

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 VAL-PAK DIRECT
MARKETING SYSTEMS, INC., VAL-PAK DEALERS' ASSOCIATION, INC.,
AND CAROL WRIGHT PROMOTIONS, INC.
(VP-CW/USPS-T35—19-25)**

The United States Postal Service hereby provides the responses of witness Moeller to the following interrogatories of Val-Pak Direct Marketing Systems, Inc., Val-Pak Dealers' Association, Inc., and Carol Wright Promotions: VP-CW/USPS-T35—19-25, filed on March 15, 2000.

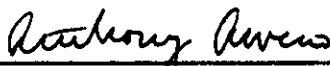
Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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VP-CW/USPS-T35-19. Please refer to your response to VP-CW/USPS-T35-6(b), where you state "Not all of [the criteria] are relevant at the rate design level." Your response further indicates that you consider Fairness and Equity (criterion 1), the Effect of Rate Increases (criterion 4), Degree of Preparation (criterion 6), and Simplicity (criterion 8) to be relevant at the rate design level.

- a. When you use the phrase "rate design level," do you mean "below the subclass level"? If not, what do you mean by that phrase?
- b. For each of the following criteria, which you did not explicitly mention in your response, please indicate which ones you consider to be not relevant at the rate design level, and explain why each is not relevant:
 - 1. Value of Service (criterion 2).
 - 2. Cost; *i.e.*, rates at least equal to attributable cost (criterion 3).
 - 3. Available alternatives (criterion 5).
 - 4. ECSI (criterion 8).

RESPONSE:

a. Yes.

b.

1. I did not consider Value of Service relevant at the rate development level. Value of Service is usually considered in the markup. Also, two yardsticks for evaluating value of service, namely, service standards and own-price elasticities, both generally apply to the subclass as a whole, not to individual rate categories, which are the purview of the rate design exercise.

2. Cost (rates at least equal to attributable cost) is usually considered at the subclass level in that it is the subclass as a whole that must cover its costs. While it is generally advisable and a desirable goal to have all pieces in a particular subclass cover their costs, it is not always a requirement. If it were, a much larger residual shape surcharge would have to have been proposed. Also, costs are

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obviously considered when determining the appropriate discount, as well as the establishment of certain rate elements.

3. Available alternatives are considered at the subclass level. While this concept may be relevant for rate design, it was not a factor in the proposed Standard Mail (A) rate design discussed in my testimony.

4. ECSI would not likely have application within the Standard Mail (A) rate design since it is my understanding that, under the DMCS, content does not vary by rate category within Standard Mail (A) subclasses.

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VP-CW/USPS-T35-20. Please refer to your response to VP-CW/USPS-T35-6(b), where you state "The criteria ... do embody **fundamental principles**, for rate design as well." (Emphasis added.)

- a. In addition to those criteria which you mention in your response as embodying fundamental principles, please: (i) list all other fundamental principles which you relied upon when designing rates for Standard A Mail, (ii) explain what makes each of them a fundamental principle, and (iii) discuss how each such principle is applied in your rate design for Standard A Mail.
- b. Please list all other "secondary" or "non-fundamental" principles or considerations which you used when designing rates for Standard A Mail (e.g., maximize profits, charge what the traffic will bear, etc.) and explain how each was applied.
- c. Please explain all principles of rate design, as well as all other factors, that led you to propose a 9.4 percent rate increase for Saturation ECR letters while proposing a rate decrease for pound-rated flats in excess of six ounces.

RESPONSE:

- a. Please see response to NAA/USPS-T35-10. The application of the principles is discussed throughout my testimony.
- b. The rate design process requires balancing the principles, and I do not assign a hierarchy to them. The use of the term "fundamental" in the quoted passage above was intended to convey that the principle involved is not required to be applied at the rate design level, but that the nature of the principle is basic and often has application at the rate design level.
- c. The proposed increase for non-destination entry saturation letters is 10.0 percent. The rate design process described throughout my testimony balances the rate design objectives (see response to interrogatory NAA/USPS-T35-10) and the rates are an output. Although the rates are reviewed to check for such things as anomalies or rate shock, the percentage changes themselves are not chosen after evaluation of the objectives.

