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Official Transcript of Proceedings

Before the

UNITED STATES POSTAL RATE COMMISSION

In the Matter of: POSTAL RATE AND FEE CHANGE

Docket No. R

R2000-1

VOLUME 10

NECEIVED

DATE: Monday, April 24, 2000

PLACE: Washington, D.C.

AGES: 3811 - 4160

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| 1 | BEFORE THE |
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| 2 | POSTAL RAIL COMMISSION |
| 3 | In the Matter of: POSTAL RATE AND FEE CHANGE : Docket No. R2000-1 |
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| 5 | Third Floor Hearing Room |
| 6 | 1333 H Street, N.W. |
| 7 | Washington, D.C 20268 |
| 8 | |
| 9 | Volume X Monday, April 24, 2000 |
| 10 | The above-entitled matter came on for bearing |
| 11 | pursuant to notice, at 9:33 a.m. |
| 12 | |
| 13 | |
| 14 | BEFORE: |
| 15 | HON. EDWARD J.GEILMAN, CHAIRMAN HON. GEORGE A. OMAS, VICE CHAIRMAN |
| 16 | HON. W.H. "TREY" LEBLANC, COMMISSIONER HON. DANA B. "DANNY" COVINGTON, COMMISSIONER |
| 17 | HON. RUTH GOLDWAY, COMMISSIONER |
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| 1 | APPEARANCES : |
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| 2 | On behalf of the National Association of Letter Carriers, AFL-CIO: |
| 3 | KEITH SECULAR, ESQ. Cohen, Weiss & Simon |
| 4 | 330 W. 42nd Street New York, NY 10036 |
| 5 | On behalf of the Newspaper Association of America: |
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| 11 | Mailers: HENRY A. HART, ESQ. |
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| 13 | East Tower, Suite 1100 Washington, DC 20005 |
| 14 | On behalf of the Classroom Publishers Association. |
| 15 | STEPHEN F. OWEN, JR., ESQ. 5335 Wisconsin Avenue, NW |
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| 17 | On behalf of $OCA-PRC$. |
| 18 | KENNETH E. RICHARDSON, ESQ. EMMETT RAND COSTICH, ESQ. |
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| 1 | APPEARANCES: (continued) |
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| 2 | On behalf of the American Business Press: DAVID STRAUS, ESQ. MERCIA ARNOLD, ESO. |
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| | 1 | | СОМТ | ENTS | | |
| . | 2 | WITNESS | DIRECT | CROSS | REDIRECT | RECROSS |
| | 3 | JOESPH D. MOELLER BY MR. ALVERNO | 3818 | | 4156 | |
| | 4 | BY MR. MCLAUGHLIN - BY MR. WIGGINS | | 3984/4145 3994 | | |
| | 5 | BY MR. BAKER BY MR. COSTICH | | 4002/4144 4038 | | |
| | 6 | BY MR. MAY By MR. VOLNER | | 4048 4064/4139 | | |
| | ~ 7 | BY MR. OLSON | | 4109 4141 | | |
| | , 0 | DI MR. IODD | | | | DAGE |
| | 8 | Designation of Writte | en Cross- | E RECORD: Examination | L | PAGE |
| | 9 | of Joseph D. Moeller ADVO-XE-T35-1 | C, USPS-T | -35 | | 3821 3985 |
| | 10 | ADVO-XE-T35-2 VP-Moeller-XE-1 | | | | 3985 4135 |
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| | 12 | EXHIBITS AND/OR TESTI | MONY | | IDENTIFIED | RECEIVED |
| | 13 | Joseph D. Moeller, U | ISPS-T-35 | c | 3819 | 3819 |
| . | 14 | Designation of Writte | n Cross- | 6 Examination | 3820 L | 3820 |
| | 15 | of Joseph D. Moeller ADVO-XE-T35-1 | C, USPS-T | -35 | 3821 3985 | 3821 3985 |
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| | | ANN RILI | EY & ASSO | CIATES, LTI orters |). | |

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| 1 | PROCEEDINGS |
|----|---|
| 2 | [9:34 a.m.] |
| 3 | CHAIRMAN GLEIMAN: Good morning. We continue our |
| 4 | hearings today to receive testimony of Postal Service |
| 5 | witnesses in support of Docket Number R2001. |
| 6 | I have one procedural matter to discuss this |
| 7 | morning. On April 19th, the Direct Marketing Association |
| 8 | filed a motion to include certain testimony from Docket |
| 9 | R97-1 in the record as part of written cross examination of |
| 10 | USPS Witness Mays. |
| 11 | DMA indicated that the items it wanted to include |
| 12 | are referred to in Witness Mays's responses to discovery. |
| 13 | DMA wants each referral to a document added in the R2001 |
| 14 | transcript, immediately behind the responses that refer to |
| 15 | it. |
| 16 | The Postal Service does not oppose this request. |
| 17 | I agree with DMA that the record would be easiest to use if |
| 18 | referred-to materials can be found in the same transcript |
| 19 | volume as the reference. |
| 20 | Therefore, DMA's motion is granted, and I will |
| 21 | instruct the Commission Staff to try to incorporate the |
| 22 | materials cited by Witness Mays, immediately after the |
| 23 | question and answers where they are mentioned. |
| 24 | Does any participant have an procedural matter |
| 25 | that he or she would like to raise today? |
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| 1 | [No response.] | | | | | | | |
|----------------|---|--|--|--|--|--|--|--|
| 2 | CHAIRMAN GLEIMAN: If not, we have but one witness | | | | | | | |
| 3 | today, Witness Moeller. Mr. Alverno, if you would please | | | | | | | |
| [:] 4 | introduce your witness? | | | | | | | |
| 5 | MR. ALVERNO: Thank you, Mr. Chairman. The Postal | | | | | | | |
| 6 | Service calls Joseph Moeller. | | | | | | | |
| 7 | CHAIRMAN GLEIMAN: Mr. Alverno? | | | | | | | |
| 8 | Whereupon, | | | | | | | |
| 9 | JOSEPH D. MOELLER, | | | | | | | |
| 10 | a witness, having been called for examination, and, having | | | | | | | |
| 11 | been first duly sworn, was examined and testified as | | | | | | | |
| 12 | follows: | | | | | | | |
| 13 | DIRECT EXAMINATION | | | | | | | |
| 14 | BY MR. ALVERNO: | | | | | | | |
| 15 | Q Please introduce yourself? | | | | | | | |
| 16 | A I'm Joseph D. Moeller. I work in the Pricing | | | | | | | |
| 17 | Office at the Postal Service. | | | | | | | |
| 18 | Q Earlier, I handed you two copies of a document | | | | | | | |
| 19 | entitled Direct Testimony of Joseph D. Moeller on Behalf of | | | | | | | |
| 20 | United States Postal Service. | | | | | | | |
| 21 | I have now given those copies to the Reporter. | | | | | | | |
| 22 | Did you have a chance to examine them? | | | | | | | |
| 23 | A Yes. | | | | | | | |
| 24 | Q And was this testimony prepared by you or under | | | | | | | |
| 25 | your direction? | | | | | | | |
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Α 1 Yes. 2 0 And do you have any changes or corrections to 3 make? NO. 4 А 5 Okay. And, Mr. Moeller, we filed an errata 0 Were those copies included in that version that 6 earlier. 7 you saw? 8 A Yes. And if you were to testify orally today, 9 0 Okay. 10 would your testimony be the same? 11 А Yes. MR. ALVERNO: Mr. Chairman, I ask that the Direct 12 13 Testimony of Joseph D. Moeller on Behalf of the United States Postal Service be received as evidence at this time. 14 15 CHAIRMAN GLEIMAN: Is there any objection? 16 [No response.] 17 CHAIRMAN GLEIMAN: Hearing none, I'll direct counsel to provide the Reporter with two copies of the 18 corrected direct testimony of Witness Moeller. 19 That testimony will be received into evidence, and as is our 20 21 practice, it will not be transcribed into the record. 22 [Direct Testimony of Joseph D. 23 Moeller, USPS-T-35 was received 24 into evidence.] 25 MR. ALVERNO: Mr. Chairman, we also have a library

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3819

reference associated with this testimony. 1 CHAIRMAN GLEIMAN: All right, Category II Library 2 Reference? 3 MR. ALVERNO: Yes. 4 BY MR. ALVERNO: 5 Mr. Moeller, are you familiar with Library 6 0 7 Reference USPS-LRI-166? 8 Α Yes, I am. And do you sponsor this Library Reference? 9 0 10 Α Yes. MR. ALVERNO: Mr. Chairman, I ask that Library 11 Reference USPS-LRI-166 be received as evidence at this time. 12 13 CHAIRMAN GLEIMAN: The Library Reference in question is received into evidence and will not be 14transcribed into the record. 15 16 [Library Reference USPS-LRI-166 was received into evidence.] 17 18 CHAIRMAN GLEIMAN: Mr. Moeller, have you had an 19 opportunity to review the packet of Designated Written Cross Examination that was made available to you earlier today? 20 21 THE WITNESS: Yes. 22 CHAIRMAN GLEIMAN: If those questions were asked 23 of you today, would your answers be the same as those you previously provided in writing? 24 THE WITNESS: Yes, they would. 25

CHAIRMAN GLEIMAN: That being the case, if you would provide two copies to the Court Reported of the Designated Written Cross Examination, I'll direct that the material be entered into evidence and transcribed into the record. [Designated Written Cross Examination of Joseph D. Moeller was received into evidence and . 8 transcribed into the record.]

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BEFORE THE POSTAL RATE COMMISSION WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 2000

Docket No. R2000-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION OF UNITED STATES POSTAL SERVICE WITNESS JOSEPH D. MOELLER (USPS-T-35)

Party Advo, Inc.

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Alliance of Nonprofit Mailers

Interrogatories

AAPS/USPS-T35-3, 6-7, 11 MOAA/USPS-T35-3-4 NAA/USPS-T35-15, 22, 43 VP-CW/USPS-T35-2, 22-23

AAPS/USPS-T35-1-3, 5-8, 11-14 ANM/USPS-T35-2 DMC/USPS-T35-4 PostCom/USPS-T35-1-3 UPS/USPS-T35-1

VP-CW/USPS-T35-1, 6, 8, 11-12

Association for Postal Commerce DMC/USPS-T35-1-2 MOAA/USPS-T35-1-2 PostCom/USPS-T35-1-3

Direct Marketing Association, Inc.

...

DMC/USPS-T35-1, 5 MOAA/USPS-T35-1-2 NAA/USPS-T35-5-6, 9, 60 VP-CW/USPS-T35-6, 12, 23

District Photo, Inc., Mystic Color Lab & DMC/USPS-T35-1-8 Cox Sampling

| Mail Order Association of America | AAPS/USPS-T35-1-3, 5-7 MOAA/USPS-T35-3-4 NAA/USPS-T35-10, 16, 22-23, 27, 35, 42-43, 45-47, 50, 52, 57 VP-CW/USPS-T35-2, 19, 21-23, 25 |
|---|--|
| Newspaper Association of America | AAPS/USPS-T35-1-2, 8, 11-12, 14 DMC/USPS-T35-1, 4 MOAA/USPS-T35-1-2 NAA/USPS-T35-2-10, 12-32, 34-60 PostCom/USPS-T35-1, 3 PSA/USPS-T35-1 PSA/USPS-T35-1 VPS/USPS-T35-1-2 UPS/USPS-T35-1 VP-CW/USPS-T35-2-8, 10-13, 19-25, 27-28 |
| Office of the Consumer Advocate | DMC/USPS-T35-2, 6 MOAA/USPS-T35-1-2 NAA/USPS-T35-10, 17, 21, 37, 45-47, 50, 53, 60 PostCom/USPS-T35-2-3 VP-CW/USPS-T35-3, 5-6, 10-11, 13, 20-27 |
| Parcel Shippers Association | PSA/USPS-T35-1-2 PSA/USPS-T27-4 redirected to T35 RIAA/USPS-T35-1 |
| Recording Industry Association of America, Inc. | DMC/USPS-T35-7 PSA/USPS-T35-1-2 RIAA/USPS-T35-1-3 UPS/USPS-T35-1 VP-CW/USPS-T35-19 |

Val-Pak Direct Marketing, Val-Pak Dealers, & Carol Wright

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VP-CW/USPS-T35-1-26

Respectfully submitted,

Margan P. Curskand

Margaret P. Crenshaw

DESIGNATED RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS JOSEPH D. MOELLER (T-35) DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory: AAPS/USPS-T35-1 AAPS/USPS-T35-2 AAPS/USPS-T35-3 AAPS/USPS-T35-5 AAPS/USPS-T35-6 AAPS/USPS-T35-7 AAPS/USPS-T35-8 AAPS/USPS-T35-11 AAPS/USPS-T35-12 AAPS/USPS-T35-13 AAPS/USPS-T35-14 ANM/USPS-T35-2 DMC/USPS-T35-1 DMC/USPS-T35-2 DMC/USPS-T35-3 DMC/USPS-T35-4 DMC/USPS-T35-5 DMC/USPS-T35-6 DMC/USPS-T35-7 DMC/USPS-T35-8 MOAA/USPS-T35-1 MOAA/USPS-T35-2 MOAA/USPS-T35-3 MOAA/USPS-T35-4 NAA/USPS-T35-2 NAA/USPS-T35-3 NAA/USPS-T35-4 NAA/USPS-T35-5 NAA/USPS-T35-6 NAA/USPS-T35-7 NAA/USPS-T35-8 NAA/USPS-T35-9 NAA/USPS-T35-10

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Designating Parties: ANM, MOAA, NAA ANM, MOAA, NAA Advo, ANM, MOAA ANM, MOAA Advo, ANM, MOAA Advo, ANM, MOAA ANM, NAA Advo, ANM, NAA ANM, NAA ANM ANM, NAA ANM DMA, DMC, NAA, PostCom DMC, OCA, PostCom DMC ANM, DMC, NAA DMA, DMC DMC, OCA DMC, RIAA DMC DMA, NAA, OCA, PostCom DMA, NAA, OCA, PostCom Advo, MOAA Advo, MOAA NAA NAA NAA DMA, NAA DMA, NAA NAA NAA DMA, NAA MOAA, NAA, OCA

NAA/USPS-T35-12 NAA/USPS-T35-13 NAA/USPS-T35-14 NAA/USPS-T35-15 NAA/USPS-T35-16 NAA/USPS-T35-17 NAA/USPS-T35-18 NAA/USPS-T35-19 NAA/USPS-T35-20 NAA/USPS-T35-21 NAA/USPS-T35-22 NAA/USPS-T35-23 NAA/USPS-T35-24 NAA/USPS-T35-25 NAA/USPS-T35-26 NAA/USPS-T35-27 NAA/USPS-T35-28 NAA/USPS-T35-29 NAA/USPS-T35-30 NAA/USPS-T35-31 NAA/USPS-T35-32 NAA/USPS-T35-34 NAA/USPS-T35-35 NAA/USPS-T35-36 NAA/USPS-T35-37 NAA/USPS-T35-38 NAA/USPS-T35-39 NAA/USPS-T35-40 NAA/USPS-T35-41 NAA/USPS-T35-42 NAA/USPS-T35-43 NAA/USPS-T35-44 NAA/USPS-T35-45 NAA/USPS-T35-46 NAA/USPS-T35-47 NAA/USPS-T35-48 NAA/USPS-T35-49 NAA/USPS-T35-50 NAA/USPS-T35-51

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NAA/USPS-T35-52 NAA/USPS-T35-53 NAA/USPS-T35-54 NAA/USPS-T35-55 NAA/USPS-T35-56 NAA/USPS-T35-57 NAA/USPS-T35-58 NAA/USPS-T35-59 NAA/USPS-T35-60 PostCom/USPS-T35-1 PostCom/USPS-T35-2 PostCom/USPS-T35-3 PSA/USPS-T35-1 PSA/USPS-T35-2 PSA/USPS-T27-4 redirected to T35 RIAA/USPS-T35-1 RIAA/USPS-T35-2 RIAA/USPS-T35-3 UPS/USPS-T35-1 VP-CW/USPS-T35-1 VP-CW/USPS-T35-2 VP-CW/USPS-T35-3 VP-CW/USPS-T35-4 VP-CW/USPS-T35-5 VP-CW/USPS-T35-6 VP-CW/USPS-T35-7 VP-CW/USPS-T35-8 VP-CW/USPS-T35-9 VP-CW/USPS-T35-10 VP-CW/USPS-T35-11 VP-CW/USPS-T35-12 VP-CW/USPS-T35-13 VP-CW/USPS-T35-14 VP-CW/USPS-T35-15 VP-CW/USPS-T35-16 VP-CW/USPS-T35-17 VP-CW/USPS-T35-18 VP-CW/USPS-T35-19 **VP-CW/USPS-T35-20**

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MOAA, NAA NAA. OCA NAA NAA NAA MOAA, NAA NAA NAA DMA, NAA, OCA ANM, NAA, PostCom ANM, OCA, PostCom ANM, NAA, OCA, PostCom NAA, PSA, RIAA PSA, RIAA NAA, PSA NAA, PSA, RIAA NAA, RIAA **RIAA** ANM, NAA, RIAA PostCom, VP-CW Advo, MOAA, NAA, VP-CW NAA, OCA, VP-CW NAA, VP-CW NAA, OCA, VP-CW DMA, NAA, OCA, PostCom, VP-CW NAA, VP-CW NAA, PostCom, VP-CW VP-CW NAA, OCA, VP-CW NAA, OCA, PostCom, VP-CW DMA, NAA, PostCom, VP-CW NAA, OCA, VP-CW VP-CW VP-CW VP-CW VP-CW VP-CW MOAA, NAA, RIAA, VP-CW NAA, OCA, VP-CW

VP-CW/USPS-T35-21 VP-CW/USPS-T35-22 VP-CW/USPS-T35-23 VP-CW/USPS-T35-24 VP-CW/USPS-T35-25 VP-CW/USPS-T35-26 VP-CW/USPS-T35-27 VP-CW/USPS-T35-28

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MOAA, NAA, OCA, VP-CW Advo, MOAA, NAA, OCA, VP-CW Advo, DMA, MOAA, NAA, OCA, VP-CW NAA, OCA, VP-CW MOAA, NAA, OCA, VP-CW OCA, VP-CW NAA, OCA NAA

AAPS/USPS-T35-1. At pages 19 and 20 of your testimony, you assert that the Postal Service has addressed the objections to the proposed ECR pound rate reduction raised by "private alternatives" in Docket No R97-1.

- a. Is it your understanding that the objections raised by AAPS were to the form of the proposed rate or to the fact that, as proposed, the effective rate against which its members compete would actually be reduced?
- b. Please confirm that the proposed rates for saturation ECR pieces are lower than current rates for pieces weighing 5 ounces and above at both SCF and DDU entry.
- c. Please confirm that the proposed rate for saturation ECR pieces at both SCF and DDU entry can be lower than current rates by more than 10%.
- d. How would yet another proposed reduction in the pound rate, and a resulting rate reduction in the postage rate for saturation ECR pieces weighing 5 ounces or more, meet the objections raised by competitors in prior cases?

RESPONSE:

a. Although what the question intends by the "the form of the proposed rate" is

unclear, it is my understanding that in its initial brief, the AAPS said that rates for

saturation mail should not be decreased by as much as 18 percent. Presumably,

that figure represented the maximum percentage rate change of a 16 ounce

saturation piece - a very rare piece, since the average weight of a saturation piece

is 2.4446 ounces. (USPS-LR-I-125, FY98 Billing Determinants). The range of

proposed decreases for sixteen ounce pieces in that docket was 15-18 percent. In

this proceeding, the range of decreases is 8-11 percent for 16-ounce pieces.

- b. Confirmed.
- c. Confirmed.
- d. I stated that the more modest reduction in the pound rate should "address" the objections, not necessarily overcome them, by limiting the magnitude of the decrease, while also recognizing the needs of small businesses who rely on the mail (and who would have likely benefited from a larger proposed decrease in the pound rate).

AAPS/USPS-T35-2. Does your table at the top of page 21 mean that, on average, pound rated ECR pieces contribute approximately 10.3 cents to institutional costs?

RESPONSE:

Yes.

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AAPS/USPS-T35-3. You conclude at page 21 that the pound rate must be too high, because revenue from one 8-ounce piece is the same as the revenue from two 4-ounce pieces. If indeed this is an incorrect relationship, wouldn't that "anomaly" also be eliminated by raising the piece rate instead of lowering the pound rate?

RESPONSE:

The revenue is slightly higher from the two 4-ounce pieces. An increase in the piece rate would indeed lessen the problem. While it is not clear how much of an increase would be required to "eliminate" the relationship, a significant increase in the piece rate, by virtue of the rate design formula, can only be achieved by a reduction in the pound rate, assuming that the target coverage is not increased and passthroughs are not changed dramatically.

AAPS/USPS-T35-5. You state at page 23 that at the Basic level, an ECR piece would have to weigh more than 6 ounces to realize a rate reduction and that the percentage of ECR pieces over 6 ounces is 6.4%. What is the percentage of saturation ECR pieces that weighs five ounces or more?

RESPONSE:

7.7 percent.

AAPS/USPS-T35-6. Would you expect that with a rate increase for piece-rated pieces and lighter weight pound rated pieces, accompanied by a rate decrease for heavier pound-rated pieces, the percentage of pieces that will actually experience a rate decrease as pieces migrate to pound-rated pieces will increase?

RESPONSE:

Since the average weight for a piece-rated nonletter is only 2.05 ounces, I would not expect a large migration of piece rated pieces to the pound rates. In other words, the typical ECR piece can add over one-ounce to its weight without any rate consequences currently. It is difficult to imagine that a lower pound rate would suddenly cause these pieces to add weight. To the extent pieces near the borderline (the point where the proposed rate increase is zero) get slightly heavier, they may move from a lowpercentage-*increase* weight, to a low-percentage-*decrease* weight. Adding weight will cause the rate for that piece to increase, of course.

AAPS/USPS-T35-7. Has the Postal Service estimated the revenue that will be lost as light weight saturation pieces paying the full piece rate migrate to pound-rated pieces where the postage cost per ounce will be much lower?

RESPONSE:

It is difficult to imagine that large numbers of light-weight saturation pieces would migrate to the pound-rated weight simply by virtue of a lower pound rate. For a oneounce piece, the postage per ounce is already much lower if mailed as part of a poundrate piece. While the proposed pound rate would make it a little lower yet (the proposed ounce rate is 3.65 cents, the current is 4.14 cents), those pieces that are sensitive to the per-ounce rate difference between piece-rated and pound-rated pieces are likely to have already found the option of co-mailing as part of a pound-rated piece. In any event, there is no explicit expectation or estimation of revenue changes that would result from such migration.

AAPS/USPS-T35-8. Have you read the "SAI Study" of alternate delivery commissioned by the Postal Service that was the subject of significant controversy in recent cases? If so, when? Also, if you have read it, please explain how you relied upon its discussion and conclusions concerning the impact of the proposed rates on alternate delivery companies.

RESPONSE:

I may have seen the study during the controversy surrounding its existence during the

1995 Classification Reform case. After that period, I have not read or seen any

updates, and in no way relied on any discussion or conclusion contained in either the

original or subsequent versions of the study in the proposed rates.

AAPS/USPS-T35-11. In response to AAPS/USPS-T35-1(d), you state that "small businesses" would likely have benefited from a decrease in the pound rate larger than that proposed.

- a. Will "small businesses" also benefit from the reduction proposed?
- b. Please confirm that one way for small businesses to benefit from the proposed reduction in the pound rate is that such reduction would reduce the postage on Saturation ECR shared mail pieces above five ounces and thus would permit such businesses to mail a piece weighing, for example, one ounce as part of a set and pay a portion of the pound rate, rather than mailing at the piece rates, which are being increased?
- c. Has the Postal Service estimated the extent to which the proposed rates will induce mailers who now mail "solo" or combined advertisements at the piece rates to change their strategy and become part of a shared mail set offered by a mailer such as ADVO?
- d. If the response to part (c) is in the affirmative, has the Postal Service calculated the cost and revenue impact of such changes? If so, please provide the estimate.

RESPONSE:

a. I have not assessed whether small businesses will benefit from the proposed

reduction, but to the extent they do, I presume they would have benefited more

from a larger reduction.

- b. The portion of the postage shared by a one-ounce piece in a 5-ounce shared mail piece is much lower, under current rates, than the rate the piece would pay if mailed individually. Under the proposed rates, incremental ounces would become less expensive, and that might enable some small businesses to afford to be part of a shared mailing, but it is doubtful the proposed rate for individual pieces will result in the sort of migration posited in this question, since small businesses are unlikely able to afford such advertising even under existing rates.
- c. It is not clear what is meant by "combined" advertisements. In any event, there is no estimate of pieces that will move from "solo" mailing to shared mailing. See response to AAPS/USPS-T35-7.
- d. Not applicable.

AAPS/USPS-T35-12. At the time that you responded to AAPS/USPS-T35-8, in which you stated that you have not read any updates to the SAI study that was the subject to controversy in Docket No. MC95-1, were you aware that (as revealed in the Postal Service's March 6th Objections) that there was a 1998 "revision" to that report?

RESPONSE:

No.

AAPS/USPS-T35-13. Given the subject matter of your testimony, which addresses among other things the impact of the reduced rate proposed for some ECR pieces on alternate delivery companies, please explain why you did not review either the original SAI report or the 1998 revision to that report.

RESPONSE:

I didn't know of the 1998 revision, and the original report would presumably be considered outdated, even if I were to view the subject matter as consequential to my testimony. The proposed pound rate is based primarily on efforts to better reflect underlying costs. I was certainly aware of the sensitivity of alternate delivery companies through my involvement in Docket Nos. MC95-1 and R97-1, even though the companies did not offer testimony regarding their pricing practices. The statements on page 23 of my testimony are intended to express sensitivity to minimizing the effect that a more cost-based approach to the pound rate would have on these companies. I was not searching for any type of quantification of the effect since intervenors themselves in previous cases have not offered such quantification in their opposition to the proposed reductions in the pound rates. To my knowledge, the SAI study is not undertaken for purposes of ratemaking analysis.

AAPS/USPS-T35-14. The Postal Service has revealed in its March 6th Objections that it possesses a January 22, 1999 "assessment," again prepared by SAI, that addresses a private sector competitor for the carriage of saturation advertising mail.

- a. Were you aware of that assessment when you prepared your testimony?
- b. Had you read it before you prepared your testimony?

c. Have you read it as of the date if [sic] your response to this interrogatory?

RESPONSE:

a. No.

- b. No.
- c. No.

U.S. POSTAL SERVICE WITNESS MOELLER RESPONSE TO INTERROGATORIES OF ALLIANCE OF NONPROFIT MAILERS

ANM/USPS-T35-2. Please produce a table showing the rate changes for nonprofit ECR Standard (A) mail that would follow from the Postal Service's proposed cost estimates if the existing statutory constraints on preferred rates remain unchanged. Please use a format comparable to "Standard Mail Rate Schedule [321.3] 322" (USPS Request, Attachment B, page 17).

RESPONSE:

Please see my response to Presiding Officer's Information Request #2, Question 1.

Also, see the attached for the rates presented in the requested format. As the Board of

Governors would review the Postal Service's rate proposal, I do not represent this

response to present what the Postal Service's proposal would be in the hypothetical

stated in the question.

Standard Mail Rate Schedule 324

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Nonprofit Enhanced Carrier Route Subclass¹

| | Current Rate (conts) | USPS/ANM-T35-2 Rate (conts) |
|--------------------------------------|----------------------------|-----------------------------------|
| l attar Siza | (Cents) | (cents) |
| Piece Rate | | |
| Basic | 9.9 | 13.6 |
| Basic Automated Letter ² | 9.2 | 10.0 |
| High Density | 7.8 | 11.3 |
| Saturation | 7.2 | 10.7 |
| Destination Entry Discount per Piece | | |
| BMC | 1.6 | 1.7 |
| SCF | 2.1 | 2.2 |
| DDU | 2.6 | 2.8 |
| Non-Letter Size ³ | | |
| Piece Rate | | |
| Minimum per Piece⁴ | | |
| Basic | 9.9 | 13.6 |
| High Density | 9.2 | 12.0 |
| Saturation | 8.4 | 11.5 |
| Destination Entry Discount per Piece | | |
| BMC | 1.6 | 1.7 |
| SCF | 2.1 | 2.2 |
| DDU | 2.6 | 2.8 |
| Pound Rate* | 29.0 | 45.0 |
| Plus per Piece Rate | | |
| Basic | 3.9 | 4.3 |
| High Density | 3.2 | 2.7 |
| Saturation | 2.4 | 2.2 |
| Destination Entry Discount per Pound | | |
| BMC | 7. 9 | 8.3 |
| SCF | 10.0 | 10.8 |
| DDU | 12.6 | 13.4 |

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

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

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.

- (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.
(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.

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).

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.

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.

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.

DMC/USPS-T35-7. At pages 1-2 of your testimony, you discuss the Standard Mail parcel barcode discount. According to Attachment A of the Request of the United States Postal Service for a Recommended Decision on Changes in Rates of Postage and Fees for Postal Services (January 12, 2000) at page 16, this discount applies to residual shape mailpieces that are entered at designated facilities, bear a barcode specified by the Postal Service, are prepared as specified by the Postal Service, and meet all other preparation and machinability requirement of the Postal Service.

- a. Which facilities have been and/or will be designated to receive parcels receiving the discount? If not known, what type of facilities will be designated?
- b. What are the specifications for the barcode which the parcel must bear to qualify for the discount?
- c. In order for parcels to qualify for the discount, must they conform with any specified dimensions (*e.g.*, minimum or maximum)?
- d. Will any address placement requirements be imposed on parcels to qualify for the discount?
- e. Can all Standard A parcels (*i.e.*, IPP machinable, IPP non-machinable, Parcel machinable and Parcel Outside) qualify for the barcode discount? If not, what machinability requirements will the Postal Service impose on parcels to qualify for the discount? Will they be the same as DMM C050.4.0 and DMM 5.0?
- f. Please identify any other mail makeup requirements which will be imposed on parcels before they qualify for the discount.
- g. What cost savings have been modeled or identified with the discount requirements?
- h. How much of a passthrough of cost savings does the discount represent?
- i. What is the TYAR volume estimate for parcels receiving the barcode discount?

RESPONSE:

a. It is my understanding that specific DMM language regarding the applicability of the

parcel barcode discount for Standard Mail (A) parcels has not been drafted. It is

not unreasonable to expect that the discount will be available to pieces entered into

the mailstream in a manner that will enable the barcode to be used to facilitate

sortation, or prepared in a manner that will allow the sortation operations to be

avoided altogether. See my testimony (USPS-T-35 at page 14, lines 4-13).

b. The DMM language has not been drafted, but it is reasonable to expect that the

specifications will be the same as those for the existing parcel barcode discounts.

- c. The DMM language has not been drafted, but it is reasonable to expect that the size limitations will be similar to those that apply to pieces eligible for the existing Standard Mail (B) parcel barcode discounts. Of course, since Standard Mail (A) has a weight limit of 16 ounces, that will also be the maximum weight for a piece claiming the parcel barcode discount for Standard Mail (A) categories.
- d. The DMM language has not been drafted, but it is reasonable to expect that the address placement requirements will be similar to those that apply to pieces eligible for the existing parcel barcode discounts.
- e. The DMM language has not been drafted, but the expectation that all parcels will be eligible for the discount is not reasonable. It is reasonable to expect that machinability requirements will be similar to those for pieces eligible for the current parcel barcode discounts. See response to subpart (a).
- f. The DMM language has not been drafted; however, I am not aware of any additional requirements that will be applied to Standard Mail (A) parcels.
- g. The Standard Mail (A) parcel barcode discount is based on the discount proposed for Standard Mail (B). See my response to Presiding Officer's Information Request No. 3, Question 11.
- h. Based on witness Eggleston's cost calculations (USPS-T-26, Attachment B, page 1), the three-cent discount represents a 100 percent passthrough of the cost savings.

 For revenue estimation purposes, the volume of pieces estimated to receive the barcode discount in Standard Mail (A) Regular is 490 million, and in Standard Mail (A) Nonprofit is 12 million.

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DMC/USPS-T35-8. Please identify all competitors of the Postal Service which impose a parcel or "residual shape" surcharge on packages.

RESPONSE:

I am not aware of any competitor that has a "residual shape" surcharge; although it is my understanding that UPS has rates that are cube-based. I am also not aware of competitors charging rates that are below cost, or are based exclusively on costs of delivering letter- and flat-shaped pieces.

MOAA/USPS-T35-1. Do you agree that a failure to pass through to mailers 100 percent of cost savings resulting from destination entry inevitably results in rates that are less economically sound? If you disagree please explain your answer fully.

RESPONSE:

No; if "economically sound" is intended to relate to the minimization of total cost by providing incentive for the party with the lowest cost of performing the workshare activity to perform the activity. It is possible that a 100 percent passthrough would send less economically sound signals to some minimum-perpiece mailers to dropship since, by virtue of the rate structure, the discounts are based on a weight of 3.3 ounces even though the piece may weigh only 0.5 ounces. Also, it depends on where the dropshipped piece would have been otherwise entered. To the extent the actual transportation (and handlings) incurred would have been less than the average which underlies the discount, it is possible that the Postal Service may have been able to perform the activities at lower cost.

MOAA/USPS-T35-2. Is it not also true that anything other than a complete pass through of Postal Service cost savings resulting from destination entry results in a false price signal to mailers? If your answer is anything other than a unqualified yes, would you please explain fully?

RESPONSE:

No. See response to interrogatory MOAA/USPS-T35-1. Another factor that might suggest that there is not a false price signal if the passthrough is less than 100 percent is that the quantification of the cost differences does not necessarily represent the cost avoidance due to the dropshipping of a typical piece. For example, the differential between non-dropshipped pieces and pieces entered at the destination BMC (DBMC) is based on the costs of non-dropshipped mail versus DBMC-entered mail. The non-dropshipped cost, therefore, excludes all mail that has already availed itself of the DBMC discount. If the discount is increased, more of this "non-dropshipped" mail (presumably the below average cost pieces in the "non-dropshipped" grouping) would find it desirable to migrate to the dropship category, thereby leaving the above-average cost pieces in the non-dropshipped grouping. Subsequent measurements of this grouping would then reflect an escalating cost benchmark, and could result in an ever-increasing discount that may be much higher than the savings that result from the typical dropshipped piece. In the extreme, the discount would increase to a level that would entice the last non-dropshipped piece to dropship, and, accordingly, overreward those mailers who had already chosen to dropship.

MOAA/USPS-T35-3. Is it a correct reading of your testimony as found on pages 19-23 that the pound rates proposed by the Postal Service are still too high, i.e. that the increase in costs resulting from increased weight are less than the increase in rates resulting from increased weight?

RESPONSE:

Yes.

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MOAA/USPS-T35-4. Please provide the Postal Services after rates volume estimates for both piece rated and pound rated nonletters, respectively, entered at the basic, high density and saturation levels.

RESPONSE: See table below. Volume in millions. From USPS-T-35, WP1,

page 21.

| | Piece-Rated | Pound-Rated |
|--------------|-------------|-----------------|
| Basic | 6491.447 | 5303.401 |
| High-Density | 888.114 | 591.14 4 |
| Saturation | 6340.858 | 2826.637 |

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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
- 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.

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.

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.

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.

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.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS MOELLER TO

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.

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.

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

had, as a by-product, different percentage rate changes. It was not

necessarily the percentage changes that were rejected, but rather the rates

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did not meet the rate design objectives.

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.

<u>Create appropriate rate relationships</u> (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)

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

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

<u>Overall reasonableness of results</u> -- 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.

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 passthough 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.

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.

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a. No.

b. Not applicable.

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.

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, 1

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.

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.

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, lines14-16, 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.

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.

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 5digit 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.

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.

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 beforerates 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 | 199.2% | 208.8% |
|----------|--------|----------|
| Total | · | <u>L</u> |

- 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.

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:

- 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

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.
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:

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- 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.

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.

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?

- 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.
- 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.

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.

- 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.

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 | |

- a. 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.
- b. 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.
- c. Please provide similar data and source using after-rates volumes.

