carried out counts the stationery as part of
17 postal cards.

18 Q Let's turn to your response to Interrogatory 59C
19 of the Postal Service.

20 A I have it.

21 Q Now, in the last sentence, you state that the
22 analogy between envelope charges and stamp card charges
23 therefore is not compelling; is that right?

24 A Yes.

25 Q All right, let's consider this for a second. With

1 respect to a stamped envelope, if you want a stamped
2 envelope, you walk to the Post Office, you pay 32 cents
3 plus, I believe, a 6-cent fee and you walk out of the Post
4 Office with an envelope with postage indicia printed on it;
5 is that right?

6 A Right.

7 Q And you paid 38 cents or, subject to check, you
8 paid 38 cents?

9 A Okay.

10 Q Right?

11 A Right.

12 Q Now, in the alternative, you can walk to the
13 stationery store, buy an envelope, say it's a nickel a
14 piece, then you can go to the Post Office, buy a 32-cent
15 stamp, affix it to the envelope and mail it, correct?

16 A Correct.

17 Q Now, with the postal card, the situation is
18 exactly the same, isn't it?

19 A It is very similar, yes.

20 Q So what's your basis for concluding that the
21 analogy between a stamped envelope -- excuse me, a stamped
22 envelope fee and a stamped card fee is not compelling?

23 A Only that it's -- there are envelopes that are
24 offered free to mailers for Priority Mail and Express Mail.
25 All envelopes are not charged for.

1 Q Don't users of those categories pay for those
2 envelopes through their postage?

3 A I assume they do.

4 Q Do those envelopes have postage affixed to them?

5 A No, it has to be added.

6 Q Okay, so there is a distinction then between
7 Priority Mail envelopes and Express Mail envelopes; isn't
8 that correct?

9 A Yes, yes.

10 Q So isn't it fair to say that the analogy between
11 stamped cards and stamped envelopes is more compelling than
12 any analogy that you have drawn between Priority Mail
13 envelopes and Express Mail envelopes?

14 A It is closer, yes.

15 Q And, in fact, stamped card has a plain face just
16 like an envelope as well, correct?

17 A Yes.

18 MR. ALVERNO: That's all I have, Mr. Presiding
19 Officer. Thank you.

20 COMMISSIONER QUICK: Any follow up cross
21 examination? I would not think so, but --

22 [No response.]

23 COMMISSIONER QUICK: Do the Commissioners have
24 questions? Mr. Chairman?

25 CHAIRMAN GLEIMAN: When Mr. Alverno began his

1 cross examination of you this morning, my recollection is
2 that one of the first areas he touched on had to do with
3 return receipt.

4 I'm sure I'll be corrected if I misunderstood
5 anything -- I hope I will -- but I was under the impression
6 that he asked you a question about return receipt perhaps
7 having been below cost because of a Postal Service error in
8 how it calculated attributable costs over the years. Then
9 he asked you whether this justifies, and he used the phrase
10 "a substantial increase."

11 You indicated, I thought, that you thought an
12 increase was justified and you characterized this return
13 receipt/certified mail portion of the Postal Service's case
14 as a rate increase, is that correct?

15 THE WITNESS: Yes, I think it was more certified
16 mail, at least in my recollection, and we were dealing with
17 an example, a hypothetical.

18 CHAIRMAN GLEIMAN: But it's the general principle
19 of it's below cost, you ought to cover your costs and make a
20 contribution?

21 THE WITNESS: Yes.

22 CHAIRMAN GLEIMAN: Are you aware -- assuming for
23 the sake of discussion that something is below cost and that
24 it's appropriate to increase the price you're going to
25 charge for it, is there any reason or any requirement that

1 you are aware of that one needs to make up the entire amount
2 of the underpriced product at one time, plus a markup?

3 THE WITNESS: Well, that's, I think, a judgmental
4 matter because one pricing criterion calls for rates to be
5 above attributable cost, but in another, it takes into
6 account effects on mailers which could call for a slower
7 transition to the new rate.

