

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

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POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS MAYES
TO INTERROGATORIES OF NEWSPAPER ASSOCIATION OF AMERICA
(NAA/USPS-T32-1 THROUGH 30)

The United States Postal Service hereby provides the responses of
witness Mayes to the following interrogatories of Newspaper Association of
America:

NAA/USPS-T32-1 through 30 (filed on February 22, 2000).

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

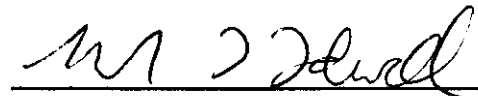
SERVICE

Respectfully submitted,

UNITED STATES POSTAL

By its attorneys:

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking



Michael T. Tidwell

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2998 Fax -5402
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RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-1. Please refer to page 36, line 7, of your testimony. Please explain how the "system average increase of 6.4 percent" is calculated. In particular, please explain whether it is a weighted or an unweighted (by volume) average of the rate increases by subclass. If weighted, please identify what volumes were used.

Response:

Please refer to my response to Presiding Officer's Information Request No. 3, Question 5.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-2. Please refer to page 8, lines 14-21 of your testimony. Is it your position that the comparison of rates to incremental cost is the only measure required to ensure that "unfair price competition" is avoided?

Response:

No. However, coverage of incremental costs is widely viewed as a measure that would guard against the possibility of unfairly competing by offering products at lower prices by having other products subsidize them. Pricing criterion 4 requires that the impact on competitors of the rate changes be taken into consideration. The goal in ratemaking should be to protect competition, not necessarily to maintain the current market situation. While it would not be desirable for the rationale or motivation for ratemaking choices to be to unfairly harm competitors or a particular competitor, there may be choices of either rate levels or rate design that may have a harmful impact on competitors or a competitor. In this context, other information, much of which would be known only to those competitors themselves, would be helpful to guard against ratemaking choices that would unfairly harm those competitors. As an example, the Postal Service does not have full information regarding the prices charged by competitors. Some changes to postal rates may cause harm to those competitors, but without knowledge of the cost structure or pricing practices of the competitors, there would not have been opportunity to prevent such harm.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-3. Please refer to USPS-T-32, p.5, line 18 to p.6, line 21, which identifies the long-run own-price elasticities relied upon in your direct testimony.

- a. Did you use these elasticities to determine your proposed cost coverages and rate levels?
- b. If the answer to (a) is yes, identify each and every way they were relied upon.
- c. Did you rely upon any other parts of the direct testimonies of witnesses Tolley (USPS-T-6), Musgrave (USPS-T-8), or Thress (USPS-T-7)?
- d. If the answer to (c) is yes, identify each and every line of the testimonies and precisely how it was relied upon.
- e. Did you make any use of the cross elasticities or elasticities with respect to other variables reported by witnesses Tolley, Musgrave, and Thress? Explain your answer in detail.

Response:

- a. Yes, as one of many factors.
- b. I considered them in the context of pricing criteria 2 (value of service), 4 (effect of rate increases) and 5 (available alternatives). Early in the iterative process, I also used a version of these elasticities with the lags truncated so as to limit the impact to that which would be felt during the test year. The elasticities with truncated lags were used to develop preliminary sets of rate levels that might satisfy the pricing criteria while achieving the goal of financial breakeven.
- c. Yes.
- d. I cannot identify each and every line of the testimonies that I relied upon, nor can I "precisely" state how the testimonies were relied upon. I had read the testimonies of these three witnesses from the most recent omnibus rate case and was generally familiar with their work in both the

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Response to NAA/USPS-T32-3, cont'd

current as well as previous cases. Please also refer to my responses to subparts b and e of this question.

- e. Yes. It is my understanding that, by definition, the only variables that should change between the test year before rates and test year after rates volume forecasts would be the prices. Therefore, I did not make use of any of the elasticities with respect to non-price variables. In developing the target cost coverages early in the iterative rate level process, I used the own-price elasticities with the lags truncated such that only the test year effect on volume would accrue. By doing this, I could simulate volume impacts prior to giving rate design witnesses target cost coverages. In this exercise, I also used some of the cross-elasticities, including the cross-price elasticities for: FCM Single-Piece Letters with respect to FCM Cards, FCM Workshared Letters with respect to FCM Cards and with respect to Standard Mail (A) Regular, FCM Cards with respect to FCM Letters, Standard Mail (A) Regular with respect to FCM Letters, Parcel Post with respect to Priority, Priority with respect to Parcel Post, and Express Mail with respect to Priority. These own- and cross-price elasticities were used to gauge the impact of potential changes on postal volumes, revenues and costs to develop the initial set of target cost coverages. Once the initial set of target cost coverages was set and the rate design witnesses developed sets of rates and fees, the full

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Response to NAA/USPS-T32-3, cont'd

forecasting models were utilized by the forecasting witnesses and there was no need for me to rely on my simplified version.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-4. At USPS-T-32, p. 7, line 12 to p. 8, line 2, you state: "use of the refined costing approach...affects measured volume-variable costs of different mail classes to differing degrees, necessitating that the rate levels proposed by the Postal Service recognize these changes in relative cost levels."

