

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

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

UNITED STATES POSTAL SERVICE
INTERROGATORIES AND REQUESTS FOR PRODUCTION OF DOCUMENTS TO
UPS WITNESS SAPPINGTON
(USPS/UPS-T6-41 - 52)

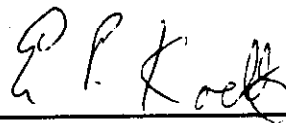
Pursuant to rules 25 and 26 of the Rules of Practice and Procedure, the United States Postal Service directs the following interrogatories and requests for production of documents to UPS witness Sappington: USPS/UPS-T6-41 - 52.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking



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June 16, 2000

USPS/UPS-T6-41. Please refer to page 9 of your testimony, where you assert that own-price elasticity of demand is "an imperfect measure of value in part because demand is influenced by many factors other than price." Please confirm that the estimates of own-price elasticity of demand utilized in postal ratemaking are derived from statistical procedures which are explicitly designed to take account of and control for the factors other than price which influence changes in demand. If you cannot confirm, please explain fully.

USPS/UPS-T6-42. Please refer to the following passage from page 9 of your testimony:

Therefore, even if the demand for a service declines substantially as its price increases, customers may value the service highly. To illustrate this fact, notice that a price increase may force customers with limited wealth to reduce their usage of a service substantially even though they cherish the service dearly.

a. Please confirm that if customers are faced with comparable price increases in all of the postal services they use, the services of which they reduce their usage most substantially are the ones that they cherish least dearly. If you do not confirm, please explain fully.

b. Please confirm that to whatever extent demand for a service declines as its price increases, customers who are no longer purchasing the service value the services or products they consume instead more than they value the service that they have chosen to forgo. If you do not confirm, please explain fully.

c. When you used the term "may" in the first of the above quoted sentences, did you more nearly mean to imply that customers "are likely to" value the service highly, or

that customers "conceivably might" value the service highly? Please explain.

d. If "the demand for a service declines substantially as its price increases," the reported own-price elasticity for that service will be relatively high. Of the postal services with relatively high own-price elasticities (see USPS-T-41 at page 11 for the own-price elasticity for each subclass), which do you believe have such relatively high price elasticities because "customers with limited wealth" have been forced to reduce their usage substantially "even though they cherish the service dearly." Please explain the basis for your answer fully.

USPS/UPS-T6-43. Is it your testimony as an economist that an adequate evaluation of the value of a service can exclude all consideration of the presence or absence of effective competition for that service? If not, please explain the exact relationship that exists between value of service and the presence or absence of effective competition.

USPS/UPS-T6-44. Is it your testimony as an economist that an adequate evaluation of the value of a service can exclude all consideration of the responsiveness of the demand for the service to changes in the price of the service, whether measured by own-price elasticity of demand or in some other fashion? If not, please explain the exact relationship that exists between value of service and the responsiveness of the demand for the service to changes in its price.

USPS/UPS-T6-45. Please refer to page 10 of your testimony, where you caution

against protecting the Postal Service from "effective competition."

(a) Do you believe that the Commission should be concerned about protecting the Postal Service from *ineffective* competition, where ineffective competition is defined as a situation in which the Postal Service is the low-cost provider of service, but imposition of a share of institutional costs above a certain level may allow higher-cost providers to undersell the Postal Service and deprive the Postal Service's remaining customers of the contribution to institutional costs that could otherwise be obtained and used to lower their rates? Please explain fully.

(b) Do you believe that the Commission, in determining what share of institutional costs is reasonable for any particular service, should attempt to take into consideration the possibility that imposition of a share of institutional costs above a certain level may facilitate ineffective competition, as defined in subpart (a)? Please explain fully.

(c) Do you believe that concerns about ineffective competition as defined above could appropriately cause the Commission to decide that a lower share of institutional costs for a particular subclass is reasonable under the criteria of the Act than might otherwise be the case in the absence of such concerns? Please explain fully.

