

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
DISTRICT PHOTO, INC., MYSTIC COLOR LAB, AND COX SAMPLING
(DMC/USPS-T35—1-6)**

The United States Postal Service hereby provides the response of witness Moeller to the following interrogatories of District Photo, Inc., Mystic Color Lab, and Cox Sampling: DMC/USPS-T35—1-6, filed on March 22, 2000.

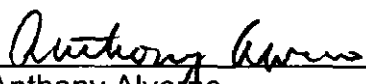
Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking



Anthony Alverno
Attorney

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2997; Fax -6187
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DMC/USPS-T35-1. Please refer to your response to VP-CW/USPS-T35-6, where you state that “[s]implicity is also considered in rate design when deciding whether to complicate the rate structure with additional rate categories.”

- a. *When simplicity is considered in the context of rate design, is sophistication of mailers using the subclass given consideration?*
- b. *If so, how would the Postal Service assess, for example, Standard A Regular and ECR mailers' ability to handle a more complex rate structure for the residual shape surcharge where destination entered pieces pay a lower rate?*
- c. *If so, how would the Postal Service assess, for example, Standard A Regular and ECR mailers' ability to handle a more complex rate structure vis-a-vis, say, Periodicals mailers?*

RESPONSE:

- a. Yes, however consideration of complexity involves more than simply whether mailers are sophisticated enough to handle added complexity. More rate cells create more rate relationships and the need to monitor potential rate anomalies or unintended shifts in mail preparation. Rate complexity also requires the promulgation of more mailing standards, which makes rate administration more complicated.
- b. The Postal Service does not have an explicit set of criteria for evaluating mailers' ability to “handle” a more complex rate structure such as the one described. As stated in response to subpart (a), however, the ability of mailers to “handle” complexity is only one aspect that should be considered.
- c. The Postal Service does not have an available set of data to measure the relative ability of various customer segments to handle complexity. Both Periodicals and Standard (A) mailings, however, are generally bulk mailings and are subject to

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complex rules and rate structures. Therefore, users of these subclasses could both
be viewed as well equipped to handle complexity.

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DMC/USPS-T35-2.

- a. Please confirm the following data and calculations in the table below. If you do not confirm, please provide correct data.

| Standard A Regular rate category | Current nonletter piece rate | Current piece rate w/surcharge | Proposed nonletter piece rate | Proposed piece rate w/surcharge | Percentage increase w/surcharge |
|----------------------------------|------------------------------|--------------------------------|-------------------------------|---------------------------------|---------------------------------|
| Basic | \$0.304 | \$0.404 | \$0.311 | \$0.491 | 21.5% |
| Basic DBMC | \$0.288 | \$0.388 | \$0.294 | \$0.474 | 22.2% |
| Basic DSCF | \$0.283 | \$0.383 | \$0.289 | \$0.469 | 22.5% |
| 3/5 Digit | \$0.240 | \$0.340 | \$0.258 | \$0.438 | 28.8% |
| 3/5 Digit DBMC | \$0.224 | \$0.324 | \$0.241 | \$0.421 | 29.9% |
| 3/5 Digit DSCF | \$0.219 | \$0.319 | \$0.236 | \$0.416 | 30.4% |

Note: "Surcharge" refers to residual shape surcharge

- b. In your response to NAA/USPS-T35-11, you state that an upper bound of 14 percent was generally set on non-destination entry Standard A rate increases. Did you consider parcel rates when applying this upper bound? If so, why do 3/5 digit parcels face a rate increase more than twice that percentage? If not, why not?
- c. The 3/5 digit DSCF nonletter below the breakpoint rate proposed by the Postal Service is \$0.236. The proposed residual shape surcharge is \$0.180.
- (i) Is it true that the Postal Service's proposed Standard A parcel rates (with the residual shape surcharge) reflect, *inter alia*, higher transportation costs incurred by parcels, but the destination entry discounts available to these parcels are based on (transportation and other) costs avoided by letters and flats? Please explain any negative response.

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- (ii) Assuming that parcel mailers would incur transportation costs in much the same basis as the Postal Service (*i.e.*, with cube as a cost driver), does the Postal Service's proposed Standard A parcel rate structure provide an appropriate incentive to the dropshipment of parcels? Please explain your answer.
- d. If the Postal Service's residual shape surcharge results in fewer Standard A parcels being dropshipped, is it true that the costs reported as incurred by Standard A parcels would increase, which logically would result in a request for a larger residual shape surcharge in the next rate case? Please explain your answer.