- a. Did these changes in measurement of costs affect the percentage rate changes and cost coverages of any class or subclass in any quantitative or qualitative way?
- b. If the answer to (a) is yes, identify each and every example of a class or subclass so affected and how it was affected.

Response:

- a. Yes.
- b. I cannot. Had the volume-variable costs upon which the proposed cost coverages are based been developed with different assumptions regarding volume variabilities, the result would have been a different set of cost coverages, even if the rates and resulting revenues remained unchanged. It is my understanding that the assumptions regarding the volume variabilities of costs would affect different categories of mail to different degrees, depending, for instance, on the relative importance of mail processing costs in the cost base for that category of mail. Please refer to the testimony of witnesses Bozzo (USPS-T-15) and Degen (USPS-T16).

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NAA/USPS-T32-5. At USPS-T-32, p.8, lines 2-3, you state that "coverage or markup indices" were not applied "mechanistically" based on "previous cost information."

- a. Were "coverage" or "markup" indices used in determining specific levels of rates for classes and subclasses in any quantitative or qualitative way?
- b. If the answer to (a) is yes, identify each and every example of a class or subclass so affected and how it was affected. In answering the question, please distinguish between coverage or markup indices if you made any such distinction.
- c. Please refer to the Direct Testimony of Witness O'Hara (USPS-T-30 in Docket No. R97-1) at p. 16, lines 13 to p.20, line 7. Do you agree with his testimony regarding the relative usefulness of markup and cost coverage indices?
- d. If your answer to (c) is not an unqualified yes, identify each and every way in which you disagree with witness O'Hara's testimony.

Response:

- a. No.
- b. Not applicable.
- c. In general, I agree with witness O'Hara's assessment of the relative usefulness of markup and cost coverage under the circumstances for which he has provided his example.
- d. It is my opinion that the usefulness of markup or cost coverage indices is to demonstrate movement of one or more markups or cost coverages from the relative positions held in previous cases. When the base to which the markups or cost coverages are compared -- the systemwide average -- changes, or the underlying development of the costs (as in the example provided by witness O'Hara) has changed from one case to another, use of a markup or cost coverage index might be useful as a reminder that, for instance, a change from a cost coverage of 145 percent

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Response to NAA/USPS-T32-5, cont'd

in one case to a cost coverage of 160 percent in another case may not actually represent a conscious decision to shift the burden of institutional cost, but rather, reflects only the change in the cost base or the relative proportions of attributable and institutional costs. However, in circumstances such as the current case where, for instance, the volume variable costs for some categories of mail have increased substantially more than the costs for other categories of mail and the cost coverages for the categories with substantial increases in costs must be mitigated, necessitating shifts of the institutional cost burden at the same time as the cost basis and the systemwide average have changed, I think that a markup index or cost coverage index is of less use.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-6. At USPS-T-32, p.8, lines 10-13, you identify (1) "the overall rate of inflation in the economy," (2) "the rate increases for other classes of mail," and (3) the "overall system-average increase," as indicators to compare to the proposed percentage rate increase for a class of mail in order to measure of [sic] the effect of the proposed rate increases on mailers.

- a. Are these factors also relevant to the effect of the proposed rate changes on competitors? Explain fully the basis for your answer.
- b. Identify precisely the numerical values of the indicators identified at p.8, lines 10-13, how these values were derived, and how they were considered in establishing the cost coverages and proposed rate levels for each of the classes and subclasses of mail.

Response:

- a. Yes. If, for example, the rate increase for a competitive service were held significantly lower than those for other categories of mail, I could understand competitors seeking additional rationale for the relatively lower rate increase. Such rationale could include better cost control for the competitive product, for example. Similarly, if the rate increase for a competitive service were lower than the rate of inflation or the systemwide average, I could understand a competitor seeking additional reasons for the relatively smaller rate increase. Given that the pricing criteria cited in the Postal Reorganization Act provide a range of issues for consideration when developing rate levels and their associated rate increases, I would expect that the rationale for the rate changes would be evident. I would expect, for instance, that the satisfaction of criterion 3 (covering incremental costs) and criterion 2 (using the own-price elasticity to measure value of service) might be just as useful in considering the impact on competitors. I would caution against using rate increases as

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

Response to NAA/USPS-T32-6, cont'd

the sole measure for comparison because a percent increase relies on a comparison of the current rates with the proposed rates. There may have been mitigating circumstances in the rate case that led to the current set of rates, such as a desire to maintain rate relationships across subclasses or a desire to limit a rate increase.

