

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

**RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS MOELLER TO INTERROGATORIES OF THE NEWSPAPER
ASSOCIATION OF AMERICA
(NAA/USPS-T35—1-40)**

The United States Postal Service hereby provides the responses of witness Moeller to the following interrogatories of the Newspaper Association of America: NAA/USPS-T35—1-40, filed on February 25, 2000.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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NAA/USPS-T35-1: Please refer to USPS-T-35-1, p.1, line 5 of your direct testimony.

- a. Please explain how the rates for Standard Mail (A) were developed using ".... rate level requirements developed by Witness Mayes (USPS-T-32)."**
- b. Please describe precisely the form in which these rate level "requirements" were developed.**

RESPONSE:

- a. The rate design formula requires, as an input, a markup on test year before rates volume variable costs. Selection of this input is related to the eventual after rates cost coverage described and supported by Witness Mayes.**
- b. See witness Mayes' testimony for discussion of the pricing criteria (pages 2-12) and the development of the proposed rate levels for Standard Mail (A) (pages 35-40).**

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NAA/USPS-T35-2: Did Witness Mayes provide you with an estimated 208.8% ratio of revenue to volume-variable cost for the Enhanced Carrier Route (ECR) Subclass (USPS-T-32, p.38, lines 4-6)?

- a. If so, did she provide you with a range, or was there some other procedure used?**
- b. If so, was Witness Mayes's 208.8% ratio treated as a constraint provided to you or was the 208.8% ratio a result provided by you to Witness Mayes?**
- c. Was the 208.8% ratio the result of an "iterative process" as described in Witness Mayes' testimony (USPS-T-35, at p.4, lines 15-16) or was some other procedure used?**

RESPONSE:

No.

- a. Not applicable.**
- b. Not applicable.**
- c. Yes.**

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NAA/USPS-T35-3: If you provided any information to Witness Mayes regarding rate level requirements, please identify the information and how it was used.

RESPONSE:

I did not provide information regarding the general rate level requirements. I did provide the calculation of the revenue that is used in the calculation of the resulting cost coverages for the Standard Mail (A) subclasses.

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NAA/USPS-T35-4: Please describe in detail the manner in which the final specific ratios of revenue to volume-variable cost were determined.

RESPONSE:

The numerator of the ratio is the expected revenue in the test year at the proposed rates. The expected revenue is calculated by applying the proposed rates to the expected volume in the test year. (see USPS-T-35, WP1, pages 22-24). The denominator is the expected volume-variable cost in the test year for the volume expected at the proposed rates. (see USPS-T-35, WP1, page 16, Column 6). The ratios are calculated on USPS-T-35, WP1, page 25.

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NAA/USPS-T35-5: At USPS-T-35, p.3, line 21, you state that one of the inputs into the rate design formula for Standard Mail (A) was "the target cost coverage for the subclass." At p.4, lines 15-16, you state that decisions on rates are made "after an iterative process that is employed until the rate design objectives are met." Your WP1, p.20, line 2, states that the "assumed" markup is 2.090 for the commercial ECR subclass.

- a. Is the term "assumed markup" in the rate design formula in your workpapers the same as the "cost coverage" as used by Witness Mayes, only converted from percentage terms to decimal format?
- b. Please provide all details regarding how the 2.090 assumption was reached, including whether any other target markups or cost coverages were also considered and whether the process of determining the markup was iterative or reached by another process.
- c. If any other target markups were considered, please identify all target coverages considered and rejected, and the reasons why they were rejected.

RESPONSE:

- a. They relate to the same principle, but they are not identical.
- b. When I selected the precise figure of 2.090, I was aware of the percentage rate change that it, in conjunction with the selected passthroughs and other decisions in the rate design, would generate. Through discussions with witness Mayes and experience gained through iterations, I was aware that this would likely generate the desired after-rates cost coverage.
- c. While I certainly entered numbers into the formula that were somewhat different from the 2.090 figure during the course of the development of the proposed rates, I do not recall precisely what they were. They were "rejected" if they generated too much or too little revenue.

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NAA/USPS-T35-6: Please refer to your WP1, p.17, line 2, where it is stated that the "assumed" markup for the Regular subclass is 1.331.

- a. Please provide all details regarding how the 1.331 markup assumption was reached, including whether the 1.331 markup was the only markup considered and whether the process of determining the markup was iterative or another process was used.**
- b. If any other target coverages were considered, please identify all target coverages considered and rejected, and the reasons why they were rejected.**

RESPONSE:

- a. When I selected the precise figure of 1.331, I was aware of the percentage rate change that it, in conjunction with the selected passthroughs and other decisions in the rate design, would generate. Through discussions with witness Mayes and experience gained through iterations, I was aware that this would likely generate the desired after-rates cost coverage. While I entered numbers into the formula that were somewhat different from the 1.331 figure during the course of the development of the proposed rates, I do not recall what they were. They were "rejected" if they generated too much or too little revenue.**
- b. See response to a.**

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NAA/USPS-T35-7: Witness Mayes's direct testimony (USPS-T-32, p.38, lines 4-6) contains a recommended cost coverage for the ECR subclass expressed as four digits for ECR Mail (208.8%). Your input for the cost coverage in the rate design formula also has four digits (209.0% after conversion to percentage - - please see WP1, p.20).

- a. Please explain in detail the manner in which your "assumed" 209.0 ratio was determined, including whether a target cost coverage ratio was provided to you with four digits or in some other format?
- b. Please explain the discrepancy between the 209.0% "assumed" markup used as an input in the rate design formula in your workpapers and Witness Mayes's recommended ratio of 208.8.

RESPONSE:

- a. I did not receive a 4-digit target cost coverage. See response to NAA/USPS-T35-5b.
- b. They are two related figures, but are not intended to necessarily match. The 209.0 figure is applied to test year before-rates costs as a way to estimate the revenue required from the rates to be developed. The 208.8 figure is the resulting ratio of the after-rates revenue and after-rates volume variable costs that are derived from the rates that were developed. Due to the volume mix changes when moving from before to after rates and related cost shifts, it is not unexpected that the numbers do not match.