- Confirmed, with further description. They represent the change in revenue from а. 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, whch results in an overall increase for pound-rated pieces.
- Not applicable. b.

| 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, lin∉ 16 |
| Difference | \$ 217,346 | |

| Revenue from pound rate for ECR Subclass at 58.4 | \$1,606.715 | WP1, page 24, line 16 |
|--|-------------------------|-----------------------|
| cents/pound, using after-rates volumes | | |
| Difference | \$ 217,346 | |
| | | |
| REVENUE CATEGORY | Amount (\$ MILLIONS) | SOURCE |

| | (\$ MILLIONS) | |
|--|---------------|---|
| Expected Revenue from Residual Shape Surcharge for ECR Subclass at 15 cents/ Piece, using after-rates volume. | 3.366 | WP1, page 14, col2) |
| Expected Revenue from Residual Shape Surcharge for ECR subclass at 10 cents/piece, using after rates volumes. Difference | 2.244 | WP1, page 13, bu: using AR volume from page 14, col (2) |

See tables below. C.

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.

- 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.

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.

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.

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.

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.

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.

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 | Percent Ibrated | lb. / piece for pound rated |
|----------------------------------|--------------------|--------------------------------|
| 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.

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

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

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.

3895

- 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.

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

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.

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 beforerates 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.

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 beforerates 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?

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

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.

- a. Confirmed.
- b. Not applicable.

NAA/USPS-T35-41: Please refer to page 13, line 12 through page 14, line 5 of your testimony, where you discuss an increase in the maximum weight of 3.5 ounces for Standard Mail (A) Automation letters.

- a. Are you proposing to change the breakpoint for Standard Mail (A) Automation letters to 3.5 ounces? Please explain why or why not.
- b. Does the discussion at the cited pages refer to both Standard (A) Regular and Standard (A) Enhanced Carrier Route automation letters? If not, please explain why not.
- c. Please confirm that you are not proposing any changes to the breakpoint for Standard (A) non-automation letters.
- d. Please confirm that you are not proposing any changes to the breakpoint for Standard (A) nonletters.

- a. As stated on page 12 of my testimony, the maximum weight for automation letters in Standard Mail (A) would be raised to 3.5 ounces in conjunction with the implementation of Docket No. R2000-1 rates. The applicable rate would be the minimum-per-piece rate.
- b. The citation should refer to page 12, line 12 through page 13, line 5. As a practical matter, yes, the weight limit for ECR automation letters would be raised to 3.5 ounces, as well. Some mailers produce mailings that contain some pieces that will destinate in the limited areas where the automation ECR rate is available, while other pieces will not. As explained in WP 1, page 25, note regarding column (4), this change in the maximum weight for automation ECR letters likewise would not be expected to have significant revenue and cost consequences.
- c. Confirmed.
- d. Confirmed.

NAA/USPS-T35-42: At USPS-T-35, p. 22, footnote 42, you identify "USPS-T-27, Attachment F, Tables 1-2" as a source for your statement that "[t]he weight per piece for parcels is slightly lower." Please explain in detail the basis for your conclusion.

RESPONSE:

The cited "Table 1" includes volumes and weight for commercial carrier route (basic), high-density, and saturation, for flats and for parcels. By summing the three rate categories, one can get total ECR weight and volume figures for flats and for parcels. The weight per piece can then be calculated, and is 0.197 pounds for flats, and 0.192 for parcels.

NAA/USPS-T35-43: Columns (1) and (2) in the table below reproduce the beforerates volume forecast data from WP1, p. 4, columns (1) and (2). Columns (3) and (4) reproduce the after-rates data provided in your testimony at WP1, page 21, column (1) and (2). The differences between before and after volumes are expressed in percentage terms in column (5) and (6) below.

| | | FY01 Volume Forecast - Before Rates | | TY Volume For Rates | ecast - After | Percent Change | |
|----|-------------------------|--|---------------|------------------------|---------------|----------------|---------------|
| | | pieces (1) | pounds (2) | pieces (3) | pounds (4) | pieces (5) | pounds (6) |
| | Letters | | | | | | ., |
| 2 | Basic | 5665.732 | | 5449.490 | | -3.82% | |
| 3 | Auto | 1891.225 | | 1851.903 | | -2.08% | |
| 4 | High-D | 411.860 | | 393.108 | | -4.55% | |
| 5 | Saturation | 2830.582 | | 2692.107 | | -4.89% | |
| 6 | Non-letters-Plece rated | | | | | | |
| 7 | Basic | 6636.358 | | 6491.447 | | -2.18% | |
| 8 | High-D | 880.537 | | 888.114 | | 0.86% | |
| 9 | Saturation | 6436.887 | | 6340.858 | | -1.49% | |
| 10 | Non-letters-Pound rated | | | | | | |
| 11 | Basic | 5421.791 | 1726.265 | 5303.401 | 1688.571 | -2.18% | -2.18% |
| 12 | High-D | 586.101 | 200.753 | 591.144 | 202.480 | 0.86% | 0.86% |
| 13 | Saturation | 2869.445 | \$73 200 | 2826.637 | 860 173 | -1.49% | -1.49% |
| 14 | Total ECR | 33630.517 | 2800.217 | 32828.211 | 2751.224 | -2.39% | -1.75% |
| 15 | subtotal - letters | 10799.400 | | 10386.608 | | -3.82% | |
| 16 | subtotal - pc. rated | 24753.181 | | 24107.028 | | -2.61% | |
| 17 | subtotal - lb. rated NL | \$877.336 | 94 1 | 8721.183 | | -1.76% | |
| 18 | subtotal - pc. rated NL | 13953.781 | | 13720.420 | | -1.67% | |

Sources:

Columns (1), (2): Moeller WP 1, page 4 Columns (3), (4): Moeller WP 1, page 21 Column (5): Column (3) / Column (1) - 1

Column (6): Column (4) / Column (2) -1

- a. Please confirm that columns (1), (2), (3), and (4) accurately reproduce the cited material from your workpapers. If you cannot confirm, please provide the correct numbers.
- b. Please confirm that columns (5) and (6) correctly calculate the percentage change in volume for each rate category that you forecast will occur as a result of the change in rates for ECR Mail you are proposing.
- c. If you are unable to confirm (b), please provide the percentage volume changes you are forecasting to occur as a result of the rates for ECR Mail you are proposing in the format of columns (5) and (6) above.
- d. Please note that a comparison of columns (5) and (6) show identical percentage changes are predicted for pieces and pounds for pound-rated ECR Mail. Is this a consequence of an assumption that the weight/piece will not change?

- e. If the answer to (d) is yes, please explain the rationale for the assumption, given your proposed increase in the piece rate and decrease in the pound rate for these rate categories.
- f. If the answer to (d) is no, please explain what changes in weight/piece you do believe will occur.

- a. Confirmed.
- b. Confirmed, however witness Tolley actually performs the forecast at the rate category level provided in WP1, page 3.
- c. Not applicable.
- d. Yes.
- e. As a matter of practice in previous rate cases, the base period billing determinants are used to distribute forecasted volumes into finer level of detail for both before rates and after rates. As a practical matter, if we were able to adjust weight per piece due to potential after-rates changes, we would expect greater revenue. Likewise, we would expect higher costs. Given, however, that costs do not increase much with weight, it is likely that the additional revenue and cost would result in a higher cost coverage for ECR, which might have led to a reduction in some ECR rates to bring the coverage back in line with witness Mayes' recommended cost coverage.
- f. Not applicable.

NAA/USPS-T35-44: At WP1, p. 34, you calculate various rate categories for revenue/piece of ECR Mail using the before-rates volumes for pieces and pounds in column (1) of your workpaper. The revenue/piece for before rates (your column 4) and after rates (your column 6) are reproduced as columns 1 and 2 respectively below:

| | | Before Rates | After Rates | Percent Change |
|------|-------------------------|--------------|-------------|----------------|
| | | Rev/pc | Rev/pc | Rev/pc |
| | | (1) | (2) | (3) |
| 11 | Letters | | | |
| 2 | Basic | 0.1477 | 0.1599 | 8.28% |
| 3 | Auto | 0.1429 | 0.1492 | 4.39% |
| 4 | High-D | 0.1199 | 0.1319 | 9.99% |
| 5 | Saturation | 0.1108 | 0.1228 | 10. 79% |
| 6] | Non-letters-Piece rated | | | |
| 7 | Basic | 0.1441 | 0.1561 | 8.37% |
| 8 | High-D | 0.1295 | 0.1313 | 1.35% |
| 9 | Saturation | 0.1173 | 0.1237 | 5.54% |
| 10] | Non-letters-Pound rated | | | |
| 11 | Basic | 0.2069 | 0.2096 | 1.29% |
| 12 | High-D | 0.2021 | 0.1924 | -4.82% |
| 13 | Saturation | 0.1685 | 0.1671 | -0.84% |
| 14 ' | Total ECR | 0.1492 | 0.1566 | 4.94% |
| 15 | subtotal - letters | 0.13614 | 0.14724 | 8.16% |
| 16 | subtotal - pc. rated | 0.13312 | 0.14295 | 7.38% |
| 17 | subtotal - lb. rated NL | 0.19419 | 0.19472 | 0.27% |
| 18 | subtotal - pc. rated NL | 0.13078 | 0.13962 | 6.76% |

Sources:

Columns (1), (2): Moeller WP 1, page 34 Column (3): Column (2) / Column (1) - 1

- a. Please confirm that column (3) of the above table correctly represents your estimate of the percentage rate change in each of the identified subcategories of ECR Mail.
- b. If you are unable to confirm (a), please identify the percentage rate changes you believe to be correct in the format of column 3 above and show how they are derived.
- c. Please refer to line (8) above where it is calculated that the revenue/piece for piece rated non-letters in the High Density Category is forecasted to increase by +1.35%. Line 8 of the table in Interrogatory NAA/USPS-T35-43 above shows a predicted volume increase of +0.86%. Please reconcile.
- d. The Saturation category of pound rated non-letters (line 13) above shows a rate decrease of -0.84%. Line 8 of the table in Interrogatory NAA/USPS-T35-43 shows a volume decline of -1.49% for both pieces and pounds. Please reconcile.

- a. Confirmed.
- b. Not applicable.
- c. It is not clear what is to be "reconciled" here. The volume forecast is for all highdensity nonletters (both piece-rated and pound-rated). The proposed rate change for that grouping is negative, which leads to a slight increase in volume for the
 - category (0.86 percent). Since the volume forecast does not differentiate between piece-rated and pound-rated categories, the information from the billing determinants regarding the mix of piece-rated and pound-rated nonletters is used to distribute the forecasted volume for high-density nonletters to the finer subgroups of piece-rated and pound-rated nonletters. The 0.86 percent volume growth is thereby implicitly assumed to apply to both subgroups for purposes of revenue calculation.
- d. Again, is not clear what is to be "reconciled." The pound-rated portion of saturation nonletters is proposed to receive a slight rate decrease. Despite this price decrease, the volume for purposes of estimating revenue shows a decline since the overall category price (for piece-rated and pound-rated nonletters) is proposed to increase. In keeping with past practice, the volume forecast (which is for the combined piece-rated and pound-rated category) is split into the subgroups based on billing determinant information. Also in keeping with past practice, the same billing determinant information is used for before and after rates. The projected volume change, therefore, will be the same for piece-rated and pound-rated nonletters.

NAA/USPS-T35-45: The table below summarizes the proposed passthroughs you recommended in Docket No. R97-1 and in this proceeding:

- a. Does the above table correctly represent the referenced passthroughs?
- b. If not, please provide the correct figures and the source of the data.
- c. Please provide the "passthroughs underlying the current rates" referred to in your testimony at USPS-T-35, p. 5, lines 1-3, together with the source of the data.

Witness Moeller Passthroughs, R97-1 Proposed and R2000-1 Proposed

| | Moeller R97-1 Proposed | Moeller R2000-1 Proposed |
|---|---------------------------|-----------------------------|
| Regular | | |
| Letters/Nonletters Basic passthrough | 40.0% | 77.0% |
| Letters/Nonletters 3/5-digit passthrough | 40.0% | 64.0% |
| Letter presort 3/5-digit passthrough | 165.0% | 95.0% |
| Letter automation Basic passthrough | 140.0% | 110.0% |
| Letter automation 3-digit passthrough | 130.0% | 106.0% |
| Letter automation 5-digit passthrough | 130.0% | 160.0% |
| Flat automation Basic passthrough | 100.0% | 230.0% |
| Flat automation 3/5-digit passthrough | 100.0% | 500.0% |
| Destination entry BMC passthrough | 80.0% | 73.0% |
| Destination entry SCF passthrough | 80.0% | 77.0% |
| ECR | | |
| Letters/Nonletters Basic passthrough | 0.0% | 0.0% |
| Letters/Nonletters high density passthrough | 35.0% | 65.0% |
| Letters/Nonletters saturation passthrough | 35.0% | 95.0% |
| letter high density passthrough | 100.0% | 125.0% |
| Letter saturation passthrough | 100.0% | 100.0% |
| etter automation Basic passthrough | 110.0% | 100.0% |
| Destination entry BMC passthrough | 80.0% | 73.0% |
| Destination entry SCF passthrough | 80.0% | 77.0% |
| Destination entry DDU passthrough | 80.0% | 77.5% |

Sources:

Moeiler R97-1 workpapers, pages 9, 11, 12 Moeiler R2000-1 workpapers, pages 9, 11, 12

- a. Confirmed.
- b. Not applicable.
- c. See table below.

| | PRC Rec. Dec. | | | | | |
|---|---------------|--|--|--|--|--|
| | R97-1 | | | | | |
| Regular | | | | | | |
| Letters/Nonletters Basic passthrough | 50.0% | | | | | |
| Letters/Nonletters 3/5-digit passthrough | 40.0% | | | | | |
| Letter presort 3/5-digit passthrough | 100.0% | | | | | |
| Letter automation Basic passthrough | 100.0% | | | | | |
| Letter automation 3-digit passthrough | 100.0% | | | | | |
| Letter automation 5-digit passthrough | · 100.0% | | | | | |
| Flat automation Basic passthrough | 100.0% | | | | | |
| Flat automation 3/5-digit passthrough | 100.0% | | | | | |
| Destination entry BMC passthrough | 85.0% | | | | | |
| Destination entry SCF passthrough | 85.0% | | | | | |
| ECR | | | | | | |
| Letters/Nonletters Basic passthrough | 0.0% | | | | | |
| Letters/Nonletters high density passthrough | 65.0% | | | | | |
| Letters/Nonletters saturation passthrough | 95.0% | | | | | |
| Letter high density passthrough | 100.0% | | | | | |
| Letter saturation passthrough | 100.0% | | | | | |
| Letter automation Basic passthrough | 100.0% | | | | | |
| Destination entry BMC passthrough | 85.0% | | | | | |
| Destination entry SCF passthrough | 85.0% | | | | | |
| Destination entry DDU passthrough | 85.0% | | | | | |

Sources:

PRC R97-1 Standard Mail (A) Workpaper 1, pages 9, 11, 12, 17, 18

NAA/USPS-T35-46: The following table shows the current (column 4) and proposed (column 5) rates for ECR piece-rated mail contained in your testimony:

| | | | | Overall | 4.9% |
|--------------|----------------|-------------------|---------|----------|-------|
| Minimum p | er piece rates | | | | |
| (1) | (2) | (3) | (4) | (5) | (6) |
| Density Tier | Shape | Destination Entry | current | proposed | %chg |
| Basic | Latter | None | 0.162 | 0.175 | 8.0% |
| | | DBMC | 0.146 | 0.158 | 8.2% |
| | | DSCF | 0.141 | 0.153 | 8.5% |
| | | DDU | 0.136 | 0.147 | 8.1% |
| | Automation | None | 0.156 | 0.163 | 4.5% |
| | | DBMC | 0.140 | 0.146 | 4.3% |
| | | DSCF | 0.135 | 0.141 | 4.4% |
| | | DDU | 0.130 | 0.135 | 3.8% |
| | Nonletter | None | 0.162 | 0.175 | 8.0% |
| | | DBMC | 0.146 | 0.158 | 8.2% |
| | | DSCF | 0.141 | 0.153 | 8.5% |
| | | DDU | 0.136 | 0.147 | 8.1% |
| High-Density | Letter | None | 0.139 | 0.152 | 9.4% |
| - | | DBMC | 0.123 | 0.135 | 9.8% |
| | | DSCF | 0.118 | 0.130 | 10.2% |
| | | DDU | 0.113 | 0.124 | 9.7% |
| | Nonletter | None | 0.151 | 0.154 | 2.0% |
| | | DBMC | 0.135 | 0.137 | 1.5% |
| | | DSCF | 0.130 | 0.132 | 1.5% |
| | | DDU | 0.125 | 0.126 | 0.8% |
| Saturation | Letter | None | 0.130 | 0.143 | 10.0% |
| | | DBMC | 0.114 | 0.126 | 10.5% |
| | | DSCF | 0.109 | 0.121 | 11.0% |
| | | DDU | 0.104 | 0.115 | 10.6% |
|] | Nonletter | None | 0.140 | 0.148 | 5.7% |
|] | | DBMC | 0.124 | 0.131 | 5.6% |
| | | DSCF | 0.119 | 0.126 | 5.9% |
| ļ | | DDU | 0.114 | 0.120 | 5.3% |

Standard Mail (A) - Enhanced Carrier Route Proposed Rates (\$)

Source: Moeller WP 1, page 31

- a. Does column 6 correctly calculates [sic] the percent changes in each of the rate categories from current to your proposed rates?b. If not, please provide the correct figures and the source of the data.

- a. Yes.
- b. Not applicable.

NAA/USPS-T35-47: The table following this page shows the current (column 3) and your proposed (column 4) rates for pound-rated ECR Mail.

- a. Do columns (5)-(16) correctly calculate the corresponding percentage changes at each ounce for ECR pound-rated mail?
- b. If not, please provide the correct figures and the source of the data.

RESPONSE:

a. Yes.

b. Not applicable.

Standard Mail (A)- Enhanced Carrier Route

Proposed Rates (\$)

| Pound-rate | d pieces | | | | | | | | | | | | | | | |
|--------------|-------------------|---------|----------|-------|-------|-------|-------|-------|-------|-------------|--------|--------|--------|--------|--------|--------|
| (1) | Ċ Ø | (3) | (4) | (5) | (9) | (7) | (#) | (9) | (10) | (11) | (12) | (13) | (14) | (15) | (16) | (17) |
| Density Tier | Destination Entry | current | proposed | | | | | | | chg at (oz. |) | | | | | |
| | | | | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 |
| Basic | per piece | 0.025 | 0.055 | | | | | | | | | | | | | |
| | per pound | 0.663 | 0.584 | | | | | | | | | | | | | |
| | | less | lesa | | | | | | | | | | | | | |
| | None | 0.000 | 0.000 | 5.4% | 2.3% | 0.1% | -1.4% | -2.7% | -3.6% | -4.4% | -5.1% | -5.6% | -6.1% | -6.5% | -5.6% | 7,1% |
| | DBMC | 0.079 | 0.063 | 5.4% | 2.0% | -0.5% | -2.3% | -3.6% | -4.7% | -5.6% | -6.3% | -7.0% | -7.5% | -8.0% | -8.4% | -8.7% |
| | DSCF | 0,100 | 0.106 | 5.0% | 1.4% | -1.1% | -3.0% | -4.4% | -5.5% | -6.5% | -7.2% | -7.9% | -8.4% | -8.9% | -0.3% | -9.7% |
| | DOU | 0.126 | 0.134 | 5.2% | 1.5% | -1.2% | -3.1% | -4.6% | -5.8% | -8.8% | -7.6% | -8.2% | -8.8% | -0.3% | -9.8% | -10.1% |
| High Density | per plece | 0.014 | 0.034 | | | | | | | | | | | | | |
| ſ | per pound | 0.663 | 0.584 | | | | | | | | | | | | | |
| | 1. | lest | iesa | | | | | | | | | | | | | |
| Į | None | 0.000 | 0.000 | 0.1% | -2.1% | -3.7% | -4.8% | -5.6% | -8.3% | -6.9% | -7.3% | -7.7% | -8.0% | -8.3% | -8.5% | -8.7% |
| | DBMC | 0.079 | 0.083 | -0.5% | -3.0% | -4.8% | -6.1% | -7.0% | -7.8% | -8.4% | -8.9% | -9.3% | -9.7% | -10.0% | -10.3% | -10.5% |
| | DSCF | 0.100 | 0.108 | -1.1% | -3.8% | -5.6% | -6.9% | -8.0% | -8.8% | -9.4% | -0.9% | -10.4% | -10.8% | -11.1% | -11.4% | -11.6% |
| | DDU | 0.128 | 0.134 | -1.2% | -4.0% | 5.9% | -7.3% | -8.3% | -9.2% | -9.8% | -10.4% | -10.9% | -11.3% | -11.6% | -11.9% | -12.2% |
| Saturation | per pieca | 0.003 | 0.028 | | | | | | | | | | | | | |
| | per pound | 0.663 | 0.584 | | | | | | | | | | | | | |
| | | 1669 | less | | | | | | | | | | | | | |
| ļ | None | 0.000 | 0.000 | 3.1% | 0.1% | -1.8% | -3.3% | -4.3% | -5.2% | -5.8% | -6.4% | -5.8% | -7.2% | -7.6% | -7.9% | -8.1% |
| | DBMC | 0.079 | 0.083 | 2.9% | -0.5% | -2.8% | -4.4% | -5.6% | -6.5% | -7.3% | -7.9% | -8.4% | -8.9% | -9.3% | -9.6% | -9.B% |
| | DSCF | 0.100 | 0.108 | 2.3% | -1.2% | -3.6% | -5.2% | -6.5% | -7.5% | -8.3% | -8.9% | -9.5% | -9.9% | -10.3% | -10.7% | -11.0% |
| | DOU | 0.126 | 0.134 | 2.4% | -1.3% | -3.7% | -5.5% | -6.8% | -7.8% | -8.7% | -9.4% | -9.9% | -10.4% | -10.8% | -11.2% | -11.5% |

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Source: Moster WP 1, page 31

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NAA/USPS-T35-48: Please refer to your testimony at page 23, lines 7-8, where you refer to "small businesses" who rely, or may want to rely, on mail advertising.

- a. Please provide your definition of "small business."
- b. Did you have, in the period from May 11, 1998, until the filing of the Formal Request that initiated this proceeding, any meetings with "small businesses" in which the "small businesses" expressed a desire for a reduction in the ECR pound rate? For each meeting, please state the date of the meeting and identify the businesses represented.

RESPONSE:

a. I was speaking of the individual service providers, entrepreneurs, and small

"mom and pop" service businesses referred to in witness Buckel's testimony

on behalf of the Saturation Mail Coalition (SMC-T-1, page 6) in Docket No.

R97-1. See also witness Otuteye's testimony on behalf of the Alliance of

Independent Store Owners and Professionals (AISOP-T-1) in Docket No.

R97-1.

b. No.

NAA/USPS-T35-49: Did you have, in the period from May 11, 1998, until the filing of the Formal Request that initiated this proceeding, any meetings with mailers of Enhanced Carrier Route (ECR) pound-rate mail in which the mailers expressed a desire for a reduction in the ECR pound rate? For each meeting, please state the date of the meeting and identify the mailers represented.

RESPONSE:

On November 6, 1998, I attended a meeting with Standard Mail (A) industry

representatives from the Saturation Mail Coalition and the Mail Order Association

of America during which the pound rate was discussed.

NAA/USPS-T35-50: Please refer to page 35, line 17, of your testimony. Please provide the "presort" tree for Standard (A) Enhanced Carrier Route mail, including the current rate differences, the cost differences as calculated in this proceeding, and the proposed rate differences.

RESPONSE: The three numbers between each box are, from top to bottom,

current rate difference, calculated cost difference, and proposed rate difference.

The arrows show the flow of the rate design passthroughs. The dotted arrows

represent implicit passthroughs that result from other passthrough selections.



NAA/USPS-T35-51: Did you receive any guidance from postal management to limit any particular increase or decrease to any particular extent? If so, please state what guidance you were given.

RESPONSE:

As discussed in response to interrogatory NAA/USPS-T35-11, there was a

general upper bound on the amount by which an individual rate cell was

proposed to increase, and the rate cell most directly affected was 3/5-digit

automation flats. I did not receive guidance regarding rate change limitations

other than this general upper bound for the subclass.
NAA/USPS-T35-52: Please provide, with supporting citation:

- a. The average weight per piece for letter-shaped mail within the Standard (A) ECR subclass.
- b. The average weight per piece for nonletter-shaped mail within the Standard (À) ECR subclass.
- c. The average weight per piece for letter-shaped mail within the Standard (A) Regular subclass.
- d. The average weight per piece for nonletter-shaped mail within the Standard (A) Regular subclass.

RESPONSE:

- a. 0.7894 ounces. FY98 Billing Determinants, G-6, page 2. (USPS-LR-I-125)
- b. 3.2079 ounces. FY98 Billing Determinants, G-6, page 2. (USPS-LR-I-125)
- c. 0.8345 ounces. FY98 Billing Determinants, G-6, page 1. (USPS-LR-I-125)
- d. 3.9948 ounces. FY98 Billing Determinants, G-6, page 1. (USPS-LR-I-125)

NAA/USPS-T35-53: Please provide the "formula" used in designing Standard (A) ECR rates.

RESPONSE:

The "formula" refers to the algebraic equation in the workpapers accompanying

my testimony at WP1, page 20, line 15. On that page, the inputs are defined

and their sources are noted. The formula is RR+D=(Vr)M+Vrp(i)+Vp(P)

RR= revenue requirement

D= Value of the discounts

Vr= Pieces paying the minimum-per-piece rate

M= Basic minimum rate for nonletters

Vrp= Pieces paying the pound rate

i= basic per piece rate for pound-rated pieces

Vp= Pounds paying the pound rate

P= Pound rate

NAA/USPS-T35-54: Please refer to USPS-T-35, page 21, lines 1-3, where you rely upon certain calculations contained in the direct testimony of Sharon Daniel, USPS-T-28, Table 3. The cited table in turn cites as its source library reference USPS-I-92, which contain the cited cost figures at Section 2, pages 10-11. These pages provide data for "Standard A ECR All Shapes Test Year Unit Costs." The volume in pieces in line 1 of page 11 for the ECR total is 33,630,517,437, which is identical (after rounding) to the ECR before rates volume contained in your WP1, page 8. Your before rates cost/piece at WP1, page 8, is \$0.0752. Library Reference USPS-LR-I 92, Section 2, page 11, calculates a cost/piece of \$0.073 (total column).

- a. Please confirm that both the unit cost figure of \$0.0752 in your workpapers and the unit cost figure of \$0.073 in USPS-LR-I-92 are test year before rates. If you cannot confirm, please explain.
- b. Please explain the discrepancy between the unit cost figure of \$0.0752 in your workpapers and the unit cost figure of \$0.073 in USPS-LR-I-92.

RESPONSE:

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- a. Confirmed.
- b. It is my understanding that the figures in the cited Library Reference, unlike

the cited figures in my testimony, do not include contingency or the "final

adjustments" made in witness Kashani's "D Report" (USPS-T-14, WP-H, D

Report, Table E).

NAA/USPS-T35-55. Library Reference LR-I-92 shows a total cost of ECR Mail in all weights of \$2,451,904 (thousands) for the test year, whereas your WP1, page 8, gives a figure of \$2,527,785 (after conversion to thousands) for the test year before rates total cost of ECR Mail.

- a. Please confirm that both the total cost figure of \$2,527,785 (thousands) in your workpapers and the total cost figure of \$2,451,904 in USPS-LR-I-92 are test year before rates. If you cannot confirm, please explain.
- b. Please explain the discrepancy between the total cost figure of \$2,527,785 (thousands) in your workpapers and the total cost figure of \$2,451,904 in USPS-LR-I-92.

RESPONSE:

- a. Confirmed.
- b. It is my understanding that the figures in the cited Library Reference, unlike

the cited figures in my testimony, do not include contingency or the "final

adjustments" made in witness Kashani's "D Report" (USPS-T-14, WP-H, D

Report, Table E).

NAA/USPS-T35-56. Please refer to USPS-LR-I-92, page 11, where a regression equation for pound-rated ECR Mail (all shapes) provides the following results:

y= 0.0247 x - 0.0495. where apparently y= cost per piece in dollars, and x= average weight of pieces in weight increment.

- a. Do you believe that this regression is a reliable basis for ascertaining the effect of weight on cost of ECR Mail?
- b. Do you believe that this equation supports or contradicts your proposal to reduce the ECR pound rate from 66.3 cents to 58.4 cents?

Explain in detail your answer to (a) and (b) above.

RESPONSE:

a. It is my understanding that this regression is not volume-weighted and is

therefore of limited use in ascertaining the effect of weight on costs. Each

data point is given equal weight, even though some data points may

represent a relatively small portion of volume.

b. As described in response to subpart (a), the regression itself is of limited use

in evaluating the proposed pound rate.

NAA/USPS-T35-57. Please refer to your direct testimony at page 20, footnote 39, and page 21, lines 6-7, where you state that "... in this instance estimates of implicit coverage can be illuminating," and that "equalizing cost coverage of the two groupings need not be an end in itself for purposes of ratemaking."

- a. Is it appropriate to establish the piece and pound rate schedule in ECR Mail to equalize the cost coverage of various weight increments?
- b. If your answer to (a) is yes, indicate whether this equalization should occur across all ounces or only across certain groupings of ounces.
- c. If your answer to (b) is that you believe cost coverages should equate for some but not all groupings, please indicate which groupings should be equated and which need not be equated and the rationale for the groupings.

RESPONSE:

- a. It is appropriate to use available information to better align rate components with their underlying cost.
- b. In the ECR minimum-per-piece/per-pound rate structure, there are essentially two groupings with regard to weight: 0 to 3.3 ounces, and 3.3 to 16 ounces. Given that the Postal Service is proposing to maintain this rate structure, it is reasonable to consider the cost information that relates to it.
- It is not required that the cost coverages of any particular subgroups be equated; however, at times comparing these coverages can help establish more appropriate rate relationships.

NAA/USPS-T35-58. Please refer to your direct testimony at page 21, lines 1-3, which cites USPS-T-28, Table 3 as the source of the cost data relied upon by you. USPS-T-28 in turn cites Library Reference USPS-LR-I-92. For each of the subclasses, the library reference appears to show a substantial increase in the unit cost of ECR Mail between 15 and 16 ounces (see Section 2, page 10). This increase appears to also occur for other subclasses of Standard A Mail. Do you attach any significance to the increases in costs for the heaviest pieces in rate design?

RESPONSE:

To the extent these pieces are of higher cost, the "significance" of relationship is reflected in the cost figures in USPS-T-28, Table 3. It is my understanding that the volume in the uppermost weight increment is relatively small and is subject to variation. Also, since the Standard Mail (A) rate structure as proposed has a uniform pound rate for weights above the breakpoint, the most "significance" that can be given the information is to have it incorporated in the cost figures that are used in my testimony at page 21.

NAA/USPS-T35-59. Please refer to your WP1, page 34, columns (4) and (6), where you provide your estimates of revenues per piece for the ECR subclass. Please also refer to the table below, which are the apparent price inputs used by Witness Tolley to calculate before-rate and after-rate volumes in USPS-LR-I-121.

| Prices used in Tolley workpapers, USPS-LR-I-121 vr_ar.wk4 and vr_br.wk4, Prices worksheet | | |
|---|----------|---------------------------------------|
| | | |
| Standard ECR | | · · · · · · · · · · · · · · · · · · · |
| ECR Letters | 0.147702 | 0.159927 |
| ECR Nonletters | 0.172589 | 0.180553 |
| Auto C/R | 0.142908 | 0.149177 |
| High Density L | 0.119938 | 0.131921 |
| High D NL | 0.158704 | 0.155950 |
| Saturation L | 0.110798 | 0.122758 |
| Saturation NL | 0.133258 | 0.137414 |

- a. Please note the similarities in the revenues per piece for ECR letters, including Basic, Automated, High-Density and Saturation between your WP1, page 34 and the table. Did you provide Witness Tolley with his letter price inputs?
- b. Please note that Witness Tolley apparently does not distinguish between piece-rated nonletters and pound-rated nonletters, while your WP1, page 34, does distinguish between these categories. Tolley's figures for nonletters appear to be an average across piece-rated and pound-rated pieces. Did you provide Witness Tolley with his nonletter price inputs? If so, how did you calculate those averages? What inputs did you use? If not, did you provide Tolley with piece-rated and pound-rated price inputs?

RESPONSE:

a. The only prices I provide witness Tolley are those presented in my WP1,

page 29. I presume the similarity between these figures is because the

same billing determinants are used to determine the average revenue for the

rate category.

Again, I simply provided the proposed rates found on page 29 of my WP1. I separately calculated the figures in the detail provided in WP1, page 34, for purposes unrelated to the volume forecast. For derivation of those figures, see WP1, pages 32 and 33.

NAA/USPS-T35-60. Please refer to your reply to NAA/USPS-T35-21, where you state that the calculation of coverages at the subclass level (ECR Total) is based on costs that are after rates, whereas the implicit coverages calculated on a weight-grouping basis (piece rated versus pound rated) are calculated before rates. You also offer an explanation of the discrepancies between the subclass coverage and the two weight groups might be explained by the fact that the subclass coverage considers a contingency whereas the implicit coverages do not.

- a. Please provide any explanation why you used different methodologies for the two calculations (for subclass coverage and implicit coverages).
- b. In your answer to NAA/USPS-T35-37 you explain why you believed it appropriate not to account for volume shifts in the calculation of the change in revenue/piece as a result of the difference between "before rates" and "after rates." In response to VP-CW/USPS-T35-3(c) you state:
 - ... Since after rates costs are not available, the before rates costs are used for the comparison with after rates revenues. Any change in costs in the after rates environment would be due to a change in volume mix. Since the volumes are being held constant for the revenue calculation, it would be appropriate to use after rates costs, even if they were available, for this comparison of implicit cost coverages.

Please explain why you believe "volume shifts" should be accounted for in some cases and a "constant mail mix" in others. Please also explain why you have different approaches in the cited examples.

RESPONSE:

a. The two calculations are not meant to be directly comparable. The

calculation of the subclass level coverage is an after-rates figure because that

is the calculation needed for the Postal Service to determine if the test year

revenue requirement is being met. The implicit coverage calculations are

performed using available data to compare different groupings of mail within

the same subclass. Those comparisons need not reflect a contingency, or be

on an after rates volume basis.

b. The cited examples both use a "constant mail mix." Perhaps the confusion is based on the inaccurate transcription of my response to VP-CW/USPS-T35-3c. In that response, I state that it would be "*inappropriate*" to use after rates costs, whereas the passage cited above says "*appropriate*." In any event, the first example refers to the calculation of the percentage rate change for the subclass and how using a constant mail mix isolates the effect on change in revenue per piece. The second example states that "volumes are being held constant for the revenue calculation" and that it is appropriate for costs to reflect the same mix.

PostCom/USPS-T35-1. Please refer to line 22 on page 13 through line on page 14, where you state, "Another reason to maintain the automation discounts is the expectation that many future mail processing developments will involve more extensive automated sortation of flats and will be enhanced by the presence of a mailer-applied barcode."

- a. Please confirm that reducing automation discounts will most likely reduce mailer investment in automation.
- b. Please list and describe all reasons why the value of a barcode will increase in the future.
- c. Please provide all studies and reports that describe why the value of a barcode will increase in the future.
- d. Please provide all studies and reports that quantify the increase in the value of a barcode in the future flats mail processing environment.

RESPONSE:

- a. Not confirmed. I do not know how costly it is for individual mailers to apply barcodes and meet the automation standards. It could be that the level of the barcode discount, even though slightly reduced from its current level, is more than enough to encourage mailers to continue to generate such pieces.
- b. It is my understanding that the Postal Service does not know if the value of the barcode will increase in the future given existing flat sortation and OCR technology.
 Please see witness Kingsley's testimony (USPS-T-10) at page 17-18 related to the continuing value of a barcode.
- c. I know of no studies that describe or measure the extent to which the value of a barcode will increase in the future. My testimony cites mail processing developments that will be facilitated by the presence of a mailer-applied barcode, but is not intended to imply there will be an absolute increase in the value of a barcode, or that such value will exceed the discounts proposed in this proceeding.

which are based on 230 and 500 percent of the measured savings for the test year.

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Also, see witness Kingsley's response to interrogatory DMA/USPS-T10-29.

d. See response to subpart (c).

