

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

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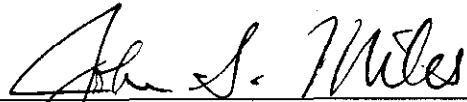
POSTAL RATE AND FEE CHANGES, 2000)

POSTAL RATE COMMISSION
OFFICE OF THE CLERK
Docket No. R2000-1

AMAZON.COM, INC.
FIRST INTERROGATORIES AND REQUESTS FOR
PRODUCTION OF DOCUMENTS TO UNITED PARCEL SERVICE
WITNESS DAVID M. SAPPINGTON (AMZ/UPS-T6-1-16)
(June 19, 2000)

Pursuant to sections 25 through 27 of the Rules of Practice of the Postal Rate Commission, Amazon.com, Inc. hereby submits the following interrogatories and requests for production of documents.

Respectfully submitted,

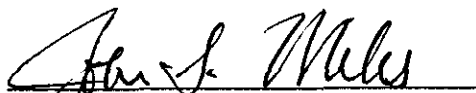


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CERTIFICATE OF SERVICE

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


John S. Miles

June 19, 2000

AMZ/UPS-T6-1.

At pages 4-5 of your testimony you state that “[h]igh rates and large rate increases can be onerous for individual and business mailers alike, and so should be avoided whenever possible.”

- a. Please define “large rate increases” as you use the term here.
- b. Please define “onerous” as you use the term here.
- c. Please explain the extent to which the term “large rate increases” refers to some absolute percentage or amount, and the extent to which it is relative to, for example, (i) the average percentage rate increase proposed for all classes and subclasses of mail, and (ii) percentage rate increases proposed for individual classes and subclasses of mail.
- d. To the extent that you define a “large rate increase” as relative in the sense described by (i) or (ii) in preceding part (c), please discuss the point at which a rate increase becomes “large” in relation to (i) the percentage rate increases proposed for other individual classes and subclasses of mail, or (ii) the average percentage rate increase proposed for all classes and subclasses of mail; *e.g.*, 1.5 times, 2.0 times, 2.5 times, etc.

AMZ/UPS-T6-2.

At page 6, lines 7-9, of your testimony, you state that “[a]n appropriate portion of the realized cost savings can be passed on in the form of rate discounts or more modest rate increases.”

- a. Please define or explain the term “appropriate portion” as you use it here.
- b. Please explain “appropriate portion” in terms of departures from a discount equal to 100 percent of the avoided cost.

AMZ/UPS-T6-3.

At page 9 of your testimony you state that “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.” For your response to this question, assume that the facts are exactly as those described in your testimony. That is, the product has a high own-price elasticity of demand, and thus the demand declines substantially as its price increases, but it is also determined (from some special sociological, psychological or other type survey, or even some other information source) that customers whose wealth is limited and who cannot afford a large rate increase, nevertheless subjectively cherish the service dearly.

- a. Based on this information, should the Commission increase or decrease the rate over the level they would recommend in the absence of such supplementary subjective information?
- b. Please describe the most important factors, other than price responsiveness, that would be important to consider when measuring value.

- c. Please describe the type(s) of information that you would recommend be gathered about these other factors to augment the estimated own-price elasticity of demand.

AMZ/UPS-T6-4.

At page 10 of your testimony, you state that:

[t]hus, more substantial increases in Postal Service rates are appropriate when mailers have ready alternatives to the Postal Service, *ceteris paribus*.... If the Postal Service cannot successfully market a service with rates that cover costs and a reasonable share of institutional costs (as determined by the criteria listed in §3622 (b)), then society may be better served when competitors, not the Postal Service, are the primary providers of the service in question.

- a. When the availability of ready alternatives gives Parcel Post a high own-price elasticity of demand, is it your opinion that the Commission should set rates sufficiently high so as to diminish volume to the point where it would reduce the total amount of any contribution which Parcel Post might make to institutional cost? Please explain your position fully.
- b. Is it your recommendation that the Commission should help price Parcel Post out of any of the market segments in which it has established a position because it makes an inadequate contribution to institutional costs, as you view it? Please explain fully.