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NAA/USPS-T35-8: Witness Mayes direct testimony (USPS-T-32, p.35, lines 13-15) contains recommended cost coverage for the Standard Mail (A) Regular subclass which has four digits (132.9%). Your input in the rate design for this subclass also has four digits (133.1% after conversion to percent -please see WP1, p.17).

- a. Please explain in detail the manner in which your "assumed" 133.1 ratio was determined, including whether a target cost coverage ratio provided to you with four digits or in some other format.
- b. Please explain the discrepancy between the 133.1% "assumed" markup in the rate design formula and Witness Mayes's recommended ratio of 132.9%.

RESPONSE:

- a. I did not receive a 4-digit target cost coverage. See response to NAA/USPS-T35-5b.
- b. They are two related figures, but are not intended to necessarily match. The 133.1 figure is applied to test year before-rates costs as a way to estimate the revenue required from the rates to be developed. The 132.9 figure is the resulting ratio of the after-rates revenue and after-rates volume variable costs that are derived from the rates that were developed. Due to the volume mix changes when moving from before to after rates and related cost shifts, it is not unexpected that the numbers do not match.

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NAA/USPS-T35-9: At USPS-T-35, p.2, line 18-19, you recommend a 9.4% revenue/piece increase for Regular Standard (A) Mail and 4.9% for the ECR subclass.

- a. Please explain in detail how were these percentages determined, including whether the percentages were provided to you, calculated by you as a result of attempting to achieve a particular cost coverage, calculated by you as consequences of achieving your objectives of rate design, or by some other approach.**
- b. Were any other percentage rate changes considered?**
- c. If the answer to (b) is yes, please identify all percentage rate increases considered and rejected and the reasons why they were rejected.**

RESPONSE:

- a. These percentages are calculated in WP1, pages 26-28. They were calculated by me. They are the result of the various rate design decisions described in my testimony, along with the selected markup that was necessary to generate the desired revenue and resulting cost coverage. Also, the percentage changes were consistent with witness Mayes' expectations associated with the cost coverage target.**
- b. During the preparation of the proposed rates, alternative rate design decisions and markups resulted in percentage changes different from those eventually proposed. Simply changing a passthrough for an individual discount can generate a different overall percentage rate change. I would not describe these resulting percentage changes as having been "considered" in that, oftentimes, the resulting percentage change was not even checked before further changes were made in passthroughs, or other rate design inputs.**
- c. I certainly generated different sets of rates while entering various inputs into the formula and rate design workpapers, and those different sets of rates**

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had, as a by-product, different percentage rate changes. It was not necessarily the percentage changes that were rejected, but rather the rates did not meet the rate design objectives.

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NAA/USPS-T35-10: At USPS-T-35, p.4, line 16, you refer to "rate design objectives" which were accomplished via an "iterative process." Please identify all of the rate design objectives employed in this process and precisely how they affected the rate design.

RESPONSE:

Many of the rate design objectives are discussed throughout my testimony, but a list of them would include the following:

Recognize worksharing efforts through discounts – In keeping with the longstanding worksharing program, various discounts are offered to encourage mail preparation that results in lower costs.

Limit the percentage increase for individual rate cells to avoid "rate shock" – As discussed at page 4, lines 16-20, passthrough selection may be affected by the limitation on percentage rate increases.

Monitor cells that are pushed up in order to finance the limitations mentioned above – Limiting increases on one rate cell is likely to cause an increase in the percentage change for other rate cells. The manner in which the limitation is achieved should be selected so as to not inordinately burden any particular grouping of mail.

Limit the reduction in the level of the discounts since the established discounts have led to significant mailer investment – See my testimony at page 11, lines 13-20.

Create appropriate rate relationships (for example, 5-digit automation and Basic ECR) – See my testimony at page 12, lines 3-11.

Avoid anomalies (for example, letters having rates higher than comparable flats)

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– The rate design process attempts to monitor potential anomalies. For example, see page 32, lines 3-8.

Provide for more cost-based rates – Increasing the residual shape surcharge and lowering the pound rate are examples of this objective.

Overall reasonableness of results -- While the above list is considered comprehensive, that is not to say that other factors would never surface that require attention in the eventual rate design.

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NAA/USPS-T35-11: At USPS-T-35, p.4, line 18, you refer to "an upper bound on the amount by which an individual rate cell is proposed to increase." Please identify precisely what upper bound you imposed and how it was determined.

- a. What specific rate cells were affected and precisely how were they affected? Please identify the affected passthrough percentages and the effect of the constraint on the selected passthrough in each case.**
- b. Did the "upper bound" affect rate proposals other than through the selection of the passthroughs? Please identify all such constraints and their effects on proposed rates.**
- c. Was there also a lower bound to the proposed rate categories?**
- d. If the answer to (c) is yes, please identify the lower bound, how it was determined, and how specific rate categories were affected.**
- e. If the answer to (c) is no, please identify in detail why not.**

RESPONSE:

The cited passage refers to the Regular subclass. The upper bound on the non-destination entry minimum-per-piece rate cells was generally 14 percent. Given the overall percentage increase for the subclass, rate cell increases in excess of 14 percent were considered excessive and therefore were to be avoided unless doing so required actions that were counter to the other rate design objectives.

- a. The rate cell which was most affected was 3/5-digit automation flats, although all cells were affected since limiting the increase for one cell may cause an increase in other cells. While it is impossible, due to the complexity of the rate design and the interdependency of the passthroughs, to discuss the effect of each passthrough individually, in general, the limit on the 3/5-digit automation flat increase was achieved by a high passthrough on the automation discount, and a limitation on the absolute increase in the letter/nonletter rate differential.**
- b. The passthroughs were the mechanism employed to limit the rate increases.**

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- c. No; however, that is not to say there would not have been one had the rate iterations included a large percentage decrease for a particular cell.
- d. Not applicable.
- e. There was not a perceived need to limit reductions, as they did not appear to be unreasonable.