- b. Please refer to the response of witness Tayman to interrogatory DMA/USPS-T9-16 for the rate of inflation over the rate cycle between R97-1 and R2000-1. Please refer to my Exhibit USPS-32D for the rate increases by classes of mail. Please refer to my response to your interrogatory NAA/USPS-T32-1 for the calculation of the overall system-average increase.

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NAA/USPS-T32-7. Does USPS-T-32, p.8, lines 14-21, identify all the factors you considered in evaluating the effects on competitors? If the answer is not an unqualified yes, please identify in detail all additional considerations and what proposed rates they affected.

Response:

Please refer to my response to your interrogatory NAA/USPS-T32-6(a). I was also aware of reports of rate changes for several private companies which provide delivery services, both general rate changes as well as rate surcharges specifically tied to service for particular areas or, in part, to increases in fuel prices. In addition, I did compare the test year before and test year after rates forecasts of postal volume for each subclass or rate category for which volumes were forecasted.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-8. Does the availability of alternatives as identified at p.9, lines 1-10, affect the specific cost coverages and percentage rate increases proposed by you?

- a. If your answer is yes, identify each and every class or subclass so affected and precisely how it was affected.
- b. Did the "availability, at reasonable cost, of alternative means of sending and receiving mail matter" (USPS-T-32, lines 2-3) lead you to propose higher percentage rate increase and cost coverages for any class or subclass than you otherwise would have proposed?
- c. If your answer is not an unqualified no, identify each such class or subclass and precisely how the recommended class or subclass was affected.

Response:

Yes.

- a. Please refer to my response to DFC/USPS-40. Low own-price elasticities of demand can be partially the result of a lack of viable alternatives. The low elasticities may be taken to indicate a high value of service which criterion 2 would suggest be associated with a relatively high cost coverage. Criterion 5 has been interpreted as providing a basis for deciding when a cost coverage should be mitigated, especially when alternatives are limited for some subset of the postal customers in question. I cannot identify "precisely" how this consideration affected each of the proposed cost coverages, but I can point in particular to the relatively low own-price elasticities for First-Class Letters as one instance in which I was aware that the relatively low own-price elasticity is likely partially the result of the restrictions on the private carriage of letters.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

Response to NAA/USPS-T32-8, cont'd

- b. In conjunction with consideration of criterion 4, when considering the proposals for services generally considered to be competitive, such as Express Mail, Priority Mail, Parcel Post and for some subclasses such as ECR for which there are known direct substitutes (which is not to exclude from this discussion other subclasses of mail for which there are alternatives available, such as electronic transmission for First-Class Mail, parcel delivery firms for Special and Bound Printed Matter or other means for delivering Periodicals), I did consider that any perceived reduction in or mitigation of the proposed cost coverages or rate increases would undergo scrutiny. While I cannot say that I proposed "higher percentage rate increases or cost coverages" for these subclasses than I otherwise would have proposed, I was sensitive to the possibility of criticism by competitors, should the rate increases or cost coverages not appear to be as high as the other pricing criteria might seem to imply.
- c. Please see my response to subpart (b).

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NAA/USPS-T32-9. At USPS-T-32, p.10, lines 11-14, you state that the required system-average cost coverage will increase, all else equal, as the overall level of worksharing increases.

- a. Did this effect influence your proposed rate increases and cost coverages for the classes and subclasses of mail?
- b. If your answer is not an unqualified no, identify all examples and explain in detail how the proposed rate increase and cost coverages were affected.

Response:

- a. Yes.
- b. The cost coverage for each and every subclass of mail was influenced by the aggregate level of worksharing in that, in conjunction with the volume-variability assumptions, the amount of worksharing affected the relative proportion of institutional costs overall. In particular, I was aware that the seeming reduction in the unit costs for First-Class Letters was partly the result of mail mix changes shifting volume shares from single-piece to workshared categories.

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NAA/USPS-T32-10. At USPS-T-32, p.11, lines 7-8, you state that the sixth criterion (degree of preparation) was "most immediately" reflected in rate design. Did degree of preparation affect the rate levels of any class or subclass as well? Explain your answer in detail.

Response:

Yes. When developing the cost coverages for subclasses with substantial worksharing participation, I had to remember that a seemingly high cost coverage might have been the result of high levels of worksharing participation which reduced the denominator, rather than a high revenue and institutional cost burden which would have increased the numerator. In particular, this was of concern when determining the cost coverages for First-Class Letters and Cards (see my response to NAA/USPS-T32-9) and ECR.

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NAA/USPS-T32-11. At USPS-T-32, p.11, lines 7-9, you state that the seventh criterion contains "the logic that understandable and rational relationships exist between various postal rates" and that this factor was "most immediately reflected in the rate design." The examples of this consideration that follow appear to be confined to matters of rate design.

- a. Did the seventh criterion play a role in determining the specific proposed level of rates for any class or subclass of mail?
- b. Unless your answer to (a) is an unqualified no, identify all classes and subclasses where the seventh criterion had an effect on the proposed cost coverage and percentage rate changes for the classes and subclasses of mail and identify the role of the effect.

