

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

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

RESPONSES OF UNITED STATES POSTAL SERVICE
WITNESS MAYES TO INTERROGATORIES OF
THE OFFICE OF THE CONSUMER ADVOCATE
(OCA/USPS-T32-1 THROUGH 7)

The United States Postal Service hereby provides its responses to the following interrogatories of the Office of the Consumer Advocate: OCA/USPS-T32-1 through 7, filed on February 1, 2000.

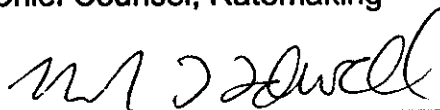
Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking



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RESPONSE OF POSTAL SERVICE WITNESS MAYES TO OCA INTERROGATORIES

OCA/USPS-T32-1. Please refer to page 19, lines 19-21, of USPS-T-32. There you state, "Movement toward or away from Ramsey prices was considered in the development of the rate level proposals in this case but did not significantly affect conclusions."

- (a) Do your rate levels for First Class letters and Standard (A) Regular reflect movement toward or away from Ramsey prices? Please explain the basis for your answer.
- (b) To what extent did Ramsey prices influence your choice of rate levels for First Class letters and Standard (A) Regular.

Response:

- a. By reference to the work presented in the testimony of witness Bernstein, USPS-T-41, at Summary Table 2 where he provides the constrained Ramsey markups and the markups implied by use of the Commission's markup index from Docket No. R97-1, I would say that the rate levels I have proposed for First-Class Letters and Standard (A) Regular reflect movement toward Ramsey prices when compared to the rate levels implied by the Commission's R97-1 markup index. For both First-Class Letters and Standard (A) Regular, my proposed rate levels result in lower markups and lower revenue per piece than would have resulted from application of the constrained Ramsey model.
- b. In the development of rate levels that would meet the statutory criteria, I would not say that there was an attempt to develop rate level proposals that would meet the constraints of any mechanical model, including Ramsey pricing. As with many considerations, the Ramsey prices represented additional useful but not determinate information brought to bear on the decisionmaking process. Given the choice between two sets of rate levels,

Response to OCA/USPS-T32-1, continued

both of which achieve the goals of meeting the revenue requirement and satisfying the nine pricing criteria for each subclass, all else equal, I would prefer the set of proposed rate levels that moved in the direction of economic efficiency.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO OCA INTERROGATORIES

OCA/USPS-T32-2. Please refer to your exhibit USPS-32B and to R97-1 exhibit USPS-30B (rev. 9/19/97).

- (a) Please confirm that in R97-1, Postal Service witness O'Hara implicitly proposed a markup index of 1.275 for First Class Total Letters ($100.02/78.42 = 1.275$). If you do not confirm, please provide the correct markup index and show its derivation.
- (b) Please confirm that in R2000-1, you have implicitly proposed a markup index of 1.416 for First Class Total Letters ($96.3/68.0 = 1.416$). If you do not confirm, please provide the correct markup index and show its derivation.

Response:

- (a) Your arithmetic is confirmed.
- (b) Your arithmetic is confirmed, as shown in Library Reference LR-I-149.

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OCA/USPS-T32-3. Please refer to exhibit USPS-33B and to R97-1 exhibit USPS-32B (rev. 10/1/97).

- (a) Please confirm that in R97-1, the test year unit attributable cost for First Class letters was \$0.1763 ($\$0.351799/1.9954$) under the Postal Service's proposed rates and costing methodology. If you do not confirm, please provide the correct unit attributable cost and show its derivation.
- (b) Please confirm that in R2000-1, the test year unit attributable cost for First Class letters is \$0.1848 ($\$0.362829/1.963$) under the Postal Service's proposed rates and costing methodology. If you do not confirm, please provide the correct unit attributable cost and show its derivation.
- (c) Please confirm that applying witness O'Hara's implicit R97-1 markup index of 1.275 to the R2000-1 unit attributable cost for First Class letters of \$0.1848 yields an average revenue per piece of \$0.345022 ($\$0.1848 \times ((1.275 \times 0.68) + 1)$). If you do not confirm, please provide the correct average revenue per piece and show its derivation.
- (d) Please confirm that \$0.345022 is six mills less than the average revenue per piece for First Class letters proposed by the Postal Service in R97-1. If you do not confirm, please explain.

Response:

- (a) With the clarification that the figures to which you have referred were the test year after rates unit volume variable costs, I confirm your calculations.
- (b) With the clarification that the figures to which you have referred are test year after rates unit volume variable costs, I confirm your calculations.
- (c) I confirm that the application of the markup index you have provided to the unit volume variable cost for First Class letters in this case results in the average revenue per piece you have calculated.
- (d) The difference between \$0.345022 and \$0.351799 is nearly 6.8 thousandths of a dollar.