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NAA/USPS-T35-12: At USPS-T-35, p.4, line 20 to p.5, line 1, you state that "passthroughs [were] adjusted in order to maintain the desired relationship" between "5-digit automation and Enhanced Carrier Route Basic."

- a. Please identify precisely how the proposed rates were affected, the amount of the rate difference between the two rate categories thought desirable, and the method used to determine the desired rate differential.**
- b. Was consideration given to achieving the desired rate relationship between the rate categories by adjusting upward the target cost average [sic] for ECR?**
- c. If the answer to (b) is yes, explain why this alternative was rejected. If the answer to (b) is no, explain in detail why not.**

RESPONSE:

- a. The current rate differential is two-tenths of a cent. The "method used to determine the desired rate differential" was to look at the existing rate differential and try to at least maintain it. As described on page 12, lines 3-11, the passthrough for the 5-digit automation discount was the principal tool used to create the rate relationship.**
- b. The selection of the target coverage for ECR is beyond the scope of my testimony, but I note that witness Mayes (USPS-T-32 at pages 38 and 39) mentions that the proposed cost coverage helps maintain rate relationships across subclasses.**
- c. The rate relationship can be maintained through a combination of passthrough selections in the ECR and Regular subclass, and cost coverage assignment in the ECR subclass. They are not necessarily "alternatives" in that one has to be done in isolation from the other. See response to subpart (b). Also, since the rate differential is 3/10ths of a cent, the "desired" rate difference of at least 2/10ths of a cent could have been met with a lower cost coverage for ECR.**

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NAA/USPS-T35-13: Were rate relationships between Standard A rate categories and those of any other class or subclass of mail considered?

- a. If the answer is yes, did these relationships affect the cost coverage of any subclasses, the rate design, or both?**
- b. If the answer is no, please explain in detail why the relationships between Standard A rate categories and those of any other class or subclass of mail were not considered.**

RESPONSE:

Yes.

- a. No.**
- b. Not applicable.**

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NAA/USPS-T35-14: At USPS-T-35, p.5, lines 1-3 of your testimony, you state that the rate design process started with "passthroughs underlying the current rates, with modifications to meet rate design objectives." Please explain in detail the basis for the answers to the following questions:

- a. Was one of the objectives to move towards a rate design incorporating 100% passthrough of cost differences?
- b. Are the starting passthroughs expressed in percentage terms or in actual cents per piece or pound?

RESPONSE:

- a. Not in particular, although that is not necessarily an unworthy objective. In general, the rate design attempts to recognize as much of the measured cost difference that is appropriate and possible. In the cited passage, however, I was speaking more in terms of limiting rate increases and maintaining a significant portion of the existing discounts.
- b. Percentage terms.

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NAA/USPS-T35-15: At USPS-T-35, p.7, line 2, you state that the proposed surcharge recovers 27.48% of the increased costs of pieces that are not letter- or flat shaped, or are prepared as parcels (the "Residual Shape Surcharge"). At p.7, line 15, you refer to the "offsetting effects of the lower pound rate." And at p.8, lines 14-15, you state that "the increased surcharge further reduces the need for the pound rate to act as a proxy for the changing shape mix as weight increases."

- a. Does the fact that these pieces remain "contribution challenged" (p. 8, line 3) lead you to conclude that the pound rate continues to serve as a proxy for the changing shape mix as weight increases?**
- b. If the answer to (a) is not an unqualified yes, please explain the basis for your answer.**

RESPONSE:

- a. The conclusion regarding the proxy-playing role of the pound rate was not based solely on the fact that parcels do not cover their costs.**
- b. I did not base the comment regarding the pound rate as a proxy for shape on the fact that parcels do not cover their costs. (In fact, the "contribution-challenged" comment was intended to address the availability of special services to parcel-shaped piece.) Rather, in my testimony at page 8, I acknowledge that in previous cases the Postal Service maintained that the pound rate acted as a proxy for the changing shape mix as weight increases. To the extent that is true, imposition of a shape-based surcharge suggests that the upward pressure that the proxy role places on the pound rate should be reduced.**

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NAA/USPS-T35-16: At USPS-T-35, p.8, lines 5-6, you propose a reduction in the basic pound rate for the Regular subclass from 67.7 cents to 66.1 cents. At p.4, lines 3-7,12-13, you state that the pound rate was determined as an input to the rate design formula, not a solution. At p.8, line 5 to p.9, line 4, you identify your considerations in proposing the change in the pound rate.

- a.** Please confirm that the considerations were (1) "the increased surcharge further reduces the need for the pound rate to act as a proxy for the changing shape mix as weight increases," (2) a "new cost study examining the effect of weight on costs" sponsored by Witness Daniel (USPS-T-28) and (3) "tempering the percentage increase for individual categories" by avoiding "an increase in the piece rate beyond that proposed."
- b.** If you cannot confirm (a) identify all other factors considered.
- c.** Please explain in detail how all the considerations identified in (a) and (b) above resulted in the specific proposal to reduce the pound rate in the regular subclass from 67.7 cents to 66.1 cents.

RESPONSE:

- a.** My testimony speaks for itself, but, yes, these were considerations made regarding the proposed pound rate.
- b.** Not applicable.
- c.** This history of the pound rate as a shape proxy led me to believe that at least some reduction in the pound rate was warranted. The 1.6 cent reduction is very modest in that for the heaviest parcel, it only offsets 8.9 percent of the proposed surcharge. ($1.6/18 = 8.9\%$). The percentage offset is lower for lighter-weight parcels. The new cost study was not used in any quantitative manner, as described in my testimony at page 8, lines 21-22. In addition, consideration of the upward effect on the piece rates led me to limit the reduction to a modest 1.6 cents.

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NAA/USPS-T35-17: At USPS-T35, p.11, lines 4-5, you refer to "rate design objectives" that would be defeated with a 100% passthrough of the cost avoidance due to presortation. Please identify precisely these rate design objectives and how they would be accomplished by departing from 100% passthrough.