Response:

- a. Yes.
- b. Criterion 7 played an important role in the determination of the treatment of Library Mail and the preferred subclasses in Periodicals. Operating in conjunction with the Revenue Forgone Reform Act, the other pricing criteria might have led to higher cost coverages or percentage rate increases, but for the concern that these categories of mail had been singled out for preferred treatment. The higher cost coverages or rate increases might have led to rates that were not lower than those of the non-preferred categories. In addition, there are some subclasses for which a hierarchy of rates related to service exists. Namely, logic dictates that Express Mail rates exceed Priority Mail rates which should exceed Parcel Post rates. The cost coverages and percentage rate increases were developed with this resulting hierarchy in mind. In addition, as in Docket No. R97-1, there was some attention paid to the possible crossover of mail from the ECR basic rate category to the Automation 5-digit rate in Standard Regular.

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NAA/USPS-T32-12. At USPS-T-32, p.11, line 18, to p. 12, line 4, you discuss the eighth and ninth criteria of the Act.

- a. Did these criteria have any qualitative or quantitative effect on the proposed cost coverages and rate levels?
- b. Unless your answer is an unqualified no, identify each and every subclass and class of mail and how it was affected.

Response:

- a. Yes.
- b. As I noted in my testimony, educational, cultural, scientific and informational (ECIS) value played a role in mitigating cost coverages for First-Class Mail, Periodicals, Special Standard and Bound Printed Matter. With regard to criterion 9, I did consider certain goals and concerns expressed by postal management, particularly with regard to narrowing the range of percentage rate increases, in addition to concerns expressed by the Commission in the past. For example, please refer to my responses to NAA/USPS-T32-11(b) and NAA/USPS-T32-25. While some of these concerns may be addressed by other pricing criteria, the emphasis placed upon them would, in my opinion, relate to criterion 9.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-13. Did you consider the per unit (e.g., cents per piece) contribution of revenues in excess of per unit volume-variable, incremental or attributable costs in your proposals for percentage rate increases and cost coverages? Unless your answer is an unqualified no, identify each and every class and subclass that was affected and how it was affected.

Response:

Rate levels have traditionally been discussed in terms of markups or costs coverages, rather than in terms of unit contribution. The purpose of establishing a set of rate levels is to derive a set of proposed percent changes in rates that will permit the forecasted volumes, costs and revenues to obtain a breakeven financial condition in the test year while complying with the pricing criteria specified in the Postal Reorganization Act. As I tested out combinations of rate levels that appeared to meet the pricing criteria of the Postal Reorganization Act, I had to keep in mind the unit contribution figures for each subclass so as to arrive at financial breakeven.

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NAA/USPS-T32-14. At USPS-T-32, p. 17, lines 1-3, you state: "the ratio of revenue to volume-variable cost is appropriate for assessing the burden of meeting the revenue requirement." You further state at p. 17, lines 6-9, that incremental cost data are relevant "for purposes of testing the adequacy of the Postal Service" proposed rates with regard to criterion 3 [cost]."

- a. Does this cited portion of your direct testimony imply that the ratio of revenue to volume-variable cost is the appropriate measure for applying the remaining criteria (other than criterion 3) in determining how the burden of meeting the total revenue requirement is distributed among the subclasses?
- b. If your answer is yes, explain why the ratio of revenue to volume-variable cost provides the only needed measure. If your answer is no, explain what other measures of revenues and costs are necessary.

Response:

- a. Yes.
- b. Please refer to the testimony of witnesses Panzar (Sections I.A. and I.B. in USPS-T-11 of Docket No. R97-1) and O'Hara (USPS-T-30 in Docket No. R97-1, particularly pages 11-16) in Docket No. R97-1.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-15. Please refer to the Direct Testimony of USPS witness O'Hara in Docket No. R97-1, at pg. 14, line 18 to p. 15, line 9, and assume that the cost coverage is 150 percent and the volume-variable cost of both products is again \$.20. Assume that the first product has \$1 million of specific fixed costs (cost incurred to serve that product alone but not included in its volume-variable cost).

- a. Please confirm that if both products pay a rate determined by the revenue to volume-variable cost, the first product, after netting out the revenues required to recover specific fixed costs, will contribute \$1 million less to the recovery of the remaining costs than the second product (all other factors assumed constant). If you cannot confirm, please explain why not.
- b. Please confirm that this is true in the example despite the fact that both product incur the same volume-variable cost per unit and by assumption have "the same evaluation on all the non-cost criteria" (O'Hara, p. 14, line 19). If you cannot confirm, please explain why not.

Response:

- a. Confirmed.
- b. Confirmed.

The questions have been framed in terms of the particular example presented.