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VP-CW/USPS-T35-21

- a. Please confirm that in this docket the Postal Service proposes the following percentage increases for ECR letter rates (without any destination entry discounts): Basic — 8.0 percent; Automation — 4.5 percent; High Density — 9.4 percent; and Saturation — 10.0 percent. If you do not confirm, please provide the correct percentages.
- b. Please refer to your answer to VP-CW/USPS-T35-2(a), where you state "The proposed rates flow directly from the cost measurement and the cost coverage." To what extent do the proposed rate increases identified in part a above, reflect the costs increases incurred by each of these respective rate categories since Docket No. R97-1? Please explain your answer fully.
- c. If such proposed rate increases reflect cost increases incurred by the above respective rate categories, how were such costs identified, since costs for High-Density and Saturation ECR letters have not been calculated in Base Year terms? (See your answer to VP-CW/USPS-T35-7(b)-(c).)
- d. If such respective rate increases do not reflect costs increases incurred by the above respective rate categories, then (i) why do Automation letters receive a below-average rate increase, while Basic, High-Density and Saturation letters receive a rate increase which is substantially above the subclass average, and (ii) why is the requested rate increase for Saturation letters more than double the subclass average?
- e. Please refer to your answer to VP-CW/USPS-T35-6(b). Did giving Automation letters a below-average rate increase have "a push-up effect" on the rates of Basic, High Density, and Saturation letters? If so, why are the proposed rates for Automation letters appropriate? Please explain your answer fully.

RESPONSE:

- a. Confirmed.
- b. The cited response was referring to costs measured at the subclass level. Costs for rate categories (like those cited in subpart (a)) are generally calculated for use in determining discounts and rate differentials within the subclass, and often include only those costs deemed "workshare-related." The rates of change of costs for these categories are not specifically calculated and considered, but the costs used in determining the discounts and rate relationships are, obviously, sensitive to any change in the underlying cost of the service.

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- c. Not applicable. As described in subpart (b), the rate of change in the costs for the categories was not calculated or considered in the rate design.
- d. The relative rate increases are driven by the costs underlying the discounts and rate differentials, as well as the passthroughs selected. They may reflect underlying variations in the costs for the relative costs for the categories, but the rate design does not explicitly consider the rate of cost increases.
- e. The proposed rate for Automation letters is driven in part by the passthrough of 100 percent of the calculated cost differential. Offering a discount places upward pressure on all other rates since the basic rate is, by virtue of the rate design formula, pushed-up to account for revenue leakages that result from discounts. In this instance, an even higher passthrough could have had a further "push-up" effect on all other rate categories, including those cited. The cited response states that the "push-up" effect should be limited, but does not say that it is inappropriate. For that matter, the saturation letter discount has a "push-up" effect on basic letters, yet offering a saturation discount is not deemed inappropriate. The push-up effect happens regardless of whether the resulting percentage changes are above or below the subclass average. So, the fact that Automation letters are proposed to increase at a rate lower than the subclass average is not what causes the "push-up" effect; rather, it is caused by offering a discount altogether. (Certainly, unless an across-the-board increase is proposed, some categories are going to be below, and others above, the subclass average.)

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VP-CW/USPS-T35-22.

Please refer to your answer to VP-CW/USPS-T35-6(b).

- a. Please confirm that you consider fairness and equity to be relevant at the "rate design" level.
- b. Please explain whether the fairness and equity criterion applies uniformly to all rate categories within a subclass or only to selected categories, and, if only to selected categories, explain how such categories are selected.
- c. Witness Mayes states at page 39 (ll. 15-16) of her testimony that application of many of the non-cost criteria at 39 U.S.C. sec. 3622(b) "would indicate a cost coverage even lower than that actually proposed." However, she expresses her belief that the rate level proposed for ECR satisfies the fairness and equity criterion, citing "the modest average ECR rate increase of 4.9 percent" (l. 18) and the need to maintain rate relationships across subclasses.
 - (i) Although the need to maintain rate relationships across subclasses does not apply to rate design within a subclass, do you feel that rate relationships across rate categories within a subclass should be maintained? Please explain why or why not.
 - (ii) Given the applicability of the other considerations mentioned with respect to each Standard A ECR rate category, please explain why a double-digit rate increase for Saturation letters is fair and equitable.
- d. In your rate design for ECR letters, how did you assess the fairness and equity of the respective rates for each rate category (*i.e.*, Basic, Automation, High Density, and Saturation)? Please explain in full, and state whether you examined the unit contribution from each rate category?
- e. Did you consider the fairness and equity of the ECR letter rates in comparison to the ECR nonletter rates? If so, how did you (and to what detail did you) analyze the fairness of rate differences between letters and nonletters? If not, why not? In responding, please explain whether you examined and compared
 - (i) coverages, (ii) markups, and/or (iii) unit contributions from letters and nonletters.