USPS/UPS-T6-46. Please refer to the following passage from pages 9-10 of your testimony:

The volume of a particular service supplied by the Postal Service may decline substantially as the rate charged for the service increases if mailers can secure comparable services from competing suppliers at reasonable cost. When mailers have ready access to reasonable alternatives, they can protect themselves from the adverse consequences

of rate increases on services supplied by the Postal Service. Therefore, they have less need of protection from the Commission than do mailers who use a monopoly service.

a. Please confirm that when alternatives exist, mailers who choose the Postal Service value its service at its current rate more than they value the service offered by the alternative at the rate charged by the alternative. If you do not confirm, please explain fully.

b. Please confirm that when postal rates increase and some mailers in response switch to an alternative service provider, they would be harmed in the sense that they would now be purchasing a service that they value less than the mail service they were purchasing previously. If you do not confirm, please explain fully.

c. Please confirm that if the Postal Service's volume of a competitive product were to decline substantially in response to a price increase, this suggests that there may be many mailers suffering the harm described in subpart b. If you do not confirm, please explain fully.

d. Please confirm that minimizing to the extent possible the potential harm (as identified in subparts b. and c.) of rate increases on mailers with alternatives is worthy of the Commission's efforts in the exact same sense that minimizing to the extent possible the potential harm of rate increases on "monopoly service" mailers is worthy of the Commission's efforts. If you do not confirm, please explain fully.

e. Please confirm that harm to "monopoly service" mailers of a rate increase may be relatively modest if many of such mailers value the service by a substantial amount more than they are currently paying for it (perhaps as a result of the rate restraint resulting from prior ratemaking proceedings). If you do not confirm, please

explain fully.

USPS/UPS-T6-47. Please refer to the following passage from pages 9-10 of your testimony:

The volume of a particular service supplied by the Postal Service may decline substantially as the rate charged for the service increases if mailers can secure comparable services from competing suppliers at reasonable cost. When mailers have ready access to reasonable alternatives, they can protect themselves from the adverse consequences of rate increases on services supplied by the Postal Service. Therefore, they have less need of protection from the Commission than do mailers who use a monopoly service.

a. Please confirm that if postal rate increases for a competitive product drive customers to competitors to such an extent that the contribution from the product (total revenue minus total cost) declines, mailers of that product may be able to "protect themselves" by leaving the postal system, but mailers who use services for which no alternative is available do not have that option and are left paying increased rates to cover the lost contribution. If you do not confirm, please explain fully.

b. Please confirm that under the hypothetical scenario described in subpart a., previous mailers of the competitive product who leave the postal system are worse off because they are paying more and/or no longer getting their first choice in service, mailers of the competitive product who stay with the product are worse off because they are paying higher rates and/or mailing fewer units, mailers of all other mail products are worse off because they must pay higher rates to recover the lost contribution, and the only ones better off are the competitors. If you do not confirm, please explain fully.

c. Please confirm that the approach you are advocating to pricing offers the

Commission no ability to protect against the risk of raising prices for competitive products to an extent that causes the situation described in subparts a. and b. If you do not confirm, please explain fully.

USPS/UPS-T6-48.

a. In your view, should the Commission try to protect competitors, or protect competition? Please explain fully.

b. Please confirm that, in general, competition is protected when prices are set so that the low-cost service provider is able to charge the lowest prices. If you do not confirm, please explain fully.

c. In recommending rates, do you think that the Commission should take into account the fact that the Postal Service has a universal service obligation and charges uniform prices established in protracted ratemaking proceedings, while its competitors can pick which portions of a market they wish to serve, may change their published prices virtually unilaterally and immediately, and may negotiate different rates for different customers? If so, how should these factors be taken into account? If not, why not?

USPS/UPS-T6-49.

a. Please confirm that a postal service with a relatively high own price elasticity could experience sustained volume and revenue growth over a period of years. If you do not confirm, please explain fully.

b. Please confirm that a postal service with a relatively low own price

elasticity could experience sustained volume and revenue growth over a period of years. If you do not confirm, please explain fully.

c. Please confirm that a postal service with a relatively high own price elasticity could maintain a large market share. If you do not confirm, please explain fully.

d. Please confirm that a postal service with a relatively low own price elasticity could maintain a large market share. If you do not confirm, please explain fully.

e. Please confirm that a postal service with a relatively high own price elasticity could offer enhanced service features. If you do not confirm, please explain fully.

f. Please confirm that a postal service with a relatively low own price elasticity could offer enhanced service features. If you do not confirm, please explain fully.

g. Please confirm that the only indicator designed to suggest whether a postal service can sustain a significant rate increase is the price elasticity of demand. If you do not confirm, please explain fully.