PostCom/USPS-T-35-2. Please refer to footnote 4 in LR-I-166, wp1_comm.xls, worksheet "parcel," which states, "Estimate of reduction in surchargable pieces due to implementation of the surcharge."

- a. Please confirm that the "Estimate of reduction in surchargable pieces due to implementation of the surcharge" is 25% for Standard (A) Regular. If not confirmed, please provide the correct figure.
- b. Please explain how this 25% figure was developed.
- c. Do the pieces that are no longer surchargable leave the Standard (A) Regular mailstream? If so, please provide a citation to where the Postal Service has adjusted Standard (A) Regular cost and volume figures to reflect this change.
- d. Do the pieces that are no longer surchargable become flat-shaped Standard (A) Regular pieces? If so, please provide a citation to where the Postal Service has adjusted Standard (A) Regular cost figures to reflect this change.
- e. If your response to part (c) was no, please describe which test year mailstream includes these no longer surchargable pieces.

RESPONSE:

- a. It is an estimate of how many pieces will have successfully avoided the surcharge.
- b. See USPS-T-35, Appendix 1, page 4-5. Since the surcharge was not

implemented until January 10, 1999, and the volume data used are from

FY98, an estimate was made regarding how many parcel shaped pieces in

FY98 would be prepared in a manner that would allow them to avoid the

surcharge. No volume data were available upon which to base an estimate.

See response to interrogatory NAA/USPS-T35-36(a).

- c. No, rather, the testimony treats these pieces for revenue calculation purposes as having the characteristics of Standard Mail (A) pieces that avoid the surcharge.
- d. As described in USPS-T-35, Appendix 1, page 5, it is likely that some parcelshaped pieces are being entered as automation flats. No cost adjustment is

made. It is my understanding that although entered as automation flats, they are usually treated and handled as parcels. See witness Kingsley's testimony (USPS-T-10, pages 16-17).

e. See response to subpart (d).

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PostCom/USPS-T-35-3. Please refer to footnote 9 in LR-I-166, wp1_comm.xls, worksheet "parcel," which states, "Estimate of reduction in surchargable pieces due to implementation of the surcharge."

- a. Please confirm that the "Estimate of reduction in surchargable pieces due to implementation of the surcharge" is 50% for Standard (A) ECR. If not confirmed, please provide the correct figure.
- b. Please explain how this 50% figure was developed.
- c. Do the pieces that are no longer surchargable pieces leave the Standard (A) ECR mailstream? If so, please provide a citation to where the Postal Service has adjusted Standard (A) ECR cost and volume figures to reflect this change?
- d. Do the pieces that are no longer surchargable pieces become flat-shaped Standard (A) ECR pieces? If so, please provide a citation to where the Postal Service has adjusted Standard (A) ECR cost figures to reflect this change.
- e. If your response to parts (c) was no, please describe which test year mailstream includes these no longer surchargable pieces.

RESPONSE:

a. It is an estimate of how many pieces will have successfully avoided the

surcharge.

- b. See response to interrogatory NAA/USPS-T35-36(a).
- c. As described in USPS-T-35, Appendix 1, page 5, it is assumed that some of the samples may have been reconfigured as flats, or perhaps left the mailstream. It is my understanding that the level of the surcharge is incorporated into the volume forecast for ECR nonletters. The extent to which samples have left the mailstream is unknown, however, and accordingly no adjustment is made to costs. The percentage of ECR nonletters that is

parcel-shaped is very low (0.2 percent), so the total revenue projection is very insensitive to the surcharge reduction estimate.

- d. See response to subpart (c). There is no adjustment to the cost figures.
- e. See response to subpart (c).

U.S. POSTAL SERVICE WITNESS MOELLER RESPONSE TO INTERROGATORIES OF THE PARCEL SHIPPERS ASSOCIATION

.

PSA/USPS-T35-1. On pages 6 through 8 of your testimony you discuss the proposed 18 cent shape surcharge and state that it equates to a 27.5% pass-through. This is based upon your calculation that the cost difference between flats and parcels is estimated to be 65.5 cents, and that the 18 cent surcharge is only 27.5% of that number. You further state that: "Ideally, a greater pass-through would be proposed. However, in order to moderate the impact on mailers, and even greater per piece increase in the surcharge is not proposed at this time."

- a. Is it not the case that your methodology and your quoted language imply that you have assumed that the amount of revenue produced per piece for flat-shaped pieces and parcels in the non-letter category are equal?
- b. Is it not a distortion to imply that the flat-parcel cost differential should be equal to the surcharge without taking into account the fact that the revenue produced per unit may suggest that no surcharge is required?
- c. If the response to (b) is in the negative, please confirm that theoretically it is possible that, even though the cost differences between flats and parcels is 65.5 cents, the amount of revenue generated by parcels could be so much greater than the revenue generated by flats that, despite the cost differences, parcels have a greater cost coverage than flats?

RESPONSE:

- a. No. There is no assumption that the revenue-per-piece for flat-shaped pieces and parcels are equal. As stated in my testimony, the passthrough methodology is the same as that cited by the Commission in its Docket No. R97-1 Recommended Decision. The quoted language simply states that a higher surcharge could be justified if not for rate impact concerns. As a point of clarification, witness Crum calculates the cost difference.
- b. My testimony does not imply that the cost differential should be equal to the surcharge. I state that a passthrough greater than 27.5 percent would be better (if not for concerns of rate impact), but I do not state that the passthrough should be 100 percent, a condition that would be necessary for the surcharge to equal the cost difference.

U.S. POSTAL SERVICE WITNESS MOELLER RESPONSE TO INTERROGATORIES OF THE PARCEL SHIPPERS ASSOCIATION

C.

It is theoretically possible for parcels to have a higher contribution than flats; however, data indicate that that is not the case with a surcharge of 18 cents. For example, in the Regular subclass, if the cost coverage for flats is 109.5 percent (23 cents divided by 21 cents), the surcharge on parcels would have to be 36 cents for parcels to have a similar coverage. (See USPS-T-27, Attachment F, Table 6.1. Since the cost of parcels is 77 cents, revenue for parcels would have to be 84 cents to generate a 109.5 percent implicit coverage. The revenue without the surcharge is 48 cents; with an additional 36 cents, the total revenue would be 84 cents. Other rate changes such as a lower pound rate or implementation of a parcel barcode discount might result in a lower revenue per piece, however, which might necessitate a higher surcharge to maintain the cost coverage.)

U.S. POSTAL SERVICE WITNESS MOELLER RESPONSE TO INTERROGATORIES OF THE PARCEL SHIPPERS ASSOCIATION

PSA/USPS-T35-2. On page 41 of your testimony you provide the Test Year After Rates Financial Summary including the revenues, costs, and coverages for the Regular, ECR, Nonprofit, and Nonprofit-ECR sub-classes. Please provide the same data separately for flats, and for IPPs and parcels, that are a part of these four sub-classes

RESPONSE:

The data presented in the table on page 41 of my testimony is made possible by

the subclass level quantification of total volume variable costs. These data are

not available in the finer detail requested, so a further break down is not

possible. Although the costs and revenues are not projected to the test year,

Table 6.1 of Attachment F to witness Crum's testimony offers insight into the

relative cost, revenue, and contribution for various shapes.

RESPONSE OF POSTAL SERVICE WITNESS MOELLER TO INTERROGATORY OF THE PARCEL SHIPPERS ASSOCIATION REDIRECTED FROM WITNESS CRUM

PSA/USPS-T27-4. According to your Attachment F Tables, the cost coverages for Standard (A) IPPs and parcels in the two ECR sub-classes fall to cover their attributable costs to a much greater degree than does the Bulk Regular Rate parcel category. Please explain why, notwithstanding the fact that the ECR subclasses have a more adverse cost revenue relationship, you nevertheless propose a surcharge for parcels in those two sub-classes that is 3 cents less than for parcels in the other two sub-classes.

RESPONSE:

The rationale for the level of the proposed surcharge in ECR can be found on pages 23-24 of my testimony (USPS-T-35). The figure of 15 cents was chosen because it is the minimum net surcharge that a non-ECR (Regular) piece eligible for the barcode discount can receive under the proposed rates. The surcharge, therefore, is never greater for an ECR piece than for a Regular piece eligible for the surcharge. ECR parcels avoid many of the cost-difference-causing sorting operations that Regular pieces lncur, so it is not unreasonable to restrain the

ECR surcharge to that for Regular pieces.

Revised 3/13/00 RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS MOELLER TO INTERROGATORIES OF RECORDING INDUSTRY ASSOCIATION OF AMERICA

RIAA/USPS-T35-1. The residual shape surcharge that you advocate applies to "Standard Mail (A) Regular that is neither letter-nor flat-shaped, or is prepared as a parcel." USPS-T-35 at 6 lines 16-17. Please enumerate each characteristic of an otherwise flat-size mail piece (as defined by DMM Section C050) that would render the piece subject to the residual shape surcharge by reason of the piece being "prepared as a parcel."

RESPONSE:

If the piece meets the DMM Section C050 definition of a flat, but is non-theiess prepared as a machinable parcel, it is this "characteristic" (being prepared as a parcel) that renders it subject to the surcharge. The machinable parcel shape definition is also in DMM Section C050, and the preparation rules are in DMM

Section M610.5.0.

RIAA/USPS-T35-2. For each of the characteristics that you have listed in response to interrogatory 1 above, please explain how the characteristic results in increased costs to the Postal Service that warrant imposition of the residual shape surcharge.

RESPONSE:

If a piece is prepared as a parcel, it is generally handled as a parcel. See my response to RIAA/USPS-T35-1. For example, a machinable parcel presorted to BMC will be sorted on a parcel sorter, and will be processed in a parcel mailstream. (Also, presortation to BMC is not as fine as presortation to 3-digit, which would be required of a flat for the 3/5-digit rate.) Parcel processing and delivery is more costly than processing and delivery of the typical flat. So, the

"characteristic" (being prepared as a parcel) results in increased costs.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS MOELLER TO INTERROGATORY OF RECORDING INDUSTRY ASSOCIATION OF AMERICA

RIAA/USPS-T35-3. Please refer to your response to DMC/USPS-T35-7 (filed April 6, 2000):

- a. In response to subpart i of that interrogatory you state that for "revenue estimation purposes" the volume of pieces estimated to receive the barcode discount in Standard Mail (A) Regular is 490 million. Please confirm that this number represents 76% of the net volume of "surchargeable pieces" as reflect in your workpaper 1, page 14. If you do not confirm, please state how the 490 million pieces set forth in your response to DMC/USPS-T-35-7(i) was derived.
- b. Does your estimation of the number of pieces that will receive the barcode discount include any pieces that are deemed machinable pursuant to DMM C050.4.3? If so, what percentage of the 490 million pieces set forth in your response to the DMC interrogatory are estimated to be eligible for the barcode on this basis, and how was such estimate derived?
- c. Please confirm that the 490 million pieces set forth in your response to the DMC interrogatory does not include any pieces that are estimated to be entered as flats. If you do not confirm, please explain your answer in detail.
- d. Is the reference to "revenue estimation purposes" contained in your response to subpart i of the DMC interrogatory meant to imply that, for purposes other than revenue estimation, different volumes and different estimates of the percentage of pieces that will receive the barcode discount were used? Please explain your answer in detail.

RESPONSE:

- a. Confirmed.
- b. The estimate is related to the definition of machinable parcels in DMM C050.4.3 in that it is based on the assumption that all pieces weighing six ounces or above will receive the discount. Six ounces is the minimum weight for a machinable parcel, unless a BMC plant manager authorizes lighter-weight pieces to be prepared as machinable parcels. Although some parcels weighing over 6 ounces may not claim the discount, this may be

offset by those pieces weighing less than 6 ounces that receive eligibility for preparation as machinable parcels.

- c. Confirmed. Pieces entered as flats will not be eligible for the parcel barcode discount.
- d. The reference to "revenue estimation purposes" in this question was not intended to imply that there was some other estimate of pieces that will claim the barcode discount. I know of no other estimate of barcoded volume. I do understand, however, that a slightly different percentage (75 percent instead of 76 percent) was used in the calculation of the fixed weight index for Standard Mail (A) Regular. The 75 percent figure is an average for all noncarrier-route Standard Mail (A) parcels, and the 76 percent figure is for Standard Mail (A) Regular.

U.S. POSTAL SERVICE WITNESS MOELLER RESPONSE TO INTERROGATORY OF UNITED PARCEL SERVICE

UPS/USPS-T35-1. Identify all instances in which you have relied on or used in your testimony in any way any FY 1999 cost, revenue, volume, or other data, and state in each such instance why you used FY 1999 data instead of data for BY 1998.

RESPONSE:

I did not directly use any FY 1999 data. The rate design does include information from

other witnesses that may have incorporated some FY 1999 data. See the responses of

witnesses Tolley (UPS/USPS-T6-9), Thress (UPS/USPS-T7-1), Tayman (UPS/USPS-

T9-1), Kingsley (UPS/USPS-T10-4), Kashani (UPS/USPS-T14-1), Yacobucci

(UPS/USPS-T25-1), Eggleston (UPS/USPS-T26-4), Crum (UPS/USPS-T27-1), Daniel

(UPS/USPS-T28-1), and Mayes (UPS/USPS-T32-1).

VP-CW/USPS-T35-1. Please refer to USPS-LR-166, WP 1, page 10.

- a. In what part of your testimony do you use the costs shown in lines 5-6 for letters, and where do you use the alternative costs shown in lines 32-33?
- b. Where do you use the unit costs shown for Basic Automation flats in line 10, and where do you use the unit cost for Basic Automation flats shown in line 37?
- c. Why is the mail processing unit cost for Basic Automation flats in line 37 higher than the mail processing unit costs shown in line 10?

RESPONSE:

- a. I use lines 5-6 in Worktable 1 on page 11 of WP 1, and in lines 8 and 10 of Column (1) on page 12 of WP 1. I use lines 32 and 33 in the calculations in Worktable 2 on page 11 of WP1.
- b. Line 10 is not used. Line 37 is used in line 2 of column (1) on page 12 of WP 1.
- c. On page 12 of Appendix 1 of my testimony, I note that, in some instances, there are two separate measurements of mail processing costs for some categories in order to isolate the particular worksharing savings underlying the discounts or rate differentials. Not surprisingly, since in some instances there are two distinct measurements, one is going to be higher. For discussion of how the measurements were determined, see witness Yacobucci's testimony (see USPS-T-25).

VP-CW/USPS-T35-2.

At page 18 (lines 5-8) your testimony states:

In Docket No. MC95-1, the Postal Service proposed and the Commission recommended the creation of the Enhanced Carrier Route subclass so that the distinct cost and market characteristics of mail within this subclass could be more fully recognized.

- a. Were the proposed rates for ECR mail in this case designed so that the distinct cost and market characteristics of ECR mail could be more fully realized? If so, explain how this was done.
- b. Please indicate the rates or rate levels that in your view would constitute full recognition of the distinct cost and market characteristics of ECR mail to which you refer in your testimony quoted above.
- c. At current rates, how far away is ECR mail from achieving full recognition of the distinct cost and market characteristics of ECR mail?
- d. If your proposed rates for ECR mail were to be adopted, how far away would ECR mail be from achieving full recognition of the distinct cost and market characteristics of ECR mail?
- e. Comparing your proposed rates for ECR mail with current rates, how much closer do your proposed rates get to achieving full recognition of the distinct cost and market characteristics of ECR mail compared with current rates?

RESPONSE:

a. It is my understanding that since ECR is a subclass, it is assigned a cost

coverage based on the relevant pricing criteria. The market characteristics

are considered in the cost coverage in criteria 2 and 5, and the cost

characteristics are also considered in that the coverage is applied to the

separately-measured subclass costs for ECR as provided by criterion 3.

See witness Mayes testimony (USPS-T- 32) at pages 38 and 39. The

proposed rates flow directly from the cost measurement and the cost

coverage. This is more recognition of the cost and market characteristics

U.S. POSTAL SERVICE WITNESS MOELLER RESPONSE TO INTERROGATORIES OF VAL-PAK AND CAROL WRIGHT PROMOTIONS than would be the case if carrier route were still a rate category, rather than a subclass.

b. The rate level itself is beyond the scope of my testimony. As described in response to subpart a, the creation of the subclass leads to recognition of cost and market characteristics, along with all of the other pricing criteria. It is not clear in any event what this interrogatory intends by reference to the "full recognition" of the distinct cost and market characteristics. As noted in my response to subpart a, the pricing criteria require that the market characteristics and costs be considered. While I note that witness Mayes states that, considered in isolation, many of the criteria would indicate a coverage lower than the proposed coverage (See witness Mayes, USPS-T-32, at page 39, lines 14-16), it is my understanding that all of the pricing criteria must be considered in determining the cost coverage. Balancing the implications of the pricing criteria against each other might result in a cost coverage that does not seem to follow from one pricing criterion in isolation. This does not imply, however, that cost characteristics or market characteristics were not "fully recognized."

c-e. See responses to (a) and (b).

VP-CW/USPS-T35-3. Please refer to your testimony at the top of page 21 (table).

- a. [This interrogatory as filed did not include a subpart a.]
- b. Please confirm that the piece-rated data include both letters and flats. If you do not confirm, please explain what the piece-rated data represent.
- c. For all piece-rated ECR nonletters, what is the unit revenue, unit cost and implicit coverage, respectively, both before and after rates?
- d. For all ECR non-letters combined (i.e., both piece and pound-rated), what is the unit revenue, unit cost and implicit coverage, respectively, both before and after rates?
- e. For all piece-rated ECR letters, what is the unit revenue, unit cost and implicit coverage, respectively, both before and after rates?
- f. The unit cost in your table for pound-rated matter using costs with a 3.0 and a 3.5 ounce dividing line is, respectively, \$0.0901 and \$0.0916. What is the estimated cost per pound that was used to determine these different unit costs? Should your answer be to the effect that no explicit unit cost estimate was used to derive these figures, please explain fully.

RESPONSE:

- a. N/A
- b. Confirmed.
- c. As far as unit costs are concerned, witness Daniel's testimony (USPS-T-28)

at page 16 lines 2-5 explains:

Since the IOCS weight data do not allow costs to be calculated exactly at the breakpoint used in rate design (*i.e.*, 3.3 ounces), either the average cost of pieces above and below 3.0 or 3.5 ounces can be used to proxy for the cost of pound-rated and piece-rated mail.

The cost estimates in USPS-T-28, Table 3, page 17 show that the

TYBR unit cost for ECR non-letters weighing less than 3.0 ounces is

\$0.0657 and the TYBR unit cost for ECR non-letters weighing less

than 3.5 ounces is \$0.0674. New unit costs are not calculated for

TYAR.

The revenue per piece for piece-rated nonletters is \$0.13078 before rates, and \$0.13962 after rates. (See WP 1, page 34). In order to isolate the effect of the rate change, the volumes underlying these figures, as well as the volumes used in other subparts of this response, are held constant before and after rates. These estimates do not attempt to incorporate the effect of the residual shape surcharge, which would be minimal.

Implicit coverages, similar to those in the referenced table on page 21 of my testimony, would be 199.1 percent or 194.0 percent (using the 3.0 and 3.5 breakpoints, respectively) before rates, and 212.5 percent and 207.2 percent (for 3.0 and 3.5, respectively) using after rates revenues. Since after rates costs are not available, the before rates costs are used for the comparison with after rates revenues. Any change in costs in the after rates environment would be due to a change in volume mix. Since the volumes are being held constant for the revenue calculation, it would be inappropriate to use after rates costs, even if they were available, for this comparison of implicit cost coverages.

d. The cost estimates in witness Daniel's testimony (USPS-T-28, Table 3, page 17) show that the TYBR unit cost for all ECR non-letters is estimated to be \$0.0757. New unit costs are not calculated for TYAR. The unit revenue is \$0.15544 before rates, and \$0.16104 after rates.

U.S. POSTAL SERVICE WITNESS MOELLER RESPONSE TO INTERROGATORIES OF VAL-PAK AND CAROL WRIGHT PROMOTIONS The implicit coverages, therefore, calculated as described in subpart

c, are 205.8 percent before rates and 212.7 after rates.

- e. See response to subpart (c). The cost estimates in witness Daniel's testimony (USPS-T-28, Table 3, page 17) show that the TYBR unit cost for ECR letters weighing less than 3.0 ounces is \$0.0669 and the TYBR unit cost for ECR letters weighing less than 3.5 ounces is \$0.0678. New unit costs are not calculated for TYAR. The unit revenue is \$0.13614 before rates, and \$0.14724 after rates. The coverages would be 203.5 percent or 200.8 percent (using the 3.0 and 3.5 breakpoints, respectively) before rates, and 220.0 percent and 217.2 percent (for 3.0 and 3.5, respectively) using after rates revenues.
- f. No explicit unit cost estimate per pound was used to derive these figures. The costs are summarized in witness Daniel's testimony (USPS-T-28, Table 3, page 17) and were derived in USPS LR-I-92 using a methodology described in USPS-T-28 pages 3-10.

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VP-CW/USPS-T35-4. Did you or the Postal Service develop the unit cost estimates that underlie any of the individual cells for your proposed rates for Standard A Mail shown on pages 17 and 28 of your testimony? If so, please provide such estimates, and indicate where these unit costs estimates can be found.

RESPONSE:

i

Cost estimates underlying the cited rate cells were not developed.

VP-CW/USPS-T35-5. Please refer to USPS-LR-I-166, WP 1, page 20.

- Please confirm that after the parameters and data shown in lines 1-13 have been specified, the rate design formula shown on this page will determine (i) the rate for piece-rated flats, and (ii) the piece rate for pound-rated pieces. Please explain any non-confirmation.
- b. Would you agree that it is the inputs to the formula on page 20 that determine the design of the rates for individual cells, and not the formula shown on lines 14-18? If you do not agree, please explain.

RESPONSE:

- a. Confirmed. More specifically, though, the piece rates that are outputs are for the Basic tier.
- b. If "design" of the rates is intended to mean the relationships between rate

cells that result from selection of the various passthroughs, then yes, it is the

inputs that generate these rate relationships. The formula produces the

base rates necessary to generate the required revenue.

VP-CW/USPS-T35-6. Your testimony at page 4 (lines 17-18) states that "in consideration of the effect on users (criterion 4), the rate design employs an upper bound on the amount by which an individual rate cell is proposed to increase."

- Please confirm that your reference to "criterion 4" is to 39 U.S.C. section 3622(b)(4).
- b. When designing rates for the two subclasses of Standard A Commercial Mail, did you consider or rely on any of the other non-cost criteria contained in section 3622(b) of the statute? If so, please state which criteria you relied upon, which rate cells were affected by your reliance on each of those other criteria, and how your overall rate design was affected by reliance on those other criteria. If not, please explain why you relied upon only one non-cost criterion and did not consider or apply any of the other non-cost criteria.
- c. When designing the rates for Standard A Mail, did you consider criterion 4 to be more important than all the other non-cost criteria?
- d. In your opinion, should the Postal Service and the Commission apply the non-cost criteria of section 3622(b) to the rate design within individual subclasses?

RESPONSE:

- a. Confirmed.
- b. The criteria are to be considered explicitly for rate level determination,

however, they do embody fundamental principles for rate design, as well. Not all of them are relevant at the rate design level; however, the broad notion of fairness and equity seems applicable. Certainly, it should not be an objective of the rate design to be unfair and inequitable. For example, while consideration of the effect of rate increases might lead to a passthrough selection of greater than 100 percent, consideration of fairness and equity may come into play since tempering the rate increase for one rate cell has a push-up effect on other rate cells. 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. Degree of preparation is broadly considered in that the rate design includes discounts that require certain levels of preparation. (See witness Mayes, USPS-T-32, at page 9.) Simplicity is also considered in rate design when deciding whether to complicate the rate structure with additional rate categories. In the Standard Mail (A) proposal, a barcode discount is proposed for parcels after determination that such a discount would provide incentive for mailer-applied barcodes without unnecessarily complicating the rate structure.

- c. I did not judge the relative importance of the factors embodied in the criteria.
 The effect of rate increases, however, did play an important role in the rate design.
- d. As stated in my response to subpart b, I believe some of the principles have applicability at the rate design level.
VP-CW/USPS-T35-7. Please confirm that in this docket the Postal Service proposes the following percentage increases for ECR letters and piece-rated non-letters (without any destination entry discounts – *see* PRC Order No. 1279, Attachment B, p. 17).

| | Letters | Non-Letters |
|--------------|---------|-------------|
| High Density | 9.4% | 2.0% |
| Saturation | 10.0% | 5.7% |

If you do not confirm, please explain.

a. The Postal Service press release which accompanied the filing, in explaining why business rates are increasing, states that:

In general, rate increases for each subclass reflect overall cost trends for that subclass. As a result of the letter automation program, increases for letter-shaped items, particularly First-Class Mail, are generally smaller.... At the same time, costs have increased more rapidly for flat-shaped items, such as Periodicals, Standard Mail catalogs and Bound Printed Matter.... The proposal calls for larger-than-average increases for those categories.

In light of the cost trends asserted in the Postal Service press release, please explain why your rate design reflects rate increases for ECR letters that substantially exceed the rate increases proposed for ECR non-letters.

- b. For High-Density and Saturation ECR letters and non-letters, what is the estimated unit cost in the Base Year?
- c. What was the estimated unit cost for the above-mentioned items in the Base Year of Docket No. R97-1?

RESPONSE:

a. I presume the reference to increasing costs for Standard Mail catalogs

relates to the rate increases for automation flats. These cost changes are

not as critical for ECR flats since they avoid most of the piece-distribution

operations that automation flats incur. In any event, the rate design for ECR

relies on the cost differentials referred to in my testimony. The difference in

the rate change percentages for letters and flats relates to these cost differentials, and the applied passthroughs.

- To my knowledge, costs for High-Density and Saturation ECR letters and nonletters were not calculated in Base Year terms.
- c. To my knowledge, costs for High-Density and Saturation ECR letters and nonletters were not calculated in Base Year terms.

VP-CW/USPS-T35-8. Your testimony at page 24 (lines 7-9) states that "The surcharge only applies if the sample is not letter- or flat-shaped, or is prepared as a parcel."

- a. In FY 1999, how many flat-shaped pieces were prepared as parcels under the current rates?
- b. What incentive(s) do mailers have to prepare flat-shaped pieces as parcels under current rates?
- c. What incentive(s) do mailers have to prepare flat-shaped pieces as parcels under your proposed rates?

RESPONSE:

- a. The "prepared as a parcel" language is applicable to pieces (primarily machinable parcels) that may meet the dimensional criteria of a flat, but are prepared according to parcel preparation requirements. It is my understanding that there are no volume estimates of how many pieces that meet the flat-shaped definition were nevertheless prepared as parcels.
- b. Some mailers of pieces that would meet the flat shape definition may choose to mail the pieces as machinable parcels for simplicity in themail preparation requirements. Machineable parcels need only be prepared to BMC (unless there is enough volume to warrant 5-digit presort), whereas flats must be prepared to 3-digit (which is a finer depth of sort than BMC), to receive the 3/5-digit presort rate. Also, to the extent the mailing includes pieces that exceed the dimensions of a flat, a mailer may find it easier to combine all of the machinable parcels in one mailing, rather than cull those pieces that could be mailed as flats.
- c. The same type of incentives exist under the proposed rates as the current rates.

VP-CW/USPS-T35-9.

a. Did you utilize the principles of Ramsey pricing in any way when designing Standard A rates? Please explain your answer, regardless of whether it is affirmative or negative.

b. Do these principles have any relevance to rate design within the Standard A subclasses? Please explain your answer, regardless of whether it is affirmative or negative.

RESPONSE:

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a. No. The issue of the appropriate allocation of institutional costs is one that customarily has been handled at the subclass level, and that is not the subject of my testimony. I understand, however, that many of the types of issues that would need to be addressed to respond fully to this question are discussed in of the testimony of Peter Bernstein, USPS-T-41. See witness Mayes' testimony (USPS-T-32) at page 19 for a discussion of Ramsey pricing and its effect on the rate level proposals.

b. The relevant guidelines to be followed within the Standard Mail (A)

subclasses are described throughout my testimony. I do not have an opinion as to whether Ramsey pricing principles have relevance below the subclass level, although, as a practical matter, I know of no reason why one could not approach the rate design with some consideration of relative demand.

VP-CW/USPS-T35-10.

- a. Please explain your familiarity with and understanding of the concept of efficient component pricing.
- b. In your opinion, is efficient component pricing an important principle for design of rates in the Standard A subclass?
- c. Suppose the average rate increase for one subclass is substantially higher than the rate of inflation, while the average rate increase for a second subclass is substantially less than the rate of inflation. Is efficient component pricing a more important principle for rate design in either of the two subclasses? For each case, please explain why or why not.
- d. When determining the various passthroughs that you recommend within the Standard A subclass, what effort did you make, if any, to incorporate the principle of efficient component pricing?

RESPONSE:

a. Witness Bernstein (USPS-T-41) defines the principle at page 78, lines 9-12,

as "designed to minimize the total cost of providing mail service by

establishing the workshare discount that provides incentives for the party (the

Postal Service or the mailer) with the lower cost of performing the workshare

activity to perform that activity."

- b. Yes, but it is not the only principle.
- c. The principle itself is important and is considered within each subclass. While a number of considerations must be weighed in the rate design, the overall percentage increase and whether it is above or below the rate of inflation does not, by itself, render efficient component pricing more or less important.
- My testimony recognizes the cost savings due to worksharing while meeting the other rate design constraints and objectives described throughout my testimony.

VP-CW/USPS-T35-11. For cost savings that arise from dropshipment of Standard A ECR Mail, you recommend passthroughs varying between 73 and 77.5 percent in this case.

- a. Do these passthroughs represent the "optimal" passthrough for Standard A ECR Mail, or are they constrained in this case by other considerations? If the latter, please describe all other considerations that you consider significant.
- b Under what conditions would you consider a 100 percent passthrough for dropship discounts to be appropriate?
- c. Under what conditions would you consider a passthrough of more than 100 percent (*e.g.*, including a markup) for dropship discounts to be appropriate?
- d. Was consideration given to retaining the current passthrough of 85 percent (see Docket No. R97-1, *Op. & Rec. Dec.*, para 5501)? If so, why was this option rejected? If not, why not?

RESPONSE:

- a. I view these passthroughs as optimal in that they meet the objectives of the rate design as discussed in my testimony, page 14, line 14, through page 16, line 15, and page 26, line 16, through page 17, line 3. Another factor one might want to consider is the fact that the dropship savings are expressed in terms of cents per pound, and the discount for letters assumes a weight of 3.3 ounces, even though the average weight for a letter is significantly lower.
- A 100 percent passthrough might be appropriate if it did not cause other rate design objectives to not be met. Also, see responses to interrogatories MOAA/USPS-T35-1-2.
- c. As is the case with the automation discounts in this proposal, passthroughs of greater than 100 percent can be considered if necessary to avoid significant reduction in the current discounts. Such a consideration would be sensitive to the investments made by mailers to take advantage of the discounts.

d. As described in my testimony at page 5, lines 1-3, in general, the rate design process begins with the passthroughs underlying the current discounts. On page 15, lines 1-3, of my testimony, I note that passthroughs higher than those proposed would conflict with the general guideline of tempering individual rate increases. Also on page 15, lines 4-11, of my testimony, I describe the effort to maintain or increase the differential between the levels of destination entry.

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VP-CW/USPS-T35-12. Transportation costs represent a significant portion of the costs avoided by dropshipment to destinating facilities. In Priority Mail rate design, transportation cost differences reflect cost plus contingency plus markup (see USPS-T-34). Your cost differences are between 73 and 77.5 percent of identified cost savings. Which principle of rate design is correct? That is, is it most desirable to reflect transportation cost differences in rate design at (i) less than 100 percent, (ii) 100 percent, or (iii) somewhat more than 100 percent (e.g., the full cost difference times the subclass coverage factor)? Regardless of your answer, please explain all rate design principles upon which you rely to support your position.

RESPONSE:

I believe that it is desirable to reflect transportation costs in a manner that is consistent with the rate design objectives for a particular subclass. In both Standard Mail (A) and Priority Mail, a markup and contingency are applied to transportation costs. However, the cited aspects of Priority Mail rate design and Standard Mail (A) rate design are not directly comparable. In Standard Mail (A), some transportation costs and mail processing costs are deemed destinationentry related and are quantified for purposes of offering a workshare discount. As such, a passthrough of these costs (which represent savings to the Postal Service if the mailer performs the activity) is applied to determine a discount. See my response to interrogatory VP-CW/USPS-T35-11 regarding the level of the passthrough and how much of the cost difference should be reflected in the rate design. As with all workshare discounts, these calculated cost differentials are not marked up. It is my understanding that there are no workshare discounts in Priority Mail.

VP-CW/USPS-T35-13.

- a. At page 5 (I. 18) of your testimony, you state that the Postal Service has a "desire to moderate rate increases for individual categories." Please explain (i) the basis or reason why individual categories should have their rate increases moderated, and (ii) whether such moderation is inconsistent with having rates that reflect costs.
- b. Assume that the Standard A Regular or ECR Subclass as a whole has an average rate increase of X percent. What is the maximum increase in any given rate cell, stated as a multiple of X, that you consider to be desirable? Please explain the basis for your answer.

RESPONSE:

- In my testimony, I cite the principle embodied in criterion 4 of the statutory ratemaking criteria as the basis for moderating the rate increases for individual categories. Such moderation is not inconsistent with rates based on costs.
- b. The rate design did not employ a multiple of the overall subclass rate change as the upper bound on rate increases for individual cells. In ECR, the highest percentage increase for non-destination entry rates is roughly two times the overall subclass change. This is not the analysis that was employed in the rate design, although the result, a maximum of about 10 percent, is not unacceptable.

VP-CW/USPS-T35-14. Does the Postal Service have any delivery standards (or service standards or goals, commitments, etc., by whatever name they are called), other than those identified in Attachment G of the Postal Service's request (in response to Rule 54(n)) for delivery of (i) Standard A ECR Mail and (ii) Standard A Regular Mail?

RESPONSE:

It is my understanding that the cited attachment depicts the current service

standards for Standard Mail (A).

VP-CW/USPS-T35-15. Please provide all data in the possession or control of the Postal Service that show actual performance in the delivery of (i) Standard A ECR Mail and (ii) Standard A Regular Mail since reclassification in Docket No. MC95-1.

RESPONSE:

It is my understanding that there are no nationally representative performance

data for these categories for this time period.

VP-CW/USPS-T35-16. For (i) Standard A ECR Mail and (ii) Standard A Regular Mail, what performance measurement system does the Postal Service plan to have implemented by the end of the Test Year, and what performance data do the Postal Service plan to have available by the end of the Test Year?

RESPONSE:

It is my understanding that there is no plan to have any performance data for

Standard Mail (A) available by the end of the test year.

VP-CW/USPS-T35-17. Since the Postal Reorganization Act became effective, please identify (i) each occasion when the Postal Service attempted to develop a performance measurement system for third-class or Standard A Mail, (ii) any results obtained from each such performance measurement system, and (iii) the elapsed time from the beginning of implementation until discontinuance.

RESPONSE:

Although I am not familiar with the history of performance measurement since

postal reorganization, I am aware that there have been a number of efforts (e.g.,

EX3C, ADVANCE/DAR, TCMAS) to measure performance of individual mailers'

mail, with the goal of developing nationally representative performance figures;

however, it is my understanding none of these efforts culminated in a

performance measurement system.

VP-CW/USPS-T35-18. Has the Postal Service ever attempted to develop an external performance measurement system for monitoring the service given to third-class mail or Standard A Mail? Please explain fully any affirmative answer.

RESPONSE:

It is my understanding that the Postal Service developed EX3C; however, it did

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not culminate in a performance measurement system. See response to VP-

CW/USPS-T35-17.

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.

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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

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.

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:

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- 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.

VP-CW/USPS-T35-21

- 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?
- 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.

- 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.
- The proposed rate for Automation letters is driven in part by the passthrough of 100 e. 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 "pushup" 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.)

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 (II. 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" (I. 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?
- 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

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

saturation letters. I did not examine relative coverages, markups, or unit

contributions for letters and nonletters.

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.

- 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.

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.

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 perpiece 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.

VP-CW/USPS-T35-26. Please refer to your testimony at page 24 (II. 3-6) where you state "[p]arcel-shaped pieces are excluded from ECR unless they are merchandise samples, so the only surchargeable pieces are merchandise samples. Pieces of these dimensions are also required to use Detached Address Labels (DALs), so, merchandise samples with DALs are the only surcharged pieces." You also state at page 23 (I. 17) that the ECR residual shape surcharge "is equivalent to the net surcharge on Regular barcode-discounted parcels."