8 CHAIRMAN GLEIMAN: So when you talk about the
9 effect on mailers, you're talking about the B-4 ratemaking
10 criteria?

11 THE WITNESS: Yes.

12 CHAIRMAN GLEIMAN: Again, you're going to have to
13 help me and if Postal Counsel feels the need to help me, I
14 won't be upset.

15 There was some discussion about determining the
16 value of a product to a customer. Value is determined by
17 what a customer will pay competitors. I thought that was a
18 question that was asked and a response that you said --

19 THE WITNESS: I think the -- as I remember that,
20 the value paid to alternative suppliers would give some
21 indication of the value to consumers of the service.

22 CHAIRMAN GLEIMAN: Are you aware of whether any
23 commercial mail-receiving agencies charge a non-resident fee
24 for the rental of the boxes, that they ask their customers
25 whether they are residents of the area or not?

1 THE WITNESS: No, I'd be very surprised if they
2 do.

3 CHAIRMAN GLEIMAN: So if they didn't charge --
4 these are the alternative folks to the Postal Service for
5 box rental -- so if they didn't charge a fee, then one might
6 deduce from that perhaps there wasn't a high value of
7 service associated with nonresidents in terms of box
8 rentals?

9 THE WITNESS: It's possible one doesn't know where
10 the CMRAS are located and so on, but yes.

11 CHAIRMAN GLEIMAN: Again, dealing with prices
12 charged by competitors, and I may need some help on this
13 again, you were asked a question about prices charged by
14 competitors that were either higher or lower than I guess
15 what the Postal Service would charge and you were asked to
16 characterize this situation relative to the allocation of
17 resources and the overall economy.

18 I thought that I heard you say that this situation
19 would seem to be a misallocation of resources?

20 THE WITNESS: I think it was prices above and
21 below cost or something.

22 CHAIRMAN GLEIMAN: That, I understand, is a
23 general economic principle?

24 THE WITNESS: Yes.

25 CHAIRMAN GLEIMAN: It's a principle that I

1 believe, and you need to tell me, involves basically a free
2 market situation, if you will, as opposed to one where a
3 player is a monopoly or has a monopoly position?

4 THE WITNESS: I think it would apply there as well
5 in that a price that's below cost not only leads to
6 consumption by mailers of a service. They pay marginally
7 less than the cost of society providing the service, which
8 is a misallocation, plus the institutional -- there is a
9 deficit as a result which other mailers have to make up, so
10 it would contribute to misallocation.

11 CHAIRMAN GLEIMAN: There's been a lot of
12 discussion, a number of questions about the fees for post
13 office boxes and that they should cover the cost of
14 providing that service.

15 The Postal Service is proposing that certain post
16 office boxes be provided gratis for no fee at all.

17 Do you know whether there are any costs associated
18 with those boxes that the Postal Service proposes to offer
19 for free?

20 THE WITNESS: No. They are virtually free now.
21 We are talking about a two dollar a year charge so it's very
22 small.

23 CHAIRMAN GLEIMAN: No, I mean are there costs that
24 the Postal Service incurs?

25 THE WITNESS: My -- I guess is it an assumption --

1 would be that the alternative of delivering that mail would
2 cost substantially more so that given the alternative it
3 might be lower cost to give the boxes away.

4 It denies -- it's in areas I think where delivery
5 is denied, delivery to the resident, so --

6 CHAIRMAN GLEIMAN: Yes, it's in areas where there
7 is no delivery available.

8 THE WITNESS: So I would assume even though there
9 is a cost there, it's lower than the delivery cost.

10 CHAIRMAN GLEIMAN: But there is no delivery so
11 there is no delivery cost.

12 THE WITNESS: That's right. That's right, but
13 that cost is saved by offering the boxes and that would be a
14 way to think about the benefit of offering the boxes.