AMZ/UPS-T6-5.

At page 11 of your testimony, you state that “[a] policy that reduces Postal Service rates as competition increases and permits revenues to fall toward incremental cost can also encourage the Postal Service to choose an inefficient production technology with unnecessarily large institutional costs and relatively low incremental costs for competitive services.”

- a. Please provide one or two specific examples of an inefficient production technology with unnecessarily large institutional costs and relatively low incremental costs for competitive services. The examples should be within the context of the Postal Service, unless you are unable to cite any, in which instance the examples would preferably be from either the delivery services or transportation industry.
- b. For each example provided in response to preceding part (a), please explain fully which costs of the technology would be considered institutional, rather than incremental, and why. Please provide citations to all studies, reports, or published literature on which you rely to support your answer.

AMZ/UPS-T6-6.

At page 11 of your testimony, you state that “the Postal Service can drive competitors from the market if it is permitted to reduce rates toward (artificially low) incremental costs whenever effective competition develops.”

- a. Do you contend that the Postal Service's estimate of incremental costs for Parcel Post is artificially low? Please explain fully any answer that is not an unqualified negative.
- b. Your testimony mentions that in certain years preceding the filing of a new rate case, the revenues from Parcel Post have failed to cover attributable costs. Please indicate the adverse effects which this situation has had on the prices, revenues, volume, and market share of UPS and other competitors.

AMZ/UPS-T6-7.

At page 16 of your testimony, you state that "[t]herefore, the incremental cost of producing V_0 units of the service is the sum of these extra costs (areas A and B) **plus any fixed costs incurred to provide the service.**" (Emphasis added.) Please explain whether the marginal cost of the first unit includes specific fixed costs required to provide the service.

AMZ/UPS-T6-8.

At page 17 of your testimony, you state that "[h]istorically, the Commission has employed such approximations of incremental cost when formulating its rate recommendations because incremental cost measures were not available.... To provide stronger safeguards against cross subsidies, reasonable estimates of incremental cost should be employed when they are available."

- a. Is it your contention that estimates of incremental costs for Parcel Post were not available in Docket No. R97-1?

- b. Is it your contention that the estimates of incremental costs for Parcel Post that were available in Docket No. R97-1 were not reasonable?
- c. Unless your answers to preceding parts a and b are unqualified negatives, please explain fully the shortcomings of the Postal Service's estimate of incremental costs for Parcel Post in Docket No. R97-1.
- d. In Docket No. R97-1, for each instance where attributable cost of any class or subclass, including but not limited to Parcel Post, was less than incremental cost, explain why you think the Commission erred in not using incremental cost as the basis for its markups. Please explain.
- e. Is it your contention that no reasonable estimate of incremental cost for Parcel Post is available in this docket? Please explain fully any affirmative answer.
- f. In your opinion, what are the major shortcomings of the Postal Service's estimate of incremental cost for any class or subclass, including but not limited to Parcel Post, in this docket? In your answer, please indicate each estimate of incremental cost that, in your opinion, is unreasonably low and provides an inadequate safeguard against cross subsidies.
- g. For the Postal Service's submission in this docket, provide each instance of which you are aware where the Commission's methodology for determining attributable cost will result in an amount that is less than the Postal Service's estimate of incremental cost and present a danger of cross-subsidy.

AMZ/UPS-T5-9.

Refer to your testimony at page 39, where you state “I recommend a 31.1% increase in the average rate for Parcel Post.”