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OCA/USPS-T32-4. Please refer to pages 20-23 of your testimony and to pages 22-25 of USPS-T-30 in R97-1. Other than the increase in the implicit markup index for First Class letters that you have proposed, the OCA is unable to perceive any material difference between your R2000-1 testimony and witness O'Hara's R97-1 testimony. Please explain why your testimony justifies a markup index for First Class letters of 1.416 instead of 1.275.

Response:

In the absence of significant changes in cost behavior (criterion 3), entry or departure from the marketplace of competitors (criterion 5), technological changes (criteria 5 and 6), or changes in the content of a particular mail category (criterion 8), I would not expect to see material differences in the testimony discussing the application of the statutorily mandated pricing criteria from one rate case to the next.

For some subclasses of mail, I have specifically pointed to one or more overriding considerations which caused the proposed markup to be higher or lower than one might have expected from review of previous cases. However, individual markups ultimately must result in a complete set of rate levels and rate and fee proposals that permit the Postal Service to break even in the test year, apportioning the institutional cost burden to the subclasses of mail in a fair and equitable manner. In the current case, in deference to criterion 4, it was necessary to moderate the cost coverages for several subclasses of mail which experienced substantial increases in costs in order to moderate the impact on mailers, as measured by percent increase in rates. The shift of some of this

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO OCA INTERROGATORIES

Response to OCA/USPS-T32-4, continued

institutional burden to First-Class Mail, particularly in view of the relatively small increase in First-Class Mail rates, was not viewed as unfair.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO OCA INTERROGATORIES

OCA/USPS-T32-5. Please refer to your exhibit USPS-32B and to R97-1 exhibit USPS-30B (rev. 9/19/97).

- (a) Please confirm that in R97-1, Postal Service witness O'Hara proposed that First Class Total Letters bear 62 percent ($\$16,809,020/\$27,043,982$) of institutional costs. If you do not confirm, please provide the correct proportion and show its derivation.
- (b) Please confirm that in R2000-1, you have proposed that First Class Total Letters bear 64 percent ($\$17,774,380/\$27,801,806$) of institutional costs. If you do not confirm, please provide the correct proportion and show its derivation.
- (c) Please explain why you have proposed to increase the share of institutional costs borne by First Class letters.

Response:

- (a) I confirm that in R97-1, witness O'Hara proposed that First Class Total Letters bear 62 percent of the non-volume variable costs.
- (b) I confirm that I have proposed that First Class Total Letters bear 64 percent of the non-volume variable costs.
- (c) Please refer to my responses to OCA/USPS-T32-4(c) and OCA/USPS-T32-7.

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OCA/USPS-T32-6. Please confirm the following properties of a markup index. If you do not confirm, please provide a mathematical demonstration of the contrary.

- (a) The markup index for a subclass of mail is directly proportional to the relative portion of institutional costs borne by that subclass.
- (b) The markup index for a subclass of mail is inversely proportional to the relative portion of attributable costs borne by that subclass.
- (c) Simultaneously increasing the institutional share *and* decreasing the attributable share of costs borne by a subclass will unambiguously cause the markup index for that subclass to increase.

Response:

(a) I have attached a table based on my Exhibit USPS-32B. For illustrative purposes, I have added a column which calculates for the subclasses shown the portion of total non-volume variable costs represented by the difference between each subclass's revenue and its volume variable costs. As shown in the attachment to this response, I cannot derive any meaningful mathematical relationship between the markup index and the relative portion of non-volume variable costs.

(b) As shown in the attachment to this response, I cannot derive any meaningful mathematical relationship between the markup index and the relative portion of volume variable costs borne by a subclass as measured by the percent of total volume variable costs represented by a subclass's volume variable cost.

(c) Although it seems plausible that if a subclass's share of total volume variable costs decreases and the subclass's share of total non-volume variable costs increases, the markup index for that subclass will increase, I have been unable to mathematically confirm this relationship so I am unsure that it would always be true.