RESPONSE:

As discussed at page 4 of my testimony, lines 14-16, the selection of passthroughs and other rate design decisions is an iterative process, and the decisions are interdependent. If the passthrough in question were changed to 100 percent in isolation of any other changes, however, it would have a push-up effect on the basic rates, most notably the Basic letter automation rate. Avoiding the nearly 10 percent increase that would result for automation letters with a passthrough of 100 percent is the type of "rate design objective" to which the cited passage refers. Basic automation letters and 3-digit automation letters bear the brunt (by virtue of their high volume) of the effort to limit the increases for automation flats (see page 5, line 16 through page 6, line 1). Deviating slightly from 100 percent on the cited passthrough offers some offsetting relief to the Basic automation letter category.

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NAA/USPS-T35-18: At USPS-T-35, p.11, line 23 to p. 12, line 11 you refer to adjustments to increase the passthroughs of cost avoidances due to mailer preparation of automation letters to 160%. You state that this adjustment is designed to encourage mailer use of 5-digit automation regular subclass rather than ECR basic.

- a. Did you consider achieving this objective by limiting the 5-digit automation letter passthrough to 100 percent and instead accomplishing this objective by raising the cost coverage for ECR?
- b. If so, please explain why this alternative was rejected.
- c. If not, please explain in detail why not.

RESPONSE:

a-c. I did not consider increasing the cost coverage for ECR as that was beyond the scope of my testimony. Please see response to NAA/USPS-T35-12.

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NAA/USPS-T35-19: At USPS-T-35, p.12, lines 6-7, you state that the rate for five digit automation letters is less than the ECR basic rate and "[t]his has led to significant beneficial changes in mail preparation." Please identify precisely what these beneficial changes are and provide any data or study of which you are aware that identifies the amount of mail volume affected.

RESPONSE:

Witness Kingsley discusses the growth in volume of barcoded letters and the derived benefits (USPS-T-10 at pages 8-9 and 25). It is my general understanding that 5-digit automation letters can be sorted to Delivery Point Sequence (DPS) on automation, whereas Basic carrier route letters either have to be sequenced manually by the carrier, or sent to mail processing to be barcoded and then sorted to DPS. In Docket No. R97-1, it was estimated that 5-digit automation letters represented 30.9 percent of the combined Basic ECR letter and 5-digit automation letter volume in the test year before rates scenario. In the after rates scenario, which included the desired rate relationship, the percentage grew to 66.5 percent. This represented a growth of over 3.3 billion automation letters in the Regular subclass. (Docket No. R97-1, PRC Standard Mail (A) workpapers, Page 3). Preliminary information from work on the GFY 1999 Billing Determinants (the rate relationship went into effect during the course of the fiscal year) show that over half of the letters in this combined grouping of letters are in the 5-digit automation category. That percentage figure would be higher if the rate relationship had been in effect for the entire fiscal year.

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NAA/USPS-T35-20: At USPS-T-35, p.15, lines 2-3, you identify "the general guideline of tempering individual rate increases."

- a. What precisely were the "general guidelines"?**
- b. What "basic rates" were tempered by these guidelines and what was the effect of the tempering?**

RESPONSE:

- a. See my response to NAA/USPS-T35-11.**
- b. "Basic rates" generally refers to the basic presort tier rates produced by the rate design formula. By extension, when those rates are pushed up due to higher passthroughs of cost avoidances, many of the other rates are also increased. As discussed in NAA/USPS-T35-11, the effect of the tempering was to limit non-destination entry rate increases to near 14 percent.**

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NAA/USPS-T35-21: At USPS-T-35, p.21, lines 1-3, you refer to WP1, p.34, lines 15-16 for the source of the revenue/piece figures used for calculating before-rates and after-rates "implicit cost coverages" as follows for ECR (using 3.0 ounce dividing line for costs):

	BEFORE RATES IMPLICIT COVERAGE	AFTER RATES IMPLICIT COVERAGE
Piece Rated	200.8%	215.6%
Pound Rated	215.5%	216.1%

WP1, page 8, and WPI, page 25, respectively, calculate the following before and after rates cost coverages, respectively, for all commercial ECR mail:

ECR Mail Total	199.2%	208.8%
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- a. Please explain how the after-rates cost coverage for commercial ECR mail can be 208.8 (p.41) given the implicit coverage for piece-rated pieces of 215.6 and for pound-rated pieces of 216.1 at the 3.0 ounce cost dividing line.
- b. Please refer to p.21, lines 1-3 of your testimony, 3.5 ounce dividing line. Please explain how the after-rates cost coverage for commercial ECR mail can be 208.8 (p.41) given the implicit coverage for piece-rated pieces of 211.5 and for pound-rated pieces of 212.6 at the 3.0 ounce cost dividing line.

RESPONSE:

- a-b. The coverages at the subclass level are based on costs that are after-rates, and include a contingency. The weight-grouping costs are before rates, and do not have a contingency. The addition of the contingency leads to a lower coverage for the subclass figures, and the after-rates cost adjustment due to volume shifts might also affect the after rates coverage.

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NAA/USPS-T35-22: At USPS-T-35, p.19, line 10, to p.23, line 8, you identify the factors considered in proposing a reduction in the pound rate for the ECR subclass to 58.4 cents from 66.3 cents.

- a. Please confirm that the factors you considered were (1) "a new cost approach that supports the proposed rate" (Witness Daniel's direct testimony at USPS-T-28), (2) the per-piece rate for pound-rated mail is only \$0.003 for pound-rated Saturation non-letters, (3) the pound rate is no longer needed as a proxy for shape, because the weight-per-piece for flats and parcels is about the same, and (4) the reduction in the pound rate would have a limited impact because of the higher piece rate for pound-rated pieces, which is "designed to allay concerns for those that contend they may be disadvantaged by a significant reduction in the pound rate."**
- b. If you are unable to confirm (a), identify all other factors you considered.**
- c. Please identify how the factors identified in (a) and (b) above were used to derive the specific proposed rate of 58.4 cents.**

RESPONSE:

- a. My testimony speaks for itself. This is a paraphrasing of the considerations that is not necessarily incorrect, but a more full discussion is in the testimony.**
- b. The factors discussed in my testimony were considered when proposing the pound rate. Also, as discussed in my response to interrogatory NAA/USPS-T35-16a, any further reduction in the pound rate may have led to undesirable increases in the piece rates.**
- c. Again, my testimony discussed the factors more explicitly, but in general, factor (1) was used to confirm that indeed costs are not as weight-driven as the current pound rate might suggest, and examination of costs and revenues shows that the relative cost coverages for piece-rated and pound-rated pieces are comparable with the proposed pound rate of 58.4 cents. Factors (2) and (3) are qualitative observations about the history of the pound rate, and the questionable rate relationships that exist under the**

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current rates. Factor (4) acknowledges the apparent sensitivity to the pound rate proposals in the past and notes that the current proposed reduction is more moderate. While a larger decrease might be supportable based on the cost data, and more advantageous to small businesses that are seeking a low-cost advertising medium, the proposal limits the reduction to 58.4 cents.

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NAA/USPS-T35-23: Please refer to your direct testimony in Docket No. R97-1, USPS-T-36, pp.24-27. There you give five reasons for reducing the ECR pound rate. The five reasons are: (1) that the current rate design formula is "illogical" because, for pound-rated saturation nonletters, the rate doubles as weight doubles (although this doubling happens only at the saturation level) USPS-T-36 at 24; (2) that the pound rate no longer serves as a proxy for shape in ECR mail, because parcels constitute only a small share of ECR mail; (3) that the proposed residual shape surcharge further reduces the need for the pound rate to act as a proxy for shape; (4) that the "new cost study" filed as Library Reference LR-H-182 shows that weight plays a "very small role" in ECR costs; and (5) that a lower pound rate is needed because ECR mail "is in a competitive market and is susceptible to diversion to alternative media." USPS-T-36 at 24-26.

- a. Please confirm that of these five previously mentioned reasons, your current direct testimony includes only the first rationale.
- b. If you are unable to confirm (a), specify which of the remaining reasons identified in your Docket No. R97-1 direct testimony you believe also are applicable to the current proceeding.

RESPONSE:

- a. Not confirmed.
- b. Although the paraphrasing of points (2) and (3) may make them sound different, they are fundamentally the same as my discussion of role the pound rate has played as a proxy for changing shape mix. Also, although it is not the same cost study as provided in Docket No. R97-1 (factor (4)), there is a cost study that supports the proposed pound rate in this docket.

Although the Postal Service understands that there is competition for the type of advertising mailed in the ECR subclass, the pound rate proposal is not based on an effort to stem diversion to alternative media. See my response to interrogatory NAA/USPS-T35-22.

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NAA/USPS-T35-24: Please explain fully the extent to which the competitive status of the Postal Service in the delivery of above-breakpoint advertising mail influenced your proposed reduction in the pound rate for commercial ECR mail.

RESPONSE:

The lower pound rate is based primarily on the cost and rate design information discussed in my testimony and in my response to NAA/USPS-T35-23. The lower pound rate is not intended to divert business from other entities involved in the delivery of advertising, but the Postal Service recognizes that this product is in a competitive market, that the lower pound rate might attract advertising from small businesses that might not otherwise advertise, and that advertisers are price sensitive.

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NAA/USPS-T35-25: At USPS-T-35, p.23, lines 2-3 you state that the percentage of ECR volume over 6 ounces is 4.6 percent based on Witness Daniel's weight study.

- a. What rates were in effect at the time this weight distribution was calculated?**
- b. Do you believe that this weight distribution is representative of either the before-rates volumes in the test year, the after-rates volumes, both or neither?**

RESPONSE:

- a. The weight distribution is from FY 1998. The rates in effect at the time were the rates put in effect on July 1, 1996, as a result of the Classification Reform case.**
- b. In the rate development process, test year volume mix estimates below the level of detail provided in the volume forecast are based on the billing determinants in the base year. (See USPS-T-35, Appendix 1, page 1.) Similarly, with the mix of mail by weight increment, the FY98 data is assumed to be representative of the test year mix, both before and after rates.**

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NAA/USPS-T35-26: At USPS-T-35, p.21, lines 1-2, and p.23, footnote 44, you identify revenue/piece for piece and pound-rated ECR mail, citing WP1, p.34, lines 15-16. Column (1) of the cited workpaper refers to WP1, p.32, column 1 for the source of data on volume by ECR rate category, which in turn contains estimates of "FY01 Volume Forecast- Before Rates."

- a. Please confirm that these same before-rates volumes are used to calculate the revenue/piece using proposed rates in WP1, p.33.
- b. Was a similar calculation performed to calculate revenue/piece at current and proposed rates using after-rates volumes?
- c. If the answer to (b) is yes, please provide the comparable computation using after-rates volumes.
- d. Do you believe that your proposed changes in rate design for Standard Mail (A) will effect the distribution of pieces by rate category and weight? Please explain your answer fully.
- e. If you have accounted for the revenue and cost consequences any shifts in volume identified in part (d), identify all analysis that was undertaken.

RESPONSE:

- a. Confirmed. This is done to isolate the effect of the rate change.
- b. No.
- c. Not applicable.
- d. There may be changes in mail mix due to the proposed rates.
- e. The volume forecast provides volumes by major rate categories, so to the extent volume shifts occur due to changing rate relationships, the volume forecast may contemplate such shifts, and the after-rates revenue calculation will reflect the shifts. Also, it is my understanding that the after rates costs include after-rates volume mail mix adjustments. At levels of detail below the volume forecast (e.g., weight per piece, destination entry profile), no quantification of shifts is projected.