However, I would note that, in practice, cost coverages are set with respect to volume-variable costs, so as to reflect concerns about efficiency and fairness, as expressed so well in witness O'Hara's testimony. Cost coverages for subclasses of mail for which incremental costs greatly exceed volume-variable costs are set with consideration to the contribution made to institutional costs after the specific fixed costs for that subclass have been covered.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-16. At USPS-T-32, p.18, lines 5-20, you cite to witness O'Hara's direct testimony in Docket No. R97-1, USPS-T-30, pp. 14-16, which purports to show alleged inefficiencies arising from calculating cost coverages based on attributable costs or incremental costs. You state at lines 16-20 that the example allegedly shows an inefficiency because one product will be limited to applications where its value is equal to the *rate* resulting from the markup, whereas for the other product the last unit will be exactly worth its *volume-variable cost*.

- a. Please confirm that witness O'Hara's example in fact purports to show that both products will be limited to applications where the product is worth to the customer an amount equal to the rate produced by the markup (33 cents and 27 cents respectively in Witness O'Hara's example) and in no case would the last application be worth to the customer an amount equal to volume-variable cost.
- b. If you cannot confirm, please explain why not.

Response:

- a. Confirmed.
- b. Not applicable.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-17. At USPS-T-32, p.18, lines 9-16, you discuss an example where two subclasses have identical volume-variable cost and identical evaluation on the pricing criteria of the act, yet one of those subclasses has specific fixed costs.

- a. Please confirm that if the ratio of revenue to volume-variable costs is used to assess the burden of meeting the revenue requirement, both pieces of subclasses of mail will pay the same postage per piece and make an identical cent per piece contribution over and above the volume-variable cost.
- b. If you confirm (a) above, do you believe the resulting rates violate the standards of unfairness and inefficiency referred to at p. 18, line 7? Explain fully your answer.

Response:

- a. Both pieces will pay the same postage per piece and the difference between their postage per piece and volume-variable cost per piece will be the same.
- b. No. Please refer to my testimony at page 18, lines 16 through 20 and to the testimony of witness O'Hara from Docket No. R97-1 (USPS-T-30, pages 14-16). Evaluation of pricing decisions necessitates examination of the resulting changes in costs and revenue. In the examples discussed by witness O'Hara and myself, the emphasis is on the fairness and efficiency of the prices facing the marginal piece, the next additional piece of mail in each subclass. Each additional piece will impose the unit volume-variable cost on the postal system. The specific fixed costs for one of the subclasses was not imposed by the next additional piece, and will not go away should that piece not materialize. Stepping outside of the

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Response to NAA/USPS-T32-17, cont'd

example for a moment, I would note that for subclasses of mail with specific fixed costs, the proposed rate levels were set such that, not only would the incremental costs be covered (criterion 3), but that the excess of revenue over volume-variable costs would be sufficient to not only cover the specific fixed costs but also provide a meaningful contribution to institutional costs as well.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-18. At USPS-T-32, p. 20, lines 10-16, you propose a 196 percent cost average [sic] for First Class Mail, which you note results in a one cent increase in both the first and additional ounce rate for single piece First Class letters.

- a. What role did the one cent increase in the first and additional ounce rates play in your selection of the cost coverage for First Class Mail?
- b. Identify precisely the role that cost coverages, percentage rate increase and unit rate changes (cents per ounce) played in establishing the proposed rate levels and rate design discussed in your direct testimony, p. 20, line 8 to p. 23, line 9.
- c. Did you apply any of the Section 3622(b) ratemaking criteria to the one cent increase for the first and additional ounces of First Class mail as described at p. 20, lines 14-15 of your testimony? Please explain fully.
- d. Did you consider the costs associated with additional ounces in First Class mail in selecting the proposed coverage for First Class Mail? If so, please explain how those costs affected your selection of a proposed cost coverage.

Response:

- a. My testimony does not state that the cost coverage "results" in a one-cent increase in the first or additional ounce rates. Because of the prominence of the rate for the first ounce of First-Class letters, both in terms of revenue generation as well as visibility, it merits special attention from postal management as well as in the development of the First-Class cost coverage. In most recent omnibus rate proceedings, the systemwide rate increase has been very closely mirrored by the rate increase for the first ounce of First-Class Mail single-piece letters, due to the prominence of that category of mail in terms of revenue and contribution, and to what had been the patterns of cost incurrence for First-Class Mail and the postal system as a whole. In this case, the change in the first-ounce rate does not mirror so closely the systemwide rate increase. Establishing the

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

Response to NAA/USPS-T32-18, cont'd

actual rate design within the subclass in conjunction with the target cost coverage is the responsibility of witness Fronk (USPS-T-33). As the target cost coverages for all subclasses of mail were developed, I was aware of the limited number of rate elements within the First-Class rate structure, and the fact that small changes in many of those rate elements could result in significant shifts in revenue. I would not characterize the direction of causality the way that your question has.