15 CHAIRMAN GLEIMAN: Well, again, with respect to
16 ensuring that we are going to cover costs in whatever it is
17 that we ultimately recommend here, this case was filed last
18 June and it was filed with a FY '96 test year and of course
19 here we are well into FY '97.

20 Do you think it is prudent for us to go forward
21 with this case based on FY '96 cost year, with costs that
22 might not when the rates go into effect some time next year
23 actually cover costs or since cost coverage is such an
24 important consideration for the Postal Service that perhaps
25 we ought to find out what the cost for these, projected cost

1 for these particular services are in terms of FY '97?

2 THE WITNESS: Well, if there is some sort of
3 across-the-board easy way to do that, it might be worth
4 doing, but in cases of this kind for years the test year has
5 sometimes been a year that was completed before the case
6 began. I am thinking of electricity, for instance. A year
7 ago case might even have been used, so it is not
8 unprecedented to use a test year --

9 CHAIRMAN GLEIMAN: I am not sure. I have only
10 been here a couple of years so I am not sure whether it's
11 been precedent --

12 COMMISSIONER QUICK: Excuse me just a moment. Mr.
13 Chairman, if you could be so kind as to speak into the
14 microphone, I believe everybody would be able to hear you.
15 Thank you.

16 CHAIRMAN GLEIMAN: I didn't want you to hear me.
17 [Laughter.]

18 CHAIRMAN GLEIMAN: Because I didn't want you to
19 get upset.

20 MR. ALVERNO: Well, the record may benefit from
21 that.

22 CHAIRMAN GLEIMAN: Having you be upset?

23 MR. ALVERNO: No.

24 CHAIRMAN GLEIMAN: I understand we visited that
25 the other day.

1 In any event, what I was saying was that I wasn't
2 aware, having only been here for a couple of years, whether
3 there was a precedent or not for having cases before the
4 Commission where the test years were completed before the
5 rates that were proposed went into effect, and inasmuch as
6 in the case of several of the Special Services before us the
7 issue seems to be whether in fact we are above cost, it just
8 seemed to me to make sense to perhaps have an idea of what
9 the projected costs were going to be for the current fiscal
10 year so that we could be assured, given the Postal Service's
11 serious concern about things being below cost, that we
12 weren't below cost when we made our recommendations.

13 THE WITNESS: No, that would not be an
14 unreasonable concern. It's just -- well.

15 CHAIRMAN GLEIMAN: I have no further questions.

16 COMMISSIONER QUICK: Commissioner LeBlanc?

17 COMMISSIONER LeBLANC: Let's see, Dr. Sherman, I'm
18 getting to where I like to follow the Chairman.

19 He asks some of my questions.

20 I just want to make one quick statement before I
21 ask a couple more clarifying questions.

22 In light of the answer that the Chairman got when
23 he asked about possibly and possibly yes, there is an old
24 story about when I was in the construction-land, real estate
25 development business I told a man one time the price of that

1 property was \$3.50 to \$4 a square foot.

2 Well, he came in with a contract at \$3.50 and he
3 said that is exactly what you said, which was not exactly
4 what I said -- I said between \$3.50 and \$4. Well, he heard
5 what he wanted to hear, so I would just suggest to all of us
6 in the room that we read the transcript very carefully and
7 be very cautious about that because a couple times you have
8 said "possibly" and "maybe" --

9 THE WITNESS: Right.

10 COMMISSIONER LeBLANC: -- and so forth, so just a
11 word of caution to all concerned.

12 In your testimony, Dr. Sherman, you touch on the
13 stated goals that are not met in a round about way, and I
14 don't want to paraphrase what you said but, by the Postal
15 Service, and one of the things I think that you touched on
16 was the fact that money orders and COD were not included in
17 the revenues that were lower than attributable cost.