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NAA/USPS-T35-27: Please refer to your workpapers, WP1, p. 7 and p. 28.
They contain the following calculations:

REVENUE CATEGORY	AMOUNT (THOUSANDS)	SOURCE
Revenue from pound charge for ECR Subclass (FY01 Revenue Before-Rates) at 66.3 cents/pound.	\$1,856,544	WP1, page 7, line 16
Revenue from pound rate for ECR Subclass (TY Revenue after Rates) at 58.4 cents/pound.	\$1,635,327	WP1, page 28, line 16
Difference	\$ 221,217	

REVENUE CATEGORY	Amount (\$ MILLIONS)	SOURCE
Expected Revenue from Residual Shape Surcharge for ECR Subclass (FY01 Revenue before rates) at 15 cents / piece.	3.425	WP1, page 14
Expected Revenue from Residual Shape Surcharge for ECR subclass (FY01 Revenue before Rates) at 10 cents/piece	2.283	WP1, page 13
Difference	\$1.142	

- Please confirm that these differences represent the loss of revenue from the proposed decreased pound charge and increase in revenue for the proposed increase in residual shape surcharge respectively for the commercial ECR subclass for the test year using your before-rates volumes.
- If you are unable to confirm (a), please provide data that you believe to be correct with an explanation of the source of the data.
- Please provide similar data and source using after-rates volumes.

RESPONSE:

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- a. Confirmed, with further description. They represent the change in revenue from the pound-rate element only of the rates for pound-rated mail, and the change in revenue from the residual shape surcharge, using before-rates volumes, and prior to the application of any destination entry discounts. While the revenue from the pound-rate element does decrease by \$221 million, the revenue from the piece-rate element for pound-rated pieces increases \$246 million, which results in an overall increase for pound-rated pieces.
- b. Not applicable.
- c. See tables below.

REVENUE CATEGORY	AMOUNT (THOUSANDS)	SOURCE
Revenue from pound charge for ECR Subclass at 66.3 cents/pound, using after-rates volume.	\$1,824.061	WP1, page 24, line 16, but with 66.3 entered for pound rate in lines 13-15
Revenue from pound rate for ECR Subclass at 58.4 cents/pound, using after-rates volumes	\$1,606.715	WP1, page 24, line 16
Difference	<u>\$ 217,346</u>	

REVENUE CATEGORY	Amount (\$ MILLIONS)	SOURCE
Expected Revenue from Residual Shape Surcharge for ECR Subclass at 15 cents/ Piece, using after-rates volume.	3.366	WP1, page 14, col(2)
Expected Revenue from Residual Shape Surcharge for ECR subclass at 10 cents/piece, using after rates volumes.	2.244	WP1, page 13, but using AR volume from page 14, col (2)
Difference	<u>\$1.122</u>	

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NAA/USPS-T35-28: At USPS-T-35, p.24, line 10 to p.25, line 5, you propose a zero passthrough of the letter/non-letter cost differential, citing the Postal Service's concern regarding its letter automation program.

- a. Is this the same concern as you discussed at p.12, line 3 to line 11?**
- b. Did you consider increasing the cost coverage for ECR Mail so that the letter/non-letter cost differential in ECR might be recognized, while simultaneously permitting the desired relationship between rate levels for ECR Mail and 5-digit automation letters in the Regular subclass?**
- c. If no consideration was given, explain in detail why. If this alternative solution was considered and rejected, explain in detail why.**

RESPONSE:

- a. Yes.**
- b. I did not consider increasing the cost coverage for ECR as that was beyond the scope of my testimony. Please see response to NAA/USPS-T35-12b.**
- c. The creation of the desired rate relationship was achieved primarily by a combination of factors: the 160 percent passthrough for 5-digit automation, and the zero percent shape passthrough at the Basic tier of ECR. I note, however, that witness Mayes (USPS-T-32 at pages 38 and 39) mentions that the proposed ECR cost coverage helps maintain rate relationships across subclasses.**

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NAA/USPS-T35-29: At USPS-T-35, p.29, lines 20-21 and p.30, lines 10-17, you state that the markup for nonprofit Standard (A) Regular Mail should be one-half that of the commercial markup (due to the Revenue Forgone Reform Act) and the rate design "should mirror the commercial subclass."

- a. Apart from the difference in the cost coverage, are the ratemaking criteria in rate design that you apply to the two subclasses otherwise identical?**
- b. Unless your answer to (a) is an unqualified yes, please identify any differences between commercial and nonprofit Standard Regular that you took into account, apart from the statutory requirements regarding cost coverage.**

RESPONSE:

- a. In general, the principles are the same. Also, for clarification, the mirror subclass for Regular is "Nonprofit", not "nonprofit Regular".**
- b. The upper bound on percentage rate change was lower for nonprofit, however, since the overall change was lower. I attempted to limit the rate increases to less than 10 percent. Also see my responses to interrogatories NAA/USPS-T35-30 and NAA/USPS-T35-31.**

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NAA/USPS-T35-30: At USPS-T-35, p.8, line 4 to p.9, line 4, you address the pound rate for the Standard Regular commercial subclass.

- a. Are these same ratemaking considerations applicable to the pound rate for the Standard Regular nonprofit subclass?**
- b. If your answer is not an unqualified yes, provide all information you believe justifies a difference, apart from the statutory requirements regarding cost coverage in the Revenue Foregone Reform Act.**

RESPONSE:

a-b. The pound rate for Nonprofit is based more heavily on rate relationships between pound-rated and piece-rated pieces. There are fewer pieces subject to the residual shape surcharge, so it is less important to address the shape-proxy concern that is prevalent in the Regular subclass. Treating the nonprofit subclass and its commercial counterpart differently when determining the appropriate pound rate is not without precedent and is not unreasonable, as can be seen in the Commission's Docket No. R97-1 Opinion at paragraphs 5414-5415. The Commission's rationale behind the recommended pound rates for the nonprofit subclasses differs from the rationale for the commercial subclasses in paragraphs 5416-5425.

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NAA/USPS-T35-31: At USPS-T-35, p.31, lines 1-2, you state that an increase in the pound rate for nonprofit Standard (A) was necessary to avoid "upward pressure on piece rates."

- a. Why was it thought desirable to avoid upward pressure on piece rates?**
- b. What specific increases in the pound rate would otherwise have occurred had you not attempted to avoid upward pressure on piece rates, and why should they be avoided?**

RESPONSE:

- a. It was desirable to limit the increase for the individual Nonprofit subclass rate cells so that customers would not experience rate shock.**
- b. No further increases in the Nonprofit subclass pound rate would have occurred if an attempt had not been made to limit the increases in the piece rates.**

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NAA/USPS-T35-32: At USPS-T-35, p.37, lines 3-4, you state that the nonprofit Standard ECR rate is designed "to mirror the commercial subclasses."