- a. Do all DALs accompanying ECR parcels qualify for the barcode discount? Please explain your answer.
- b. If the DALs to an ECR mailing currently lack barcodes, what happens to the mailing? For example:
 - (i) Is it deferred?
 - (ii) Does the Postal Service refuse to accept it?
 - (iii) Does the Postal Service run the DALs through an OCR and generate a barcode?
- c. Will the treatment of such DAL ECR mailings change in the Test Year environment (or, "when the docket is implemented?")?
- d. Was the ECR parcel surcharge rate set on the expectation that all DALs accompanying ECR parcels would already qualify for the barcode discount in the Test Year?

RESPONSE:

- a. No. Detached Address Labels do not qualify for a parcel barcode discount.
- b. To my knowledge, whether a DAL is barcoded does not affect how the mailing is

handled. See witness Kingsley's responses to VP-CW/USPS-T10-1 and

NAA/USPS-T10-12.

- c. I am not aware of any changes expected in the Test Year with regard to nonbarcoded DALs.
- d. No. The proposed ECR residual shape surcharge has nothing to do with DALs "qualify(ing) for the barcode discount". The proposed discount is set at a level equal to the surcharge in the Regular subclass net of the barcode discount. The operations for which the barcode is of value are bypassed entirely by ECR pieces, so in this case it is reasonable that the ECR surcharge be set at least as low as

the net surcharge (i.e., the residual shape surcharge less the barcode discount) in

Regular. Please see my response to PSA/USPS-T27-4 redirected from witness

Crum.

VP-CW/USPS-T35-27. Please refer to your response to VP-CW/USPS-T35-21, where you confirmed that under the Postal Service's proposed rates, Standard A ECR Basic letters face a rate increase of 8.0 percent; Automation — 4.5 percent; High Density — 9.4 percent; and Saturation — 10.0 percent. You were asked (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? You responded that "[t]he relative rate increases are driven by the costs underlying the discounts and rate differentials, as well as the passthroughs selected." However, in your response to NAA/USPS-T35-17, you state that a presortation passthrough of 100 percent would have given Automation letters nearly a 10 percent increase, and that avoiding such an increase was a "rate design objective."

- a. Why was it a rate design objective to reduce Standard A Regular Automation letter rate increases from nearly a 10 percent increase, but not Standard A ECR High Density, and Saturation letter rates?
- b. How were the passthroughs selected for Standard A ECR Basic, Automation, High Density, and Saturation letters?

RESPONSE:

a. The response to interrogatory NAA/USPS-T35-17 addresses why a less-than-

100-percent passthrough was selected for presort discounts in the Regular subclass. As stated in the response, the passthrough was selected to offset some of the "push-up" that Basic automation letters were receiving due to efforts to limit the rate increases for automation flats. The response notes that, absent the lower presort passthrough, the increase for Basic automation letters would have approached 10 percent. However, the 10 percent figure, per se, was not the driving factor in the passthrough selection. Rather, it was the acknowledgement that Basic and 3-digit automation letters were bearing the brunt of the efforts to limit the increases automation flats. (As discussed in

response to interrogatory NAA/USPS-T35-10, one of the rate design objectives is to monitor cells that are pushed up in order to finance the limitations on percentage increases for individual cells.) By contrast, in ECR, High Density and Saturation letter rates were not "bearing the brunt" of efforts to avoid rate shock elsewhere in the ECR rate schedule, so the 10 percent increases were not particularly troublesome. In fact, efforts were made in the rate design to limit the percentage increases to 10 percent (similar to the efforts for automation flats in the Regular subclass.)

b. The passthroughs were selected as described in my testimony. In general, the rate design began with the passthroughs used in the Commission Recommended Decision from Docket No. R97-1; those passthroughs were adjusted to meet rate design objectives. For instance, to limit the rate increase for saturation letters, the passthrough between Basic and High-Density letters was increased from 100 percent to 125 percent.

VP-CW/USPS-T35-28. Please refer to your response to VP-CW/USPS-T35-22, where you state that the rate relationships between letters and nonletters in the Standard A ECR rates are fair and equitable.

- a. Were the presort discounts (i) for nonletters calculated from nonletter costs incurred, and (ii) for letters calculated from letter costs incurred?
- b. If so, how is this approach fair and equitable, since Basic letter rates, which serve as the baseline for other ECR letter rates, are artificially high, with the letter-flat differential passthrough for ECR Basic rates set at zero? Please explain why it would not be more appropriate to calculate ECR letter rates from the baseline of actual letter-flat cost differential data.

RESPONSE:

- a. The presort discounts (or density discounts) for letters and nonletters are based on cost differentials between the tiers for letters and nonletters, respectively. See USPS-T-35, WP1, page 19, column (2), lines 2, 3, 7, and 8.
- b. Actually, at page 26, lines 9-10, of my testimony, I state that the high passthrough (125 percent) between the Basic and High Density letter tiers helps mitigate the effect of the zero percent passthrough for shape at the Basic tier. Incidentally, if the High Density discount for letters were viewed purely as an incentive for Basic letters to be prepared as High Density, a 100 percent passthrough would create the appropriate price signal regardless of how the Basic letter rate was set. Also, a zero percent shape passthrough at the Basic tier, accompanied with 100 percent passthroughs for the density tiers in Docket No. R97-1, is what underlies the current rates, which were established by the Commission with due consideration of fairness and equity.

CHAIRMAN GLEIMAN: I take it that the Reporter has 1 been given the copies of the material? 2 MR. ALVERNO: Yes. 3 Is there any Additional CHAIRMAN GLEIMAN: 4 Designated Written Cross Examination for this witness? 5 [No response.] 6 CHAIRMAN GLEIMAN: If not, that brings us to oral 7 cross examination. Ten parties have requested oral cross 8 examination, Advo, Inc.; the Association for Postal 9 Commerce; Direct Marketing Association; District Photo; Mr. 10 Color Lab; Cox Sampling; the Mail Order Association of 11 12 America; the Newspaper Association of America; Office of the Consumer Advocate; the Parcel Shippers Association; the 13 Recording Industry Association of America; and ValPak-Carole 14 Wright. 15 Is there anyone else who wishes to cross this 16 witness? 17 [No response.] 18 19 CHAIRMAN GLEIMAN: If not, then we'll begin with 20 Mr. McLaughlin, when you're ready. 21 MR. McLAUGHLIN: Yes. 22 CROSS EXAMINATION BY MR. McLAUGHLIN: 23 24 Q Good morning, Mr. Moeller. Good morning. 25 Α

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ANN RILEY & ASSOCIATES, LTD. Court Reporters 1025 Connecticut Avenue, NW, Suite 1014 Washington, D.C. 20036 (202) 842-0034 1 Q You are, of course, the witness who is responsible 2 for the rate design within Standard A Regular and the ECR 3 subclasses; correct?

A Correct.

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Q And my questions today will focus on the pound rate. And you received a number of questions about the pound rate in interrogatories, and I wanted to present to you, two cross examination exhibits which I supplied to your counsel, I believe, last Thursday.

10 A Yes.

MR. McLAUGHLIN: Mr. Chairman, these cross-examination exhibits have been identified as ADVO-XE-T35-1 and T35-2. And I handing two copies of these to the reporter for inclusion in the record. For reference, I do intend, in my cross-examination, to introduce them into evidence.

17 CHAIRMAN GLEIMAN: The cross-examination exhibits18 will be included in the record.

19[Cross-Examination Exhibits No.20ADVO-XE-T35-1 and ADVO-XE-T35-221were marked for identification,22received into evidence, and23transcribed into the record.24

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Comparison of Proposed ECR Basic and Saturation Flats Rates With ECR Unit Costs by Ounce Increment

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ADVO-XE-T35-1



Comparison of Proposed ECR Saturation Flats DDU Rate

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ADVO-XE-T35-2

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BY MR. McLAUGHLIN:

2 Mr. Moeller, I would first like to turn your Q attention to ADVO-XE-T35-1, which shows a comparison of 3 4 proposed ECR Basic and Saturation Flats Rates with ECR Unit Costs. And just so that the record is clear as to what this 5 represents, toward the bottom of the chart there are a bunch 6 of rectangular dots. Is it your understanding that those 7 represent the average unit cost by ounce increment that 8 9 Witness Daniel derived in response to ADVO Interrogatory T28-10? 10

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Yes, that is my understanding.

12 Q And have you had a chance to review this to 13 determine whether this is an accurate representation of 14 those unit costs?

15 A I was more concerned about the rates, but I 16 recognize the curve and I remember the interrogatory.

Q And the straight line that runs along those rectangular dots, it is your understanding that is Witness Daniel's unweighted regression line representing those dots? A Yes.

Q Now then, the other two lines above that represent your proposed rates. The lower line, ECR Saturation DDU Rate, is that an accurate representation of your proposed rates for ECR flats that are drop shipped to the Destination Delivery Unit?

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A 1 Yes. 2 And is that the lowest rate that is available for 0 ECR mail above the break point? 3 Yes, it is. 4 Α And the line above that captioned ECR Basic Rate, 5 0 6 is that the highest rate that is charged for ECR mail above 7 the break point? А Yes. I was just noticing, though, near the break 8 point, if you added a 10 cent surcharge to the lower rate, 9 the ECR Saturation DDU, it might go above it. 10 Or if you are talking a surcharge parcel? 11 0 12 Α Right. Okay. But for flats, this --13 0 14 Α Oh, for flats, yes, I am sorry. Yeah. 15 Now, if you notice, out at the -- near the 16 Q 16 ounce increment, there is a unit cost figure there that 17 seems to be quite a bit, substantially above the other unit cost figures, is that correct? 18 19 Α Yes. Do you know offhand what proportion of ECR volume 20 0 21 falls into that 15 to 16 ounce increment? 22 Α I know it is very small, but I don't know the precise number. 23 I believe Witness Daniel testified that it was, in 24 0 25 response to an ADVO interrogatory, it was four

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ten-thousandths of the total ECR volume.

2 A That sounds right, yes.

3 Q Okay. That doesn't surprise you at all, does it?
4 A No. No.

5 Q So it is a very tiny portion of total ECR volume? 6 A Yes.

Now, I don't want to debate with you whether that . 7 0 8 15 to 16 ounce data point is an aberration or whether it is simply due to the very small sample sizes involved. Let's 9 just assume for purposes of these questions that that, in 10 fact, represents the average unit cost for pieces in that 15 11 I am not asking you to state to 16 ounce increment. Okay. 12 13 that that is the case, just assume that. Okay.

14

A I will assume that.

Q Even in that case, isn't it true that the lowest ECR rate that you propose is higher than that data point? A You mean the lowest flat ECR rate is above that point.

19 Q And that is for a saturation mail entered at the 20 DDU?

21 A That's correct.

Q Now, in terms of designing rates, I am particularly looking at a pound rate, if you look at the data points here for those unit costs, in terms of a rate design decision, would you think it would be appropriate to

1 base a pound rate solely on that very last data point?

A No, that wouldn't be appropriate.

3 Q You would, in fact, I take it, look at the overall 4 relationship over the entire range, is that correct?

5 A Yes. Especially since there is one -- the 6 structure is set up to have one pound rate for the entire 7 weight spectrum, I would be concerned with the overall cost 8 behavior of that increment, or that section of the weight 9 spectrum.

Q And, in fact, would it be true that in a situation like this, that if you were to entirely base your pound rate on that very last tiny increment of volume, that you might be setting a rate that was substantially -- very much too high for the other 99.96 percent of the ECR volume?

15 Α Yes. The pound rate would be much too high. 16 Now, I would like to refer you to the other 0 cross-examination exhibit, ADVO-XE-T35-2. This exhibit 17 18 comes from a -- the unit costs shown here are the same rectangular boxes, come from a different response of Witness 19 20 Daniel to ADVO Interrogatory T28-13. And in this case these unit costs represent the Unit Costs for ECR Saturation and 21 High Density Flats. Is that your understanding? 22

23 A Yes.

1

2

Q And the rate line that is shown there, above the cost lines, is it your understanding that that is an

accurate representation of your proposed ECR rates for
saturation mail that is drop shipped to the Destination
Delivery Unit?

4

A Yes, it is.

Q Now, you might notice on this graph, out at that 6 16 ounce data point, do you notice there that the 16 ounce 7 data point in the case of saturation flats is actually not 8 out of line with the other data points?

9

A Yes, I can see that.

10 Q Would that suggest to you that, to the extent that 11 there is some unusual cost number, that it is not involving 12 saturation ECR mail, it would be involving basic flats?

13 A I think that is a conclusion that could be reached 14 by looking at the combination of these two cross-examination 15 exhibits.

Q Now, in terms of looking at this relationship between the saturation costs and the ECR saturation DDU rate that you are proposing here, would it be true that the further out you go, the difference between -- the unit difference between the unit cost and the rate increases substantially?

22 A Yes.

Q Now, in terms of, I believe you were asked some questions about the extent to which you considered competition in terms of setting your pound rates, and I

believe that question was in terms of saturation mail in 1 competition with private delivery, such as newspapers. Let 2 me ask you a question from a different standpoint. Let's 3 assume that there are saturation mailers out there today who 4 are mailing above the break point. To the extent that those 5 saturation mailers themselves were to shift mail into their 6 own private delivery operations, would that result in a loss 7 of contribution for that mail that is over the break point? 8

9 A Yes, if we are currently getting revenue from that 10 particular piece you are speaking of, that is represented by 11 a line similar to the top line on this last exhibit we have 12 been talking, since these are proposed rates, rather than 13 current, we would lose more revenue than we would with --14 than we lose costs, so there would be a contribution loss.

MR. McLAUGHLIN: I have no further questions, Mr.Chairman.

Mr. Chairman, I did mention earlier that I did intend to ask that these two cross-examination exhibits be identified in the record. I believe the witness has vouched for them, and I do move that they be received in the record and transcribed in the transcript.

22 CHAIRMAN GLEIMAN: I think we indicated earlier on 23 that they were going to be received into the record and 24 transcribed. But thank you again just for clarifying that 25 point.

1 Mr. Wiggins. 2 MR. WIGGINS: Thank you, Mr. Chairman. CROSS-EXAMINATION 3 4 BY MR. WIGGINS: Mr. Moeller, I am Frank Wiggins for the 5 0 6 Association for Postal Commerce. In your answers to MOAA/USPS-T35-1 and 2, what you are doing here, as I read 7 these questions and responses, is explaining why it is that 8 9 a 100 percent passthrough of the savings resulting from drop shipment destination entry is not appropriate and that the 10 discount passthroughs that you propose, 77 percent and 73 11 percent, I believe, are more appropriate. Do I have sort of 12 the bottom line of that right? Is that what you are trying 13 to explain to me here? 14

15 A No, I think -- I mean obviously it is involves the 16 drop ship discounts and the passthroughs, but the question 17 specifically asked if failure to apply a hundred percent 18 passthrough to those cost savings that I was presented, 19 results in -- inevitably results in rates that are less 20 economically sound. So that is what the answer is about 21 here.

Q And one of the reasons for that, reading these two answers together, two of the reasons for that are, one, that some of the drop shipped mail is going to be low in weight and perhaps have short transportation legs to reach the

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destination entry point at which it is delivered, and,
therefore, that the cost that the Postal Service would save,
if it carried that mail to the destination entry point,
would be less than the discount, is that right?

5 A I wasn't trying to explain why you can't just say 6 that a hundred percent is always going to lead to -- I mean, 7 inevitably lead to more economically sound rates.

And I was giving the two examples that you were just giving, is that the pound -- the drop-ship discount for piece-rated pieces is based on the assumption that they weigh 3.3 ounces, when they may only weigh one ounce.

So some may say that giving 3.3 ounces worth of a discount to a one-ounce piece might over-incent them to drop-ship. So in that instance, it would not, and that's why I listed it as a response to this question.

Q The core of it is that given the discount structure, you in some instances are going to be overpaying the drop-ship mailer for the activity that is encouraged by the discount?

That that drop-ship mailer, if it had substantially lower costs in performing the drop shipment than the discount, could be induced to do the drop-shipping activity for a smaller discount; is that right?

A Well, that's true, too. People might do the discount -- might do the drop-shipping, even if the discount

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were lower, because they are located very near the place of
 entry or whatever.

3 That's a true point. I'm not sure if that's what 4 I'm actually saying here, but --

5 Q Well, you say, and I'm now reading the last 6 sentence of the first of the two MOAA interrogatories, "To 7 the extent the actual transportation (and handlings) 8 incurred would have been less than the average which 9 underlies the discount, it is possible that the Postal 10 Service may have been able to perform the activities at 11 lower cost."

12 A Right. Say we're giving a five-cent discount, and 13 it costs the mailer three cents to do something that would 14 have only cost us two cents to do it, we're giving them five 15 cents and they're willing to take on three cents of work to 16 do it, and it's a net gain to them.

17 But it would have only cost us two cents, because 18 they're located very near the plant or whatever, our 19 facility.

20 Q But that's kind of what I meant when I said you're 21 overpaying the mailer to perform the drop-shipping activity.

A Well, there's averaging in a lot of the discounts, and that's probably going to be true.

Q Well, that's really the point; isn't it? Isn't there only one cure for the phenomenon that you cite here?

And that's to have a whole lot of different drop-ship
 discounts so that you'd be closer to the actual savings?

A I suppose there's an ideal price for every piece of mail out there, but given our rate structure, we obviously can't have such a situation. We have --

Q Well, to have the perfect rate, you'd have to have some reverse auction; wouldn't you, where the lowest bidder gets the drop-ship discount?

9 A Well, you always have to know what their other 10 alternative would have been.

11 Q And you decline to go through the exercise, for a 12 number of reasons that you explain in your testimony, of 13 deeply variegating the drop-ship discounts? You don't want 14 to have a whole bunch of them?

15 A I mean, we proposed one set of drop-ship discounts 16 for the reasons that are in my testimony.

Q Now, there's -- and let's -- and I take it, given the context of these questions, you think, because you recommended the discount level, the past three levels that you did, that you think that the levels that you recommend are superior to 100 percent; is that right?

22 A Yes.

Q There is one vice in not giving 100 percent; isn't there, Mr. Moeller? And that is that there could be out there, a drop-shipper who could perform the drop shipment

1 undertakings, more economically than the Postal Service, but 2 only would undertake that activity if the pass-through were 3 higher than 77 and 73 percent?

4 Unless you had a higher discount, the cheaper 5 performer would not undertake the exercise; can you imagine 6 that?

7 A I wouldn't dispute that there might be one 8 situation out there where that might be the case.

9 Q Well, do you really think there's only one? 10 A No, but I thought you asked me, could I envision 11 that.

12 Q Sure. There's going to be some population mailers 13 as to whom that's true; isn't it?

A I mean, I really have no way of knowing that for sure, but I would agree with you that that would seem likely that there might be that situation.

17 Q But it would be gravely improbable that there 18 wouldn't be some of those; wouldn't it?

A But to get that last person to drop-ship, or however many there are -- and that's the point of the next question, I guess; is that you give a much larger incentive than needed to the ones on the other end of that spectrum.

Q Was there something in the terms that you and I have been talking about, the relative economics of drop-shipping in relationship to the level of the

1 pass-through, is there something magical about 77 percent 2 and 73 percent?

A Well, I think I explained in the testimony, why I chose those particular pass-throughs. And despite all the discussion we've had about this MOAA interrogatory, the reasons are listed in my testimony.

Q I appreciate that your reasoning was richer than what I said. I'm trying to ask you whether there was something not apparent to the casual non-economist reader, or even the focused non-economist reader, that touts the virtues of the particular numbers that you've used.

12 A Well, the testimony lists the reasons why those 13 pass-throughs were chosen, and I -- for instance, one of the 14 reasons is in the last proceeding.

There was a reduction in the differential between BMC and SCF. So this time -- and that caused some commotion, and so this time I was careful to monitor that rate relationship.

19 Q You shouldn't call it commotion. It was a very20 dignified testimony.

21 [Laughter.]

22 BY MR

BY MR. WIGGINS:

Q You talk about that in your answer to ValPak-Carole Wright, T-35-11, in Subpart (d), and that was actually next in line in my efforts to understand.

Are you saying to me that recommending a discount 1 of 100 percent of the measured cost savings is inconsistent 2 with maintaining or increasing the differential between 3 4 levels of destination entry? Could you not do that with 100 percent 5 pass-through? 6 А This is, again, in response to (d) of ValPak? 7 Subpart (d), ValPak Number 11, where you cite to 0 8 9 that same portion of your testimony, page 15, lines 14 and 11 that you just talked about -- 14 through 11. 10 My specific pass-throughs are not the only 11 Α pass-throughs that would make that relationship happen. 12 Thank you. In your answer to PostCom-USPS-T-35-1, 13 0 you talk about, because our question was about, bar codes. 14 And we said in Subpart (a), please confirm the 15 16 reducing automation discounts will most likely reduce mailer 17 investment in automation, and your answer is not confirmed, because you don't know how costly it is for individual 18 mailers to apply bar codes and meet the automation 19 20 standards. Did you mean to suggest -- and you go on to say 21 22 some other things, but let's pause there if we could. 23 Did you mean to suggest by that articulation that there is a single cost of set of costs applicable to all 24 individual mailers to apply bar codes and meet the 25

automation standards or a range of costs? 1 2 I wouldn't expect that everyone, every mailer, has А 3 the same costs of application of a bar code. 4 It's like that there are a range of cost curves 0 that different mailers face, maybe even the same mailer 5 faces, depending upon the mail piece? б 7 Α Yes. Applying the bar code in meeting the automation 8 0 9 standards; is that correct? 10 А Yes. 11 0 Is it also likely that some of those costs curves 12 are going to be such that the reduction in the discount will discourage that mailer from applying bar codes and meeting 13 the automation standards? 14 There could be a mailer who is -- who would -- who 15 Α today is bar-coding because the discount is X-cents, but if 16 17 that were to be X-.1 or .2, might not bar-code, but the cost savings that we've calculated that support these discounts 18 19 would suggest that that may not be the wrong thing, because 20 we don't save -- we're passing through much more than 100 21 percent on these cost savings. 22 MR. WIGGINS: I appreciate that, Mr. Moeller. I have no further questions. 23 CHAIRMAN GLEIMAN: Direct Marketing Association? 24 25 There doesn't appear to be anyone in the room from DMA. ANN RILEY & ASSOCIATES, LTD.

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District Photo/Mystic Color Lab/Koch Sampling? 1 2 MR. OLSON: Mr. Chairman, I have to be here until 3 the end of the day anyway, and I would be prepared to do both of mine at the same time. I don't have much for 4 District, anyway, for this witness, but if I could put it to 5 the end with ValPak, I would be grateful. 6 7 CHAIRMAN GLEIMAN: Your colleagues would probably appreciate that, too, unless they're not ready to cross yet. 8 Next would be Mail Order Association of America. 9 10 MR. TODD: We'll have no oral cross examination for this witness. 11 CHAIRMAN GLEIMAN: Thank you, sir. 12 13 I bet you the next one in line doesn't say that. Newspaper Association of America, Mr. Baker? 14 MR. BAKER: Thank you, Mr. Chairman. I wasn't 15 16 quite expecting to be up so soon. 17 CROSS EXAMINATION 18 BY MR. BAKER: 19 0 Good morning, Mr. Moeller. 20 Α Good morning. 21 Q I am Bill Baker, representing the Newspaper 22 Association of America. Several things I would like to discuss with your 23 this morning, and I may as well start with your proposed 24 25 pound rate in enhanced carrier route commercial mail.

First of all, am I correct, your average overall 1 2 proposed increase for commercial ECR is about 4.9 percent? That's correct. 3 А 4 Q And the average increase for commercial standard A 5 regular is about 9.4 percent? 6 Ά That's correct. 7 0 Are these are the averages just of rates or are 8 they weighted by the volume? 9 Α They are weighted by the test year before rate volume mix. 10 11 Now, you are not proposing, are you, an 0 12 across-the-board increase in the rates for the average in ECR? 13 14 Α The increase is not across the board, no. And in fact, you are proposing both increases and 15 0 16 some decreases in rate categories in standard A commercial mail; is that correct? 17 18 Α When you combine the effect of the per-piece and 19 the per-pound rates that are proposed, some pieces that are 20 proposed have their rates decreased. 21 0 Okay. And by contrast, all of the pieces, I 22 think, that pay the below break point rates are seeing an 23 increase, are they not? 24 Yes, all the minimum per-piece rate cells are Α 25 proposed to increase.

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1 Q And as you know, you are proposing reduction in 2 the pound rate that works out to a rate deduction at certain 3 weight increments and beyond; is that correct?

A Yes, certain weight increments, but overall, pound rated mail does receive a rate increase despite the fact that the pound rate is being reduced.

Q And if you could turn your attention to the table or chart that's attached to the answer to NAA-47 to you, there, we calculated and you confirmed the rate changes for ECR pound rated mail. Do you have that there?

11

Yes, I do.

Α

Q And can you just confirm for me that would show that for basic tier, the rate reduction kicks in for -- at least for destination-entered pieces, at six ounces, five ounces for high-density, and five ounces for destination saturation mail?

17 A No, not exactly. It's six ounces for the basic 18 tier. High density actually starts getting rate decreases 19 at four ounces.

20 Q Well, I was looking at destination-entered rates 21 there.

A Oh, I'm sorry. But anything that's destination entered four ounces, the high density will start decreasing.

24 Q And saturation, the --

25 THE REPORTER: High density will start what?

THE WITNESS: Experiencing rate decreases. 1 BY MR. BAKER: 2 And at saturation, the destination entered pieces 3 Q 4 start to experience the decreases at the five ounce level; 5 is that correct? А 6 Yes. 7 Okay. As I recall, you were the standard A mail 0 rate design expert in R97 as well; were you not? 8 I was here in the same role in R97. 9 Α Are you denying the expert status? 10 0 I'm just trying to choose my words carefully. 11 Α 12 And as I recall, you also proposed to decrease the 0 13 pound rate for commercial mail in that docket as well, did you not? 14 There was a larger, actually, proposed reduction 15 Α in the pound rate. 16 And in ECR mail, did the Commission reject that 17 0 18 recommendation? The Commission's decision was to maintain the 19 Α current pound rate that was available at that time. 20 21 Okay. I reviewed your testimony in that case and 0 in this case, and I wanted to just touch on what struck me 22 as a couple differences I noticed. 23 24 One is kind of a similarity in that in that case, 25 there was a cost -- well, actually, Witness Daniel I think

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characterized it as a cost distribution. In R97, it was
 sponsored by Witness McGrane, and in this case, Witness
 Daniel has provided a similar but somewhat difference cost
 analysis. Is that correct?

5 A Witness Daniel made an effort to address many of 6 the concerns that were expressed about the McGrane study and 7 presented it in this docket.

In Docket Number R97, your testimony 8 0 Okay. regarding the pound rate reduction seemed to address 9 10 competitive concerns more than it does in this case, and I guess my question is, on page 20, line 2 of your testimony, 11 there is what I call an oblique reference to the objections 12 raised by private alternatives in the last case, but aside 13 from that, is there any specific discussion of competitive 14 factors in your testimony in this case regarding the ECR 15 pound rate? 16

17 A There were some interrogatories that got to that 18 notion, I think filed by you. Let me see if I can find 19 them.

Q I believe the AAPS may have filed a few too on the subject. But those were in interrogatories; I'm just asking in your testimony, in your direct testimony.

23

A Well, let's just look at it here.

You were reading from the testimony, if you would read the next sentence, it talks about small businesses rely

on the mail. But the word "competition" doesn't show up
 there, if that's what you're asking.

3 Q From your perspective, are competitive concerns 4 relating to the pound rate the same as they were in the R97 5 case?

A I think the reasons for the proposed pound rate are as described, and you were mentioning the introduction of the cost study, and not only is it a new version of it that attempts to deal with some issues that have been in dispute in the past, my use of it also changed, and I think that was -- those are the overriding reasons why this pound rate is proposed as it is.

13 Well, in your R97 testimony, you stated that the 0 enhanced carrier route sub-class is in a competitive market 14 15 and is susceptible to diversion to alternative media and, as 16 such, the rate structure should be sensitive to and priced 17 competitively with the alternatives, and a lower pound rate is more consistent with the rates for other advertising 18 19 media that are not as sensitive to weight, and that's reference to your testimony in R97 at I believe page 20. 20

21 My question is, you don't seem to be saying that 22 in this case. Is that no longer a rationale for the rate 23 reduction?

A Well, as I said, the previous answer, it's driven primarily by the cost. If the costs hadn't shown up the way

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4007

they did, we wouldn't have proposed a lower pound rate. I 1 am certainly familiar with the testimony in the last case 2 also from Witnesses Buckel and Oututeye regarding the 3 4 market, and I don't dispute what they say. So does this mean that competitive concerns are 5 0 less important to the Postal Service in this case than in 6 R97 with respect to the ECR pound rate? 7 8 Α Less, yes. 9 Q Do competitive concerns play any role in all in setting the piece rate for ECR mail, the below break point 10 rate? 11 Α Well, there are a number of piece rates below the 12 break point. 13 14 0 Well, let's start with the basic one, with the undiscounted one. 15 Well, if you're familiar with the rate design and 16 Α 17 formula, --18 Q I have seen it. Α I was --19 20 Well, my question was, when you're looking at the 0 below break point rates that you're charging, were you 21 thinking at all about the competitive market situation and 22 whether the rate increase you're proposing below the break 23 point would change the Postal Service's position in that 24 25 market?

A No, and in fact, in that rate schedule, you might be able to see that had I had been concerned with this competition you're speaking of, I probably would not have had the rate cell for high-density non-letters be the lowest of all those minimum per-piece rate cells.

Q So the answer is it was not? Competitive factors were not a concern below the break point? I think that is what you said. I am just trying to --

9 A Yes.

10 Q Okay. Now, the pound rate that you propose in ECR 11 commercial is 58.4 cents, is that right? I am talking about 12 the undiscounted basic pound rate.

13 A Yes.

Q That is a mighty precise number, down to, my economists tell me, three significant digits. Did you pick that number? Is that a number you selected, or is that a number that was generated by the rate design formula?

A Well, if you will recall, in Docket Number R97, there was a minor change proposed to how the formula operates, and I believe the words the Commission used was it was a distinction without a difference. And I then went ahead and used that formula as we had modified it, and I am again using it now, which has as an input, the pound rate, not an output.

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Q So you selected 54.8 to be the input?

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58.4.

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2 Q Excuse me. Similarly, there is the per piece charge for the pound rated mail. I would like to talk about 3 that a moment. When you ran the formula this time, were 4 they the output, or did you also pick that and was some 5 6 other number the output when you ran the formula? 7 Α The per piece rate for pound rated mail is an 8 output. And as you lower the pound rate, if you were to keep everything else the same, that per piece rate for pound 9 10 rated mail goes up. And if I recall, the per piece charge ranges from 11 0 12 5-1/2 cents at the basic tier to 2.8 cents in saturation, is 13 that right? А That's correct. 14 15 0 Okay. Is the per piece charge for above break 16 point pieces supposed to bear any relationship to piece-related costs above the break point? 17 18 А Well, the nature of the formula is that you choose 19 one and the other one comes out. 20 0 Right. 21 Α I think you can certainly look at the resulting 22 rates and try to make some analysis about if it accurately 23 depicts the effective weight and, alternatively, the 24 piece-related cost for pieces above the break point. And 25 when the per piece rate for, say, saturation flats was zero,

which implied that there was absolutely no piece-related cost involved when you went above 3.3 ounces, I think you can make a reasonable conclusion that that is probably not the case.

Well, I am trying to see if there is a distinction 5 0 6 between two alternatives. And alternative one would be, 7 yes, the per piece charge above the break point is a deliberate effort to try to identify piece-related cost and 8 assess a piece, you know, a charge to cover those costs 9 10 specifically, or, the alternative, well, yeah, there are probably some piece-related costs above the break point and 11 it is good to have a piece charge, but we don't make too big 12 13 an effort to try to identify the costs and build up the rate 14 from them. Which would be a more accurate description of 15 how you go about picking the piece charge?

16 Α Well, over the years there have been studies that offect attempt to identify the effective weight, and in this case, 17 that is what I am working with. I don't have a study that 18 says, here is how much a piece costs of zero to 16 ounces. 19 20 So I go with what I have. And there has always been a focus over the years, despite the fact that the formula had the 21 pound rate as an output, there was always more of a focus on 22 trying to understand the effect of fective weight on costs rather 23 than this other alternative you are talking about, which is 24 the piece-related costs of pieces from zero to 16 ounces. 25

Q Well, I am interested in weight, too, but I was interested right then in a piece charge, and to see what that was attempting to cover. So, I think you told me that the piece charges were the outputs when you ran the formula this time.

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A The per piece?

Q The per piece charges, right.

8 A Yes.

9 Q And, so, you did not attempt to identify piece 10 charges and build up a per piece rate from that in this 11 case, a per piece charge in this case?

12 A I did not build up a rate, but I mean whenever you 13 run this formula and you get some output, you look at all 14 the rate cells and see if they make sense. A negative, for 15 instance, a negative per piece rate probably wouldn't make 16 sense. Something greater than zero at least is more 17 reasonable.

Q Okay. I would like to turn then to the weight part of the equation. And at page 19, when you begin discussing, this is your testimony, you begin discussing the ECR pound rate, and at the bottom of that page you refer to a new cost approach that supports the pound rate. Do you see that?

24 A Yes.

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Q And is that a reference to Witness Daniel's

1 testimony?

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| 2 | A Yes. |
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| 3 | Q And I notice that your wording there uses the |
| 4 | formulation that, quote, "that supports the rate." That |
| 5 | suggests to me that you did not rely on the Daniel's |
| 6 | testimony to set the rate or to calculate it, rather, you |
| 7 | used it as a support for the rate that you put into the |
| 8 | pound formula, pound rate formula, is that right? |
| 9 | A I think it is saying that I didn't take specific |
| 10 | figures and put those figures into some sort of mechanical |
| 11 | calculation that produced 58.4. But we did do analysis of |
| 12 | the cost study, which is on the following pages, and |
| 13 | compared it to the rates. So there is a direct, there is a |
| 14 | relationship there, it is just not the one I think you were |
| 15 | trying to ask me about, was it a mechanical application of |
| 16 | some output of Witness Daniel that produced 58.4? |
| 17 | Q Okay. Well, let's turn to the table that is at |
| 18 | the top of page 21 of your testimony where you did make use |
| 19 | of the Daniel's testimony. And there you present a table |
| 20 | that compares the implicit cost coverages of piece rated and |
| 21 | pound rated ECR mail. And you show, in the column on the |

22 right, that under your proposed rates, the implicit cost 23 coverages are about the same.

The first question, does this table include the per piece charges?

A The revenue figures you see are the total revenue, based on the total revenue generated from pieces above and below the pound rate, and that total would include the piece rate.

5 Q Okay. Is making the implicit cost coverages of 6 piece and pound rated mail a rate design objective?

7 A While equalizing cost coverage of the two 8 groupings need not be an end in itself for purposes of rate 9 making, the information does suggest that a reduction in the 10 pound rate can be made without grossly distorting the 11 relative coverage of the two groups.

Q Well, I understand that. What I am interested in, what do you mean by "need not be an end in itself"? Does that mean it is a rate design objective, or it is not a rate design objective?

16 I think this goes to say that I did not have as a Α 17 goal to make these directly comparable. I think Witness 18 Daniel has explained that, as the cost study was performed 19 this time, we erred on the side of having weight be more represented, if anything, in response to disputes or 20 21 disagreements on what should be the role of weight on 22 certain cost segments. So I would not want to, since that 23 was sort of the purpose of the study, I would not want to 24 rigidly link the results of that to the rate.

25

Q Would a difference in the implicit coverages for

1 the piece and pound rated mail of, say, 9 or 10 percent be 2 acceptable, too?

A Again, I guess your other question, implicit coverages are used for illuminating purposes, but are not an end in themselves. If you will look at the before rates, right now there is a 15 percent gap basically, and we are living with that. So --

Q Did you check to see whether higher pound rates would generate similarly equivalent cost coverages, implicit cost coverages? Did you say what would happen if you kept the pound rate where it was?

