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

POSTAL RATE AND FEE CHANGES, 2000   )   Docket No. R2000-1

RESPONSE OF VAL-PAK DIRECT MARKETING SYSTEMS, INC.,
VAL-PAK DEALERS' ASSOCIATION, INC., AND
CAROL WRIGHT PROMOTIONS, INC.
WITNESS JOHN HALDI TO INTERROGATORIES OF
NEWSPAPER ASSOCIATION OF AMERICA (NAA/VP-CW-T1-1-13)
(June 28, 2000)

Val-Pak Direct Marketing Systems, Inc., Val-Pak Dealers' Association, Inc., and Carol

Wright Promotions, Inc. hereby submit responses of witness John Haldi to the following

interrogatories of the Newspaper Association of America: NAA/VP-CW-T1-1-13, filed on

June 14, 2000. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

William J. Olson
John S. Miles
WILLIAM J. OLSON, P.C.
8180 Greensboro Drive, Suite 1070
McLean, Virginia 22102-3860
(703) 356-5070

Counsel for:
  Val-Pak Direct Marketing Systems, Inc.,
  Val-Pak Dealers' Association, Inc., and
  Carol Wright Promotions, Inc.

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.

William J. Olson

June 28, 2000

Response of VP-CW Witness John Haldi to Interrogatory
of Newspaper Association of America

NAA/VP-CW-T1-1.

Please refer to your testimony pages 18-19, where you propose setting the ECR pound rate at $0.661, which is "slightly less than the existing rate and is equal to the same rate proposed by witness Moeller for the Standard A Regular Subclass." You justify this rate in Footnote 13 by stating "Should the Commission adopt witness Moeller's proposed pound rate of $0.661 for the Regular Subclass, rather than the current $0.663, the rate proposed here will avoid having the anomalous situation of an ECR pound rate which exceeds that of the Regular Subclass."

     a.   Does this constitute the entirety of your reason for your proposed ECR pound rate? If not, what other reasons support your ECR pound rate proposal?

     b.   Why would it be anomalous if the ECR pound rate were to exceed the Regular pound rate?

     c.   Your statements seem to imply that the Regular pound rate is a constraint on the ECR pound rate rather than a reason for a particular value for the Regular pound rate. Do you agree with this interpretation? If so, what would be your rationale for choosing the pound rate aside from the constraint? If you disagree with this interpretation, do you propose that the ECR and Regular pound rate always be set equal?

     d.   If the Regular pound rate were instead raised as part of an across-the-board increase of 9.4% for the Regular subclass to $0.663*1.094 = $0.725, would you then find it reasonable to set the ECR pound rate also to $0.725. Why or why not?

Response:

     (a)   No. Reasons supporting my proposed pound rate are presented at pages 18-19 and Appendix B of my testimony, where I argue that cost estimates based on the IOCS systematically understate the effect of weight on costs. Indeed, given the way IOCS tallies are recorded, I doubt whether any amount of analysis of IOCS tallies could ever result in the development of a credible

relationship between weight and costs. There is now, as there has been for

years, an unfilled need for the Postal Service to perform a credible weight-

cost study. Such a study could proceed either by (i) devising a new and

original statistical methodology, including an appropriate sampling strategy,

or (ii) building a carefully calibrated model that takes into account all

relevant causative factors (see my Appendix B, page B-26, lines 6-16, for

further discussion). Pending such a study by the Service, no credible

rationale exists for changing the pound rate of Standard A ECR Mail in any

but a marginal way, such as I suggest by (i) the adjustment from 0.663 to

0.661 dollars per pound, and (ii) not adjusting the pound rate upward while

all piece rates increase, which reduces the pound rate in relation to the piece

rate. I would note that Appendix B grows out of prior critiques which I

have done on the use of IOCS tallies to determine the cost function of

weight. In Docket No. R97-1, I specified how such a study could be

undertaken. The implications of the Postal Service's refusal to do a proper

study are for someone else to draw, but the wrong response would be for the

Commission to base rates on a study simply because the Postal Service

refuses to undertake a proper one.

(b)   The anomaly is implicit in the discussion in Appendix B of my testimony.