- a. Apart from anticipated legislation, are the ratemaking criteria otherwise identical?**
- b. Unless your answer to (a) is an unqualified yes, please identify any differences between commercial and nonprofit Standard ECR that you took into account, apart from the anticipated legislation, and how they were taken into account.**

RESPONSE:

- a. In general, principles are the same.**
- b. As described in response to interrogatory NAA/USPS-T35-29, there may be different upper bounds of percentage rate changes. See response to NAA/USPS-T35-33.**

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NAA/USPS-T35-33: At USPS-T-35, p.19 to p.23, line 8, you address ratemaking considerations you believe should apply to the pound rate for the commercial ECR rate.

- a. Apart from anticipated legislation, are the ratemaking criteria otherwise identical?**
- b. Unless your answer is an unqualified yes, please identify any differences between commercial and nonprofit that you took into account, and how they were taken into account.**

RESPONSE:

- a-b. I assume the question is intended to ask whether the criteria are identical for NECR. See response to interrogatory NAA/USPS-T35-30. For a discussion of the proposed pound rate for NECR, see my testimony at page 37, lines 10-13.**

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NAA/USPS-T35-34: At USPS-T-35, p.41, footnote 62, you state that "due to mail mix changes in the after rates volumes, the after rates coverage (and markup) increases."

- a.** Please provide all data and analysis upon which this statement relies.
- b.** What specifically is the cause of the changes in coverage and markup?

RESPONSE:

a-b. This statement was intended to explain why the nonprofit coverage was not precisely 50 percent of the commercial markup. The statement is based solely on the understanding that mail mix changes in the after rates volume forecast might skew the revenue to higher revenue-per-piece categories, which might affect the after-rates coverage. After-rates cost adjustments may also affect the coverage. Also see response to interrogatory NAA/USPS-T35-7.

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NAA/USPS-T35-35: At USPS-T-35, Appendix 1, at p. 1, lines 9-25, you describe your workpapers.

- a. Please confirm that the billing determinants shown in WP1, p.1, and converted to percentages in WP1 p.2, are assumed to be the same in all calculations (e.g., for both before and after rate volume forecasts).
- b. Specifically confirm that your workpapers assume that the following billing determinants would remain constant for before-and after-rates volumes:

ECR	<i>Percent lb.-rated</i>	<i>lb. / piece for pound rated</i>
Non-letters- Basic	44.96%	0.318
Non-letters- High density	39.96%	0.343
Non-letters- Saturation	30.83%	0.304
Source: WP1, page 2, columns 3,5		

- c. If you cannot confirm (a) or (b), please identify all places where you have assumed a different percentage distribution of billing determinants than for FY98 and provide in each instance the billing determinant that you used.

RESPONSE:

- a. Confirmed.
- b. Confirmed.
- c. Not applicable.

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NAA/USPS-T35-36: At USPS-T-35, Appendix 1, p.4, lines 13-15, 19-23 and p.5, line 11, you state that the estimate of the revenue from the residual shape surcharge "includes the assumption that the percentage of nonletter pieces which would be subject to the surcharge remains constant before and after rates." However, you also state that "the estimate also includes an adjustment that attempts to account for the potential loss of surcharge revenue due to the implementation of the surcharge and mailer attempts to avoid it." You further state that "the parcel [sic] percentage applied to the nonletter volume is from FY98, which was prior to the implementation of the surcharge."

- a. Please provide all evidence upon which you relied to conclude that the revenues from imposing the 10 cent surcharge (WP1, p.13, line 7) would be 50% (WP1, p.13, line 9) of the amount that would be received assuming no mailer volume response to the surcharge (WP1, p.13, line 3).
- b. Would it be equally true that the billing determinants from FY98 in WP1, p.s 1-2, do not account for mailer response to other rate design changes arising from the rate changes imposed by Docket No. R97-1? Explain your answer in full.
- c. Please confirm that the difference between WP1, p.14, column 1 (TYBR Volume nonletters, before rates) and column 2 (after rates) represents your estimate of the effect of the proposed 4.9% average rate increase in this proceeding on ECR mail volumes.
- d. If you are unable to confirm (c), please provide an explanation of the difference.
- e. Please confirm that the difference between column 2 of WP1, p.14 (ECR expected residual volume after rates) and column 2 (ECR net volume expected) represents your estimate of the effect of the imposition of the 10 cent surcharge in Docket No. R97-1 in FY2001, assuming your proposed average 4.9% rate increase is implemented.
- f. If you are unable to confirm (e), please provide an explanation of the difference.
- g. Did you at any place account for the effects of your proposed increase from 10 cents to 15 cents on the residual shape surcharge on FY2001 revenues of ECR Mail?
- h. If the answer to (g) is yes, please indicate where and how the effects were accounted for.

RESPONSE:

- a. The assumption is not based on any concrete evidence. I have a general impression based on the reaction of mailers and their associations that it is likely that a significant reduction in volume would occur with the imposition of

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the surcharge. As stated in USPS-T-35, Appendix 1, p.5, lines 9-11, the revenue projection is very insensitive to this estimate.

- b. It is true that mailer response to the Docket No. R97-1 rates are not reflected in the FY98 billing determinants; however, the residual shape surcharge was the only bulk Standard Mail (A) structural change implemented as a result of Docket No. R97-1. Another major change (though not a structural change) was the ECR Basic letter rate relationship with 5-digit automation. The volume forecast anticipates the resulting migration, so the billing determinants are not a factor in assigning volume to these categories. The billing determinants are used to distribute volumes from the forecast to a finer level of detail, such as destination entry. The destination entry discounts have been in place since 1991, and the rates from Docket No. R97-1 did not change rate relationships to the degree that one would expect significant changes in destination-entry profile. The FY98 billing determinants were not adjusted, therefore, to try to anticipate any changes that may have resulted from the Docket No. R97-1 rates.
- c. Not confirmed.
- d. These figures are derived from witness Tolley's testimony. It is my understanding that the difference in the before and after rates volumes is dependent upon the proposed rate changes for the particular rate category, not necessarily the overall percentage change for the subclass.
- e. Confirmed.
- f. Not applicable.