- a. Please state whether your recommendation for a 31.1 percent rate increase is intended to apply equally to every Parcel Post rate schedule, or whether this is an average of various different proposed increases.
- b. If your response is anything other than an equal increase on each rate schedule, please provide the rate increases which you propose for each rate schedule separately, and show how you determine that they result in a 31.1percent increase in the average rate for Parcel Post.
- c. Please state whether your recommendation for a 31.1 percent rate increase includes the 63 percent markup on DDU-entry pieces as recommended by UPS witness Luciani, UPS-T-5, at page 32, lines 13-14, of his testimony.
- d. If your recommendation is intended to include witness Luciani’s 63 percent markup on DDU-entry pieces, please specify the average rate increases which you propose for DBMC and DSCF entry, along with all other rate increases you propose, and show how you determined that combined they represent a 31.1 percent increase in the average rate for Parcel Post.
- e. Did you prepare an explicit rate design for any portion of Parcel Post? If so, please provide.

AMZ/UPS-T5-10.

Refer to your testimony at page 39, where you state “I recommend a 31.1 % increase in the average rate for Parcel Post. This rate increase reflects a cost coverage of 111 %....”

- a. Is the 111 percent cost coverage computed on an After Rates basis? If not, please explain the basis on which it was computed.
- b. Please provide the numerator and denominator (*i.e.*, total revenue and total cost) which you used to compute the cost coverage of 111 percent.
- c. Explain fully how you derived your After Rates estimate of total revenue and total cost based on a 31.1 percent average rate increase. Please indicate clearly all Before Rates data which you used as input to the derivation of your After Rates estimate.
- d. What is the After Rates volume associated with the total revenue and total cost used to compute the 111 percent coverage?

AMZ/UPS-T5-11.

Refer to your testimony at page 39, where you state “[t]he 31.1 percent rate increase that I recommend reflects in large part the substantial increase in Parcel Post’s attributable costs since the R97-1 rate case.” Also refer to page 40, lines 10-15 which elaborate on this point.

- a. Would you agree that the total attributable costs of \$685.9 million in the R97-1 test year reflected both the volume in that year as well as the rates charged? Please explain fully any negative response.

- b. Would you agree that the total attributable costs of \$898.7 million in the current test year reflect both the volume in that year as well as the rates charged?
Please explain fully any negative response.
- c. Would you agree that the increase in total attributable costs between the R97-1 test year and the current test year reflect changes in both the volume of Parcel Post and changes in the rates charged? Please explain fully any negative response.
- d. Before determining that the increase in total attributable costs was the most relevant cost measure to use to support your recommended average rate increase, did you examine the change in unit attributable cost for Parcel Post, which isolates cost changes from volume changes? If you did not, please explain why you did not consider it pertinent. If you did, please provide all data which you examined, and indicate the change(s) in unit attributable cost shown or derived from those data.
- e. Please explain fully why the magnitude of changes in total attributable costs, which at least in part reflect changes in volume, is more relevant to supporting the magnitude of a proposed change in the rates for Parcel Post than the magnitude of change in unit attributable cost. Please provide all studies, reports, or economic literature upon which you rely to support your position that the magnitude of changes in total attributable costs should be used as the basis for the magnitude of changes in rates.

AMZ/UPS-T5-12.

Refer to your testimony at page 39, where you state “[t]he recommended markup also reflects the higher value that its new Delivery Confirmation Service and its new rate categories enable Parcel Post to deliver to its customers.” Also, on page 45, where you state that “[a]s of March 14, 1999, Parcel Post shippers have the option of purchasing Delivery Confirmation Service for their shipments. This new feature further increases the value of service that Parcel Post now delivers to its users.”

- a. Is it your understanding that the attributable costs associated with providing delivery confirmation for Parcel Post are included in the attributable costs of Parcel Post? Please explain any affirmative answer.
- b. For those Parcel Post shippers who elect not to use Delivery Confirmation Service, please explain fully all “further increases in the value of service” which they derive from the optional availability of this service.
- c. Please provide a detailed justification and explanation as to why the value of an optional special service, such as and including Delivery Confirmation, should be used as a reason for increasing the Parcel Post rates paid by all customers, including those who do not use the service, rather than incorporated into the price charged for the separate special service itself. Please provide full citations to all economic teachings upon which you rely to support your recommendation that the value of an optional service should be reflected in the base rate, rather than the price of the option itself.