18 THE WITNESS: Right.

19 COMMISSIONER LeBLANC: Can you touch on that for
20 me? I mean, I know I read your testimony but I'm concerned,
21 having heard your colloquy now with the revenue costing
22 issues here, how you feel about that now at this late state?

23 THE WITNESS: I still wish COD and money order
24 services had been included. Because they do seem to be
25 priced at below their attributable cost.

1 COMMISSIONER LeBLANC: Well, that concerns me a
2 little bit because -- it concerns me only and I need a
3 clarification, because in your response to Interrogatory T-
4 100-60, where you state, and again you touched on this with
5 USPS counsel, that the words "market power" and "monopoly
6 power" are often used to represent the power to raise price.

7 So, given that statement, why would the Postal
8 Service then, if you believe that, not raise COD and money
9 orders?

10 THE WITNESS: I don't know.

11 COMMISSIONER LeBLANC: Now, you talked about
12 demand pricing and you said that demand pricing can be used,
13 but -- and, again, I don't want to distort or misparaphrase
14 anything that you said but you seem to be talking about a
15 distortion, if you will, I use that word, of demand pricing.

16 THE WITNESS: I'm not sure what you mean when you
17 say "demand pricing."

18 COMMISSIONER LeBLANC: Ramsey pricing.

19 THE WITNESS: Ramsey pricing, okay.

20 COMMISSIONER LeBLANC: And you seem to allude to
21 the fact, again, I'm staying with the fact that they only
22 seem to -- they, the Postal Service, only seem to be
23 addressing certain, as you called it, I believe a piecemeal,
24 in your testimony, approach. So can you elaborate for me
25 how this distorts overall Ramsey pricing relationships?

1 THE WITNESS: Well, if overall Ramsey pricing
2 relationships even approximately are achieved and a couple
3 of years pass and a case is brought that looks at only a few
4 services and changes prices of those, the markups are
5 probably not in balance any longer, the way they were from
6 the omnibus case.

7 COMMISSIONER LeBLANC: Probably? Is there a good
8 probability that they're not?

9 THE WITNESS: It's a good probability.

10 COMMISSIONER LeBLANC: I mean, here we go again
11 with our words.

12 THE WITNESS: It's a good probability that fixing
13 a subset of rates will leave the relationships between those
14 rates and the remaining rates out of line with what might --
15 with something like Ramsey principles.

16 COMMISSIONER LeBLANC: How would you look at that
17 same approach in light of the fact that this is not a
18 revenue-neutral case?

19 THE WITNESS: Well, I think that's --

20 COMMISSIONER LeBLANC: In other words, are you
21 saying then, I guess what I am trying to get a further
22 clarification, had this been revenue neutral, how would you
23 have looked at it?

24 THE WITNESS: It wouldn't be an issue.

25 COMMISSIONER LeBLANC: Okay.

1 THE WITNESS: It would be changing classification,
2 perhaps, and essentially adhering to the old relationships
3 insofar as that was possible.

4 COMMISSIONER LeBLANC: Okay, I just wanted to make
5 sure I heard.

6 In your colloquy with counsel from USPS again, you
7 talked about there could be -- and I wrote this down and I
8 may be misquoting you and I apologize but a plan to work out
9 increases that would come but you weren't sure. And
10 something along the order of, in order to do this, we have
11 to have accurate cost, revenue and so forth, which you seem
12 to question, even after the colloquy with counsel.

13 THE WITNESS: I think what I was thinking of then
14 was the possibility of over several years looking at a few
15 services at a time rather than omnibus cases.

16 COMMISSIONER LeBLANC: Correct.

17 THE WITNESS: It would seem to me to require some
18 agreement with the Commission on how to proceed in this way
19 to work out how this was to be done, how the revenue
20 requirements would be worked, just how you might separate
21 the task of a big case down into smaller units. It might be
22 possible to do that.