12 A I didn't do this analysis in the table, I don't 13 believe putting in the -- well, I do in the first three 14 columns. I mean that is using the current rates.

15 Q But not the current minimum per piece rate, 16 though?

17 A Yeah, the before rates unit revenue in that first 18 column.

19 Q Right. Excuse me. I misspoke, it does include 20 the current, it does include the proposed. The first column 21 is the current rates, not the proposed minimum piece rate. 22 Okay.

I notice that your testimony does not present a table like this on page 21 for Standard A Commercial Regular. Is there a reason why you did not include such a

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corresponding table for Commercial Regular mail?

A The support for what the pound rate is proposed to be in Regular has its own section in the testimony. And, given the proposed rate that we were proposing for the pound rate in Regular, this type of analysis wasn't really necessary because we were not changing that pound rate as dramatically, I didn't think.

8 Q Did you run the numbers to come up with the 9 implicit cost coverages for both above and below break point 10 mail, or three and five, you know, your proxy of a 3 ounce 11 and 3-1/2 ounce?

12 A My memory is not real clear, but I know when we 13 were discussing how we were going to use the data, we may 14 have looked at a larger spectrum of the mail than just ECR, 15 but I can't recall the results, if we carried it to this 16 extent, or we carried it out this explicitly.

Q Would you be surprised if the variation between the piece rated coverage and the pound rated coverage in Commercial Regular, calculated in the same way here, was around 9 percent?

A Would I be surprised over the 9 percent figure?
Q Yes. A 9 percent range.

A I can't say I would be surprised by any particular results. I mean I could review them and see if they made sense and see if they seemed to be logical.

They are what they are and they have been 1 0 2 calculated, but whatever the difference is, it doesn't 3 trouble you so much that you feel constrained from actually proposing the rates you are proposing in commercial regular? 4 There are a number of issues at play in commercial 5 Д б regular involving the residual surcharge and the effect of 7 push-up on the piece rates, and a number of issues that I 8 quess I view as supporting why the pound rate is what is 9 proposed to be.

10 Q Do you ever compare your rates in Commercial 11 Standard A with of First Class mail of similar weight to get 12 a sense of whether they're in the same ball park?

13 A When we're putting together our rates, we check 14 for anomalies and whatnot that might have the occasion for 15 me to look at certain First Class rates.

Q Well, do you happen to know what the -- admittedly -- well, do you happen to know what the rate would be for work share three-ounce First Class letters under Mr. Fronk's proposed rates?

20 A I don't have his rate proposal with me, I so I 21 don't know that.

Q And even if we looked at the un-discounted rates, where the proposal here is for 34 cents for the first ounce and 23 thereon. That works out to about 80 cents for a First Class letter that gets no discounts; is that right?

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Α

If you've done the math correctly.

Q As a rate design expert, is that something that -or, witness -- is that something you worry about, or is that more Witness Mays's province, to compare the rates across classes?

A Well, I think there are subclasses for various reasons, and Standard A is different than First Class, is different than Periodicals, different from Parcel Post.

9 And the rate design is approached differently for 10 different subclasses. And I'm sure I'm comfortable with 11 what we've done here.

12 Q All right. I'd like to talk to you a little bit 13 about, going back to the subject of competitive effects of 14 the pound-rate proposal.

15 And from our earlier discussion, I take it that 16 you are not justifying your proposed reduction in the ECR 17 pound rate on a perceived need for the Postal Service to be 18 more competitive for heavy-weight mail.

Your answer tends to focus more on the observedcosts?

A It certainly is concentrated on the cost aspect. Q And, indeed, I believe that in your testimony you stated that reduction in this case, because is it is not as large as the one proposed in R97-1, that it might be more palatable to private competitors.

Did you say something like that?

A Yes, and there were some interrogatory responses about those, too. I mean, it's a much more moderate proposal in terms of reduction of the pound rate, and I would hope that that would at least move in the direction that would make it less objectionable.

Q Well, Mr. Straus is unavoidably absent this
morning, so let me ask a couple of questions he might have
asked, were he here, in this regard.

10 What factors did you consider when you looked at 11 the effect on alternate delivery of the pound rate proposal?

12 A Well, the procedure for choosing the pound rate 13 and why it was selected as it has been proposed, is there in 14 my testimony.

I am familiar, generally, as I said earlier, with testimony from various parties in the last case, and although I'm aware of that and I don't dispute it, and I -the pound rate is still based primarily on the costs.

Q Well, when you state on page 20 of your testimony that the smaller proposed reduction in the pound rate addresses the Commission's prior concerns and should also address the objections raised by private alternatives, were you thinking of the testimony and positions that the private alternatives took in the R97 case?

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A Well, I think AAPS asked the same question.

1

Q Right.

| 2 | A In the AAPS brief, for instance, it said that |
|----|--|
| 3 | saturation mail should not be decreased by as much as 18 |
| 4 | percent. And I looked it up, and that is the reduction that |
| 5 | a 16-ounce saturation piece would have received under our |
| 6 | proposed rates, which is a very rare piece, because there's |
| 7 | not a lot of volume out there, as I discussed earlier. |
| 8 | The range for that ounce increment, 16-ounce |
| 9 | piece, the range of the decrease proposed was from 15 to 18, |
| 10 | depending on where it was entered. |
| 11 | And in this proceeding, that range is eight to 11 |
| 12 | percent. |
| 13 | Q In preparing your testimony and your rate |
| 14 | proposals in this case, did you make any inquiry or do any |
| 15 | research as to the alternate delivery industry today? |
| 16 | A No. |
| 17 | Q Can you identify for me, who you would consider to |
| 18 | be the two largest alternate delivery companies? |
| 19 | A I don't know the names of the two largest |
| 20 | alternate delivery companies today. |

Q And have you conducted any investigation of the effect of the 1995 mail reclassification case and the changes in Postal Service mail classification resulting from that on alternate delivery companies? A I didn't do any analysis of the effect of MC-95 on

1 alternate delivery.

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| 2 | Q And AAPS also asked you about the SAI study that |
|----|--|
| 3 | has been the subject of some motion practice. I take it |
| 4 | that you did not review the study in preparing your |
| 5 | testimony, at all? |
| 6 | A I did not. |
| 7 | Q And you were not aware that it had been updated |
| 8 | since the last case? |
| 9 | A I didn't know there was an update, no. |
| 10 | Q Okay. And did you take any look at newspaper |
| 11 | advertising rates when you were preparing your testimony? |
| 12 | A Not this time around, no. |
| 13 | Q NAA-49, to you, in your response to that, you |
| 14 | stated that in November 1998, you attended a meeting with |
| 15 | Standard A representatives from the Saturation Mail |
| 16 | Coalition and the Mail Order Association of America, during |
| 17 | which the pound rate was discussed. |
| 18 | Do you remember that response? |
| 19 | A Yes, NAA-49? |
| 20 | Q Yes. Did the Saturation Mail Coalition, MOAA, |
| 21 | representatives express to you a view that the pound rate is |
| 22 | too high, at that time? |
| 23 | A I mean, that's just such a generally understood |
| 24 | position by those groups that I don't know if those words |
| 25 | were distinctly said, but it kinds of goes without saying. |
| | |

0 Is that the understanding that you walked away 1 from the meeting with? 2 What was my understanding? 3 А That the pound rate might -- that they think the 4 0 pound rate is too high? 5 They think that, I thought, going into the meeting б Α 7 and walking out of the meeting. Nothing they said changed your mind at that 8 0 meeting. And have you not talked to any other mailers of 9 pound-rated mail since the end of the last rate case until 10 this one was filed then? 11 Was this a question asked about any meetings? 12 Α 13 0 Yes. 14 Α And I know of no other meetings where that was the topic of discussion, necessarily. 15 16 Q Okay. Were there any other meetings where it was the topic of discussion at all? 17 18 Α Well, again, like I said earlier, it's such an 19 understood position, in my mind, that it wouldn't surprise me if there had been a discussion with someone along the 20 way, oh, about the pound rate. 21 22 But everyone -- their position, my position, is that it's too high. 23 24 0 If you could turn back one interrogatory to your response to NAA-48? And here you were asked about the small 25 ANN RILEY & ASSOCIATES, LTD. Court Reporters

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1 businesses who you allude to in your testimony.

And, again, here you were asked whether you had met with any of these small businesses or representatives of them. And, again, you hadn't met with them either; that's correct?

6

A That's correct.

Q I'll make a note to have my client meet with you
before the next rate case, because the meetings seem to have
a successful result.

10

11

A We've met with your client.

Q I don't believe you were in the meeting.

12 A Well, I have been in several meetings involving 13 the weight issue, as a matter of fact, not the pound rate, 14 but an issue regarding weight.

Q If you could turn to your response to NAA-24? And here we've started asking you about what might happen as a result of a reduced pound rate, and you state that the lower pound rate might attract advertising from small businesses that might not otherwise advertise.

Are you suggesting here that the reduced pound rate may induce small businesses that don't advertise at all, to begin solo mailings at ECRAs? I mean, heavy solo mailings?

A No. I think -- I believe -- I don't know if it was Mr. Buckel or Mr. Otuteye, where they describe the

advertising market for these advertising positions, these
 small businesses find themselves in.

And this sentence is related to that explanation of what they're facing when they're trying to make their advertising decisions.

Q Well, I'm interested in what form their
advertising might take. And maybe it would be helpful if
you would turn to your answer to AAPS-11.

9 [Pause.]

Yes?

10 And take a moment to review that. I'm 11 particularly looking at -- interested in Subpart (b) of that 12 question.

13 A

Q Okay, so am I correct here that you don't -you're not suggesting here that a small business that does not currently advertise is suddenly going to start mailing five- or six-ounce ECR packages, solo packages, as a result of the pound rate; are you? I'm talking about solo mail.

19 A I don't believe these particular businesses will.20 There may be some.

Q Well, there's always somebody who might do something. But, in general, you're not expecting this pound rate to induce folks who don't advertise at all, suddenly to start doing it in a solo mailing where they're the only product?
1 A I think even Witness Green in the last case said 2 that even with that low -- the larger reduced pound rate in 3 that proposal, would not move him to the mail.

Q And even if they currently do mail solo packages below the break point, they -- I take it from your answer here, you're not really expecting they will add weight to their package to mail at above break point, because that rate is probably still higher than the piece -- postage they'd be paying below the break point?

10 A I think they'll choose to advertise, based on what 11 makes sense for them. And if it makes sense to put more 12 pieces in there because now it doesn't cost as much, they 13 might.

14 Q Okay.

15

A Or make the piece heavier.

Q Now, let's talk about a situation where the advertiser is deciding whether they wish to participate in a shared mailing.

And in that case, whether a small business participates in a shared mailing will depend on the price it pays the mailer, not the postage that the mailer pays; is that correct?

- 23 A [Nods affirmatively.]
- 24 Q You're nodding.
- 25 A Yes.

1 Q Okay. Is there any requirement that the shared 2 mailer pass through to its customers, any reductions in 3 postage costs that it may enjoy from the reduced pound rate?

A Well, with your previous question, I probably would have said yes. I mean, obviously, when an individual advertiser decides to become part of a combined advertising piece, they're paying the -- they're not paying the Postal Service the postage; they're paying some price for that ability to put the advertising piece in there, to the person who is mailing the piece itself, the big piece.

Q Right. And if the mailer of the big piece is seeing a price reduction of the pound rate, that mailer is not obligated to pass any of that reduction through to the advertisers who may want to ride along on the shared piece; is it?

16 A Obligated as a point of law, no, but maybe as a 17 point of economics, they would have to.

Q Right, but if the mailer wanted to pocket the difference to improve its margins, it might be able to do so; that's another possibility; isn't it?

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21 A I assume they'll charge whatever the market will 22 bear for that advertising.

Q Okay. And so you don't really know if any small business will see a reduced advertising cost due to lowering the pound rate; do you?

I don't control the pricing of those marriage mail 1 А 2 people in any way. З MR. BAKER: Mr. Chairman, I'm about to launch into a different line of cross, and I wondered if you wanted to 4 take the mid-morning break around now? 5 6 CHAIRMAN GLEIMAN: That's very gracious of you to 7 keep all the rest of us in mind, including the witness. Ι 8 think we will take a break now, and we'll come back on the 9 hour. [Recess.] 10 11 CHAIRMAN GLEIMAN: Mr. Baker, whenever you are ready to continue. The witness is ready. 12 THE WITNESS: Yes. 13 MR. BAKER: Thank you, Mr. Chairman. 14 BY MR. BAKER: 15 Mr. Moeller, I would like to talk to you some 16 0 17 about the cost coverage for ECR mail and we asked you a 18 number of interrogatories that essentially I think made a mess of the situation, so let me try it a different way. 19 There must have been a time when someone came to 20 21 you and said, Mr. Moeller, we need you to design rates for 22 Standard A mail in this case. Right? 23 Α I wish I could remember when that exactly happened. Yes, at some point in time it became clear that I 24 25 was going to be the one doing this.s

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4027

Q Okay, and when you were asked to design them, I am interested in what you were instructed or told as to how much money you were supposed to be designing rates to recover.

5 Were you given a total projected ballpark revenue 6 requirement or was it expressed in cost coverages or what --7 how did they tell you to start?

8 A Well, you mentioned making a mess of things. I 9 should probably at least start where we have tried to deal 10 with this earlier. Is it an NAA response?

11 Q We went into it from time to time from NAA-1 12 through 07 and maybe later but I was -- well, if you want 13 one to look at, we can start with your response to NAA-5 and 14 -7.

A Okay. So this is the old iterative process -Q Right. Well, my question is, maybe it doesn't
provide a simple answer but I thought it could.

18 Where do you start? In particular, here you 19 select, this refers to you selecting a precise figure of 20 2.090, which is your answer to 5(b).

I can't imagine you actually started with that number and that was the only number you looked at the whole time.

A That's correct.

25 Q Okay.

1 A As I say in part (c), it certainly ended up 2 numbers other than 2.090.

Q Did Witness Mayes come to you and say, you know, we need "x" amount of money and try a cost coverage in this ballpark, or did she give you a ballpark to start with? You didn't start with a markup of, you know, 130 so why did you start at 2.090?

A I didn't start at 2.090.

9

8

Q Okay, I get it.

You'll recognize that the spreadsheets are 10 А 11 virtually identical except for changes that had to be made to the ones that were from the last case, so I would 12 imagine -- I am not even sure. I am not trying to not 13 answer your question but there was already a markup in there 14 when I decided to copy this one from use in R97 to use it in 15 16 this case, so that may have been the one that was in there 17 I don't even know, but -- and I think that Witness first. Mayes could probably explain better to you how she arrives 18 19 at the various markups by subclass, but she has a general notion of what is needed to get the revenue and she knows 20 generally perhaps what percentage increases those might be, 21 22 what those markups might have to be, and then in the conversation process we sit very near each other in the 23 office. 24

25

It devolves and we narrow down on a figure that

comes up with the -- a cost coverage that makes sense and a
 percentage -- whatever goes into her determination of the
 appropriate markup.

Q I guess what I am interested in, are you, when you are doing this are you trying to get to a particular revenue and then you look at your costs and you look at the markup range that gets you there, or are you looking at a markup and then seeing what happens?

9 A Well, they are so interrelated. The revenue is 10 driven by the markup and the percentage change is driven by 11 the revenue and it is hard to isolate which one we are 12 trying to get at any one time.

13 Q Did Witness Mayes or anyone else give you a target 14 to be getting at or a range that you worked within?

15 A It is a moving range because over time as you run 16 iterations you might have to make some changes on what is 17 going to be obtained from each subclass.

Q Well, let me ask it a different way maybe. I gather what you are saying, it did not happen like this -she came to you and said, Mr. Moeller, you need to design rates to have a revenue of "x" billion dollars to do that, you know -- I expect you will have a cost coverage between, you know, 200 and 230 and tell me what you end up with.

A If you add what that might be in terms of a percentage change for the subclass, she knows the criteria

she needs to consider for that. That is not in implausible
 interaction we may have had regarding the markups and the
 contribution produced and the percentage change.

Q Well, would it be more like she said, Joe, Mr. Moeller, I am expecting that ECR rates will rise 4.8 to 5 percent and start working with that?

7 A Percentage change is a number that everyone can 8 relate to, so oftentimes things are presented in that way, 9 but she's choosing markups with percentage changes in mind, 10 I would imagine.

11 Q But ultimately you selected the precise figure of 12 2.09 -- 2.09 rather -- and that was the number that resulted 13 from your work, is that correct?

14 A Yes.

And that was the final number and you gave it to 15 0 16 her, which she then converted and used in her own testimony? 17 Α Well, as this interrogatory explains, you put in a figure such as the 2.090 and you have an idea what that is 18 19 going to mean in an after-rates world when you have got some 20 volume moving around and you are not going to get exactly 2.09 as the cost coverage. 21

Q Right, and that is what your answer to NAA-7 is discussing, is it not?

A Well, actually no. In 5(b) there are discussions with Witness Mayes and experience gained through iterations.

I was aware this would likely generate the desired
 after-rates cost coverage.

Q Right, and when we turn to 7, you explain the difference between the 2.09 figure and her 208.8 figure? A Correct.

Q All right. And when you finally selected the number 2.09, that was -- well, you said this is the number that gives me the revenue I need, is that right?

9 A The 2.09 figure was the last iteration that we 10 ran, obviously. So, at the time I put it in there, I may 11 not have known that was going to be the final, but it turns 12 out it was the final.

13 Q Is that because she then came back to you and 14 said, thank you, we have got it?

15 A Well, the organization as a whole said we are 16 going to go with these rates.

I also want to change subjects one more 17 0 Okay. 18 time and talk to you a little bit about one of the rate design issues you have, which is the relationship between 19 the five digit automation letter rate in Regular and the 20 Basic ECR letter rate. Your rate design objective here is 21 2.2 to have the regular five digit automation rate to be less than the Basic ECR letter rate, right? 23

A That is one of the desired outcomes of the rate design.

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4032

And that is because the Postal Service prefers for 0 1 operational reasons, for as much of that mail to be entered 2 3 as Regular automation and not as ECR Basic, is that right? If a piece is going to be letter shaped, we would 4 А rather it be entered as a five digit bar coded pieces than a 5 6 Basic carrier route letter piece. 7 And currently, today, the difference between the 0 two rates is .2 cents? 8 9 А I believe that is correct. I will check to make 10 sure. 11 Q And I believe you are proposing to increase it .3 12 cents? Yes. Now this rings a bell, with the 13 Α interrogatory response we used those two figures. 14 15 Now, at page 12 of your testimony, you are Q 16 discussing the passthrough at the five digit automation 17 tier, and you are proposing a 160 percent passthrough at that point. I am directing your attention particularly to 18 lines 3 through 5, at page 12. Do you see that? 19 20 Yes, I do. А And you say that is, I think you -- and you use 21 Q the word principally based on achieving the desired rate 22 relationship for ECR Basic letters. Understanding that that 23 24 rate relationship is a design goal, would it be fair to say 25 that a passthrough of 160 percent if more than you

1 ordinarily would want?

A Well, each passthrough decision has a lot of things that go into why it is selected the way it is, and, again, they are all spelled out. This one, I say why it is above a hundred percent.

Q I understand why it is. I am just saying if you
didn't have this crossover situation, isn't it likely that
8 the passthrough would be closer to 100?

9 A Well, it would depend on what rate that would 10 produce. There are other times when I choose passthroughs 11 not for some kind of rate relationship situation but to 12 temper a rate increase. So I can't say that that is what 13 would have been had there not been the rate relationship 14 with ECR and five digit automation.

Q Well, I understand that everything else is never equal. But if everything else were equal, would you prefer passthroughs at around 100 percent, closer to 100 percent, or farther away from 100 percent?

A A hundred percent is generally what you would
propose, if there were no other considerations, of which I
describe in my testimony.

Q And in this case, as in R97, you have again proposed not to recognize any shape difference at the Basic tier in ECR, is that right?

25

A The passthrough at the Basic tier is zero percent,

1 which has that affect of having no difference in the rates.

2 Q All right. And is the crossover between the ECR 3 Basic letters and the regular five digit automation letters 4 a reason for that passthrough being zero at ECR Basic tier?

5 A The rate relationship is created by a number of 6 things. I am not sure how much is done by which aspect of 7 it. But one of the pieces of support I point to for the 8 zero percent passthrough is this rate relationship.

9 Q And is the gist of the reason something like this, 10 that if there were a recognition of the letter/flat 11 difference at the Basic tier in ECR, the tendency would be 12 to push the letter rate down and the flat rate up, and the 13 parcel rate perhaps even more up, is that right?

14 A Yes. The letters would be priced lower than the 15 flats.

Q And if the letter is priced lower, then you would run a danger that that rate might be depressed to a point below the regular five digit automation rate. That is something you would want to look at?

20 A Yes, that is what we have been talking about here, 21 is trying to make that rate below the five digit automation 22 rate.

Q And in your response to NAA-12, we talk about
this. If you could turn to that, and particularly B and C.
A Yes.

1 And I think as we said, current rate, the 0 difference here between the five digit automation Regular 2 3 letter and the ECR Basic letter is .2 cents. My question, and I notice in C, you mention that the rate relationship 4 5 can be maintained through not only passthrough selections, 6 but also cost coverage assignment. And I note here you say 7 cost coverage assignment in the ECR subclass, but couldn't it also be affected by the cost coverage in the Regular 8 subclass? 9

10 A Well, anything that affects the rate for five 11 digit automation, and certainly the markup on the Regular 12 subclass or the cost coverage for the Regular subclass has 13 some impact on what the five digit automation rate is. So 14 if that is your point, yes. A number of things can work to 15 create this rate relationship.

Q Does the fact that the average increase for Regular is 9.4 percent, and that is just about twice the average increase for ECR mail of 4.9 percent, aggravate this rate design problem in this case?

20 A Well, I think the rate relationship was able to be 21 proposed using these tools at the disposal, and I don't 22 think that in particular was a stumbling block in getting 23 this rate relationship.

Q Wouldn't it have been simpler if ECR had had the same percentage increase as Regular across the board?

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4036

A Well, the percentage increases are going to be driven by, well, the costs underlying, plus the cost coverages assigned by Witness Mayes. So, that is how -that is what driving those percentage changes.

5 Q Well, I understand that, but if Witness Mayes had 6 proposed the same percentage increases for Standard Regular 7 as for Standard ECR, would this rate design problem of the 8 crossover have been simplified for even this case?

9 A Well, presumably, she has looked at all the 10 criteria and decided that the appropriate coverages are what 11 produce these percentage changes.

12

18

Q But does she look at rate design issues?

A Well, with regard to this particular issue, I say in response B that Witness Mayes mentions that the proposed cost coverage helps maintain rate relationships across subclasses, so, I mean her answer I guess suggests that she does look at rate relationships at times.

Q At least this one.

A Well, I am just quoting her from her testimonyhere. I am not sure.

MR. BAKER: Okay. All right. I can go look her testimony, ask her tomorrow, in fact, if she was thinking about this.

24 Mr. Chairman, I have no more questions.
25 CHAIRMAN GLEIMAN: That brings to the Office of

the Consumer Advocate. 1 MR. COSTICH: Thank you, Mr. Chairman. 2 CROSS EXAMINATION 3 BY MR. COSTICH: 4 5 0 Good morning, Mr. Moeller. Α Good morning. 6 7 Could you turn to your response to Q DMC/USPS-T-35-2? 8 9 Α Okay. 10 0 And, particularly, your response to Part B? [Pause.] 11 12 Α All right. 13 In the third sentence, you say pieces subject to 0 the residual shape surcharge, in particular, were not viewed 14 as subject to the 14-percent increase, in light of the fact 15 16 that the establishment of the surcharge in Docket Number 17 R97-1 was viewed as a first step toward improved recognition 18 of the higher costs of these pieces relative to flats; is 19 that correct? That's correct. 20 А 21 Q Would you expect, after the initiation of that surcharge, that some pieces, initially subject to that 22 23 surcharge, would change their characteristics so as to

A Yes. As a matter of fact, I expect that some

become a different shape and avoid the surcharge?

24

25

pieces have reconfigured as automation flats or otherwise
 converted to flat-shaped pieces.

3 Q If those pieces converted to flats, would that 4 increase the letter flat cost differential?

5 A Well, it depends on what their cost 6 characteristics are as flats. So to the extent they do not 7 take on the typical cost of the typical flat, then that 8 could affect the flat costs, which would then affect the 9 letter flat cost difference.

10 Q Isn't it likely that if the pieces essentially had 11 a choice between looking like a flat or looking like a 12 parcel, that they would have chosen to look like a parcel if 13 that were the easiest thing for them to do?

A Well, I would assume that a mailer of a piece that could be configured as either shape, would look at the cost of producing that piece, the rates they're going to pay, and other considerations, probably, too, in deciding whether they want to be a flat or a parcel.

19 Q Does that suggest that most of the pieces that 20 could easily become flats would already be flats before the 21 institution of the surcharge?

A No. Before there was a surcharge, it was quite likely that a piece would choose to be a machineable parcel instead of a flat, assuming they had the option, because the makeup requirements were easy for machinable parcels.

1 They could achieve the three-five-digit presort by 2 making up BMC separations, which is not as fine as a 3 three-digit separation they would have to make if they were, 4 instead, declared to be flats.

5 Q So, before the institution of the surcharge, the 6 incentive was for -- the incentive offered by the Postal 7 Service was, make yourself a parcel rather than a flat?

A I mean, they could speak for themselves on how they made the decisions, the producers of the mail piece, but since the rate was the same for a three-five-digit flat, and a three-five-digit parcel before the surcharge, one big difference between those two types of pieces were the makeup requirements for the parcels.

14 It was easier to make them up to BMC, rather than 15 have to make up all the three-digit separations. And they 16 got the three-five-digit rate for making them up to BMC.

Q Since the surcharge has been in effect, have you
observed a shift from parcel-shaped to flat-shaped?

19 A I haven't observed the shift, but based on 20 explanations that were put forth in a lot of our 21 publications to mailers, telling them how to do the 22 preparation for automation flats, and especially those that 23 are eligible for FSM-1000 processing, which is the thicker 24 piece which is more likely to be what these pieces as 25 parcels would convert to, led me to believe that this is a

1 phenomenon that's probably happening. 2 Does it cost the Postal Service more to process a Q piece on the 1000 than on the 881? 3 4 Α Well, Witness Yacobucci is the flat processing cost witness, and I don't know enough about all the flat 5 processing costs to start answering those questions. 6 7 0 You don't have a clue? Well, there may be things that work that I'm not 8 Α 9 aware of that might -- I mean, I think the productivities that are in Witness Yacobucci's testimony would speak to 10 that better than I can. 11 12 Could you look at Part (d) of that same 0 interrogatory response? 13 Okay. Α 14I think it's the third sentence, again, that I 15 0 want to focus on. You say future prospects for a larger 16 residual shape surcharge seem probable; is that correct? 17 18 Α That's a correct reading of my response, yes. And is it still correct? Ο 19 20 Α Yes. 21 0 Aren't you sending a message to mailers here to switch from being a parcel to being a flat? 22 23 Α I think the message that might have them switching 24 is driven primarily by the rate advantage they could get as 25 a flat, rather than my statement here.

If they're saying that they're -- oh, maybe this is what you mean: The fact that I am foreshadowing that we may propose an increase in the surcharge, I think that would always behoove mailers to maybe think, well, maybe we better be thinking about -- I mean, it's always good to plan ahead, I guess, and think what might happen and act accordingly.

Q You are increasing the residual shape surcharge in8 this case, correct?

9 A We have proposed an increase in the surcharge.

10 Q Do you expect to see another shift from parcels to 11 flats over the course of the test year or the year 12 thereafter?

13 A I don't make any projections of any further shift. 14 Q So, is it correct that in your revenue 15 calculations, you use the same shape proportions after rates 16 as exist before rates?

A For purposes of estimating the revenue from surcharge, I assume that the percentage of non-letters that are parcel shaped remains the same. And then I also applied a factor trying to get to this phenomenon we have been discussing, that is the same factor before and after rates.

22 Q Let me see if understood that. You hold -- you 23 look at non-letters as a whole?

24 A That is the first step, yes.

25

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Q And you have a test year before rates proportion

1 of flats and residuals?

Let me just find the work paper and it will be 2 Α You might want to look at Work Paper 1, page 14. 3 clearer. And the second line in those two columns is a percentage 4 5 that is residual shape. So, there is a percentage of 6 non-letters that are parcel shaped that, you can see in the after rates column I used that same figure. 7 So I assume the 8 percentage of non-letters that are parcel shaped will remain the same. 9

10QIn the test year before and after rates?11AThat's correct.

12 Q Now, as concerns the proportions of letters and 13 non-letters, do they stay constant before and after rates in 14 the test year?

Well, that is going to be driven by the before 15 А rates and after rates volume forecast, so I don't know if 16 they remain the same, but looking at the volume forecast, 17 one could calculate the percentage of total pieces that are 18 letters in the before rates volume forecast and then that 19 same percentage in the after rates. And my guess is they 20 are not being held constant, they are not the same, it is 21 22 whatever the volume forecast has them work out to be.

23 Q Do you have separate volume forecasts for letters 24 and non-letters?

25

A I receive a volume forecast that is on page 3 of

Work Paper 1 that shows the categories for which I receive -- yeah, for which I receive a volume forecast, and there are separate ones for letters and for flats -- or letters and non-letters.

Q All right. If we focus on the non-letters, if parcels do migrate to flats in the test year, once the new rates are in effect, and assuming that there is, in fact, an increase in the residual shape surcharge, won't you get less revenue actually than you are projecting?

10 A Well, the next step back on page 14 was -- earlier 11 we discussing applying that percentage that was parcel shape 12 to that non-letter volume to get the expected residual 13 volume, and then both in before and after rates, I apply a 14 factor of 25 percent to try to get to this issue you are 15 talking about, the migration.

16 Q Twenty-five percent?

17

A That is the figure that was used here.

Q Oh, I don't doubt that that is the figure you used. I am just asking if that seems excessive to you.

20 A No, it doesn't seem excessive.

21 Q Is your conclusion based on prior experience with 22 the surcharge?

A Well, as I discussed, you remember we filed this, when we filed this case, the implementation of the surcharge was not until January 10th, 1999. So I didn't want to

ignore the fact that this may be happening, so I made a judgment based on, as I said earlier, the efforts that seemed to be putting forth by mailers to make this change to flat shape, that knowledge of that helped me come at this figure. And, again, as you mentioned earlier, this is an attempt to try to estimate how much revenue is going to be generated by the surcharge.

8 Q The 1999 billing determinants are available now, 9 right?

10 A Yes.

11 Q Have you had a chance to look at those to see if 12 you can detect the kind of migration we are talking about 13 here?

14 A The billing determinant information that I have is 15 an annual basis for 1999. I haven't attempted to see what 16 the migration has been of those particular pieces.

MR. COSTICH: Mr. Chairman, could we ask that the witness look at the billing determinants and tell us whether he can detect the kind of change we have been talking about? CHAIRMAN GLEIMAN: We sure can ask him.

21 Mr. Moeller, when do you think you can get back to 22 us? After lunch?

THE WITNESS: I know the actual billing determinants that were produced do not have a line item for that, so I can't speak to how difficult it is going to be to

1 try to determine what it would be if we had a measurement of 2 it. So I can't -- I don't want to -- I can't tell you 3 exactly how long it will take, but we will certainly try to 4 do it as quickly as we can.

5 CHAIRMAN GLEIMAN: Well, it is 11:30 on Monday 6 morning and I don't expect you will be on the stand much 7 beyond the end of the day today. So that would give you 8 four days between -- of freedom between now and the end of 9 the week where you might be able to figure all this out and 10 let us know. So perhaps by Friday you will let us know 11 whether.

12 THE WITNESS: Sure.

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13 CHAIRMAN GLEIMAN: And when. Okay?

14 THE WITNESS: Okay.

15 CHAIRMAN GLEIMAN: Thank you.

16 MR. VOLNER: Mr. Chairman.

1.7 CHAIRMAN GLEIMAN: Yes, sir.

18 MR. VOLNER: Whether and if it is possible, how 19 much has migrated?

20 CHAIRMAN GLEIMAN: I assumed the when part

21 included your addition.

22 MR. VOLNER: Okay. I just wanted to make sure. 23 CHAIRMAN GLEIMAN: With the product we would get.

24 MR. VOLNER: Fine. Thank you.

25 THE WITNESS: I need to clarify something, too.

We are not going to know how many of the non-letters would have been parcels. We can hopefully determine how many pieces paid the surcharge, which will tell you how many surcharge pieces there are. But we will not know how many of the non-letters would have been residual shape pieces. I guess that kind of goes without saying.

7 CHAIRMAN GLEIMAN: Mr. Costich, Mr. Volner, are we 8 all on the same wavelength now?

9 MR. VOLNER: I understood what he was saying. 10 MR. COSTICH: I understand what the witness is 11 saying, Mr. Chairman, but I am wondering if there is 12 anything in the 1988 data that would give shape comparisons 13 that we could use. That is, how many pieces would have been 14 residual in '98 if there had been a surcharge?

15 THE WITNESS: Well, that gets to my estimate here, 16 where I take the 5.9 percent. That is based on some measure 17 of how many parcel shape pieces there were as a proportion 18 of non-letters, so that may offer some insight as a starting 19 point.

20 BY MR. COSTICH:

21 Q And that is probably the best we will get?

A It is the best I thought we could use for thiscalculation of this revenue.

24 MR. COSTICH: All right. If that is still the 25 best, that is what we will have.

I have no further questions, Mr. Chairman. 1 2 CHAIRMAN GLEIMAN: That being the case, that moves us along to Parcel Shippers Association. Mr. May. 3 If someone is willing to relinquish their 4 microphone? You may have mine if you wish. 5 CROSS EXAMINATION 6 7 BY MR. MAY: Just a few questions about your proposed surcharge 8 0 9 for, shape surcharge for Standard A. The proposal is to 10 increase the surcharge from 10 to 18 cents, isn't that 11 correct? Yes -- 18 cents prior to any application of the А 12 barcode discount. 13 0 And except for ECR where it is 15, increased to 15 14 cents, isn't that correct? 15 Α That's correct. 16 17 So the increase is in one case an 80 percent 0 18 increase in a rate element and in the other it is a 50 percent increase in the rate element? 19 18 is 80 percent increase from 10; and 15 is a 50 20 Α percent increase from 10. 21 Would you have reference to your response to 22 0 23 RIAA-T35-1? You there state that if a piece is flat but nevertheless, quote, "prepared as a parcel" it is subject to 24 a surcharge." 25

1 You elsewhere respond, quote, that "a parcel that 2 is prepared as a flat will not pay the surcharge."

3 Tell us, how do you know whether something is, 4 quote, "prepared as a parcel" or, quote, "prepared as a 5 flat"?

A Well, starting with the "prepared as a flat" phrase that you were speaking about, that involves if they make efforts to prepare the pieces as automation flats, particularly the FSM-1000, perhaps, rules there is a distinct set of makeup requirements and if those requirements are followed and the pieces are entered as flats in that regard then they aren't surcharged.

Q Is the principal preparation difference, as you previously described, that flats must be made up to a three-digit level whereas a machineable parcel can be made up just to the BMC. Is that principal preparation difference?

A Well, if you have seen the DMM you can see there were pages and pages on automation flats and other types of shapes and how the requirements are. Automation has a whole set of requirements that differ from a parcel.