There, I show that the more a mail product has to be processed by the

Service, the greater is the likely understatement of weight-related costs, as a result of ignoring the impact of weight on processing costs. ECR mail by definition requires far more worksharing than Standard A Regular Mail. Since the Service has to undertake substantially more processing per piece of Regular mail than per piece of ECR mail, I would expect ECR to have a relatively smaller amount of weight-related costs than Standard A Regular. Given this situation, I would regard it as anomalous if the ECR pound rate were to exceed the Regular pound rate.

(c)   Yes, as explained in my response to preceding part (b), the pound rate for Standard A Regular Mail should serve as an upper bound on the pound rate for ECR mail. See my response to part (a) for my rationale for choosing the pound rate. (The third sub-question included in part (c) is not applicable.)

(d)   No, not necessarily. See my response to preceding parts (a) and (b).

**Response of VP-CW Witness John Haldi to Interrogatory
of Newspaper Association of America**

NAA/VP-CW-T1-2.

You state on pages 19-20, that "Nevertheless, I would suggest that this 85 percent passthrough and the resulting destination entry discounts be applicable to all Standard A Mail, as has been the custom in prior dockets, and as the Postal Service proposes to continue in this docket." Do you agree that your statement is intended to state that the passthrough (whatever number is used) should apply to all Standard A Mail, and is <u>not</u> intended to state that the Postal Service is proposing to continue a 85 percent passthrough?

<u>Response</u>:

Yes. In terms of witness Moeller's proposed destination entry passthroughs, which

obviously are not 85 percent, his testimony speaks for itself.

**Response of VP-CW Witness John Haldi to Interrogatory
of Newspaper Association of America**

NAA/VP-CW-T1-3.

On page 22, lines 1-2, you state "However, the per-piece presort discounts do not recognize or reward any such cost avoidance..." Is it possible that the per-piece presort discounts reflect an average of weight-related cost avoidance and piece-related cost avoidance? Why or why not?

<u>Response</u>:

The derivation of presort discounts for Standard A Mail is reported by witness Miller[1] who states: "My analysis relies upon shape-specific CRA mail processing unit costs, which are reported by cost pool in the In-Office Cost System (IOCS).... The CRA mail processing unit costs are subdivided into 52 cost pools.... The costs are 'mapped' to each cost pool using the Productivity Information Reporting System or MODS operation number associated with each IOCS tally.... I have classified each cost pool into one of three categories: worksharing-related proportional, worksharing-related fixed, or non-worksharing related.... When it is not possible to isolate CRA mail processing unit costs at the rate category level,... I have used cost models to de-average an appropriate CRA mail processing unit cost benchmark. A cost model has been developed for each rate category."[2]

To answer this question, one needs to assess whether and to what extent weight-related costs are captured by (i) witness Miller's analysis of MODS costs pools using IOCS tallies, and (ii) witness Miller's cost models that were used in the absence of an appropriate

---

[1]   USPS-T34, pp. 3-11, 15-18, and Appendix II.

[2]   *Id.*, pp. 4-5.

Response of VP-CW Witness John Haldi to Interrogatory
of Newspaper Association of America

CRA mail processing unit cost benchmark. To assist in answering this question, I have

compiled the following information from the tables in witness Miller's Appendices I and II.

A. Distribution of Cost Pools
(number)

	Worksharing Related		Non-Work-Sharing Related
	Proportional	Fixed	
First-Class Letters			
Bulk Metered Mail Letters	11	6	35
Automation Carrier Route Presort	11	6	35
Standard A Letters			
Nonautomation Presort	16	2	34
Automation Noncarrier Roue Presort	11	7	34

B. Distribution of CRA Mail Processing Unit Costs
(percent)

	Worksharing Related		Non-Work-Sharing Related
	Proportional	Fixed	
First-Class Letters			
Bulk Metered Mail Letters	67	13	20
Automation Carrier Route Presort	65	15	20
Standard A Letters			
Nonautomation Presort	69	2	29
Automation Noncarrier Roue Presort	60	15	25

As can be seen in Part A above, many cost pools are classified as non-worksharing

related. However, as shown in Part B, only about 20 to 29 percent of all mail processing

unit costs are classified as non-worksharing related. It would seem reasonable to presume

that some weight-related costs are captured in witness Miller's worksharing related costs

pools. I would note, however, that neither the analysis of MODS cost pools using IOCS

tallies, nor the modeling approach, recognize weight as a distinct factor. The "work-

sharing related proportional" category is based on piece volume; unit costs in the models

are likewise derived by division into piece volume.