23 COMMISSIONER LeBLANC: Might be, but we are not
24 sure in this particular case?

25 THE WITNESS: Right. I think it would require

1 some thought and care and planning to see whether it would
2 be possible. It would have the advantage that fewer
3 services would be involved, it would be a little easier for
4 that reason but it would have the disadvantage that you
5 can't look across all mail classes.

6 COMMISSIONER LeBLANC: In your response to the
7 Chairman's question about the test years and in your answer
8 to, and I am sorry I don't remember the exact exchange with
9 the counsel, you were talking about costs and somebody
10 mentioned the word "pure" cost, I thought. I can't remember
11 who it was but pure costs don't necessarily mean accurate
12 costs, do they?

13 THE WITNESS: I don't know. I can't remember the
14 "pure cost" reference. I don't know what it would
15 necessarily be.

16 COMMISSIONER LeBLANC: I am just talking about the
17 relationship between test years and so forth, like we talked
18 about. There may be some movement, if you will, of cost and
19 so forth.

20 THE WITNESS: Yes. Right. I'm not sure what the
21 meaning of "pure" would be in that setting, though.

22 COMMISSIONER LeBLANC: I might have misheard. I
23 apologize if I did.

24 Thank you very much.

25 Thank you, Commissioner Quick.

1 COMMISSIONER QUICK: Commissioner Haley?

2 COMMISSIONER HALEY: No questions.

3 COMMISSIONER QUICK: Mr. Chairman, any further
4 questions?

5 CHAIRMAN GLEIMAN: I don't have another question.
6 I do want to make a comment and I appreciate the remarks
7 that Commissioner LeBlanc made before he began his
8 questions.

9 MR. HOLLIES: You're sinking into inaudibility
10 again, Mr. Chairman.

11 CHAIRMAN GLEIMAN: I've not been accused of that
12 very much, you know. This may be a real record here. I'm
13 glad this is getting in the record. I am going to have it
14 blown up and posted in here for other Postal Service
15 attorneys and participants' counsel who think that I am a
16 little too loud at times.

17 What troubled me was, earlier on in the
18 proceeding, a question was asked and an answer was given and
19 Professor Sherman, much to your credit, I think you are a
20 rather soft spoken individual and I had difficulty hearing
21 your response.

22 The question was asked again. I don't know and
23 did not know at the time whether the question was asked
24 again because counsel didn't hear or because counsel didn't
25 want to accept the answer that you gave the first time,

1 which I thought I heard, which had the word "possibly" in
2 it. And I just get concerned sometimes about repetitive
3 questions which were very softly put to you and don't equate
4 with badgering a witness but, you know, sometimes people
5 don't like the answer they get and they -- and they give the
6 same question over again.

7 So it was a problem with that and also with
8 hearing what your first response was, your first impression,
9 which I assume was the more deeply held feeling that you had
10 in response to that question. In any event, we would all do
11 well to read the record. Thank you.

12 COMMISSIONER QUICK: Does any participant have
13 followup cross examination as a result of the questions from
14 the bench?

15 MR. ALVERNO: I have none.

16 COMMISSIONER QUICK: Thank you.

17 This brings us to redirect. Mr. Costich, would
18 you like an opportunity to consult with your witness before
19 stating whether redirect testimony will be necessary?

20 MR. COSTICH: I think I can safely say there will
21 be some redirect.

22 COMMISSIONER QUICK: How much time would you like?

23 MR. COSTICH: Could I have 10 minutes?

24 COMMISSIONER QUICK: How much?

25 MR. COSTICH: Ten minutes.

1 COMMISSIONER QUICK: We'll reconvene at 12:20 p.m.

2 [Recess.]

3 COMMISSIONER QUICK: Mr. Costich?

4 MR. COSTICH: Thank you, Commissioner Quick.

5 REDIRECT EXAMINATION

6 BY MR. COSTICH:

7 Q I'd just like to clear up a few points with
8 Professor Sherman. Professor Sherman, could you turn to
9 your response to Postal Service Interrogatory 1?