Q The DMM section M610.6.2 I think you referred to, is the regulation for flats. Are you saying that if you comply with that section you can turn a parcel into a flat? A Well, I think you are reading from the one

interrogatory response that we revised. It wasn't -- I 1 think you said Section M610.6.2 but it is actually 5.0. 2 It is 5.0, excuse me. Yes, and I do have that. 3 0 Okay. 4 Α But with that amendment, is that what you are 5 Ο 6 saying, that if a parcel meets these preparation requirements it is now a flat? 7 8 Α Well, those are the preparation rules and I don't have the DMM here, but that sentence says that the 9 preparation rules in Section M610.5.0 are regarding 10 11 machineable parcel shapes, so they would have to be prepared as flats to be considered flats in terms of the application 12 of the surcharge. 13 140 But it was a parcel. I mean it measures as a 15 parcel but nevertheless it is prepared as a flat so now it is a flat? 16 There are a number of pieces apparently that would 17 А have been considered parcels that have made an effort to 18 meet the requirements for the FSM-1000 and have themselves 19 20 declared flats for ratemaking purposes. And conversely, you have also said that something 21 0 22 that is a flat will be surcharged as a parcel if it is prepared as a parcel, is that what you are saying? 23 2.4 Α Yes. If a piece that has the potential of being a 25 flat but is prepared in the fashion that machineable parcels

are prepared in, it is going to be handled as a parcel. Its 1 cost will probably be parcel-like, and it is subject to the 2 surcharge. 3 These DMM sections that you refer to, those are 4 0 5 your rules. They are not the Commission's rules, is that 6 correct? 7 Α Well, it is not part of the DMCS. It is the DMM. Yes, you made those up and presumably you can 8 0 9 change them. 10 Α When you say "you" you are speaking of --I mean the Postal Service, yes. 11 0 Well, there is a process for DMM changes. 12 А 13 You publish it in the Federal Register and then Q people can comment and then you ignore the comments and do 14 15 whatever you want. 16 [Laughter.] THE WITNESS: Well --17 BY MR. MAY: 18 19 Something like that. Well, are you testifying Q that by changing the preparation requirements for flats and 20 parcels that the Postal Service can on its own without 21 coming to the Commission either cause a surcharge to be 22 imposed on something that is a flat and exempt a parcel from 23 paying its surcharge because it is prepared as a flat? 24 25 You are saying that the Postal Service can do

1 this?

A Well, we changed -- we implemented rules regarding FSM-1000 that allowed some pieces to be defined as flats and if that is what you are asking me, yes, then we can change rules that then say the surcharge doesn't apply to pieces that are flat-shaped by that definition.

7 THE REPORTER: Mr. May, could you pull it a little 8 closer to you?

9 MR. MAY: If it is any closer, I'd be chewing it. 10 BY MR. MAY:

11 Q And I believe that currently you have determined 12 that for that parcel to be treated as a flat, in addition 13 its dimensions, thickness, have to be between .75 and 1.25 14 inches, is that correct?

15 A To be prepared as an FSM-1000 flat, the thickness 16 can be up to 1.25 inches.

Q So it is theoretically possible for the Postal Service to simply do away with this surcharge that the Commission has recommended and approved by changing the dimension that a flat can be? A parcel can be treated like a flat, so you can do this on your own?

A Again, if it is a DMM rule that goes through the procedures for amending the DMM, and the Postal Service says that this is now considered a flat if it is prepared in accordance with these rules, and the surcharge applies to

5 is that correct? 6 А 7 blame for that happening, yes. 8 0 couldn't vou? 9 А it. 0 can make this change? 19 Α That's where I refer to the lawyers. MR. ALVERNO: I object to the questions, Mr. give a legal conclusion. THE WITNESS: I was just going to do that. [Laughter.] 25 MR. ALVERNO: Mr. Chairman, I believe what he is ANN RILEY & ASSOCIATES, LTD. Court Reporters 1025 Connecticut Avenue, NW, Suite 1014 Washington, D.C. 20036 (202) 842-0034

pieces that are nonletter or nonflat shaped, then that is the result.

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And it is the Postal Service and not the 3 0 Commission that caused the 1.25 inch thickness requirement, 4

It is certainly the Postal Service's credit or

And theoretically you could make it two inches,

We would have to have some reason to -- I mean the 10 1.25 increase was related to the physical dimensions that 11 the FSM-1000 can handle. Theoretically maybe there is some 12 13 other measurement that might be more appropriate. I doubt 14

But the point I am making is that you can do it --15 16 is there any point at which you would believe you have to return to the Commission and ask the Commission whether you 17 18

20 Chairman, because I believe that requires Mr. Moeller to 21 22

23 24 asking is, you know, what the Postal Service must bring to
 the Commission in terms of a proposed change in
 classification, and I think that the witness is not
 qualified to give that answer.

5 I think that is a question that can be reserved 6 for legal argument.

7 CHAIRMAN GLEIMAN: Mr. May, would you like to 8 proceed with another question?

9 MR. MAY: Yes, I will.

10 BY MR. MAY:

11 Q Just to reconfirm the fact that you did indeed, 12 though, the Postal Service did indeed subsequent to the 13 Commission's recommendation of a shape-based surcharge in 14 R97, subsequent to the Commission's recommendation, the 15 Postal Service did implement a rule in the DMM that would 16 allow a parcel to avoid payment of the flat surcharge, you 17 did do that, the Postal Service did do that?

18 A The DMM was changed to allow pieces, and again on 19 the timing, the exact dates of when all these things 20 happened, I am not real clear on.

Q Would you direct your attention to your answer to PSA's 27-4.

23 A Yes.

Q And in that question, you were asked to explain why, even though the two ECR subclasses of irregular shaped

and parcels have a much wider revenue cost gap than does the
 bulk regular rate category, that despite that, you have
 proposed a smaller surcharge, that is, 15 cents, for the ECR
 qroup, versus 18 cents for the regular.

5 And your response was that 15 cents, quote, "is 6 the minimum net surcharge that a non-ECR regular piece 7 eligible for the bar code discount can receive under the 8 proposed rates."

9 Are you saying that you propose 15 cents for ECR 10 because that's the cheapest rate that you could have for a 11 non-ECR?

12 A The 15-cent figure is the lowest surcharge that 13 might be applicable, the net surcharge when you consider the 14 bar code discount and the surcharge itself for a non-carrier 15 route piece.

And the question goes on. The response goes on, ECR parcels avoid many of the cost difference causing sorting operations that regular pieces incur, so it's not unreasonable to restrain the ECR surcharge to that for the regular pieces.

Q But how does that explain why you have proposed a smaller surcharge for the parcels that lose the most money, at least according to your data?

A Well, the surcharge is based on the cost difference, not necessarily the revenue cost relationship.

And this particular decision isn't related to the 1 particular cost coverages of these two groupings of mail. 2 It's more just to avoid the -- it's not an 3 4 anomaly, but it's strange that a surcharge would be higher on something that involves few piece sortations than does 5 another piece. 6 Well, I notice that in your response, you say that 7 0 one of the reasons is that the ECR parcels avoid many of 8 9 what you call the cost difference-causing sorting 10 operations. If that's so, if ECR does avoid those operational 11 costs, then why doesn't your cost data show that to be the 12 13 case? Why does your data show that it's more expensive? 14Well, the cost data, again, is Witness Crum. He 15 Α can -- he may have tried to explain to you why the costs are 16 17 what they are for ECR and non-ECR parcels, versus flats. You mean that they're just not reliable; is that 18 0 19 what you're suggesting? I don't think I said anything like that. I said 20 Α that I think he's the one who can explain the costs for 21 these parcel-shaped pieces. 22 Would you look at your answer to Parcel Shippers Q 23 35-1(b), and in that answer, you state there that in your 24

25 testimony you didn't intend to imply that the cost

differential between flats and parcels should be equal to
 the surcharge on parcels.

But you also say that, quote, "a pass-through qreater than 27.5 percent would be better," close quote.

5 First of all, is pass-through the correct term to 6 use?

7 A The language that I used in both my testimony and 8 in this response, was attempting to use the terminology that 9 was used in the recommended decision from the last case, and 10 that figure was referred to as a pass-through, and that's 11 why I'm using that term.

12 It is similar to what's done in other situations 13 where you have a cost difference and you apply a percentage 14 to it. That's generally thought of as a pass-through.

15 Q But normally a pass-through is a pass-through of 16 cost avoidance; isn't that normally the use of pass-through 17 in Postal terminology?

18

A Cost avoidance, cost difference.

19 Q Well, what we're trying to -- aren't you basically 20 trying to bridge a gap between the revenue on the parcel and 21 the cost of the parcel?

A Yes. Parcels, we lose money on parcels. And one way to try to lessen that problem is to have a surcharge. Q But what you call the pass-through is actually -what you're comparing here is apples and oranges. You're

comparing the cost of a parcel-shaped Standard A piece and a
 flat piece.

3 You're comparing the cost of two different things;
4 are you not?

A Well, if they were not different things, their cost might be exactly the same. There is always going to be some difference between two groupings of mail when you're trying to establish a rate difference between them.

9 Q But isn't it irrelevant, what the cost differences 10 are between two different things, and that the really 11 crucial question is, are both or either of these covering 12 their costs with the amount of revenue they earn?

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13 A Well, there -- again, I'm using the methodology 14 that was used in the decision last time, but on the record, 15 there is also evidence -- also figures that show what you're 16 getting at, the fact that these regular subclass parcels 17 lose 29 cents apiece, I believe the figure is.

Q Well, but the parcels, these parcels also produce considerably more revenue, on average, than a flat; is that not the case?

A Correct, and that 29-cent figure has baked into it, the fact that they pay higher revenue because of their weight, for instance.

Q Now, you also say that, quote, "for example, in the Regular subclass, if the cost coverage for flats is

109.5 percent, you get that 23 cents and divide it by 21
 cents, the surcharge on parcels would have to be \$36 for
 parcels to have similar coverage."

Is it not the case then that in order to have a 109.5 percent cost coverage for parcels, you'd only have to what you call pass-through in the form of a surcharge, 36 cents of the 65.5 cent cost difference?

A Well, I think the question was asking me about the cost coverage of these two groupings of mail, and I said if there were to be an effort to equalize their cost coverages, here's what the surcharge would have to be.

12 Q And that would require that you'd only have to 13 pass through 36 cents of the 65.5 cent cost differential; 14 isn't that correct?

15 A My response says what the surcharge would have to 16 be to equalize the cost coverages, and if you do math, which 17 I think is what you're doing, that surcharge over the cost 18 difference would yield what the pass-through would have been 19 to generate that 36 cents.

20 Q Yes, in your testimony you said it would have to 21 be 36 cents.

A If one were to use these data and say we wanted to make these cost coverages similar.

Q Yes, but you could have equal cost coverage by passing through only slightly more than half of the cost

differential; could you not? 1 2 А You would apply some percentage lower than a hundred percent to the cost difference that I use to get 3 that 36 cents. 4 What is troubling is your use of these 5 0 differentials as though -- as a proxy for what you imply is 6 7 a loss on parcels. 8 Otherwise, why do you even speak of the cost differential between flats and parcels? 9 There is a cost differential between flats and 10 Α parcels. 11 And isn't there also a cost differential between 12 0 Priority Mail and the First Class letter mail? 13 14 А [No audible response.] 15 0 But of what consequence is the fact that they have a cost difference? 16 Well, there's a cost difference between letters 17 А 18 and non-letters, and we have a shape-based rate for that aspect of the feature of the mail in Standard A. 19 20 0 No, but Standard A non-letters cost differentials are not phrased in terms of the cost differential between 21 letters and non-letters; are they? 22 I believe they are. There's a pass-through at the 23 А basic tier and the three-five-digit tier that is a 24 25 percentage of the cost difference measured between letters
1

and non-letters at those tiers.

Q Well, but isn't that simply the same thing as saying that for what you have done is simply raise the amount of the rate for the non-letters to produce a certain coverage?

6 A It's not based on any kind of analysis of implicit 7 coverage of letters and non-letters.

8 Whatever you choose for the pass-through is 9 obviously going to affect the revenue, and that's going to 10 affect whatever coverage would underlie those pieces.

11 Q Well, but you don't have a surcharge for 12 non-letters; do you?

13 A It depends on how you define the rate differences 14 between those two pieces. Is it a letter discount, or is it 15 a letter flat differential? That's what we usually term it 16 as.

Q You have spoken of a non-letter surcharge?
A No. I said we speak of it as a letter/non-letter
differential, generally.

Q So, but in this case, it is a surcharge, correct?
A What is?
Q The proposal you're making for the shape-based.

23 A The parcels? The residual shape surcharge?

24 Q Yes.

25 A Yes, it's a surcharge.

1 Q And why do you call that a surcharge, and you 2 don't call what you do to Standard A non-letters a 3 surcharge?

A I don't know how the terminology evolved, but it's always been viewed, ever since MC-95 when UPS demonstrated that there was a negative cost coverage -- no, a cost coverage below a hundred percent for parcels, then we've been discussing a parcel surcharge that then became a residual shape surcharge.

10And it's a surcharge that applies to the pieces.11QExcuse me, you can finish. I'm sorry.12AIt's a surcharge that within a subclass is13uniformly applied to all pieces that meet the requirements

14 for it.

Q But don't you think that it's misleading for you to constantly talk about a differential in the costs between flats and parcels, and never at the same time, mention the differential in revenues between flats and letters?

A Well, I keep going back to the Commission decision where there was an acknowledgement that the surcharge is being derived by applying a pass-through to a cost difference.

And it went on to say that that doesn't preclude people from looking at the revenue implications, too, and that's exactly what Witness Crum's Attachment F, Table 6.1

1 does.

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How we get to the surcharge that's proposed is just a matter of which route you take. But the fact of the matter is, parcels cost more, and contribute much less than non-letters, and this surcharge is trying to alleviate that situation.

Q Well, you mean, contribute much less, they
contribute more revenue. They just don't -- isn't that the
case?

10 A And they contribute even more cost. But when I 11 say, contribute, I'm speaking of the term contribution, 12 which is the revenue minus cost.

Q Yes, but can you find anyplace in your testimony where you have informed the Commission, for example, or anyone else, in your testimony, while constantly highlighting the cost differences, anywhere where you've highlighted the revenue differences between flats and parcels?

A Well, I think this response we are discussing gets to the point. It involves revenue in that calculation of those figures, which is in essence acknowledging the higher revenue that comes from parcels because of their heavier weight per piece.

24 MR. MAY: That's all, Mr. Chairman. Thank you.
25 CHAIRMAN GLEIMAN: Thank you, Mr. May.

Next is the Recording Industry Association of 1 2 America, Inc. MR. VOLNER: Thank you, Mr. Chairman. 3 CROSS EXAMINATION 4 BY MR. VOLNER: 5 Mr. Moeller, my name is Ian Volner and I will be 6 0 7 examining you for the Recording Industry Association of America, and I'm happy to say that both Mr. May and the OCA 8 have simplified my life a little bit, so we can hopefully 9 get through this guickly. 10 You were discussing with the OCA workpaper 1, page 11 12 13, 14. Can we start from there, --Yes. 13 Α 14 0 -- see if we can't get some clarification here. 15 Now, you show volume after rates -- let's use the 16 after-rates column on page 14 -- of 860 million pieces of 17 residual shape, and that, I assume, includes pieces that are greater than three-quarters of an inch but less than 18 one-and-a-quarter inch; is that correct? 19 20 Α That is using the definition of a parcel which has pieces over three-quarters of an inch being called parcels, 21 so to the extent there are some pieces in there in that 22 thickness range that you just described, then yes, they're 23 in that number. 24 25 Q They're in that number. And they're in that

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4064

number regardless of how they were prepared; is that correct? If they were prepared as flats and run across a flats automation machine in FSM 1000, they are still in that number?

5 A I think this predates the -- I think these 6 figures, the 5.9 percent -- and I didn't derive that figure, 7 but it's from a time period prior to the FSM 1000 relaxation 8 of the rules that allow pieces of those dimensions to be 9 prepared as automation flats.

10 Q Conversely, pieces that are less than 11 three-quarters of an inch thick are definitionally flats; is 12 that correct, in the pre-surcharge era?

13 A Well, I always defer to Witness Crum on how the 14 pieces are described in terms of the costing of them.

15 Q I'm not asking about costing; I'm asking about 16 revenues.

17 A Oh. Okay.

Q The revenues are based upon a volume, expected residual volume, and what I'm asking you is how did you arrive at the expected residual volume in terms of this Witness Crum's dichotomy of characterization?

A Well, at the root of that is how the 5.9 percent figure was derived, and it's my understanding that that is the percentage that met the parcel definition as it relates to the data source which the number is based on, and I can't

tell you -- it's described to me as the percent of 1 2 parcel-shape pieces of the non-letter category. That begs the question, doesn't it? The 3 Q percentage of parcel-based pieces means we need to know what 4 a parcel is for purposes of that volume number, don't we? 5 Yes, and I'm sure that Witness Crum has explained 6 Α how the mix of shape and non-letters -- his volume estimates 7 that he needs is derived. 8 So that you simply took it from Witness Crum's 9 Q 10 number; is that correct? Yes. The citation for the --А 11 5.9 percent? 12 0 There was a citation there to --Yes. 13 А Okay. 14 0 -- Attachment F --15 A You did not investigate further? 16 Q Over the course of the years, I have had 17 Α 18 discussions with Witness Crum about a number of issues, about volume and cost, but he's the one who provides this 19 number and I cite him here. 20 Now, let us say for the sake of indulgence that 21 0 this 5.9 percent residual shape number entirely excludes all 22 23 pieces that met the dimensions of and were prepared as Indulge me in that assumption. We don't know, do 24 flats. we? 25

A This number at this time frame is going to exclude all pieces that were prepared as flats because the three-quarter-of-an-inch thickness was still the maximum at that time.

5 Q But it's also going to include pieces that were 6 not prepared as flats, isn't it?

7 The 5.9 percent figure is going to include what? А Pieces that were not prepared as flats because 8 0 they were between, say, three-quarters of an inch and an 9 inch and a quarter, and, as you said in response I believe 10 11 to Mr. Kostich, prior to the implementation of the surcharge, what was the incentive of the mailer to prepare 12 them as flats? 13

A I was following you until that last point, but the 5.9 percent figure -- again, I'm not sure on how it was arrived at, but it's the percentage of parcels, however parcels are defined in the volume side of this of non-letters, the percentage of parcels as a part of the larger group of non-letters.

20 Q However defined.

21 A Correct.

22 Q And that sufficed for your purposes?

23 A For the purposes of trying to come up with an 24 estimate of how much revenue is going to be involved in both 25 the surcharge and the bar code discount, these were the

- 1 1
 - numbers -- what I used.

Now let's take a look at PostCom -- your response 2 0 to PostCom interrogatory 2(d), please. And you say, "It is 3 likely that some parcel-shaped pieces are being entered as 4 automation flats." 5 Were you referring to the base year? 6 No, I'm referring to the post-January 10 7 Α environment. 8 So that this explanation is post-January 9 0 I see. 10, 1999, but the numbers on workpaper page 14 -- workpaper 10 1, page 14, though characterized as test year after rates, 11 really aren't, are they? 12 13 Α Well, that is why that 25 percent figure is in 14 there. We are going to get to the 25 percent figure in a 15 Q 16 Now, you go on to say, in your response to Post/Com moment. 17 Interrogatory 2(d), an I am quoting you, "It is my understanding that, although entered as an automation flat, 18 they are usually treated and handled as parcels." So, do I 19 understand that for operational purposes, and, therefore, 20 for cost purposes, it doesn't matter what the mailer does to 21 prepare these pieces, they are usually treated as parcels? 22 But for revenue purposes, if prepared as a flat, they don't 23 enter into your equation of the revenue? 24 When you get to that last sentence, I lose it. 25 Α

But if you see that I go on to cite Witness Kingsley there, 1 and it is my understanding that pieces that appear to be 2 3 parcels, and may be over three-quarters of an inch thick, even if they are prepared as automation flats and go through 4 whatever has to be done to meet those requirements, they are 5 usually treated and handled as parcels, which has a whole 6 other set of questions that someone might ask about why that 7 8 is the case. But I am not sure --

I am about to. Let's stop right there. I don't 9 0 mean interrupt you. But why are they usually treated as 10 parcels if they are prepared as flats and meet the dimension 11 of flats? Is it that the field is simply ignoring 12 instructions, or has some instruction been sent out -- never 13 mind, these are parcels, we are going to get them on the 14surcharge -- and what it does is it, in fact, drives up the 15 16 apparent cost, thereby justifying the higher surcharge?

17 A The logic there doesn't follow through, but --18 Q I'm sorry. Let me phrase the question again. 19 Why, if they meet all of the criteria of a flat, are they 20 usually being treated as a parcel?

A Because, despite our allowing them to be prepared as flats and avoid the surcharge, when they show up, given the constraints, apparently, and Witness Kingsley can speak to this better than I can, they are not processed as automation flats. And when they get to the delivery unit,

they are not handled as flats there. So they are incurring this extra cost. It is not a matter of people not following directions. If it doesn't make sense to put something on a flat sorter machine to the people who run the flat sorter machine, they shouldn't do it.

Q Well, did you then consider the possibility that, in calculating the revenues, you should have included pieces even though they don't pay the surcharge, to realign the cost definition of a parcel with the revenue definition of a parcel?

This page 14 is an attempt to determine how much 11 А volume is going to pay the surcharge, and it tries to 12 recognize that the Postal Service is allowing pieces that 13 are ostensibly parcels to be prepared as automation flats. 14 15 And the goal here is to try to come up with the best estimate I can of what the revenue is going to be. And, 16 obviously, there is limited information that is available 17 because of the timing of the implementation of the case and 18 19 whatever.

20 Q The best estimate of what the revenue is going to 21 be, without regard to the impact on cost?

A The cost is a separate issue. I am trying to determine here how much revenue we can expect from the residual shape surcharge.

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Q Well, didn't you say on page 7 of your testimony

1 that the purpose of the surcharge is to more closely align 2 the revenues derived from these pieces, however they may be 3 defined, with the apparent cost?

4 A Can you give me a line number here?

5

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Q I shall do so.

A The revenue.

Q Page 6. I'm sorry, page 6, line 17. This increase in the surcharge furthers the goal of greater precognition of the cost difference. I assume the cost difference is between letters and flats -- I'm sorry, between parcels and flats, non-letters.

12 A That is the cost difference I am speaking of 13 there, yes.

Q The goal of greater recognition of the cost difference between those two categories or types of mail, or shapes of mail, is supposed to be reflected in this surcharge, even though for operational purposes, the operation treats pieces that are, in theory, less costly, as parcels anyway. Is that correct?

A Ask me another -- take a crack at that again, because it doesn't seem to follow, the following part doesn't seem to relate to the first.

Q What the purpose of the surcharge -- can we agree that the purpose of the surcharge, or your stated purpose in proposing an increase in the surcharge is to further the

- goal of greater recognition of cost difference between two 1 2 definable categories of mail?
- Yes. 3 Α

4 Ø And the cost difference, can we agree, is in part based upon how it is processed and how it is treated at the 5 delivery unit? Can we agree to that? б

Α Yes.

And for your purposes you say it doesn't matter 8 0 whether pieces that meet the dimensions of a flat and are 9 prepared as a flat are counted as, before adjustment, 10 subject to the residual shape surcharge, even though they 11 12 will, in fact, be processed as parcels?

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They are likely to be processed as parcels. А 14 0 Okay.

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But we have assumed that they are going to take 15 А advantage of the flat rates and not generate this revenue 16 17 that I speak of on page 14.

I understand that. Now, let's talk about the 25 18 0 percent adjustment. Is it fair to say that the 25 percent 19 20 reduction from projection on Work Paper 1, page 14, was designed to recognize that the percentage of residual shape 21 pieces to total non-letters might change as a result of the 22 increase in the surcharge? 23

Actually, it is a recognition that the surcharge, 24 Α 25 as it is now, may have caused that to happen.

1 Q Yes, I noticed that, because I noticed that the 2 reduction 25 percent before rates is the same as the 3 reduction 25 percent after rates on that page. Is that 4 correct?

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A That is correct.

Q Well, Mr. Costich has asked you what the basis for that number was, and if you could turn to Post/Com Interrogatory -- your response to Post/Com Interrogatory 2(b). I take from the next to the last sentence in that response that you had -- no volume data were available upon which to base an estimate?

12

A That's correct.

Q So what was this, sort of a -- how did you arrive
at 25 percent? Let me put it to you directly.

15 Α Well, that's been asked and I guess I was faced with an absence of having any figure. I was faced with not 16 putting that line in there at all and having you come here 17 and ask me questions, well, isn't it possible that some of 18 these pieces are now being flats and you won't get the 19 20 revenue from those pieces -- which I didn't like that prospect, so I thought a more reasonable approach would be 21 to recognize that the Postal Service has an effort to be 22 responsive to customers who were not wanting to pay that 23 surcharge, rules that allow some of these pieces to be 24 25 declared flats.

Q And if in fact the 25 percent number, either in 1999, which would be after the 10 cent surcharge was put into effect, or in the test year after rates, which is the column we are looking at now, Column 2, was much higher than what actually happened, would not very significantly result in an understatement of what you have characterized as expected revenues from the surcharge?

8 A If the 25 percent figure in actuality turns out to 9 be lower than 25 percent, then there will be more revenue 10 from the surcharge than I have expected here.

11 Q Now I am interested in another piece to this. 12 When I compare the Regular subclass with the next group 13 down, the Enhanced Carrier Route subclass, I find that in 14 that subclass you have estimated a reduction from projection 15 of 50 percent.

16 A Yes.

Q So nearly double that that you have estimated in the Regular rate subclass, and that I take it is the same sort of explanation that you just gave for -- it just seems like it ought to be more because it's ECR?

A Well, it is a bigger percentage increase for them. Since the surcharge is 10 cents regardless of the base rate that they pay, the 10 cents is a much greater percentage increase for, in this instance, these are sample mailers and just as I was describing how I was aware of customer

interest in getting those FSM-1000 rules written so that they can avoid the surchange, we were similarly hearing from sample mailers that this is going to really affect the programs that they had planned regarding samples being mailed.

5 So that is the reason it is higher, but it is 7 not -- as you can see, the expected revenue from the 8 surcharge even with that 50 percent, is only \$3.3 million in 9 ECR so it is not that sensitive to that number anyway.

10 Q I see, so it just doesn't matter what leaks out? 11 A It matters in terms of the calculation of the 12 total revenue here.

13 Q And it matters a lot in the case of the Regular 14 subclass, doesn't it?

15 A The 25 percent assumption is more—variations on 16 that assumption would have a greater impact on the revenue 17 that we expect.

18 Q Well, however you arrived at this 25 percent 19 number, where is this stuff going to go? Do you have any 20 idea? Let's confine ourselves to Regular subclass.

I mean did you make any kind of purely subjective judgment as to where these 25 percent pieces or roughly are a little more than 115 million pieces of mail is going to go?

25

A Well, let's find our interrogatory response about

1 this one.

Q Well, let me help you.

3 A Okay.

Q You answered a question for Mr. May on behalf of Parcel Shippers in which you said you expected that most of it will become flats, will be prepared as flats and get out from under it.

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Will you accept that?

9 A PSA --

10 Q I think it was PSA-5, or am I mistaken?

11 A No, I don't think they asked that many questions. 12 No, I didn't have a PSA-5. I have PSA-1 and -2 and one 13 redirected from Crum.

14 Q I'm sorry. I did not bring it with me. Well, let 15 me just ask the question.

Where do you think these pieces are going to go? A Well, for purpose of the revenue calculation I have assumed they are all nonletters, so they are going to be there either as a flat or a parcel.

One page 14 I am just estimating how many of them are going to be paying a surcharge, so they are not going away. I think that is your question.

Q Okay. In the case of the Regular subclass?A Yes.

25 Q And if they do not migrate -- well, let me phrase

1 the question slightly differently.

Let's suppose that they do migrate or some
percentage -- maybe not 25, maybe only 5, maybe 10, but some
percentage migrate to flats.

5 Did you make any assessment of whether those would 6 be heavier or lighter weight pieces?

A No.

7

Q Well, indulge me in the assumption that if the lighter weight pieces migrate to flats, and the heaviest weight pieces -- would that in and of itself mean that the average revenue per piece from parcels, however defined, will increase?

13 A If lighter weight parcels for whatever reasons 14 stop mailing or go to another rate category --

15 Q Right.

16 A -- and they are lighter than the typical parcel 17 piece, then the unit revenue from those pieces from the 18 parcel side would be lower -- I mean higher, sorry --

Q Thank you. Now this may not be a fair question but I am going to ask you anyway. You made reference to Library Reference 92.

Did you make any attempt to calculate what percentage of parcels in Library Reference 92 were above certain weight points in trying to derive this 25 percent number?

I did use some information about weight 1 Α distribution of parcels later on. 2 0 Right. 3 When I was trying to say how many of them would 4 А avail themselves of the parcel barcode discount. 5 Right. We are going to get to that shortly, but 6 0 now I am asking you in terms of deriving the 25 percent 7 reduction from projection, did you look at the weight of the 8 pieces, the distribution of weight? 9 10 Α No. Will you accept, subject to check, that almost 50 11 0 percent of total volume is in excess of 10 ounces? 12 Fifty percent of what volume? Α 13 0 Of parcels. 14 Fifty percent of --15 Α -- the volume of parcels reflected in Library 16 0 Reference 92. 17 For which subclass? 18 Α Standard A Regular -- well, let me do it a 19 0 20 different way. If it is not too difficult for you to do that 21 calculation, when you provide, if you provide a response to 22 the earlier request for information, we would like to know 23 that number. 24 Well, the number that is likely to come, and again Α 25

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I don't know, but the billing determinant figure we were 1 discussing earlier will probably who is paying the 2 3 surcharge, I mean how many surcharge pieces there were. 4 I am not sure how detailed the data will be surrounding that 5 figure. Well, if you can get us the --6 0 7 The weight per piece? Α By weight per piece -- that would be helpful 8 0 Let us talk about the barcode discount for a 9 moment because the barcode discount also enters into your 10 revenue calculation, doesn't it? 11 12 Α Yes. Could you turn to page 6 of your testimony, line 13 0 14 20, please? А Page 6, line what? 15 20. 16 0 17 Α Line 20, okay. And we start a very interesting discussion, some 18 Q of which is in the footnotes, but let's start with the 19 20 phrase, "automation eligibility requirements." 21 The whole sentence reads, "Now mailers can 22 partially offset the proposed 8 cent increase by tendering parcels that mean automation eligibility requirements." 23 24 I assume you mean machinable requirements, am I 25 correct?

1 A It's whatever requirements that will be in place 2 for them to avail themselves of the 3-cent parcel barcode 3 discount.

Q But a piece that is prepared as a flat will not be eligible for the 3 cent barcode discount, will it? It will get the automation flat rate, won't it?

7 A They can't claim both the flat discount and a
8 parcel barcode discount.

9 Q So that when you talk about automation eligibility 10 here, you mean parcel automation?

11 A Yes.

12 Q Okay. Now then, let's go back to your work paper 13 if we can, page 14, footnote 12.

What we are really referring to here is a heading on that work paper which you call a barcode discount leakage in which I take it what you are attempting to do is to estimate the amount of money the Postal Service will not get because pieces get the 3 cent barcode discount? Is that right?

A It is attempting to determine how much revenue, yes, will not be obtained by virtue of mailers taking advantage of the parcel barcode discount.

Q Now in this case, you have postulated that approximately 76 percent of the pieces in Standard A will gualify for the barcode, is that correct?

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A 76 percent --

2 Q Well, take a look at the second column on your 3 page.

A Yes, I apply a 76 percent factor to those surchargeable pieces, the pieces paying the surcharge, and assume they will be claiming the barcode discount.

7 Q And you assumed that to be the case both before8 and after rates?

9 A We have to do it before rates because the rate 10 design formula requires that you anticipate how much leakage 11 you are going to have for not only this discount but for all 12 the other discounts, and that is what the previous pages of 13 the work paper here does.

Q But before rates in this case means before the bar code discount existed, right, so that that 76 percent figure assumes that 76 percent of the parcels, and now we are using parcels to mean parcels that are not flats? Are already barcoded, is that what you are saying?

I mean this is strictly in anticipation. 19 А NO. It says before rates. It is in anticipation of what is going 20 to have to be recovered in the base rates to fund the 21 22 various discounts, so the before rates has to anticipate how oresor much leakage there is going to be from drop ship, free sort, 23 24 barcode and in this case the parcel barcode discount. Ι 25 mean, the drop --

1 Q And you assume no increase in the volume of pieces 2 that will be bar-coded or avoid the surcharge after the 3 discount takes effect?

A Are you back up to the 25-percent figure now?
Q No, I'm still on that 76-percent figure.
A I say the same percentage of pieces -D Before and after rates.

Q Before and after rates.

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A Will claim the bar code discount.

9 Q What is the basis for the 76-percent figure? And 10 I think you've given it to us. It's simply the percentage 11 of parcels over six ounces; is that correct?

12 A I used that as a measure that might approximate 13 what we might expect to see. And in my appendix to my 14 testimony -- we might as well get into it here -- on page 14 15 of Appendix 1, it starts in at line 13:

The assumption is that all parcels six ounces and above will claim the discount. While some of these pieces may not, in fact, be machinable, or otherwise not eligible for the discount, this may be offset by pieces weighing less than six ounces, that by approval of the BMC manager, can be prepared as machinable parcels.

22 So, I mean, I understand that using the 23 greater-than-six-ounce figure is not -- it can be higher 24 than that or lower than that, but that's the number that 25 seemed to match at least one of the requirements for how you

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can get the parcel bar code discount.

2 Q I see, that's very helpful. But let me ask 3 another question:

There is a provision of the definition of a machinable parcel that says -- and it's called an exclusion -- it says items categorized as flats, irregular parcels or outside parcels, may not be prepared as machinable parcels.

8 Now, what is your understanding of that term, 9 flat, in the context of your calculation of 76 percent bar 10 coding? And let me try to be specific about it:

Indulge me in this piece, which happens to be not
 a video, but happens to be an audio.

13 We have marked it as Exhibit C and it's 7/8ths of 14 an inch thick, and it weighs 5.9 ounces.

15 Is that piece characterized as a flat for purposes
16 of the DMM? *H*

A I depends on how it's prepared. It would be a flat if it's following the preparation rules for the FSM-1000, but it could be a machinable parcel if it's following those preparation rules.

Q So that your understanding of the DMM -- and we need to be very clear about this, because I don't want to be here a year from now complaining to the Commission that my people are trying to claim bar code discounts and they, the Postal Service, won't allow us to do it because they've

1 characterized it as a flat.

What you're saying is that the mere fact that it 2 3 meets the definition of a flat does not -- dimensional definition -- does not disqualify it from your parcel bar 4 code discount in this case? 5 А That's correct. 6 7 All right, well, that is helpful. But now we 0 still have one other problem. 8 You use pieces six ounces and above. And as 9 you've explained, there might be some pieces below six 10 ounces and that do qualify because the BMC manager allows 11 12 them. 13 And there might be some pieces above six ounces. Did you say they do not qualify or might not claim? 14 15 Α Well, if they weigh over six ounces, for a number 16 of reasons, they may not be -- they may not -- the mailer may not want to do it, bar code, or the piece may be of a 17 configuration that it wouldn't meet the machinability aspect 18 19 of the requirements. And in that case, the BMC manager cannot let it in 20 Q 21 anyway? 22 Α I think the exclusion or the exception that's written there regarding the BMC manager's authority means 23 24 going lighter than six ounces, at least that's my

25 understanding of what the BMC manager can authorize.

Q I think your understanding is correct, but let me finish the line. Do we have any idea of how many pieces there are weighing less than one pound, weighing more than six ounces, that do not otherwise meet the dimensions of a machinable parcel?

A I don't want to say there's no measure that might illuminate that issue. I'm not aware of a figure that gets to that.

9 Q And you didn't have a figure when you calculated 10 the all but 24 percent of the parcels will qualify?

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11 A No, I'm just acknowledging that there may be 12 pieces like that that will not get -- not be able to get the 13 bar code discount.

Again, I think that's going to be offset in some way by those pieces that are below six ounces that will get the bar code discount.

Q But it is tautological, isn't it, that to the extent that you've overstated the number of pieces that either qualify for or claim the bar code discount, you have understated the revenue effects?

A If it's not precisely 76 percent that claim the bar code discount, my revenue will be off one way or the other. I mean, it will not be precisely correct, I guess. Q Okay. Now, there's one last piece on this line that does trouble me. Could you turn to DMC, District

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Photo-7, please?

[Pause.]

Okay.

3 A Okay.

4 Q And let's just focus on Subpart (d) of your 5 response.

6 A D?

Q The second sentence: It is reasonable to expect
that the machinability requirements will be similar to those
for pieces eligible for the current parcel bar code
discounts.

11 What we have been discussing throughout this whole 12 15-minute exercise, is an existing DMM provision which I 13 thought defined a machinable parcel.

14 Why are we talking about something that will be 15 similar to?

16 A Let's see what (d) is asking them for. Will any 17 address placement requirements be imposed on parcels to 18 qualify for the discount?

19 Q I wasn't looking at (d), I was looking at (e).

20 A Oh, I thought you said D.

21 Q E.

22 [Pause.]