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- g. Adjustments due to the proposed increase in the surcharge are not made explicitly in the workpapers. It is my understanding, however, that the after rates volume forecast for the subclass overall included recognition that the surcharge was proposed to increase.
- h. Not applicable.

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NAA/USPS-T35-37: At USPS-T-35, Appendix 1, p.7, line 20, to p.8, line 11, you state that "before rates volume" was used as a "constant mail mix" to calculate the percentage change in revenue per piece, in order to "control" for the "effects of migration within subclass, or across subclasses."

- a. Does this mean that the calculation of the estimated percentage rate increases assumed no "migration" within subclass or across subclasses, i.e., a "constant mail mix," if proposed rates are put into effect?**
- b. If the answer to (a) is yes, please explain the reason why no account was taken of the effect of the change in mail mix on the percentage rate increase.**
- c. If the answer to (a) is yes, please also explain why you attempted to account for the effects of the change in mail mix in WP1, p.s 13-14, arising from the imposition of the 10 cent residual shape surcharge in R97-1, but not the changes in mail mix arising from the changes in rate design proposed by you in this proceeding.**
- d. If the answer to (a) is no, please explain in detail how the expected change in mail mix was accounted for.**

RESPONSE:

- a. Yes.**
- b. It is not a matter of whether "no account" was taken of the effect of the change in mail mix. The percentage change without controlling for migration is easy to calculate. The percentage rate increase is a measure that can be calculated in various ways. The figure in my testimony is calculated using a constant mail mix. In Docket No. R97-1, it was particularly useful to use a constant mail mix since the proposed rates caused a significant cross-subclass migration out of ECR and into Regular. The migrating pieces were low revenue-per-piece relative to the Regular subclass, which caused a suppression of the after-rates revenue-per-piece. When this after-rates-revenue-per-piece was compared to the before-rates figure (which did not include the effect of the presence of these low revenue migrating pieces), it could have created the impression that the rate increase was lower than it**

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really was.

- c. The estimation of the effect of the implementation of the surcharge as a result of Docket No. R97-1 is unrelated to the calculation of the overall percentage change for the subclass due to the proposed rates. The former is to better estimate the revenue in the test year. The latter is merely an attempt to quantify a meaningful measure of the percentage changes implied by the proposed rates. See my response to subpart (b).
- d. Not applicable.

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NAA/USPS-T35-38: At USPS-T-35, WP1, p.3, you provide the before and after rates volumes used in your testimony.

- a. For each row, please identify the assumed rate changes, elasticities, and any other data or formula that explain the difference between the before-rates and after-rates volumes.**
- b. Please refer to your WP1, p.34. If the rate changes provided by you in response to (a) above are not the same as those contained in WP1, p.34, please explain the source of the difference.**
- c. How were the rate differences identified in part (a) determined and how were they calculated?**

RESPONSE:

- a. The cited volumes are from witness Tolley. It is my understanding that the before-rates prices are in Tables 1-6 and 1-8 on pages 10 and 11 of Workpaper 1 accompanying USPS-T-6; after-rates prices are in Tables 1-19 and 1-21 on pages 19 and 20 of Workpaper 1 accompanying USPS-T-6; elasticities are in USPS-T-7, Tables II-10 and II-11 on pages 58 and 59, and in Workpaper 1 accompanying USPS-T-7, pages 103 and 112; share equations are calculated in USPS-T-7, see pages 172 - 174, 183 - 185, and 188 - 189.**
- b. The rate changes implied by the prices cited in subpart (a) and those for comparable categories provided in WP1, page 34, are the same.**
- c. It is my understanding that the before-rates prices were calculated in USPS-LR-I-119 and after-rates prices were calculated in USPS-LR-I-120.**

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NAA/USPS-T35-39: At USPS-T-35, WP1, page 3, you provide the before and after rates volumes used in your testimony.

- a. Please confirm that the only difference in the assumptions underlying the two forecasts is the rate changes you propose in this proceeding.**
- b. If you are unable to confirm (a), please identify in detail all differences in assumptions between the two forecasts.**
- c. For each row, please identify the assumed rate changes, elasticities, and any other data or formulae that explains the difference between the before-rates and after-rates volumes.**
- d. Please refer to your WP1, page 34. If the rate changes provided by you in response to (a.) above are not the same as those contained in WP1, page 34, please explain the source of the difference.**
- e. How were the rate differences identified in part (a) determined and how were they calculated?**

RESPONSE:

- a. Confirmed.**
- b. Not applicable.**
- c-e. See my response to NAA/USPS-T35-38a-c.**

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NAA/USPS-T35-40: Please refer to your WP1, page 4, column (1) and (2), where you provide your estimates of pieces and pounds for the ECR subclass, labeled "FY01 Volume Forecast Before Rates." Please also refer to your WP1, page 21, column (1) and (2), which provides estimates of TY Volume Forecast-After Rates," which USPS-T-35, page 15, lines 19-20, describes as the distribution of test year after rates volumes to "rate categories using the billing determinant information from page 2."

- a. Please confirm that, despite the nominal labeling differences, that the only difference in assumptions between page 4 (before rates) and page 21 (after rates) are the rate changes in each of the rate categories assumed in the testimony of Witness Tolley.**
- b. If you are unable to confirm (a), identify all differences in assumptions underlying the two volume forecasts and how they explain the differences.**

RESPONSE:

- a. Confirmed.**
- b. Not applicable.**

DECLARATION

I, Joseph D. Moeller, declare under penalty of perjury that the foregoing answers are true and correct, to the best of my knowledge, information, and belief.


JOSEPH D. MOELLER

Dated: 3/10/00

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.



Anthony Alverno

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March 10, 2000