RESPONSE:

- a. Confirmed, for those parcels weighing less than 3.3 ounces; however, most Standard Mail (A) Regular parcels weigh more than 3.3 ounces and will experience smaller percentage increases than shown in the table.
- b. As stated in the question, the upper bound was "generally set" on non-destination entry rate increases. It was not viewed as a hard "ceiling" on the rate increase for every individual piece. Pieces subject to the residual shape surcharge, in particular, were not viewed as subject to the 14 percent increase in light of the fact that the establishment of the surcharge in Docket No. R97-1 was viewed as a first step toward improved recognition of the higher costs of these pieces relative to flats. The magnitude of the rate increase was considered, however, as discussed in my testimony (USPS-T-35 at page 7, lines 1-6).
- c. (i). It is my understanding that only 7 cents of the 65 cent cost differential (of which only 27.5 percent is passed through) underlying the surcharge is due to purchased transportation. It is also my understanding that the destination entry cost avoidances are based on pieces of all shapes.

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- (ii). Pieces of different shape, different weight, and different origin location may result in different amounts of costs avoided if dropshipped, yet the rate structure does not attempt to recognize this myriad of different amounts and combinations of costs avoided. Mailers located close to a destination facility might be viewed as receiving an inappropriately large incentive to dropship, while mailers located very far from a destination facility may receive "too small" of an incentive. Also, the incentive to dropship is provided by more than just rates. In effort to take advantage of the low rates available to merchandise shipped via Standard Mail (A), some mailers, in order to obtain service levels similar to higher-priced parcel services, may choose to dropship regardless of the level of the destination-entry discount.
- d. It is unclear how the residual shape surcharge, in and of itself, would result in a lower percentage of parcels being dropshipped. If, for some reason, the portion of dropshipped parcels declines, then presumably the unit cost of parcels will increase. However, future prospects for a larger residual shape surcharge seem probable even if the cost differential does *not* increase. The proposed passthrough was suppressed to 27.5 percent in order to moderate the rate increase on parcel mailers. A higher passthrough applied to the same cost differential in the next rate case would, by itself, result in a higher requested surcharge.

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DMC/USPS-T35-3. Was any consideration given to establishing distinct flat and parcel rate categories in Standard A? Please explain your answer.

RESPONSE:

It is not clear what is meant by "distinct flat and parcel rate categories," but there was no explicit consideration given to proposing separate parcel rates that parallel those that currently exist for nonletters and letters in Standard Mail (A).

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DMC/USPS-T35-4. In Docket R97-1, the Commission found merit in Dr. Haldi's alternative proposals that the shape costs be based on average transportation cost or, alternatively, that destination entry discounts be deaveraged by shape. The Commission further called on the Postal Service "to study this issue before the next rate case, as the base rate should be consistent with the discount subtracted from it." *Op. & Rec. Dec.*, Docket No. R97-1, para. 5483.

- a. Was any such study performed? If so, please provide a copy of the study. If not, why not?
- b. Is any such study planned? If not, why not?
- c. What consideration was given to developing destination entry discounts for parcels which reflect the costs avoided by such parcels?

RESPONSE:

- a. Please see witness Crum's response to DMC/USPS-T27-6(c)(ii).
- b. No study on deaveraging destination entry discounts by shape, in addition to those already performed, is planned, although subsequent rate requests will review existing studies for modifications and updates. See response to subpart (a).
- c. The idea was considered, but, as described in my testimony (USPS-T-35, page 15, line 12 through page 16, line 15) was not proposed.

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DMC/USPS-T35-5. Did you look at the projected decrease in total (*i.e.*, all four subclasses combined) Standard A parcel volume (from 983 million in 1996 to 905 million in 1998) when setting rates? If so, what impact did this (pre-residual shape surcharge) decrease in volume have on your rate design? If not, why not?

RESPONSE:

The cited volumes did not affect the level of the rates proposed. However, the expected volume of pieces paying the surcharge, and the revenue generated, is considered when designing the rates and is an input into the rate design formula. The existence and level of the surcharge is based on the fact that there is a cost difference between flats and parcels, and is not dependent on how many hundreds of millions of pieces will be subject to it.

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DMC/USPS-T35-6.

- a. Please confirm that in Docket No. R97-1, you estimated that Test Year After Rates (1998) Standard A parcel volume would reach 1.2 billion pieces. Response to PSA/USPS-T36-8 (Tr. 6/2886).
- b. How do you account for the variance between you estimate and the actual volume?
- c. What impact would you expect your proposed Standard A rates in this docket to have on Standard A parcel volume in Test Year 2001?

RESPONSE:

- a. For purposes of estimating revenue that would be derived from the surcharge, I estimated that the percentage of nonletters that are parcel shaped would remain constant in the test year. That citation is correct.
- b. I do not attempt to explain why fluctuations in volume occur, but it is clear that the residual shape surcharge did not have an effect on the cited actual volumes since it was not implemented in FY1998.
- c. As described in subpart (b), the surcharge is not an explanation for past variation in parcel volumes. With regard to the test year, I do not expect the incremental increase in the surcharge that is proposed in this proceeding to have much of an effect on parcel volume.

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: 4/4/00

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

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2997; Fax -6187
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