**Summary of Estimated Test Year After Rates Finances
Revenue and Volume Variable Cost
(Dollars in Thousands)**

<u>Description</u>	<u>Volume Variable Cost</u> (1)	<u>Revenue</u> (2)	<u>Revenue as Percent of Cost</u> (Col. 2/Col. 1) (3)	<u>Revenue Minus Vol. Var. Cost</u> (Col. 2 - Col. 1) (4)	<u>Markup Index</u> (Col. 3 - 100%) (5)	<u>Portion of Non-Vol. Variable Cost</u> (6)	<u>Markup Index Divided by Portion of Non-Vol. Var. Cost</u> (7)	<u>Portion of Volume Variable Cost</u> (8)	<u>Markup Index Divided by Portion of Vol. Var. Cost</u> (9)
First-Class Mail									
Total Letters	18,456,821	36,231,201	196.3%	17,774,380	1.416	63.9%	2.216	45.1%	3.138
Total Cards	708,877	1,052,689	148.5%	343,812	0.713	1.2%	57.685	1.7%	41.146
Total First-Class Mail	19,165,698	37,283,889	194.5%	18,118,191	1.390	65.2%	2.134	46.9%	2.966
Priority Mail	3,064,062	5,542,259	180.9%	2,478,197	1.189	8.9%	13.346	7.5%	15.874
Express Mail	480,984	1,068,567	222.2%	587,583	1.797	2.1%	85.017	1.2%	152.742
Mailgrams	1,000	1,136	113.6%	136	0.199	0.0%	40,891.895	0.0%	8,156.711
Periodicals									
Within County	81,397	81,647	100.6%	450	0.008	0.0%	502.373	0.2%	4.089
Outside County	2,384,191	2,416,926	101.4%	32,735	0.020	0.1%	17.151	6.8%	0.346
Total Periodicals	2,465,588	2,498,774	101.3%	33,186	0.020	0.1%	16.585	6.0%	0.328
Standard Mail (A)									
Regular	6,823,933	9,070,437	132.9%	2,246,504	0.484	8.1%	5.992	16.7%	2.901
Enhanced Carrier Route	2,471,864	5,162,024	208.8%	2,690,160	1.601	9.7%	16.543	6.0%	26.478
Total Commercial	9,295,797	14,232,461	153.1%	4,936,664	0.781	17.8%	4.399	22.7%	3.436
Nonprofit	1,320,611	1,543,087	116.8%	222,476	0.248	0.8%	30.964	3.2%	7.672
Enhanced Carrier Route	208,577	264,218	126.7%	55,641	0.392	0.2%	196.051	0.5%	76.915
Total Nonprofit	1,529,188	1,807,305	118.2%	278,117	0.267	1.0%	28.741	3.7%	7.152
Total Standard Mail (A)	10,824,985	16,039,766	148.2%	5,214,781	0.708	18.8%	3.776	26.5%	2.676
Standard Mail (B)									
Parcel Post	1,052,158	1,200,362	114.1%	148,204	0.207	0.5%	38.865	2.6%	8.051
Bound Printed Matter	479,204	563,443	117.6%	84,239	0.259	0.3%	65.333	1.2%	22.061
Special Rate	301,195	338,784	112.5%	37,589	0.183	0.1%	135.785	0.7%	24.905
Library Rate	47,444	49,672	104.7%	2,228	0.069	0.0%	861.894	0.1%	59.525
Total Standard Mail (B)	1,880,001	2,152,241	114.5%	272,240	0.213	1.0%	21.751	4.6%	4.632

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO OCA INTERROGATORIES

OCA/USPS-T32-7. Please refer to page 21, line 18, through page 22, line 4, of your testimony. You state that your "proposed modest increase [in the First Class letter rate] . . . reflects the concern of the Postal Service about emerging alternatives [to First Class letters]" Please explain how increasing the share of institutional costs borne by First Class letters "reflects the concern of the Postal Service about emerging alternatives."

Response:

Mailers pay rates, not institutional cost burdens, not markups. Along with non-price considerations such as ease of use, familiarity with and trust of the technology, mailers will make decisions regarding the substitution of alternatives for First-Class Mail on the basis of the relative prices of the alternatives, not on the basis of the share of institutional costs that the prices imply. The rates that mailers will pay for First-Class letters will be, on average, 3.5 percent higher than the rates they are currently paying. Not to trivialize consideration of cost coverages or the distribution of institutional cost burden, but it is the 3.5 percent increase in rates which will affect users of First-Class Mail. This rate increase is below the rate of inflation and thus, represents a decrease in the real price of First-Class letters. It was with this decrease in the real price of First-Class letters in mind that I stated that the rate proposal reflected the concern about emerging alternatives to First-Class letters.

DECLARATION

I, Virginia J. Mayes, declare under penalty of perjury that the foregoing answers are true and correct, to the best of my knowledge, information, and belief.


Virginia J. Mayes

Dated:

2-15-80

CERTIFICATE OF SERVICE

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

A handwritten signature in black ink, appearing to read "M T Tidwell", written over a horizontal line.

Michael T. Tidwell

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February 15, 2000