I have not attempted to analyze the non-worksharing related cost pools to determine

what share of weight-related costs they might represent. To the extent that the per-piece

presort costs and discounts do reflect an average cost that includes some weight-related

costs, that illustrates an important part of the problem, because weight as a distinct factor

in both mail processing costs and presort savings is thereby left unrecognized. That is one

reason why my testimony proposed that destination entry discounts, which do incorporate

the effect of weight, should be maintained at the current 85 percent level, rather than being

reduced, as witness Moeller proposes.[3]

---

[3]   USPS-T-35, pp. 26-27.

**Response of VP-CW Witness John Haldi to Interrogatory
of Newspaper Association of America**

NAA/VP-CW-T1-4.

On page 23, lines 1-3, you state "Maintaining the passthrough at a level at least equal to 85 percent will retain the incentive for Standard A mailers to continue taking advantage of destination entry discounts." Would retaining the absolute amount of the discount also retain the incentive? Why or why not?

<u>Response</u>:

No. If the absolute amount of the discount were retained, the incentive would be weakened in relation to increases in the costs that destination entry avoids. Mailers must balance costs which they incur against the discounts earned. When mailers' costs increase while the discounts stay frozen at previous absolute levels, for some fraction of mailers who had previously engaged in cost sharing, the balance turns unfavorable, and such mailers will respond by letting the Postal Service carry the increased load. With respect to destination entry, transportation costs are the primary consideration, and they tend to increase as fuel prices, vehicle costs, and drivers' wages rise. It should be kept in mind that rate cases are needed in the first place because of cost increases.

NAA/VP-CW-T1-5.

On page 23, lines 1-6, you discuss the "competitive private sector transportation network." What evidence do you have that costs for this network have increased at the same rate as transportation costs for the Postal Service?

<u>Response</u>:

I have not stated that the costs of the competitive private sector network have increased at the same rate as transportation costs for the Postal Service, nor do I have any data or other evidence that such an assertion is necessarily correct. It is not germane to the point which I made in my testimony.

By way of further discussion, however, for intercity transport the Service relies on contracted services, drawing generally on the same pool of private-sector long-distance contractors as worksharing mailers. As indicated in my response to NAA/VP-CW-T1-4, all operators of trucking fleets are faced with paying the prevailing market rate for fuel, vehicles and wages (subject, of course, to any existing contractual arrangements which might result in a short delay before costs are passed through). When these underlying costs increase, they will generally increase in tandem for all operators and users, including the Postal Service. The net transportation cost to users, however, depends on additional factors such as the percentage of capacity of trucks that is utilized, as well as the number of hours per day the vehicle is utilized. Finding ways to keep trucks filled and rolling can help hold down unit costs in the face of rising costs for factor inputs such as fuel.

Response of VP-CW Witness John Haldi to Interrogatory
of Newspaper Association of America

NAA/VP-CW-T1-6.

Please refer to your testimony page 25, lines 4-8, where you state that a "fair and equitable starting point for rate design would be an across-the-board increase by the required amount. However, maintaining the pound rate essentially unchanged negates even the possibility of such an across-the-board increase." Do you agree that if you were not held to this restriction on the pound rate, that an across-the-board increase would be possible? Why or why not?

Response:

Yes. Of course, this possibility is grounded in elementary mathematics. Beyond that, such an across-the-board increase would be a reasonable starting point if all rates could be thought of as having settled into a configuration of approximate mutual equilibrium. What we often see, however, is an ongoing adjustment process reflecting the fact that rates have not settled into a configuration that could be described as mutual equilibrium. Valid reasons why an across-the-board increase may not be the most appropriate rate design can arise from considerations such as new forms of rate de-averaging, previous de-averaging that is still being phased in, changes in costs arising from automation and new data, new cost studies, or changes in cost methodology.