- b. Please see my response to subpart a above. The cost coverage was of concern to me, particularly as it represented an increase relative to the Commission's recommendation in recent cases. The percentage increase was of concern to me, in deference to criterion 4. However, unit rate changes, the development of the actual set of rate elements within the subclass, were the responsibility of witness Fronk.
- c. Not explicitly. Please refer to my responses to subparts a and b above.
- d. No. Please refer to my responses to subparts a and b above.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-19. At USPS-T-32, p. 35, lines 13-15, you state that the proposed average rate increase for Standard Mail (A) Regular is 9.4 percent, resulting in a proposed coverage of 132.9 percent over volume-variable costs.

- a. Identify in detail all considerations which led you to conclude at p. 36, lines 11-14 that the fact that this proposed increase is greater than the system average increase (stated to be 6.4% at p. 36, line 7) "suggests that competitors are not unfairly targeted by this increase."
- b. What evidence would be necessary in your opinion to conclude that competitors had been unfairly targeted by a Postal Service rate proposal?
- c. Identify all factors you considered in concluding that the average rate increase for Standard Mail (A) Regular should be 9.4 percent in order to comply with the statutory ratemaking criteria.

Response:

- a. The percent increase is higher than the system average and higher than the overall rate of inflation since the last rate change. These have been used in the past as benchmarks against which to measure rate changes. Please refer to my responses to your interrogatories NAA/USPS-T32-6 and NAA/USPS-T32-7.
- b. As I noted in my response to your interrogatory NAA/USPS-T32-6, I would expect competitors to question the rationale for rate increases for competitive services which were substantially below the benchmarks listed in subpart a above. Other information, such as details about competitors' costs, prices and volumes, much of which would be known only to those competitors themselves, would be helpful to guard against creating a harmful impact on competing firms.
- c. Please refer to my testimony at pages 35-37. In addition, I was aware of the relationships among the cost coverages and resulting rate increases

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

Response to NAA/USPS-T32-19, cont'd

for Regular and Nonprofit. I also recognized the goal of postal management to keep a relatively narrow range of rate increases when possible while appropriately considering the pricing criteria as well as the relative importance of Standard Mail (A) Regular to postal revenue and contribution.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-20. Please refer to the proposed Standard Mail (A) Regular average rate increase of 9.4 percent and the proposed average rate change for the Enhanced Carrier Route (ECR) subclass of 4.9 percent. Please provide any information that you believe represents a change in circumstances and facts between the Commission's decision in Docket No. R97-1 regarding Standard Mail (A) and ECR and the time you prepared your direct testimony.

Response:

As I have noted elsewhere, such as in my responses to OCA/USPS-T32-4 and to NAA/USPS-T32-5, percentage increases and cost coverages must be developed for all subclasses such that the set, taken together, provides for financial breakeven, and comports with the pricing criteria. Thus, proposed changes in rates for any one subclass cannot be viewed in isolation. However, I will note by reference to my Table 2 on page 6 of my testimony and to Table B-1 of witness O'Hara's testimony in Docket No. R97-1 (USPS-T-30) that the reported own-price elasticities for both Regular and ECR are higher in this case than in R97-1. Please refer to the Docket No. R2000-1 testimony of witnesses Tolley (USPS-T-6) and Thress (USPS-T-7) for discussion of the elasticities. The higher measured elasticities would result in more substantial reductions in volume for these two subclasses in response to increases in rates than would have been the case in R97-1.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-21. At USPS-T-32, p. 38, lines 4-8, you state that the Postal Service is proposing a cost coverage of 208.8 and a 4.9 percent average rate increase, "...reflecting a desire to lower the very high cost coverage of this subclass."

- a. Please identify all factors taken into account in determining that a reduction in ECR cost coverage would be desirable and how the specific value for the desired reduction was determined.
- b. Did a desire to reduce the pound rate for pound rates ECR pieces or any other rate design criteria affect the determination of the desired cost coverage? Explain your answer in detail.

Response:

- a. It is my understanding that ECR was established as a subclass with the intent of more directly reflecting the unique cost and market characteristics of this mail. As a rate category of Standard Mail, the ratio of revenue to cost for this category had been very high. Establishing ECR as its own subclass permits the direct application of the pricing criteria which, when considered all together, may justify a lower ratio of revenue to cost than had been the case when ECR was only a rate category. However, as a look at Library Reference LR-I-149 would demonstrate, the cost coverage for ECR as proposed by the Postal Service does not represent a reduction in the cost coverage relative to what the Commission recommended in Docket No. R97-1. There is a disconnect between the desire to reduce the cost coverage and the conclusion, after considering all of the pricing criteria, that a reduction would not be feasible at this time without shifting the burden for institutional cost recovery to other subclasses and possibly exacerbating the relatively high rate

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

Response to NAA/USPS-T32-21, cont'd

increases or cost coverages already being borne by those subclasses.

Please see my response to your interrogatory NAA/USPS-T32-23.