RESPONSE:

- a. Confirmed.
- b. The concept of fairness and equity is not exclusively applicable to selected categories.
- c. (i) It depends on what is meant by "rate relationships." Some rate relationships, such as saturation being at least as low-priced as high-density, are relationships that should be maintained. Absolute relationships, in terms of cents-per-piece or

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comparable percentage increases need not be maintained, however. For example, the rates implemented as a result of Docket No. R97-1 included an 8.0 percent increase for Basic letters, and a 2.3 percent *reduction* for Saturation letters, thereby increasing the differential between the least and most workshared density categories.

(ii) The rate increases for each rate category in ECR are fair and equitable. They are result of the rate design process described in my testimony at pages 19 through 27. Saturation letters, being the most work-shared category, benefit from higher passthroughs. The proposed passthroughs equal or exceed those that underlie the current rates. In fact, one passthrough (the one between basic and high-density letters), is increased to 125 percent in order to mitigate the increase for high-density and saturation letters.

- d. The proposal as a whole was deemed fair and equitable. The rate design process included recognition of the calculated cost differentials between the categories. As described in subpart (c)(ii), the passthroughs were either maintained or increased from their current levels. Unit contribution was not examined.
- e. The rate relationships between letters and nonletters are a result of the careful application of the rate design process described in my testimony at pages 19 through 27. The rates produced from that process, and therefore the rate relationships between the various categories, are fair and equitable. One step in the process was the decision to passthrough 125 percent of the cost differential between basic and high-density letters in order to limit the percentage increase for

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saturation letters. I did not examine relative coverages, markups, or unit contributions for letters and nonletters.

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VP-CW/USPS-T35-23. Please refer to your response to VP-CW/USPS-T35-6(b), where you state "Fairness and equity, therefore, would argue for some limitation on how much some cells are increased in order to avoid even larger increases for other cells."

- a. Did you apply such a limitation in your rate design for Standard A ECR?
- b. If so, (i) what was the limitation applied, (ii) where was it applied, and (iii) how was it calculated?
- c. If not, why not?

RESPONSE:

- a. The passage from the cited interrogatory response was intended to note that there should be some limit on how much other cells, *i.e.*, those that are not at risk of exceeding the cap, are increased as a consequence of attempts to restrain increases in other cells, *i.e.*, those that are likely to exceed the cap without further adjustments to the rate design. This is a realization of the fact that limiting one increase almost always causes an increase in some other rate cell. In attempting to be "fair" to one cell, another cell may be adversely affected. In the case of ECR, the passthrough of 125 percent between basic and high-density letters in order to restrain the increase on saturation letters was not unduly unfair to the affected rate categories. In isolation, a passthrough of 100 percent, which is the passthrough underlying the current discount, would have resulted in an increase of 12.3 percent for saturation letters, and lower increases (than those proposed) for some other cells. To limit the increase for saturation letters, the passthrough was increased, and the effect on other cells was not unacceptable.

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- b. See response to subpart (a). There was no explicit limitation on the degree to which individual cells would be allowed to increase as a result of efforts to temper other increases.**
- c. There was no perceived need to quantify the limitation. The resulting rates, after meeting the rate design objectives, are fair and equitable.**

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VP-CW/USPS-T35-24. Please refer to your response to VP-CW/USPS-T35-6(c), where you state "The effect of rate increases, however, did play an important role in the rate design." Please explain fully what role the effect of rate increases for Standard A ECR Basic, High-Density, and Saturation letters, respectively, played in your rate design.

RESPONSE:

The cited interrogatory referred to a section of my testimony regarding the Regular subclass, but the effect of rate increases played a role in ECR, as well. As described in the response to interrogatory VP-CW/USPS-T35-22(c), the extent of the rate increase on high-density and saturation letters was mitigated by selecting a 125 percent passthrough for the cost differential between basic and high-density letters. The effect of the pound rate reduction on letters was also considered in the rate design.

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VP-CW/USPS-T35-25. Are there reasons why rates within a subclass should be set so that the more highly workshared mailpiece should be required to provide a higher per-piece contribution? Please explain your answer fully, including the role such considerations played in your rate design for Standard A ECR.

RESPONSE:

I know of no reasons why a highly-workshared category should be *required* to make a greater per-piece contribution; however, I did not attempt to calculate contribution per piece by rate category, and would not necessarily consider the scenario posited in the question as unacceptable if the rates as a whole met other rate design objectives.

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: 3/29/00

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.



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March 29, 2000