10 A I have it.

11 Q Counsel for the Postal Service quoted a portion of
12 your response that appears near the bottom where you say,
13 "For the Postal Service, optimal prices are Ramsey prices."
14 Do you recall that?

15 A Yes.

16 Q Do you recall saying in response to Counsel the
17 words "in this setting, in this case"?

18 A Yes.

19 Q By the phrase, "in this case," were you referring
20 to this docket?

21 A No, I meant in this instance, in this
22 circumstance.

23 Q Circumstance of what?

24 A Of the context of this answer to the
25 interrogatory.

1 Q At the beginning of your response to
2 Interrogatory 1, you define optimal pricing and that
3 eventually leads you to your discussion of Ramsey pricing,
4 is that correct?

5 A Yes.

6 Q Is it correct that Ramsey pricing produces
7 allocative efficiency?

8 A Yes.

9 Q If the Commission were to have goals in addition
10 to allocative efficiency, would it be likely to deviate from
11 Ramsey prices?

12 A Yes, the Ramsey prices could be modified for other
13 -- to achieve other aims.

14 Q At the end of his cross examination, Counsel for
15 the Postal Service was discussing postal cards with you, do
16 you recall that?

17 A Yes.

18 Q He took you through a hypothetical involving a
19 large increase in the manufacturing costs of postal cards,
20 do you recall that?

21 A Yes.

22 Q Part of that hypothetical was that solely as the
23 result of this large increase in manufacturing costs of
24 postal cards, the rate for the subclass that includes both
25 private and postal cards went up, do you recall that?

1 A Yes.

2 Q In relation to other attributable costs of postal
3 cards or the attributable costs of the subclass, how large
4 are the manufacturing costs of postal cards?

5 A Well, they are quite small. They're a small
6 portion.

7 Q If those costs were to double and all other costs
8 were not to change at all, how likely is it that there would
9 be any change in the rate for the subclass?

10 A Well, small, I think. Not likely.

11 MR. COSTICH: Thank you. I have no further
12 questions, Commissioner Quick.

13 COMMISSIONER QUICK: Did the redirect generate any
14 recross examination?

15 MR. ALVERNO: Yes, Mr. Presiding Officer, we do
16 have some recross.

17 COMMISSIONER QUICK: Mr. Alverno.

18 RE CROSS EXAMINATION

19 BY MR. ALVERNO:

20 Q In the last set of questions that you had with
21 Mr. Costich, you discussed the effect on the postal and
22 postcard subclass of a change in the manufacturing costs of
23 postal cards, correct?

24 A Correct.

25 Q Now, let's suppose that we removed those costs

1 entirely from the postal and postcard subclass and put them
2 somewhere else, either institutional costs for the Postal
3 Service or a special service fee. Okay?

4 Are you also suggesting that the Commission need
5 not be concerned about the rate for the postal and
6 postcard -- or the rates, the rate categories in the postal
7 and postcard subclass as a result of a shift in those
8 manufacturing costs?

9 A I'm not sure I understand. If the manufacturing
10 costs are placed over, let us say, an institutional cost?

11 Q Okay, in this docket, where the manufacturing
12 costs are moved out of the postal and postcard subclass?

13 A Yes.

14 Q And put in the special service fee, should the
15 Commission be concerned about the rates for the postal and
16 postcard subclass?

17 A I -- I still don't understand what the question
18 is. There would be interest in the rate.

19 Q Is a reevaluation necessary given that they are
20 such a small part of the attributable costs of the postal
21 and postcard subclass?

22 A Whether they are a significant part or not, does
23 this also include the separation of the two as far as
24 pricing is concerned? The postal card will now have a
25 different price from private cards?