A I'm sorry, now I've lost the question. I've beenreading. What's the question?

25 Q Well, the question has to do simply with the fact

1 that you referred to, by District Photo, referred to the 2 existing C050.

And your response is, it is reasonable to expect that machinability requirements will be similar to those. Why didn't you simply say C050 defines a machinable parcel for purposes of a bar code eligibility?

7 A Well, the first sentence there says the DMM 8 language has not been drafted, and I didn't want to 9 presuppose the exact rules that would come into play.

10 And the second sentence was trying to -- and 11 obviously did not -- kind of allay the fear that there's 12 going to be some drastic rulemaking exercise that's going to 13 make the parcel bar code discount not available to Standard 14 A parcels.

For instance, now, I think -- well, there is a pound limitation on some of these things, so that's one change that will have to happen. This will have to allow lighter weight pieces to claim it.

19 Q There's a pound limitation in the definition of 20 machinable parcels, but it's way above one pound. For books 21 or other printed matter, the maximum weight is 25 pounds.

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A No, no, no minimum weight.

Q The minimum weight is something we've been
discussing for some time now. There are two minima.
There's one at eight inches, and one between six and eight,

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and you used six, didn't you?

A I'm sorry I went down the road there that wasn't what you were looking for. I'm talking about the fact that today's people who claim the parcel bar code discount are not in Standard A.

6 And they're of a different -- they're in 7 subclasses that have different weight minimums.

8 But again, this response was in no way to 9 foreshadow some sort of expectation or fear that the rules 10 we have been talking about, how you define a machinable 11 parcel, and the six-ounce and the eight-ounce and the 12 exclusion by the BMC manager, would change in any way.

Q In any way?

A In any way that would preclude a big chunk of these pieces that are now prepared as machinable parcels -they're prepared as machinable parcels and are run on the equipment that's going to have the parcel bar code reader, so I don't see why there would be some departure from the machinability, the machinable parcel rules that we were discussing earlier.

Q Is the parcel bar code the same as the bar code that is used on a flat?

23 A No.

Q Now, there's one last question on this line:
The purpose of calculating revenue leakage is to

figure out what the net revenues of the class or the subclass or the category, in this case -- assuming we can define it -- are going to be; is that correct?

A It's an attempt to assist in the measurement of how much total revenue there is going to be from the various subclasses.

Q And you, going back to page 6, say that -- I'm
sorry, let's go to Footnote 12 on page 7, which actually
appears on page 7.

10 A Actually before I lose the question before, if 11 you're speaking in the after rates situation, yes, we're 12 trying to determine what the total revenue is from the 13 subclasses, and that's why the leakage is important to try 14 to anticipate.

15 Now, what was the cite?

16 Q Page 7, Footnote 12.

17 [Pause.]

Now, the sentence reads, since most parcels are machinable, and since many are already bar-coded, the net surcharge for many parcels will be 15 cents.

I take that that the statement, most parcels are machinable, is based upon your workpaper calculation, which would put it at 76 percent?

A It seems to be consistent with that.

25 Q Okay. And the next part of that sentence, and

since many already are bar-coded, where did you get that
from?

A That's just -- I'm not sure what series of discussions there were, but it's my understanding that many people who are mailing parcels that are today getting the parcel bar code discount, that it's available for the other subclasses that have parcels in them, may, as a point of production, produce them for the pieces less than a pound also, so they may be on there.

10 Q They may, and then again, they may not; is that 11 correct?

12 A They may not, yes. But it's funny because the 13 last part of that doesn't really rely on that part of the 14 sentence, anyway; it just acknowledges that people who do 15 bar-code, whether or not they're bar-coding today, will see 16 a net increase in the surcharge of five cents.

17 CHAIRMAN GLEIMAN: Mr. Volner, do you have much18 longer to go?

MR. VOLNER: Mr. Chairman, I was going to suggest that I probably have another 20-25 minutes, the way we're going. I'm perfectly happy to -- I'm sorry, I meant to --CHAIRMAN GLEIMAN: That's okay. I didn't want to interrupt one of those last questions in that line. How about if we break now for lunch and come back at 2:00. I just wanted to mention one further thing for the

| 1 | record, that Commissioner LeBlanc is not here today. | |
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| 2 | [Whereupon, at 12:50 p.m., the hearing was | |
| 3 | recessed, to reconve this same day at 2:00 p.m.] | |
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AFTERNOON SESSION 1 2 [2:00 p.m.] CHAIRMAN GLEIMAN: Well, Mr. Volner, it looks like 3 all the key players except for my colleagues, -- some of my 4 5 colleagues are here. MR. VOLNER: Your colleagues are here. 6 7 CHAIRMAN GLEIMAN: I was going to say all the key 8 players, but then I noticed them coming in and I didn't want to disparage them. So I figured I would include them in key 9 players also. 10 Fire away. 11 12 Whereupon, JOSEPH D. MOELLER, 13 the witness on the stand at the time of the recess, having 14 been previously duly sworn, was further examined and 15 testified as follows: 16 17 CROSS-EXAMINATION [resumed] BY MR. VOLNER: 18 Mr. Moeller, when we broke, we were discussing 19 0 20 this business of the bar code discount leakage, revenue leakage issue, and I have only a few more questions on that 21 22 subject. Let me make sure that I understand the methodology 23 employed on workpaper 1, page 14. What you did first was you took the 25 percent deduction of pieces that you assume 24 25 are going to stay in the system, but are not going to be

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subject to the surcharge?

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A That's correct.

Q And then when you took the 76 percent that are expected to receive the bar code discount, that was after the other pieces had been taken out of the calculation?

6 A Yes. You will notice that above the 76 percent 7 figure is the 645 million, and that is after the application 8 of the 25 percent figure.

Q Excellent. And we agreed earlier, didn't we, that the bar code that you have to put on a flat in order to be prepared as a flat, is not the same as the bar code that you have to put on a parcel in order to qualify for the parcel bar code discount, didn't we?

A It is my understanding that the parcel -- the format of the bar code for a parcel is different than the format of the bar code for the flat.

Q Well, in order to expedite this, I have put in front of you some of my wares, if you will, merchandise, and just for the sake of this illustration, will you accept, subject to check, that the item that I have marked as Exhibit A is three-quarters of an inch and, therefore, would be eligible to migrate to flat, wouldn't it?

A Based on its thickness, whether it meets all theother things.

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Q Assume that it meets the other dimensions. In

fact, I will represent that it meets all of the dimensions. 1 2 Α Yes. And Exhibits B and C are seven-eighths of an inch 3 Ο thick and, therefore, assuming that they meet the other 4 5 dimensions, they would also be eliqible to be prepared as a flat? 6 7 Α Under the FSM 1000 preparation rules. 8 Q Right. Now, Exhibit D, assume that it is one-and-a-half inches thick. That one would not be eligible 9 under any circumstance to be prepared as a flat, would it? 10 It would not be eligible for the flat bar code Α 11 12 discount. And Exhibit E, the big job, is an 13 0 inch-and-three-quarters inch thick, and that would also not 14be eligible, would it? 15 It would not be eligible. 16 Α Now, in developing your model to determine the 17 0 revenue leakage, you simply treated parcels over six ounces, 18 or the percentage of parcels over six ounces as 19 definitionally eligible for the bar code? 20 I have a citation to the number on the 21 Α Yes. record that describes the number, the percentage of pieces 22 that are over six ounces that are parcel shaped. 23 Right. Now, let's suppose that I am the mailer of $\mathbf{24}$ 0 25 those pieces A through E and they are coming down off the

addressing machine, isn't it true that I would have to stop the machine in order to change bar code, assuming that they came in the sequence that I got them, once I got past Exhibit C?

A If you were going to try to claim the flat bar code discount for a portion of this mail that is in front of me, you would not be able to prepare them in one mailing right off the line, because of the bar code differences and what else, the other things you mentioned.

10 Q Pardon me? I didn't -- the other bar code 11 differences and?

12 A The other -- and the shape, and other consequence, 13 other characteristics of what qualifies for the respective 14 bar code discounts.

Q And if, in that situation, I said, look, this is just too complicated, guys, I am not going to try to qualify for the flats rate, all I am going to do is put the parcel bar code on all of my pieces. That would have an affect on your calculation of both revenues and revenue leakage, wouldn't it?

A If there are pieces -- well, again, the assumption was just based on the six ounces and above, and the 76 percent figure is from that. If there is something that that, pieces over six ounces not bar coding, for whatever reason, then the number will not be the 76 percent figure,

unless it is offset by the BMC managers authorizing pieces
 below six ounces.

Q I guess my question wasn't very clear. It is pieces that are bar coding, but are not trying to qualify as flats, even they might otherwise do so, that is of interest to be in terms of your revenue leakage calculation. If more pieces bar code that you have estimated to be the case, that would increase your revenue leakage, wouldn't it?

9 A If more pieces claim the bar code discount than I 10 have anticipated, then the leakage will have been 11 understated.

Q And since we have agreed that you can't get both the flats automation and the bar code, if more pieces claim the bar code, that would also increase the expected revenue from the surcharge, wouldn't it?

16 A If those pieces would have otherwise chosen to be 17 automation flats, if they are willing to be surcharged and 18 not avail themselves of the flat bar code discount, then we 19 have the revenue from the surcharge, yes.

20 Q Let's go on to my last topic then. Would you turn 21 to page 7 of your testimony, please?

22 A Yes.

Q At line 17, you make the statement, "Even the proposed surcharge resulted in an implicit cost coverage on the surcharge pieces that slightly exceeded 100 percent, the
Postal Service does not think it undesirable for Standard A mail parcels to make," and we are going over now to page 8, "some contribution to institutional costs." What is your definition of "slightly exceeded"?

5 A I think what I am saying there is if a parcel were 6 to actually make a contribution and its revenue actually 7 exceeded its cost, that is a good thing. And it is not \mathcal{A} 8 undesirable, it is good thing. If we could actually have 9 pieces that actually make a positive contribution, that is 10 good.

11 Q Well, would it be good if they exceeded cost by 12 200 percent?

13 A I am just trying to get the notion in my mind that 14 we would be making that much coverage on these pieces. I 15 mean the rate design for all the rates is done in a way that 16 addresses passthrough issues and larger level markups, and 17 whatever comes out of those rates -- whatever rates come out 18 of that process are okay.

19 Q I see. So that you didn't have any quantification 20 in mind when you made the comment that if they slightly 21 exceeded cost, direct cost, or cost, that is okay, but if it 22 got too high, that wouldn't be so desirable?

23 A Again, I don't think we are in danger of it 24 getting what I would think would be too high.

25 Q Well, in order to figure that out, wouldn't you

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- have to calculate what the contribution, revenue

2 contribution is for the parcels?

A Yes. And the previous part of this paragraph is
discussing that very issue.

5 Q Right. Now, the Commission, obviously, its R97-1 6 decision did make a computation of the revenue contribution 7 which you have cited at lines 8 through 10 of your 8 testimony, is that correct?

9 A Yes, that is my citation.

10 Q Did you make the same contribution here?

11 A Did I make the same contribution?

12 Q I'm sorry, the same calculation here.

13 A I think I did something similar to it in the 14 interrogatory response I was discussing earlier.

Q Well, let's take a look at that interrogatory response that you were discussing earlier. That is PSA-1, isn't it?

18 A I think so.

19 Q I think it was 1(c).

20 A It is PSA-1(c).

Q Now, Mr. May asked you a series of questions about it, I don't, fortunately, have to repeat them. But you are taking flats, the implicit contribution for flats on average, nonletters on average, and comparing it with a single subclass of parcels?

1 Α Well, the citation there in that response is to 2 Appendix -- I'm sorry, Witness Crum's testimony, USPS-T27, Attachment F, Table 6.1. 3 4 Do you happen to have that handy or would you like 0 me to supply you with a copy? 5 6 Α I think I have it. I have it. 7 MR. ALVERNO: I don't have a copy, if you have 8 one. MR. VOLNER: Sure. 9 10 BY MR. VOLNER: In order to calculate the implicit contribution, 11 0 12 you were working from the table called Flats, or from the 13 box called Flats? 14 Α I think the question asked me what would -- it was 15 alluding to the question, what if they had the same coverage, flats and parcels? So, in order to do that kind 16 17 of analysis, I looked at the box that you are referring to called Flats, and I calculated the implied coverage using 18 those figures for revenue and cost. 19 And you compared it with the box called IPPs and 20 0 21 Parcels? 22 Α Yes. 23 Okay. Now, we are working here within a single Q Is that your understanding of what the Commission 24 subclass. was doing when it calculated the net revenue shortfall of 25

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7.8 cents that you cited on line 10 of your testimony, of
 page 7 of your testimony?

A I am not sure, the preface to your question about we are working inside of one subclass, I am not sure I follow that. I think it was a similar calculation. I mean I don't have the backup, what was behind the Commission's figure of 7.8 cents.

8 Q So you don't know how the Commission arrived at 9 that 7.8 cent shortfall?

10 A Well, I think it was looking at what was on the 11 record for R97 and there was a lot of discovery in that case 12 that probably made this type of calculation doable. I think 13 it is a similarly calculated number and that is revenue 14 minus cost.

15 Q But you didn't do it here at all, did you? You 16 didn't do it either for the Standard A Regular subclass or 17 for all of the classes in aggregate?

A Except on page 7 in my testimony at line 12, I say, "However, if the revenue cost relationship were to be considered using the cost as presented in this proposal, one would find that the proposed surcharge still results in a revenue shortfall."

Q And you refer to Attachment F, Table 6 as theauthority for that proposition?

25 A Correct.

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Q Okay. Now, let's go back to Attachment F, Table 6.1 for a moment. That negative contribution per piece shown for IPPs and parcels was based on what year, do you know?

5 A This is FY '98.

6 Q So that the 10 cent surcharge is not reflected 7 there, it is?

8 A That's correct.

12

9 Q Okay. Do you know -- well, we know, don't we, 10 that the Commission recommended a 10 surcharge in the last 11 rate case?

A Yes, it was recommended 10 cents.

13 Q Do you know what percentage of that -- what 14 percentage that was of the calculated total revenue 15 shortfall?

16 Α Again, the surcharge was set by applying a 17 passthrough to the cost difference. You can look at revenue minus cost and see how far below these pieces are falling 18 19 below cost, and then seeing what portion 10 cents represents 20 of that, if you would like. But I am not sure what the --21 to answer you, I'm sorry, I don't think I answered your 22 question. I don't know what percentage 7.8 was of the 23 negative contribution that was calculated in that same case. 24 0 Okay. Now, in Table 6.1, since we are dealing 25 with FY 1998, that is before migration to flats, is that

1 correct?

2 A That's before migration of the nature we were 3 speaking of where pieces were qualifying for the FSM 1000 4 rate.

5 Q Right. And that is -- well, we don't know whether 6 it is before or after the bar code, do we? Because your 7 testimony is that you believe that the bar code was being 8 applied to 76 percent of the pieces in the base year, isn't 9 that your testimony?

10 I said 76 percent of the pieces were -- no, you Α are going back to that page 14 where I was explaining the 11 12 before rates scenario, and the reason there is the 13 assumption that pieces are bar coding in there is because we 14 need to predict in the rate design formula how much revenue 15 is going to be leaked by virtue of all the discounts. So it 16 is not saying that in the base year that many pieces were 17 bar coded, it is just saying in the test year, here are the 18 number of pieces that are likely to take advantage of the bar code discount. Here is what that means in terms of 19 20 revenue. And that means that the base rates have to be pushed up enough to fund those discounts. 21

Q Well, I actually wasn't referring to workpaper 1, page 14, I was referring to the statement in the footnote, which is footnote 12 on page 7, in which you say, "many already are bar coded." Does the "already" refer to the

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base year, the test year, or some intermediate year?

A I think there may be something on the record that speaks to the fact that many of these pieces have been bar coded in recent years, absent the bar code discount.

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Q With the parcel bar code?

A Correct.

MR. VOLNER: Well, I am going to have to ask this. If you or counsel could supply me to the place where that appears on the record, I would be grateful. And I don't need it right away.

11 THE WITNESS: I think I may have a cite. I don't 12 have the actual number in front of me, but I think it might 13 have been a Witness Crum response to a PostCom

14 interrogatory, where he was presenting data from a previous 15 proceeding, I believe.

MR. VOLNER: Mr. Chairman, I am going to leave the record stand. There was indeed an exchange between Mr. Crum and myself about the extent of the barcoding and we will just let the record stay the way it is.

20

BY MR. VOLNER:

Q Now since you are relying on Attachment F, Table 6.1, am I correct that there is no way from this table to calculate the average revenue per piece for test year before -- well, test year after rates?

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You can make some assumptions about how things may

move on this table, but this is not a test year after rates table. You were correct earlier that the revenue would be higher if the surcharge would have been in place.

If you were to move to a test year situation, you would have the higher surcharge, you would have some barcode reduction, you would have some reduction in the revenue per piece because we are proposing a lower pound rate, so there are a number of things that have reasons why this is not a test year figure.

10 0 Now the other thing that I noticed, as a matter of fact all of us have noticed, from Attachment F, Table 6.1, 11 is that there is a significant -- not 6.1 but the Attachment 12 13 6.1, 6.2 and so forth -- there is a significant variation in the revenue shortfall, as you call it, by subclass, so that 14for example as between Regular and ECR in the Commercial 15 16 category, it is 29 cents shown and 59 cents shown. Is that 17 right, negative contribution?

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For Regular and for ECR, yes.

19 0 Now if you had done this separately by subclass, you might have found, might you not have, that the proposed 20 21 surcharge still results in a revenue shortfall for some 22 subclasses but not others, or that the revenue shortfall is significantly different for some subclasses than others? 23 24 А I will go with the second part of that finding, 25 yes, that they might be significantly different if you were

to reproduce these tables and I don't think they would all be -- I think they would probably all still be below cost, negative contribution.

Q Negative contribution. But you don't know. You said probably. I mean you haven't calculated it separately for each subclass, have you?

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A I don't have any specific figures, no.

Q Okay. Now you said in response to a question from Mr. Baker that we have different subclasses for -- I think your phrase was "various reasons". Can we agree that the average weight per piece among the four subclasses that are subject to this surcharge is not the same?

13 A The pieces subject to the surcharge are not of 14 uniform weight per piece across all these subclasses.

15 Q Can we agree that the volume distribution by 16 weight for each of the subclasses may or may not be the 17 same?

18 A Yes.

Q Can we agree that the extent of drop entry of
these parcels by subclass may or may not be the same?
A Yes.

22 Q And do we agree that the proposed pound rate for 23 the two commercial subclasses is not the same?

A We have proposed different pound rates for the two commercial subclasses, yes.

1 Q And whereas in the last case you also proposed 2 differentiating the pound rates, what did the Commission do 3 in the case of Regular Standard A in the last case with the 4 pound rate? Do you recall?

5 A I know in ECR it was kept the same and I am 6 inclined to think that was the case for the other pound rate 7 but I am not sure. It was not reduced, I am pretty sure of 8 that.

9 Q Well, it was not reduced for either of the 10 subclasses. Will you accept subject to check that in fact 11 there was a slight increase in the pound rate in the last 12 rate case for Standard A Regular?

A I will accept it subject to check, yes.

Q Okay. All of these differences have differing
effects, don't they, on the extent of negative contribution?

16 A Well, the revenue per piece figure is reflective 17 of whatever weight mix, drop ship mix was in that subclass 18 so yes, those various rate elements are going to affect the 19 revenue per piece.

20 Q And yet for the two Regular subclasses you have 21 proposed essentially the same surcharge, is that correct?

22 A For the two commercial subclasses --

Q No, no, I meant by that the nonprofit andcommercial Regular subclasses?

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A The noncarrier route subclasses.

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Yes -- okay, good.

A Yes, we proposed the same surcharge in both those subclasses.

Q And similarly you proposed the same but different surcharges for carrier -- for the two carrier route subclasses?

7 A The two carrier route subclasses have the same
8 proposed surcharge.

9 Q Did you feel compelled to develop the surcharge on 10 a cross-class basis? I mean, were you told by your lawyers 11 that you've got to do it that way or you can't do it at all?

MR. ALVERNO: Objection, it relates to attorney-client privilege.

14 MR. VOLNER: I will withdraw the question. Let me 15 rephrase it.

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BY MR. VOLNER:

Q Was there a reason of policy that you chose to
establish a single surcharge for the two non-ECR subclasses?

A Well, it certainly is the precedent now to do it that way, because that's the way the current surcharge is formulated.

Q Did you consider alternatives?

A I never considered a different surcharge for nonprofit. Especially, I can't imagine proposing one for nonprofit that would be higher than the commercial

1 surcharge, in any event.

| 2 | Q Did you consider establish separate surcharges for | | |
|-----|--|--|--|
| 3 | each of the subclasses subject to the surcharge? | | |
| 4 | A I mean, aside from the fact that there's a | | |
| 5 | different surcharge for the carrier route and the | | |
| 6 | non-carrier route subclasses? | | |
| 7 | Q Yes, based on the differences in revenue | | |
| . 8 | contribution, for example? | | |
| 9 | A No. | | |
| 10 | Q One last question, and then I am concluded: Let's | | |
| 11 | go back to page 7. | | |
| 12 | You say that surcharge pieces might slight exceed, | | |
| 13 | and you don't consider that undesirable, and then you go on | | |
| 14 | to say especially in light of the fact that special services | | |
| 15 | such as delivery confirmation this is on page 8 are | | |
| 16 | being extended to pieces paying the residual shape | | |
| 17 | surcharge. | | |
| 18 | Do I get If I'm mailing those Exhibits A | | |
| 19 | through E, do I get delivery confirmation for free? | | |
| 20 | A No. | | |
| 21 | Q Does delivery confirmation have its own | | |
| 22 | contribution? | | |
| 23 | A It has its own price attached. | | |
| 24 | Q Okay. | | |
| 25 | A And the point of this was just, you know, flats | | |
| | | | |

can't purchase delivery confirmation, but parcels and Λ 1 2 Standard A can. And given that they can avail themselves of 3 a special service, I think that might help someone come to the terms with the fact that they're paying a higher rate. 4 5 They have a privilege that other pieces do not. 6 0 I see. 7 MR. VOLNER: Mr. Chairman, I have no further 8 questions, thank you. 9 CHAIRMAN GLEIMAN: I am not sure whether District 10 Photo, et al, is going first, or ValPak-Carole Wright. I'11 11 let you figure out which hat to put on, Mr. Olson. MR. OLSON: I think we'll take it alphabetically. 12 13 CROSS EXAMINATION 14 BY MR. OLSON: 15 Mr. Moeller, hi, Bill Olson, representing District 0 16 Mystic Cox. And I, not surprisingly, have a few questions 17 about the residual shape surcharge. 18 Could you take a look at your response to DMC 19 Number 4? 20 [Pause.] 21 Α Yes? 22 Okay, you will recall, will you not, that in 0 23 R97-1, a proposal was made to have different residual shape 24 surcharge with a lower surcharge for pieces that were destination-entered? 25

I know this guestion refers to Dr. Haldi's 1 Α alternative proposals that shape cost be based on average 2 transportation costs, or, alternatively, that 3 destination-entry discounts be de-averaged by shape. 4 If that was the nature of his proposal, then, yes. 5 Okay, we'll, you're familiar with his proposal, 6 0 however characterized, correct? 7 Α Yes. 8 Okay, and you do say that you in response to Part 9 Ο 10 C, considered an idea the Commission had asked the Postal Service to study the issue before the next rate case. 11 And you said you considered some idea, but did not 12 13 propose it, correct? А My response says that the idea was considered, but 14 15 as I describe in my testimony, we did not propose different drop-ship discounts by shape. 16 When I cross examined Mr. Crum a couple of 17 Q Okav. days ago, we talked about some responses he had made to an 18 interrogatory where we had asked him about how the 19 destination entry avoided costs were greater for parcels 20 than they were for letters and flats. 21 And he provided a response to an interrogatory. 22 Do you recall that response? Are you familiar with that at 23 all? 24 25 I believe it was a transportation cost aspect of Α

1 it?

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Q Yes.

A Yes, I'm familiar with that response.

Q And he had said that he was -- I had asked him if he had given you those numbers, and he said he was in a meeting with you, I think, and wasn't sure if you ever got the numbers.

8 Have you ever sought those numbers out before you 9 made your proposal in this case, the avoided costs, 10 specifically data that shows that the avoided costs of 11 destination-entered parcels is greater than that of letters 12 and flats?

13 A Well, I knew that that was the case, and I knew 14 that the study was being done in a way that allowed one to 15 look at those particular groupings of mail.

16 Q Did you have that document in front of you during 17 the preparation of your testimony?

18 A In the preparation of the testimony was over a 19 long period of time. We generally knew that there was a 20 cost difference; that shape did affect the relative savings 21 of drop-ship.

But we also knew that we were not going to be increasing the surcharge, which is the base rate that these parcels will pay, by a tremendously significant amount that would -- we think would have to be necessary before we

started considering peeling discounts off of that of any
 magnitude for shape.

3 Q You mean a tremendously significant discount which 4 exceeded 50 or 80 percent?

5 A It's just to say that we have not fully recognized 6 the cost difference on the base rates, and we didn't think 7 it was the right time, at least, to start offering discounts 8 based on shape.

9 Q Okay, and in the last docket, the Commission made 10 a comment about how the Postal Service objected because this 11 introduced additional complexity into the rate structure.

Do you recall that argument that the Postal Service made in R97-1?

14 A We mentioned that this would complicate the rate 15 structure.

16 Q Do you believe that to be a serious objection to 17 such a proposal?

A Well, there was an interrogatory response about this, and the nature of it was that it's not just whether the mailers can handle it, but it creates a lot of rate relationships that you have to monitor, and check for anomalies and make sure you're not incenting flats to become parcels or whatever.

Q Okay, well, I think I have that marked. I think that was your response to Interrogatory DMC-1. Is that the

- 1 one you were thinking of?

A Yes.

Q Okay, so there you say that, as you just said now, it's not just whether the mailers are sophisticated enough, you said it was the rate relationships, and then you talk about rate administration within the Postal Service, correct?

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A Response A speaks to those issues.

9 Q And those are the three aspects of complexity, as 10 you see it, correct?

11 Α Well, I'm not saying it's an exhaustive list, but certainly when you introduce a new schedule of rates, or new 12 13 column of rates, it gets a little more complicated from a 14 rate acceptance perspective, rate design, in that you have 15 to monitor more rate relationships to make sure you're not 16 creating anomalies or incenting behavior that's not what you 17 want to have done, and just the nature of having more rate 18 cells.

19 Q Okay, but now you say it may not be an exhaustive 20 list. Could you make it an exhaustive list? Is there 21 anything else you could think of to add to this list about 22 the different aspects of complexity?

A Well, I think this morning, or whenever it was, we can see how complicated it can get when you're talking about pieces that can be called flats or parcels and whether they

1 get a parcel bar code discount or flat bar code discount.

And now you're going to layer on top of that confusion, what drop-ship discount are they getting. I mean, I think that today we've seen an example of how complex these rate issues can be, and the mail preparation issues, and certainly if you had a drop-ship discount by shape, you'd probably have a number of new regulations that would have to be drafted to accommodate such a thing.

9 Q Wouldn't all of that be subsumed under -- well, is 10 that a fourth category then, complexity for the mailer, rate 11 relationships, rate administration and new regulations --

12 would that be a fourth category?

A Well, it might even fall under the rateadministration part of that.

Q Well, I am just trying to get a handle on this. I mean when it comes to the simplicity of structure vis-a-vis mailers, you say in your response to (c) that Standard A mailings are complex already and the mailers could be viewed, you say, as well equipped to handle the complexity, correct?

A My response to (c) says that obviously Standard A and periodicals are both complex rate structures now and people use those rates.

Q And manage to get by day to day? A Yes. The question was particularly asking me to

1 try to, say, compare periodical mailers with Standard A
2 mailers and my response was just saying that they are both
3 complex and both mailers types are able to deal with the
4 complexity apparently.

5 Q If you gave mailers a reduced rate for destination 6 entered parcels, do you think the complexity would upset 7 them?

8 A Anybody who can get a lower rate is probably 9 willing to take on some added complexity.

Q That's been my experience.

10

With respect to rate relationships, that is really a problem for you as a weight design expert and for the Commission as it every few years looks at these rate relationships, correct?

15 A It makes it more difficult to monitor and make 16 sure that you are not creating an anomaly, and believe me, 17 the anomaly situation would become less of a factor if the 18 surcharge were much larger, that you would really have to be 19 careful that you weren't creating some strange incentive to 20 people, for mailers to reorient their pieces in some way.

Q Based on your discussion with Mr. Costich, we are getting there, to that day, I guess, but at the moment it does create a problem for you as a rate design expert and perhaps for the Commission in determining these rates, but that is not an ongoing problem for the Postal Service, is

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it, the issue of rate relationships and potential anomalies?

2 A What is an ongoing -- I mean every time we adjust 3 rates we have to try to monitor rate anomalies.

Q Right, but that is when you develop a case, come over here, present it, defend it, and when the Commission decides whether you have been persuasive and whether it wants to accept your position, correct? -- I mean that is not something that is going to confront each of the RCSCs as they administer a two-tiered surcharge, for example?

10 A Yes, the administration would not be complicated 11 but if something happens and the rates are put into place 12 and we don't realize what incentive we are creating, we live 13 with that for awhile, so in that sense it would have an 14 effect.

And rate administration, making it more 15 Q complicated, I do understand that you would have to take a 16 look at the point that the piece was entered. Suppose a 17 18 parcel was being entered at a DDU and you wanted to give them a 12 cent surcharge instead of an 18 cent surcharge --19 20 that is more complex, but do you think that is a particular 21 difficulty for Postal Service and the people who handle acceptance? Just trying to quantify the extent to which 22 complexity is really a problem. 23

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I don't know how you put a number on how complex

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I think it is hard to quantify how.

1 something is.

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2 Q You did make the surcharge more complex this time,3 did you not, yourself?

A The surcharge itself I don't believe is more complex. The fact that there is a barcode discount that might be used in conjunction with it may add complexity to the rate structure as a whole.

8 Q Well, you are actually proposing two different 9 residual shape surcharges, one for ECR and one for Regular. 10 There's two to begin with, correct?

A Yes, but they are in separate subclasses.

Q Okay. And then you are adding the barcode discount for the Regular pieces, like you say. I think you call that in your testimony "a modicum of complexity" -- is a modicum okay?

16 A I think it was saying that that complexity can 17 be --

18 Q Tolerated.

A Accepted given the ability of the barcode to have
value to the Postal Service.

Q One of the other objections that you have to recognizing the fact that parcels avoid more costs than do letters and flats when they are destination entered you said was that the surcharge is not yet high enough to worry about those kinds of peeling off decisions, correct?

1 A I just think that if you were to keep the 2 surcharge the way it is proposed but add on some additional 3 discounts for parcel-shaped pieces you will have that 4 Appendix F figure of 29 cents or whatever it would be in the 5 after rates world get worse.

Well, let me ask you, suppose you had a situation 6 0 where you gave a discount, picking a number for fun, of, 7 say, a nickel, for a piece that is DDU entered, and that 8 was, I think you said that the purchase transportation costs 9 alone were 7 cents. In other words, that would be a cost 10 savings of 7 cents perhaps for that piece, without even 11 12 looking at nontransportation costs and a discount of 5 cents, wouldn't you in fact wind up with better revenues 13 once you took into account the costs you avoided? 14

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A I think you are mixing a couple responses there.

I think the 7 cents figure you are talking about may have been referring to the fact that when the Commission acknowledged Dr. Haldi's work, it said that we may want to consider destination entry discount by shapes or consider not building transportation costs into the cost differential that is the basis for the surcharge.

There was an interrogatory response where that 7 cent figure came out.

Q 2(c). It is sort of the flipside of the same thing, isn't it? To achieve consistency, either you build

up the rate by using average costs and therefore don't have parcel based surcharge or when you give a destination entry discount you do credit the fact that parcels save more when they are destination entered. Isn't that basically two sides of the same coin?

6 Well, you can do the former, where you re-define Α 7 your costs where you have taken out the fact that you have 8 transportation cost difference in there between shape, which would lower the cost differential and apply a pass-through 9 10 to that so you would not have been recognizing the transportation difference in the buildup in that case, which 11 12 could meet that expectation or suggestion that you do one or 13 the other.

Either give more or discounts by shape or not build up transportation costs on the base, and this interrogatory response is trying to show that if that avenue *foloni* were take, you would still have a very wide cost difference between flats and parcels and you could apply a pass-through and come out with exactly the same surcharge that we have proposed.

Q So part of what you are saying is one is whether you are building up costs or reducing from some average cost level to get to a rate, correct?

A I think that was the point of Dr. Haldi's criticism --

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0 -- to achieve consistency?

2 A Right. I am saying if you want to achieve 3 consistency you can do it by taking the 7 cent figure out of 4 the flat parcel differential.

5 Q Right. Have you had occasion to look at the 6 manner in which parcel costs are growing? I know you had 7 this conversation with Mr. Costich about how part of your 8 testimony talks about in the future anticipate the surcharge 9 increasing.

10 Is that in part based on your looking at trends 11 and postal handling costs -- parcel handling costs?

12 A No, it's based on the recognition that at least it 13 was my understanding that the 10 cent surcharge was a first 14 step.

15 It appears as though this next step is still a low 16 pass-through or, depending on how you want to look at it, 17 not adequately pushing up revenues to cover the cost of this 18 grouping of mail, so I think it is a reasonable expectation 19 that we will continue taking those steps regardless of what 20 is happening on the costs, whether they are staying constant 21 or growing.

Q But you do know they are growing, do you not? A I know that someone had some document they were showing to one of the witnesses. I am aware of that, yes. Q Had you been aware of that before, or is this new

information? I just wondered if you had taken a look at the
 cost trends in parcels before you developed your rates?

A I was aware that in this proceeding, the measured costs were higher than the last time, and I think Witness Crum has offered some explanation of why that may be happening.

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Q What was that?

A I don't remember.

9 Q Oh, okay.

10 A I mean I am deferring to him on why the costs 11 behave the way they do. Or why the measurements may have 12 come out the way they did.

Oh, I thought you might have remembered something 13 Q that I didn't. If it is true parcel costs are escalating, 14 and that that is through no fault of mailers, there is 15 something going on at the Postal Service with respect to 16 those costs increasing, do you think there is an element of 17 18 fairness that comes into rate design that would cause you to want to mitigate the adverse affect on parcel mailers from 19 those parcel costs soaring? 20

A Well, the cost coverages that are assigned often, at least I am speaking from Witness Mayes, but we frequently take into consideration rate shock, and to the extent that comes from added costs, then maybe this comes into play there. But I don't know how it relates to the Standard A

1 surcharge necessarily.

Q Earlier, in some questions that were asked, you talked about meetings, I think Mr. Baker might have asked you about meetings with various industry groups, and you do have occasion from time to time to talk to mailers and mailer associations, correct?

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Yes.

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Q In your recollection, do you recall mailer associations or mailers coming to you and asking you to make sure you increase the residual shape surcharge so that their mail pays a lower rate, if they are, for example, a flat mailer?

13 A We didn't -- well, I am trying to think what your 14 question actually was. Did anyone ask me to raise the 15 surcharge, increase the surcharge more than we proposed? 16 No.

Q Or ability ask you to increase it all? I am just -- in terms of dealings with Standard A, mailing association or mailers, and the input you have gotten from them?

20 A I am not sure it even makes a difference. It is 21 the right thing to do from --

Q I think that is nonresponsive. I am asking you if you have had occasion where mailer associations or mailers have said to you, we think you ought to increase the residual shape surcharge? It is a simple question.

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No. Well, no.

2 MR. OLSON: Okay. Mr. Chairman, I would like to 3 change to Val-Pak and ask a couple of more questions.

4 CHAIRMAN GLEIMAN: We are going to bring baseball 5 caps into the hearing room for some of you guys, so that we 6 can tell who you are. But thank you.

7 Moving along.

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8 BY MR. OLSON:

Q Mr. Moeller, let me first ask you, we asked you in Interrogatory 27, filed on the 7th, I don't know if you had occasion to prepare a response to that yet, do you recall that one?

13 A Yes, we responded, and I think it was in the 14 packet this morning.

MR. OLSON: Maybe someone other than myself
designated it. Do you know if it was designated, counsel?
MR. ALVERNO: 20 to 27.