- d. Before determining that the recommended markup should reflect the higher value provided by the new Delivery Confirmation Service, did you examine the proposed rate, the estimated revenue and the cost of providing Delivery Confirmation to Parcel Post shippers? If not, please explain why you did not consider such information pertinent. If so, please indicate what information you examined, and explain why, based upon your analysis, you determined that Parcel Post shippers who do not use the service should nevertheless be required to pay for it as part of the markup on Parcel Post.

AMZ/UPS-T5-13.

At pages 40-41 of your testimony, you state that “[i]n contrast to the years immediately prior to the R97-1 rate case, Parcel Post volume and revenue have grown substantially in recent years, as Tables 7 and 8 show....” [footnote omitted.]

- a. Please define “substantially” as you use it here, and explain whether you consider the term to be an absolute or relative measure.
- b. For the years shown in your Tables 7 and 8 (*i.e.*, 1990-1999), please provide all data at your disposal which show size and growth of the total non-expedited parcel market in terms of (i) pieces and/or (ii) revenue.
- c. If you do not have estimates for size of the total market, please provide such data for UPS and any other firm(s) as you have available. If you do not have data for all years, please provide data for those years which you have available.

AMZ/UPS-T5-14.

Refer to footnote 55, at page 43 of your testimony, which states that “the sum of volume variable cost and specific fixed cost typically understates incremental cost. Therefore, even if measured revenue exceeds measured attributable cost, revenue may still fall below incremental cost.”

- a. For Parcel Post, please identify all costs that should be included in the incremental costs of Parcel Post, but which are not included in either the volume variable or the specific fixed costs of Parcel Post.
- b. Please provide the estimated the dollar amount of all costs identified in your response to preceding part (a), and indicate the percentage which these omitted costs represent of measured attributable costs for test year.

AMZ/UPS-T5-15.

Refer to your testimony at page 44, where you state that “the average time for delivery of Parcel Post packages has been less than four days on a fairly consistent basis since 1995....”

[footnote omitted citing ODIS Quarterly Statistics Reports.]

- a. Are you asserting that the average time for delivery of Parcel Post packages was better in 1997 and 1998 than it was in 1995 and 1996? If so, please provide all studies, reports and data upon which you rely to support your position.
- b. If the Postal Service requires between 3 and 4 days to effect delivery of a parcel from the SCF to the point where it is ready to be delivered by a carrier (*i.e.*, the point where ODIS data are collected), would you consider such delivery to

represent a “high value” service. If so, please explain why, and compare it to the service level provided by UPS for its ground products.

AMZ/UPS-T5-16.

At page 44 of your testimony, lines 10-13, you state that “the Destination Delivery Unit (“DDU”) and Destination Sectional Center Facility (“DSCF”) discounts introduced in R97-1 have enabled Parcel Post to become an integral component of even more expedited parcel services.”

- a. Is it your testimony that when parcels are entered at the DSCF or the DDU, the Postal Service handles those parcels more expeditiously and more reliably than other parcels that arrive at DSCFs and DDUs which were entered further upstream? If you answer affirmatively, please provide all data, studies, reports, or other evidence upon which you rely to support your answer.
- b. As distinguished from efforts made (and costs incurred) by others, such as Airborne Express, please explain everything of which you are aware that the Postal Service has done to make its own handling of parcels “more expedited” since Docket No. R97-1.
- c. Please explain why, in your opinion, efforts by other firms such as Airborne Express to expedite their handling of parcels to DSCFs and DDUs should result in a higher markup being applied to the rates paid by Parcel Post shippers who do not use such services. In particular, please explain how Parcel Post shippers

who do not use such services receive higher value services from Airborne (or any similar intermediary who utilizes DSCF and DDU entry).