USPS/UPS-T6-50. Please refer to the section of your testimony, "Ramsey Pricing in Disguise," at pages 11-12.

a. Please confirm that full-blown application of Ramsey pricing would result in markups and cost coverages based exclusively on the results of the Ramsey model, and no other factors would be considered. If you do not confirm, please explain fully.

b. Is it your testimony that the full-blown Ramsey pricing process described in subpart a. would be essentially the same as a pricing process in which own price elasticities are considered indicative of value of service as part of the application of criterion 2, and criterion 2 is judgmentally balanced in conjunction with all of the other criteria of the Act in order to determine appropriate markups and cost coverages? Please explain fully.

c. With respect to the Ramsey pricing testimony of Postal Service witness Bernstein, please confirm the following, or explain fully:

- (i) Because of various additional constraints that he imposes, the markups presented by witness Bernstein are "Ramsey-based" rather than "pure Ramsey" (see USPS-T-41 at page 7, line 22, through page 8, line 2).
- (ii) The Postal Service has not proposed that the Commission recommend rates to meet the markups and cost coverages underlying Mr. Bernstein's "Ramsey-based" prices.
- (iii) The markups and cost coverages actually proposed by Postal Service witness Mayes (USPS-T-32) vary significantly even from the "Ramsey-based" cost coverages and markups presented by Mr. Bernstein.

USPS/UPS-T6-51. Please refer to page 10 of your testimony, where you refer to mailers that "can secure comparable services from competing suppliers at reasonable costs."

- a. Would you agree that the importance of services being "comparable" is that they are capable of meeting the same needs of the mailer, rather than that they closely mimic the same physical processes? Please explain your answer fully.
- b. Setting aside for this specific question issues of "reasonable costs," would you agree that almost all, if not all, mailers can obtain "comparable" services of some sort? Please explain any answer other than an unqualified affirmative, and provide specific examples.
- c. What standards would you apply to distinguish between mailers for whom comparable services are available at reasonable costs, versus mailers for whom comparable services are available, but only at unreasonable costs? Please explain fully.
- d. Would you agree that within any subclass of mail, different mailers are likely to vary substantially in their access to comparable services at reasonable costs? Please explain any answer other than an unqualified affirmative, and provide specific examples.
- e. In your mind, is there an unambiguous line between a set of subclasses of mail for which reasonable alternatives are readily available, and a set of subclasses for which they are not? Please explain your answer fully.
- f. Please identify exactly which subclasses of mail are those for which you believe substantial increases in postal rates are appropriate because mailers have ready alternatives.
- g. Are all subclasses other than those you have identified in response to subpart f. equally entitled to protection from the Commission as "monopoly services"?

Please explain any answer other than an unqualified affirmative, and provide specific examples.

USPS/UPS-T6-52. Please refer to the following passage from page 10 of your testimony:

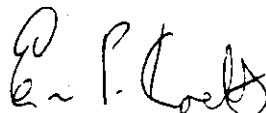
When mailers have ready access to reasonable alternatives, they can protect themselves from the adverse consequences of rate increases on services supplied by the Postal Service.

a. Please confirm that the ability of mailers with ready access to reasonable alternatives to "protect themselves" from postal rate increases may be substantially limited if competitors offering the "reasonable alternatives" use postal rates as an umbrella to their own rate offerings and can respond to postal rate increases with a comparable rate increase of their own. If you do not confirm, please explain fully.

b. Of the subclasses for which you believe mailers have ready access to reasonable alternatives, for which should the Commission not be concerned about the *inability* of mailers to protect themselves from postal rate increases because of the ability of competitors to respond with their own rate increases. Please explain exactly what it is about the structure of the market which supports your conclusion for each subclass.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.



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