1 Q No, that's not -- that's not the status quo nor is
2 it proposed in this case.

3 A I thought it was proposed in that postal cards
4 would go to 22 cents and private cards would stay at 20.

5 Q Okay, then I guess we better explore this a little
6 bit because I think you need to understand what the proposal
7 is about. The proposal is not to charge a rate of 22 cents
8 for postal cards; it is to charge postage of 20 cents and to
9 have a separate, special service fee of 2 cents per postal
10 card.

11 A But I, the mailer of a postal card, won't know
12 that; I just pay 22 cents and receive the card.

13 Q For a postal card with 20 cents postage on it.
14 But they -- as far as prices of the postage are concerned --

15 A I understand.

16 Q -- those will not be determined separately as a
17 result of this proceeding.

18 A I understand. Yes.

19 ~~Q~~ Okay. Nevertheless, the cost -- the attributable
20 cost of the postal card with or without the manufacturing
21 cost of the card is lower than the cost of a private card,
22 considerably lower.

23 A Okay, so what should the Commission do in the
24 event that the manufacturing costs are shifted from the
25 postal and postcard subclass to a special service fee?

1 A Well, a single rate will still have to be
2 determined based on those costs.

3 Q You just told me a minute ago that they were -- or
4 you told Mr. Costich they were small.

5 A I mean on the remaining costs when --

6 Q Yeah, but I mean, when they are taken out you said
7 they were very small and so they weren't a significant part
8 of the attributable costs of that subclass; isn't that
9 right?

10 A That's true.

11 Q So, is reevaluation necessary given that the
12 attributable costs that are being shifted are small?

13 A Well, it's hard for me to say that. It's hard --
14 I'm not sure whether it's appropriate or not to reevaluate.
15 I don't know, they are small, I'll grant that. I don't know
16 how large of a change it takes.

17 MR. ALVERNO: Thank you.

18 COMMISSIONER QUICK: Further questions of the
19 Bench?

20 CHAIRMAN GLEIMAN: Are you sure you understand the
21 Postal Service's proposal now?

22 THE WITNESS: Yes.

23 CHAIRMAN GLEIMAN: Okay. I just wanted to make
24 sure.

25 COMMISSIONER QUICK: Thank you, Dr. Sherman.

1 We appreciate your appearance here today and your
2 contributions to our record. If there is nothing further
3 you are excused.

4 This concludes today's hearings. We will resume
5 Monday, November 25th, when we will hear -- we will receive
6 testimony from Douglas F. Carlson and the Postal Service
7 witness on implementation, Leo Raymond.

8 Thank you very much.

9 MR. HOLLIES: I do have one question.

10 COMMISSIONER QUICK: Excuse me, Mr. Hollies.

11 MR. HOLLIES: Before we break, is there an order
12 of witnesses that has been scheduled or will be scheduled
13 for Monday?

14 COMMISSIONER QUICK: For Monday?

15 MR. HOLLIES: For Monday. The reason that I raise
16 this is that the witness in question is out of town because
17 of a family emergency and I guess I would prefer that he be
18 second rather than first.

19 COMMISSIONER QUICK: We'll certainly accommodate
20 his -- accommodate you on that, if we can.

21 Will he be returning --

22 MR. HOLLIES: I expect him back in the area at the
23 beginning of the weekend but I am not sure that he will be
24 contacting me until Monday morning.

25 COMMISSIONER QUICK: He does know that he is going

1 to be testifying?

2 MR. HOLLIES: Yes, he does. Indeed, I explored
3 the possibility that he would be called out of town with Mr.
4 Sharfman and as Mr. Sharfman may be picking up now, the
5 fears that he would be out of town on Monday are now removed
6 because he is out of town now.

7 COMMISSIONER QUICK: All right. We will take into
8 consideration your point.

9 MR. HOLLIES: Thank you very much.

10 COMMISSIONER QUICK: That ends today's hearing.

11 [Whereupon, at 12:30 p.m., the hearing was
12 recessed to reconvene at 9:30 a.m., Monday, November 25,
13 1996.]
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