- b. As I stated in my responses to interrogatories NAA/USPS-T32-11, I was aware of the possibility of rates for ECR basic bumping into the rates for Automation 5-digit rate in Standard Regular. Consideration of the possible crossover did not, however, restrict development of the cost coverages for these subclasses such that they could not be developed independently of each other. In general, any issues of rate design within the subclass were left to witness Moeller (USPS-T-35).

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-22. At USPS-T-32, p. 36, lines 6-8, you state that a 9.4 percent increase, higher than the system average of 6.4 percent, for Regular Standard A will have a "...noticeable, but reasonable impact on the users...." Please identify all factors you considered in reaching this conclusion.

Response:

Please refer to my response to your interrogatory NAA/USPS-T32-3 where I describe my usage of the elasticities. As various sets of rate levels and associated percentage rate increases were tested in an effort to develop the set of rate level proposals, I did monitor the impact on volume as well as revenue and contribution from Standard Mail (A) Regular. The volume from TYBR to TYAR for Standard Mail (A) Regular fell about 4 percent.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-23. Please refer to p. 39, lines 15-16, of your testimony. Explain in detail how you determined that the ratemaking factors identified by you "...would indicate a cost coverage even lower than that actually proposed" (p. 39, lines 15-16) and how concern over "...shifting the additional burden of covering institutional costs to other subclasses" (p. 39, lines 16-17) offset these factors in your view.

Response:

ECR is a large enough subclass that it represents a substantial contribution to institutional cost recovery (see my Exhibit USPS-32B). As I already had several subclasses for which criterion 4, impact of rate increase on mailers, would necessitate that their share of institutional burden be somewhat mitigated due to large increases in their costs, I was aware that there were not very many sources for this additional contribution. Please refer to my testimony where I discuss the application of the pricing criteria to the development of the cost coverage for ECR. I will note, briefly, that consideration included the relatively low value of service for ECR which would argue for a lower cost coverage (criterion 2) and the fact that costs were more than adequately covered (criterion 3).

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-24. At USPS-T-32, p. 39, lines 15-16, you state that "The average rate increase for ECR is slightly below the rate of inflation..." (p. 38, line 19) and "...below the system average in this case...." (p. 39, lines 14-15).

- a. Please provide the rate of inflation and system average upon which you base this statement.
- b. Please describe all factors that you used in applying the indicators mentioned at p. 8, lines 10-13, to Standard (A) ECR Mail.
- c. Please explain why you believe that the proposed average rate increase for ECR Mail, which you label a "modest" 4.9%, satisfies the "fairness and equity criterion (criterion 1)" (p. 39, lines 18-20).

Response:

- a. Please refer to my response to your interrogatory NAA/USPS-T32-6b.

The rate of inflation shown in witness Tayman's response to DMA/USPS-T9-16 for the rate of inflation over the rate cycle between R97-1 and R2000-1 is 4.8 percent, which is slightly below the rate increase for ECR.

At the time that I prepared my testimony, I was apparently working with an earlier forecast of inflation which was just over 5 percent. I will file a correction to my testimony at page 38, line 19 to reflect that change.

Given the closeness of the two numbers, however, I do not believe that the change is substantive.

- b. As I noted in my responses to your interrogatories NAA/USPS-T32-6 and NAA/USPS-T32-19, these measures are merely useful benchmarks against which to gauge the relative fairness of the resulting percent rate increase and cost coverage. I would not say that they were determinant in setting the percentage increase.
- c. Please refer to my testimony where I discuss the development of the cost coverage for ECR. Please also refer to my responses to your

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

Response to NAA/USPS-T32-24, cont'd

interrogatories NAA/USPS-T32-21 and NAA/USPS-T32-23. Although the rate increase for ECR is below the system average of 6.4 percent, the rate increase is above the rate of inflation. And, as can be seen in my Exhibit USPS-32C, this subclass of mail is bearing a substantial portion of the burden of institutional cost recovery.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-25. Please explain what "need to maintain rate relationships across subclasses" (p.39, lines 18-19) is accomplished by an ECR average rate increase of 4.9% and precisely how that need is satisfied by your proposals regarding ECR rate levels.

Response:

Please refer to my response to your interrogatories NAA/USPS-T32-11 and NAA/USPS-T32-21.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-26. At p. 39, lines 2-4, you state that among the range of alternatives available to ECR mailers, "...both alternate delivery firms and newspaper inserts may provide ways of delivering the same advertising message that would be carried in ECR." Did this availability influence the specific rate increases and cost coverages you proposed for ECR?

- a. If your answer is no, explain in detail why not.
- b. If your answer is yes, explain in detail how this availability affected your proposed rate increase and cost coverage.

Response:

Yes.

- a. Not applicable.
- b. Please refer to my response to your interrogatory NAA/USPS-T32-8 and to my response to DFC/USPS-40.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-27. USPS Witness O'Hara in Docket No. R97-1 proposed a percentage rate increase for ECR below that of the system wide increase and a cost coverage of 228 percent (USPS-T-30, p. 34, lines 18-19).