18 THE WITNESS: It was filed on the 18th.

19 MR. ALVERNO: We sent it to you by e-mail, Mr.

20 Olson.

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21 MR. OLSON: Well, maybe it is still in cyberspace. 22 Do you happen to have a copy? Oh, great.

23 MR. ALVERNO: Yes. Office of Consumer Advocate24 designated 20 to 27.

MR. OLSON: Okay. If I could just look at this

for a second, Mr. Chairman. 1 2 [Pause.] I don't see any additional 3 MR. OLSON: Okav. questions from that. But thank you for preparing that 4 5 response. 6 THE WITNESS: In advance of its due date, I 7 believe. BY MR. OLSON: 8 Let me ask you to look at your response to Val-Pak 9 0 17 and 18. And I am not sure this is necessarily your area 10 of expertise, but since you responded to these questions, I 11 want to follow up on them just with a couple of questions. 12 We asked you about the history of performance measurement 13 for Standard A mail, and you talked about a number of 14 efforts that have not yet culminated in a performance 15 16 measurement system, correct? 17 Α Yes. You reference three specific efforts, and perhaps 18 0 I should recognize these initials, but I don't. What is 19 TCMAS? 20 I don't know either. 21 А Third Class Measurement Ascertainment System or 22 0 something? 23 Well, that is pretty good, if you --24 Α I offer it you as a possible answer. 25 Q

| 1 | A No, I don't know the acronym. |
|----|---|
| 2 | CHAIRMAN GLEIMAN: Isn't that what PostCom used to |
| 3 | be about two or three iterations ago? |
| 4 | MR. VOLNER: We have the trademark on it, which we |
| 5 | have abandoned, I guess. |
| 6 | BY MR. OLSON: |
| 7 | Q How about Advance/DAR? |
| 8 | A Advance is the word advance, I think, and then |
| 9 | are you asking me what the DAR stands for? |
| 10 | Q Yes. |
| 11 | A I think it is Delivery Analysis Report or |
| 12 | something of that I think, I don't know for sure. |
| 13 | Q Do you know what Advance/DAR was in terms of a |
| 14 | performance measurement effort vis-a-vis Standard A mail? |
| 15 | A I think it was something individual mailers could |
| 16 | participate in as a way of finding out how what kind of |
| 17 | service they were receiving. |
| 18 | Q Do you know what timeframe that was operational? |
| 19 | A I know the DAR situation was several, several |
| 20 | years ago. Advance, I think may still be going on. |
| 21 | Q Oh, those are two separate programs? Because they |
| 22 | are it looks like one between commas here. |
| 23 | A Well, I must say that I got the information for |
| 24 | this response from people more knowledgeable in the systems |
| 25 | than I am. |

ı.

1 0 You hope. 2 Α So I can't tell you the timing details or anything, other than this is what I was supplied with when I 3 was asked about this question. 4 How about EX 3C? 5 0 How about it? What? Α 6 Well, in response to 18, you said it is your 7 Q understanding the Postal Service developed it, but it did 8 not culminate in a performance measurement system. 9 What does that mean? 10 Δ I think it means it was not viewed as something 11 that could be used as a nationally representative 12 performance measurement system. 13 Is EXFC still ongoing? 14 0 15 Α EXFC? 16 Excuse me, I should say EX 3C. 0 I don't know. 17 Α Is there another witness that knows about these? 18 0 19 When I saw you respond, I wanted to ask you these questions, and I held back from others. But is there anyone else you 20 21 can think of that might know about what these efforts at 22 performance measurement for Standard A have been? 23 А I can't point you to any other witness. MR. OLSON: Mr. Chairman, perhaps Postal Service 24 counsel might have quidance for me, if anyone is left to 25

whom I can ask these questions? 1 2 MR. ALVERNO: I don't have any suggestions. 3 MR. OLSON: Okay. BY MR. OLSON: 4 Do you know of any source of information that I 5 0 6 could look to at the Postal Service or elsewhere about these or other efforts at performance measurement for Standard A? 7 Well, there may have been other dockets where Α 8 these issues came up that may have some kind of support, 9 that explain them better, or say when they were. 10 11 0 Do you know if EX3C was begun or terminated since R97-1? 12 I'd rather not try to speculate on its start or 13 Α stop date because I'm not sure. 14 Have you exhausted your available information 15 0 16 about Standard A performance measurement? 17 А Yes. I wish -- I mean, we filed them on March If you'd have followups, maybe I could have tried to 18 22nd. plumb some more information for you from people who were 19 giving me this response, but --20 21 So the answer is yes? 0 I know of nothing else to tell you about these 22 Α systems. 23 Are you familiar with a Postal Service product 24 0 being tested known as Today's Mail? 25

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A I'm not sure if I'm thinking of the right thing, but I may have seen a buckslip at one point with an example of what it might be. Whether it's in place or anything, I didn't know, but I'm not sure if I'm even thinking of the right name of the project.

Q It's hard to keep track of these new ideas, but this one was for clear plastic bags that carriers would place mail into, and the Postal Service sell advertising on the bag and on a card; does that ring a bell?

10 A I'm not familiar with the details, so I don't know 11 whether to accept all your characterization of exactly what 12 it is, but I know it involved a plastic bag with ads in it.

Q Okay, well, if you don't know, that's --

A Sorry.

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14

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Q If the Postal -- strike that.

16 When you developed your pound rates, your 17 recommended pound rates, did you think about the possibility 18 of letter pieces migrating to the non-letter category?

A Well, letter pieces that go above 3.3 ounces have migrated, I guess you could say, to the non-letter rate category.

Q Well, let me be more precise. I have a piece of mail that I've used as an exhibit before, and I'll show counsel, if you like. And I'd like to show it to you. [Pause.]

Okay, I've handed you a document, or I guess you can call it a document, a wrap, something that the Postal Service delivered. As a matter of fact, just for the record, so that we make it clear, what it is you have, I'm going to ask you to measure it, and hand you a letter-sized mail dimensional standards template that I'm sure you use every day.

8 CHAIRMAN GLEIMAN: Mr. Olson, while he's doing 9 that, let me just mention to you that you ought to take care 10 to retrieve your ruler when you leave. The last time out, I 11 think you left your 18-inch ruler here, and we have it 12 somewhere around. I'm not sure exactly where, but I'll find 13 out and make sure it gets back to you.

MR. OLSON: Thank you. Actually, I was morecareful by having borrowed this one from Dockets.

16 [Laughter.]

17 CHAIRMAN GLEIMAN: In that case, make sure that 18 you retrieve it and return it to Dockets. I assume that you 19 had to sign it out as if it were a library reference.

20 MR. OLSON: They have my credit card.

21 CHAIRMAN GLEIMAN: That's even better. Where 22 shall we go to dinner tonight, colleagues?

23 [Laughter.]

24 BY MR. OLSON:

25 Q Could you just give us, roughly, the measurements

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of that piece, Mr. Moeller?

| 2 | А | Yes, the length is 10 and one-half inches, and |
|----|------------|--|
| 3 | it's a li | ttle over five and a half inches high. |
| 4 | Q | Okay. And if you lay it on the dimensional |
| 5 | template, | do you determine that that is letter-shaped? |
| 6 | А | Yes, it's letter-shaped. |
| 7 | Q | And can you shove it through the little holes so |
| 8 | that it's | less than a quarter of an inch? |
| 9 | | MR. OLSON: The record will reflect that the piece |
| 10 | went thro | ugh the hole. |
| 11 | | BY MR. OLSON: |
| 12 | Q | Have you seen pieces like this before? |
| 13 | А | I've seen marriage mail pieces before that are |
| 14 | generally | flat-shaped. |
| 15 | Q | In other words, the fact that this is |
| 16 | letter-sh | aped is a little unusual? |
| 17 | А | I haven't seen I mean, maybe there have been, |
| 18 | but it's : | not something I come across regularly. |
| 19 | Q | I'd like to ask you to open that up and see if you |
| 20 | don't fin | d an envelope in there? |
| 21 | | Thank you. And looking at that envelope, I also |
| 22 | have a sc | ale, but if you could accept, subject to weight, |
| 23 | that that | 's a 1.6 ounce envelope? |
| 24 | А | I'll accept it subject to check. |
| 25 | Q | Okay. Have you given any thought to pieces like |

1 this? Do you know if pieces like this meet current Postal 2 Service regulations?

In other words, can you put a sealed envelope inside a wrap like that and pay -- with a detached address label, and pay the non-letter rate; do you know? Have that considered all one piece?

7 A I'm not sure what restrictions are placed on what 8 can be inside this larger piece.

9 Q Do you know of any restrictions on what can be 10 inside?

11 A I can't tell you what they are. They may be some 12 kind of can't exceed the dimensions of the outside piece by 13 a certain amount. I don't know.

14 Q Okay, but that's a #10 envelope, and it clearly 15 fits within the wrap, correct?

16 A Yes, it does.

Q Okay. Have you ever seen an envelope like that inside a wrap, a sealed envelope, #10 envelope inside that kind of wrap, whether it be letter- or flat-shaped?

And I will represent to you that this is a piece that I think came from Houston, Texas, and was delivered by the Postal Service, so that you know that I didn't make it up.

A So you're telling me that it was accepted, at least by one acceptance unit somewhere.

Q That's about to be disciplined?

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2 A No. I mean, I can't tell you that it's not 3 supposed to be in there.

Q I understand. I just wondered if you had seen pieces like that before, or whether you were aware that they existed?

7 A I think maybe I have received one piece that had a 8 GEICO piece in it that may have looked like it was an 9 envelope.

10 Q If that envelope had been mailed -- had been, 11 according to your proposed rates, if it had been a piece of 12 saturation mail and DDU-entered, what would the rate be for 13 that piece of mail?

14 A The proposed rate for a DDU entered saturation 15 letter is 11.5 cents.

Q Now, if you could tell me, under your proposed rates, the pound rate, what it would cost to have that letter carried in that wrap, if it weighs 1.6 ounces, in other words, 10 percent of a pound?

20 A Well, it depends on the weight of the whole piece. 21 If it were a 4 ounce piece that then had this put in it?

Q Perhaps. I mean it adds to the weight of the piece, correct, and it adds 1.6 ounces to the weight of the piece, and the rate is calculated based on the total poundage. And what I am asking you is what the marginal
1 cost of including that sealed envelope inside the wrap is
2 under your proposed pound rates, ECR DDU entered?

A Okay. The DDU pound rate is proposed at 45 cents. Q And, so, what would the marginal cost of carrying that letter in a wrap be under your proposed pound rate?

A If a pound rated piece were to increase its weight by 1.6 ounce, you would take the 45 cents times 1.6 over 16. I guess that would be 4.5 cents.

Q Exactly.

10 A See, rates administration isn't as easy as you 11 think.

Q Now, you compare that inside the wrap at 4.5 cents with being carried as a separate piece at 11.5 cents, and do you have any thoughts about your proposed pound rate and whether it would give additional incentives to mailers to do exactly what has been done there?

17 А Well, I mean we could look at the current rates to 18 see what the situation is today, to see how much that is 19 going to change from today. Today, a piece like this, if it were a saturation letter piece, is 13 cents minus the DDU 20 21 discount of 2.6, 10.4 cents. And today's pound rate for 22 DDU, 66.3 minus 12.6, 43.7 -- 53.7, sorry. So, if you were 23 to take 53.7 and then take the 1.6 ounces worth of that, you 24 will have about 5.4 cents.

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So, today, there is a pretty hefty incentive if

1 someone is inclined to have this piece, along with a lot of 2 other pieces, today there is rate incentive for them to want 3 to get in that package and it may change a little bit under 4 the proposed rates, but I am not sure it is that significant 5 that it is going to cause a lot of people to say, yes, I 6 will now put this in here.

Q Okay. And every time -- whenever you lower the pound rate, it would create additional incentive to take that single letter and include it in such a wrap, would it not?

11 A Well, I think there are a lot of things that go in 12 the decision of where people -- how people want their 13 advertising to get to the recipient, and that might be one 14 factor, is the price they pay for it.

15 Q Price is typically one factor, I would agree. And have you given any thought to the -- we have been talking 16 17 about revenue leakage, about revenue leakage from a low pound rate? I mean, you know, we could have had a 2.6 ounce 18 19 piece, or a 3.0 ounce piece, and, clearly, as the weight of the piece went up, the amount of the savings would go down, 20 21 and, therefore, the lower pound rate that you are proposing 22 could be made more dramatic. I am not going -- I have the math worked out, but I am not going to go through it. But I 23 mean isn't it true, every time you reduce the pound rate, 24 you run the risk of having this kind of diversion? Or it is 25

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4134

one factor that provides incentive to this kind of 1 2 diversion? Well, I am sort of stuck on the every time the 3 Α pound rate is reduced. But --4 Tried to be reduced. 0 5 Again, I quess, all else equal, if the gap б Α narrows, then that might have some incremental effect on 7 people's decision on how they want their mail piece to be 8 9 delivered. MR. OLSON: Mr. Chairman, that is all I have. 10 11 Thank you. CHAIRMAN GLEIMAN: Well, it looks like we have 12 gotten to the point where we can do some follow-up. 13 Is 14 there anybody -- no, no. Too late. MR. OLSON: No, no. Someone else got away with 15 I would like to ask to mark a photocopy of the this before. 16 17 front page in the envelope for purposes of clarity as Val-Pak, or VP-Moeller-XE-1, and 1 of 1 and 2 of 2, if 18 possible to have it in the record to assist in understanding 19 of the cross-exam. 20 I think we can probably do 21 CHAIRMAN GLEIMAN: 22 Mr. Reporter? Mr. Reporter says we can do it. that. Is that received? THE REPORTER: 23 Received. Received and copied. 24 CHAIRMAN GLEIMAN: [Cross-Examination Exhibit No. VP-25

4135

| 1 | Moeller-XE-1 was marked for |
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| 2 | identification, received into |
| 3 | evidence and transcribed into the |
| 4 | record.] |
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CHAIRMAN GLEIMAN: And while Mr. Olson finishes 1 2 putting down the markings and turning them over to the court 3 reporter, we can begin with our follow-up. MR. VOLNER: I have a few follow-up, Mr. Chairman. 4 CHAIRMAN GLEIMAN: Mr. Volner. 5 6 CROSS-EXAMINATION BY MR. VOLNER: 7 0 Mr. Moeller, you were discussing with Mr. Olson --8 THE REPORTER: Would you speak into the mike, 9 please? Speak into it. 10 11 MR. VOLNER: Sorry. The microphones are -- either 12 that, or I am losing my --CHAIRMAN GLEIMAN: It is just all you soft spoken 13 attorneys out there. 14 15 MR. VOLNER: Yeah. 16 BY MR. VOLNER: You were discussing with Mr. Olson a couple of 17 Q questions about anomalies, if you variegated the parcel 18 19 surcharge. And one of the things you said is, well, you don't want to create a situation in which you incent flats 20 to become parcels, because of a superior drop entry 21 22 discount. I assume that is what you were referring to, was 23 that correct? 24 You wouldn't want a piece that could be Α Yes. 25 handled as a flat to necessarily move to a parcel shape.

Q Now, that kind of migration is not a problem, or would not be a problem, would it, if you had separate parcel surcharges for each of the four subclasses? I mean it is not very likely that somebody is going to take a piece out of ECR that is eligible as a flat and move it up into Standard A Regular and enter it as a parcel.

7 A I wasn't even referring to cost subclass8 migration.

9 Q Okay. Good. You then also said that these 10 problems of anomalies become somewhat easier to deal with if 11 the surcharge were larger?

12 A You would have more flexibility in what you could 13 do with those different drop ship discounts if the base 14 rates were further apart, and you would be less likely to 15 end up with a rate for flats that are very similar to 16 parcels.

Q So you are again confining yourself to flats and parcels and not to subclass, inter-subclass kinds of possible migrations?

A I am speaking about intra-subclass migrations. Q Now, in developing your rates, did you consider inter-subclass, or developing your surcharge, inter-subclass migration at all? And let me be specific. I don't want to be mysterious about this. This parcel which we have marked as Exhibit E weighs 13-1/2 ounces. And let's say that it,

with your proposed surcharge, would pay 85 -- 86 cents. If that surcharge were larger, wouldn't this piece have a very substantial incentive to move to, say, Special Rate 4th, for which it qualifies by content?

5 A Well, I know Witness Tolley was asked these 6 questions, and there are series of hurdles that that piece 7 would have to cross to qualify for a more attractive Special 8 Rate 4th rate.

9 Q At the surcharge your propose there might be. But 10 what I am talking about was your comment that the resolution 11 on anomalies get easier as the surcharge gets higher.

12 A If the surcharge were to get high enough that a 13 parcel would choose to be in a parcel subclass, or a more 14 parcel oriented subclass and leave the advertising mail 15 subclass, which is Standard A generally, that would be okay 16 with me.

MR. VOLNER: I have no further questions, Mr.Chairman.

CHAIRMAN GLEIMAN: Is there any additional
 follow-up? Mr. Todd.

21 FURTHER CROSS EXAMINATION

BY MR. TODD:

Q Mr. Moeller, I'm David Todd on behalf of the Mail
Order Association of America.

25

In some questions you had, toward, I believe, the

end of his cross examination this morning, counsel for the Newspaper Association of America posited the possibility that certain rate design issues that you had explored with him or he had explored with you, would have been less, had the rate increase for Standard A ECR, been the same as for Standard A Regular, as a percentage matter; do you recall that line of questioning?

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A Yes, I do.

Q I think you answered that that particular rate
design issue would have been lessened; is that correct?

11 A I mean, if you took the extreme and said that ECR 12 rates, overall, were going to go up by a much higher 13 percentage than the regular, it wouldn't be too difficult to 14 envision a situation where that basic carrier route letter 15 rate would exceed the five-digit automation rate.

Q I'm not talking about the relationship between the automation and the regular rate, in ECR regular, as opposed to -- I mean, Standard A Regular as opposed to Standard A ECR.

A Yes, the overall subclass percentage changes, 4.9
for ECR, and 9.4 for regular.

Q But, again, confining the issue to the question of whether a higher ECR rate would have alleviated that particular rate design problem?

25

A We were able to make the rate relationship be what

we think it should be with those relative percentage changes
 for those two subclasses.

Q So you're satisfied that the end result of the percentage increases that have been proposed is satisfactory from a rate design standpoint?

A Well, again, the percentage changes for the subclasses, overall, are driven by things outside my purview, which would be Witness Mays, and then the underlying costs of the subclasses.

10 Q Correct, thank you. You also had some questions 11 concerning what effect that the competition for Standard A 12 mail in terms of the pound rate, may have had.

13 And I believe I characterized your testimony 14 correctly as stating that competitive factors had no 15 significant influence on the rate design that you have 16 recommended; is that a fair characterization?

17 A Yes.

Q You were also asked about whether you had examined, I believe, the whole issue of competition and the effect it might have on parties who compete with the Postal Service for Standard A mail-type mail matter.

Did you examine the -- you also examined the R97 proceedings, and I assume that, among other things, you did read the testimony provided in that proceeding by the Newspaper Association of America; is that correct?

I read the testimony that pertained to these А 1 issues, and they filed testimony regarding the pound rate? 2 Do you recall any testimony that explained the 3 0 rate design or the approach to rates by newspapers, and, in 4 particular, the effect that weight has on the rates that 5 6 they charge their customers? No, I don't recall reading anything like that. 7 А MR. TODD: Thank you, Mr. Chairman, that's all I 8 9 have. 10 CHAIRMAN GLEIMAN: Mr. Baker? FURTHER CROSS EXAMINATION 11 BY MR. BAKER: 12 Mr. Moeller, just one question: Mr. Todd asked 13 0 you about your recollection of testimony that the Newspaper 14 Association of America filed in R97-1, and I believe I heard 15 you to say that you read testimony of an NAA witness on the 16 pound rate. Who would that have been? 17 Α Maybe I have the sponsoring entity wrong. 18 What witness? Can you recall the name of the 19 0 20 witness you were thinking of? Α Wait a minute. 21 [Pause.] 22 Well, I know there was an AAPS Witness Green, who 23 spoke of the pound rate. And I can't remember if the 24 Newspapers actually sponsored it. I guess I misspoke there. 25

1 MR. BAKER: I have no more questions, Mr. 2 Chairman. I don't think any of my --CHAIRMAN GLEIMAN: 3 4 whoops, Mr. McLaughlin, we're back at the beginning. We're doing this in reverse order, I think. If that's the case, 5 this should be the end of followup. 6 MR. McLAUGHLIN: When I say it's going to be my 7 last question, it will be my last question. 8 FURTHER CROSS EXAMINATION 9 BY MR. McLAUGHLIN: 10 You had some discussion earlier today with Mr. 11 0 Baker concerning the extent to which you took competition 12 into account in studying your ECR rate structure; do you 13 recall those conversations, generally? 14 15 Α Yes. And that conversation, as you recall, was that in 16 0 the context of competition between saturation mailers, for 17 example, and newspaper companies and private delivery 18 companies; is that your understanding of the context? 19 It involves a number of different types of 20 А entities that are involved in advertising. 21 Now, in addition to newspapers and private 22 0 delivery companies, do you know whether there are any 23 saturation mailers that also have their own private delivery 24 25 operations?

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4145

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1 A I believe that's the case, that in some locations, 2 some saturation mailers who mail in some areas, may choose 3 hand delivery or whatever the term might be, for some 4 locales.

5 Q For some portion of their distribution?

A Yes.

Q And do you know whether in the past, saturation there have been saturation mailers that have come in and gone out of the mail and sort of switched between a private delivery and the mail over periods of time?

11 A I think some of the testimony in R97 may have 12 spoken of that movement from one delivery method to another.

13 Q Are you thinking there of Mr. Buckel's testimony 14 on behalf of Saturation Mail Coalition?

15

6

A I believe so, yes.

Q Do you recall whether Mr. Buckel testified to the effect that the pound rate was a significant factor affecting decisions by mailers as to whether to put a portion of their mail into private delivery and take it out of the Postal system?

21 A Yes.

Q And that, in general, the heavier weight the mailing, the more of the cost spread between high Postal rates at the high pound rate versus what it would cost to do private delivery?

- A
 - Yes.

Q So that is one other aspect in terms of the Postal Service looking at things about how the pound rate can affect volumes, not necessarily on a competition with private delivery companies and newspapers, but as well, with mailers' decisions about whether to put their mail into the mail stream or in private delivery?

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A Yes, I was aware of that phenomenon.

9 Q And I believe we had a discussion earlier this 10 morning when we looked at some rate comparisons, some cross 11 examination exhibits, which compared the difference, the 12 spread, between costs and rates.

13 If you recall, looking at the saturation level, do 14 you recall that looking at those charts, based on those 15 units costs, that the contribution of the saturation rate 16 compared to the costs is larger for heavier weight pieces; 17 is that correct?

18 A The per piece contribution is much greater as you19 move out.

Q So if the Postal Service were to lose a customer taking its mail, putting a portion of it into private delivery at those higher rates, that would be a comparatively larger per piece contribution loss than for light weight mailing?

25 A That's correct.

MR. McLAUGHLIN: No further questions. 1 CHAIRMAN GLEIMAN: Is there any additional follow-2 3 up? [No response.] 4 CHAIRMAN GLEIMAN: I don't think any of my 5 colleagues have any questions. 6 I have some general guestions about rate design 7 perhaps you can help me with. 8 When you are doing rate design, how do you 9 approach subclasses versus rate categories? is there a 10 difference in how you come up with the rates? 11 THE WITNESS: Well, the subclass overall is going 12 to be determined -- the rate increase for the subclass 13 overall is going to be determined by the cost for that 14 subclass and whatever markup is assigned to it and then 15 within each subclass there are a series of decisions that 16 have to be made that establish the actual rate design within 17 18 the subclass. CHAIRMAN GLEIMAN: As a matter of policy, at least 19 I know the Commission's rule of thumb is that you strive for 20 21 100 percent passthrough in a uniform manner . You have got passthroughs in one of the subclasses 22 that ranges from 64 percent to 500 percent. In another of 23 the subclasses you have got low 90s to 500 percent with 24 stops along the way at 160 and 230, what have you. 25

1 That seems to deviate somewhat from the general 2 principle of trying to pass through 100 percent, which as I 3 understand it is designed to give people proper price 4 signals. Am I correct in that regard?

5 THE WITNESS: Yes. Theoretically you want to give 6 the price signal that will have the person with the lowest 7 cost of that particular worksharing item performing the 8 work.

9 CHAIRMAN GLEIMAN: How broad a passthrough range 10 does one have to have before one crosses the line between 11 passing through discounts and marking up over cost?

THE WITNESS: I didn't think about it in terms of 12 The passthroughs that you are citing with the wide 13 that. variation were done for a number of reasons as discussed in 14 the testimony, but a lot of it was the consideration of rate 15 swings that would happen if we didn't do that, because the 16 cost basis that the current discounts are based on may 17 differ significantly from the cost basis that is in this 18 docket and that is why it happens. 19

How it relates to whether you just throw in the towel and say I am just going to set a rate for each rate category based on some kind of cost and markup, if that is your question, I am not sure we have costs of the detail that you would need to have, if you were going to do such a thing, to have a bottom-up cost for each rate category that

1 you then apply a markup to.

2 CHAIRMAN GLEIMAN: Well, I understand the need to 3 mitigate rate shock but I am just wondering, you know, why 4 not 600, why not 1000, why not zero?

I mean what are the limits to which one would go in rate design in terms of passing through in order to mitigate rate shock? Are there any limits?

THE WITNESS: Well, when you see the 500 percent 8 passthrough, for instance, it is usually the passthrough 9 10 that was needed to maintain a discount at, say, 80 percent of its current value, so if that was the manner in which the 11 12 passthrough was calculated, sort of a backing into it by what you need to not wildly change the discounts and send 13 signals that vary from case to case to mailers and what we 14 want them to do, then you have to live with these -- I 15 forget the word I used in R97 when we had to do something 16 similar. 17

18 I forget the actual term I used to describe them,19 but odd-looking passthroughs.

20 CHAIRMAN GLEIMAN: I just wondered when I saw the 21 range of passthroughs when rate design for rate categories 22 in effect becomes tantamount to backing into a markup, ergo 23 doing subclass pricing. I thank you for your attempt to 24 respond to me and make me more comfortable with all these 25 numbers that I see.

2 COMMISSIONER GOLDWAY: The Chairman's line of 3 guestioning generated some thought on my part.

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You mention in your testimony that you're lowering the per pound rate because intuitively you know that it can't cause twice as much to send an 8 ounce piece as a 4 ounce piece, and therefore there must be something wrong with the costs there.

Commissioner Goldway has a question.

9 I guess intuitively to me these various 10 worksharing discounts should reflect greater and greater 11 cost savings. There should be some relationship in terms of 12 the amount of money saved by the Postal Service and the 13 amount of work done by the mailers.

Yet it appears that the cost that you are presenting on which you base the discounts don't follow that neat regression, just as the costs on weight don't seem to be intuitively correct either.

18I wonder what you think about that?19THE WITNESS: Well, back to first of all the20weight issue. I think you are talking about it seems21implausible that the cost would double so why should the22rate double when you move from, say, 4 to 8 ounces?23COMMISSIONER GOLDWAY: Right.

24 THE WITNESS: And then as far as your other 25 question is about the discounts and the savings that are

calculated that correspond to those, I am not sure exactly
 what about them you find --

COMMISSIONER GOLDWAY: It doesn't seem intuitive to me that the costs should be so erratic in terms of relating to the savings -- the work that the mailers are doing.

7 THE WITNESS: Yes, I see what you mean. Probably 8 the biggest change this time was involving the flat 9 automation savings and there are tremendous changes in how 10 flat mail is being processed.

We have started, and Witness Kingsley could have 11 spoken -- she probably did talk about this -- that we are 12 now reading addresses with OCRs so the barcode has a very 13 small incremental value in that situation if the address can 14 be read, so a number of things all conspired, I guess you 15 might say, to have a significant change on the savings that 16 we say we get when a person in this instance puts a barcode 17 on a flat versus what it was the last time I think when you 18 were talking about erratic. 19

20 Maybe that is what you are speaking of is from one 21 case to the next we may say that a particular worksharing 22 activity changes its value and the rate design attempts then 23 to keep that erratic nature of those cost measurements for 24 whatever reason they occur to sort of smooth them out a bit 25 and sometimes that requires these passthroughs that are in

1 excess of 100 percent.

2 COMMISSIONER GOLDWAY: So the rates don't 3 necessarily reflect the actual cost savings or the value to 4 the Postal Service of these different worksharing 5 activities? THE WITNESS: If you look at the point in time 6 7 that is assessing the value of a particular worksharing activity and you pass through a much higher amount of that, 8 9 then you are giving a bigger discount than the savings that we believe are generated by that worksharing. 10 Now that sends chills down some people's back when 11 12 they think, oh, my gosh, we are losing all this money, but the base rates are pushed up to account for that so that if 13 VINCI vou are -- whenever you are given the discount, regardless of 14 the size of it, the rate design anticipates how much revenue 15 you are going to be giving out in discounts and pushes up 16 17 the base rates or the nondiscounted rates enough so that after you apply those discounts to that starting point rate 18 you come back to the total you need to achieve. 19 20 CHAIRMAN GLEIMAN: I understand exactly what you just said, because I have had it drummed into me for the 21 22 past six years. It is a hard concept to grasp, but still, 23 you know, in the case of a 500 percent passthrough in effect

what you are saying is, hey, if Mailer So-and-So does suchand-such I am going to avoid one cent in cost and I am going

の日本 to give him a 5 cent break, you know, and I think in simple 1 2 quantifiable terms that is what concerns my colleague, that, 3 you know --

COMMISSIONER GOLDWAY: It is not an economically 4 rational signal to send, and I think what I understood you 5 just to say is that the base rate subsidizes that 6 uneconomically message because you have pushed up the base 7 rate. 8

I understand the need for some consistency in rate 9 design and having no rate shock and I recognize that there 10 are changes that go on over time and mail processing and the 11 costs related to it, but I just scratch my head and wonder 12 whether when you looked at these costs you thought they were 13 accurate given how different they are from the previous rate 14 15 case.

16 THE WITNESS: Well, again, back to the flat issue, which is where this primarily is. 17

I describe in the testimony that is an evolving 18 kind of situation and we anticipate changes in the 19 20 automation processing of flats that might suddenly have the 21 flat barcode be worth more.

22 Rather than have it -- maybe they are too large 23 now anyway, but moving drastically in the other direction only to come back next time and say, oh, yes, we do want 24 25 those barcodes and there are also things that go along with

1 barcoding -- that's automation compatibility -- and let's 2 say for instance that the 5 and the 1 cent example, if we 3 were to set the barcode discount then at 1 cent some mailer 4 may say, well, it costs me 2 cents to barcode so I am not going to do it anymore, and while I'm at it I am going to ,5 6 make my piece not even run on your equipment. I am going to 7 make it nonmachinable, you know, whatever, since there is no reason for me to jump through all those hoops of having a 8 9 piece that passes the droop test and the flexibility test, 10 so there are other reasons why you might not want to totally undercut the barcode discount of that magnitude. 11 12 We do certainly move in that direction. Whether 13 we go far enough, I guess that is open to debate. 14 COMMISSIONER GOLDWAY: Thank you. 15 CHAIRMAN GLEIMAN: Anybody else? Well, I sure 16 hope we drive those costs out of the system before it all 17 catches up with us somewhere along the line. THE WITNESS: Well, that is a cost reduction 18 program, which is different than --19 20 CHAIRMAN GLEIMAN: You are not the witness for 21 cost reduction programs. I understand that. Is there any follow-up to questions from the 22 23 bench? If not, that brings us to redirect. Mr. Alverno, would you like a couple of minutes with your witness? 24 25 MR. ALVERNO: Yes. Actually, more than a couple

of minutes would be much appreciated. 1 2 CHAIRMAN GLEIMAN: How much more than a couple? MR. ALVERNO: How about ten minutes? 3 CHAIRMAN GLEIMAN: Ten would be pretty good. I 4 think we can handle that. 5 6 MR. ALVERNO: All right, thank you. 7 CHAIRMAN GLEIMAN: Thank you. [Recess.] 8 CHAIRMAN GLEIMAN: We have an unbroken string 9 going back for the better part of a week now of no redirect 10 from the Postal Service. I just wanted to let you in on 11 12 that. 13 [Laughter.] CHAIRMAN GLEIMAN: Do you have any redirect, Mr. 14 15 Alverno? 16 MR. ALVERNO: I am going to break with tradition, Mr. Chairman, and ask some questions. 17 CHAIRMAN GLEIMAN: Well, fire when ready. 18 19 MR. ALVERNO: Thank you. 20 REDIRECT EXAMINATION 21 BY MR. ALVERNO: Mr. Moeller, I would like to direct your attention 22 Q 23 to your exchange with Mr. Olson on behalf of DMC and you discussed with him differentiation of shape within drop ship 24 discounts. 25

Now if one were to differentiate for shape within
 drop ship discounts, for example by providing separate drop
 ship discounts for letters, flats and parcels, within
 Standard Mail A, what effect would that have on drop ship
 discounts for letters?

There is a potential implication that might come 6 А to play for letters and under the structure we have today 7 for the minimum per piece letters and nonletters, those . 8 9 weighing from zero to 3.3 ounces, we use a weight of 3.3 ounces to calculate what per piece discount to give to those 10 letters and nonletters, and that is because for nonletters 11 when they reach 3.3 ounces there is a transition to pound 12 13 rated material, and if you don't use the 3.3 ounce as the weight for which you base the drop ship discount on, you get 14 a discontinuous rate there. It is not a smooth transition. 15

Over the years it has been done this way in order to provide for the smooth transition we use 3.3 ounces as the weight for determining the minimum per piece drop ship discounts.

Now if there were to be separate letter rates, letters stop at 3.3 ounces and if there are separate drop ship discounts for letters you wouldn't have to use the 3.3 ounce weight for letters because there is no transition to pound rated material for letters, for the letter rate material, so we offer that up as another -- just to show

that there are some implications to doing things and it is hard to think of everything that might happen, that there is another example of something that might happen and that might cause some kind of rate relationship between letters and flats that might be odd.

Q All right, Mr. Moeller, also referring to that same exchange with Mr. Olson from DMC, what is the effect of increasing discounts for certain shapes within drop ship -that is, what is the effect of the leakage on base rates?

10 A If some discounts were to get larger, and this is 11 just generally true, if the discounts become larger, if new 12 discounts are offered and they apply to a number of pieces 13 and they are significantly large, that serves as a leakage 14 which then feeds back into a push-up on the base rates.

Q I would like to now direct your attention, Mr.
Moeller, to an exchange you had with Mr. Baker concerning
Docket Number R97-1 testimony.

In particular, there was a point where you said, "I don't dispute that testimony" -- I think you were referring to Docket Number R97-1 testimony -- could you please enlighten us as to what testimonies you were referring to?

A Yes, I was referring to Mr. Buckel and Mr.
Otuteye's testimony.

25

Q All right, and the follow-up question from Mr.

Baker towards the end of today's discussion he asked you as 1 to whether or not you were referring to a specific testimony 2 3 of NAA on the pound rates. Was there something else in Docket Number R97-1 that was submitted by NAA on that 4 particular subject of which you are aware? 5 6 Α Yes. I believe it was something entitled Memorandum of Law that they submitted regarding the pound 7 8 rate. It was not testimony though, was it? 9 0 10 Α I don't believe so, but I don't know how you 11 decide what's what and what is on the record. I don't believe there was a witness attached to it 12 so I quess it wasn't testimony. 13 MR. ALVERNO: All right. That's all I have, Mr. 14 Chairman, thank you. 15 16 CHAIRMAN GLEIMAN: Is there any follow-up from 17 redirect? 18 [No response.] CHAIRMAN GLEIMAN: If there is none, then that 19 concludes our hearing for today. 20 Mr. Moeller, I want to thank you for your 21 appearance and your contributions to the record. You are 22 23 excused. 24 [Witness excused.] CHAIRMAN GLEIMAN: We will reconvene tomorrow 25

| | 1 | morning at 9:30 and we will receive testimony tomorrow from |
|------------|----|---|
| *** | 2 | Postal Service Witness Mayes. It ought to be an interesting |
| | 3 | day. |
| | 4 | [Whereupon, at 3:58 p.m., the hearing was |
| | 5 | recessed, to reconvene at 9:30 a.m., Tuesday, April 25, |
| | б | 2000.] |
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