- a. Do you believe that applying Witness O'Hara's proposed cost coverages for ECR Mail in Docket No. R97-1 would violate the ratemaking criteria as applied to ECR in this proceeding as discussed by you at p. 38, line 3 to p. 39, line 20? Explain your answer in full.
- b. Do you agree with Witness O'Hara (USPS-T-30, Docket No. R97-1, at p. 36, lines 4-9):

...a lower coverage for ECR would have made it more difficult to design rates to that the Automation 5-digit rate in Standard Regular was below the ECR basic rate, encouraging the movement of ECR basic letters into the automation mailstream. As has been the case since at least Docket No. MC95-1, this is an important operational goal of Postal Service management.

Explain the basis for your answer.

Response:

- a. Yes. The resulting percentage increase would have been large. The cost coverages are not comparable because of the shifting of the systemwide average. In addition, as I noted in my response to NAA/USPS-T32-20, the own-price elasticity for ECR reported in this case by witnesses Thress (USPS-T-7) and Tolley (USPS-T-6) is higher than the elasticity reported in Docket No. R97-1.
- b. Yes. It was my understanding that postal management was still concerned with the possibility of rate crossover in this area. Please refer to my responses to your interrogatories NAA/USPS-T32-11 and NAA/USPS-T32-21. As I noted therein, rate design issues were the primary responsibility of witness Moeller (USPS-T-35).

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-28. Did criteria 8 (educational, cultural, scientific and informational value to the recipient) as mentioned by you at p. 11 lines 17-22, play any part in your proposals for the subclasses of Standard A Mail? Explain fully your answer.

Response:

No. In keeping with past practice, I did not consider the ECSI value of Standard A Mail to warrant mitigation of the cost coverages for this material.

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NAA/USPS-T32-29. According to Exhibits USPS-32A, p. 1 of 2 and USPS 32B, p. 1 of 2, the effect of your proposals is to cause the cost coverage of Standard A (Regular) to increase from 121.4 to 132.8 and of Standard (A) ECR from 199.2 to 208.8. Explain why these proposed changes satisfy the "need to maintain rate relationships across subclasses" and otherwise accomplish desirable ratemaking standards.

Response:

Please refer to my responses to NAA/USPS-T32-27, NAA/USPS-T32-11 and NAA/USPS-T32-21. Cost coverages, while useful in understanding the allocation of institutional cost burden, ultimately tie to rate changes. The rates which result from the application of cost coverages and rate design concerns would be of more primary concern in maintaining rate relationships than would be the cost coverages.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

NAA/USPS-T32-30. Please refer to the following passage from the Opinion of the Postal Rate Commission, in Docket No. R97-1, [section] 4005:

...the Commission relies on the precedential value of its past evaluations of the evidence as a starting point and then evaluates new evidence presented to determine whether changes from its past allocation decisions are appropriate.

- a. Do you agree or not that this procedure is an appropriate method for "...making reasoned assignments of institutional costs to the subclasses of mail"? Explain your answer.
- b. Did the Commission's recommended cost coverage and percentage rate increase for ECR Mail in Docket No. R97-1 affect your proposed cost coverages and percentage rate increases in this proceeding? Explain your answer in detail.

Response:

- a. I agree that there is value in the precedent set by previous cases.

Markups and cost coverages developed in previous cases can be good starting points because they have been found to satisfy the pricing criteria, given the circumstances of that case. I would caution, however, as I did in my response to your interrogatory NAA/USPS-T32-6, that when examining the differences between one case and another, care must be taken to determine the basis for the original starting point. There may have been mitigating circumstances necessitating a shift from what would otherwise have been the result. For instance, in a previous docket, the desire to reduce what had been viewed in an even more distant case as an excessive cost coverage may have been thwarted by the need for that subclass of mail to shoulder some of the institutional cost burden that would otherwise have been borne by another subclass of mail, but for the

- b.

RESPONSE OF POSTAL SERVICE WITNESS MAYES TO NAA INTERROGATORIES

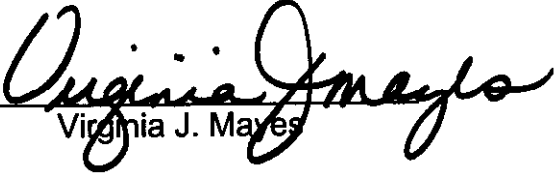
Response to NAA/USPS-32-30, cont'd

desire to mitigate the rate shock on the second subclass caused by its large increase in costs.

- c. Yes. In deference to criterion 4, the effect on mailers, I did look at the rate increase that ECR mail received in Docket No. R97-1. I was also aware that the cost coverage being proposed in this case represented a higher markup but a lower markup index than did the Commission's recommendation in Docket No. R97-1.

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: 3-8-00

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 "Michael T. Tidwell", written in a cursive style.

Michael T. Tidwell

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2998 Fax -5402
March 8, 2000