**Response of VP-CW Witness John Haldi to Interrogatory
of Newspaper Association of America**

NAA/VP-CW-T1-7.

Please refer to your testimony, page 25, lines 8-10, where you discuss two further changes to Mr. Moeller's rate design. Did you consider any other changes? If so, please describe them.

<u>Response</u>:

One change that I both considered and incorporated into the model used to design

my recommended rates was elimination of rounding in the intermediate calculations. Such

rounding, when it is undertaken in determining passthrough percentages by means of the

presort tree, can give rise to excessive discontinuities, that is, comparatively large jumps in

the final rates provoked by and disproportionate to slight changes in rate-making

parameters.

**Response of VP-CW Witness John Haldi to Interrogatory
of Newspaper Association of America**

NAA/VP-CW-T1-8.

Please refer to your testimony page 25, lines 13-15, where you propose that the
presort passthrough for High Density mail be increased from 125 to 140 percent, to help
offset the fact that the Basic letter rate is set equal to the rate for Basic nonletters. Did you
consider proposing that some of the cost difference between Basic letters and Basic
nonletters be reflected in the rates. Why or why not?

Response:

No. I was aware that witness Moeller, for understandable reasons, assigns very

high priority to keeping the Basic ECR letter and Basic ECR nonletter rates equal, in order

to support the Service's automation program, by providing mailers with strong motivation

to use the Automation category. I did not wish to frustrate this rate design objective,

which serves to support postal efficiency through automation.

NAA/VP-CW-T1-9.

Please refer to page 26, lines 6-7, where you state that "The maximum increase is 8.0 percent (and not 10.0 percent, as with witness Moeller's proposed rates)." Does this indicate that you find moderating rate increases in individual rate cells a desirable goal? Would the way to moderate rate increases for the largest number of individual rate cells be to give each rate cell the same increase? Why or why not?

Response:

Section 3622(b)(4) of the Postal Reorganization Act lists as one of the ratemaking

criteria "the effect of rate increases on the general public, business mail users, and

enterprises in the private sector of the economy engaged in the delivery of mail matter

other than letters." Although the Commission has stated that the criteria in § 3622(b) are

not binding below the subclass level, and it will not apply all of the criteria systematically

to the individual rate cells within a subclass, on numerous occasions it has nevertheless

invoked this particular criterion at the rate cell level; *i.e.*, it has rejected rate

recommendations on grounds that they did not sufficiently moderate rate increases for

individual rate cells. The criterion in § 3622(b)(4) can, of course, be in tension with other

criteria and objectives. For example, when de-averaging rates to accommodate and

promote worksharing, or to promote automation and efficiency, higher rate differentials

that work against moderation of rate increases may be desirable. In this instance, witness

Moeller's higher piece rates were driven in no small part by his proposed reduction in the

pound rate. Inasmuch as I rejected the studies which underlie his proposed pound rate, and

recommended only a moderate increase in his proposed passthroughs for destination entry

(to the level recommended by the Commission in Docket No. R97-1), moderation of rate

increases over individual rate cells assumes higher relative priority. Given the preceding

considerations, in my own proposed rate design, I wanted to be sure that I did not exceed

Moeller's largest increase, 10 percent, and I was pleased to be able to do slightly better.

As to the second question in this interrogatory, I assume the reference to having the

same rate inceases means the same percentage increase, as opposed to the same absolute

increase. It is a mathematical truism that the way to minimize the largest percentage rate

increase is to make the percentage rate increases for all rate cells equal to each other, but

see my response to NAA/VP-CW-T1-6 for a discussion of valid reasons for deviating from

an equal percentage increase in each rate cell. Similarly, it is also a mathematical truism

that the way to minimize the absolute amount of rate increase is to set the absolute amount

of rate increase equal in all rate cells.

**Response of VP-CW Witness John Haldi to Interrogatory
of Newspaper Association of America**

NAA/VP-CW-T1-10.

Please confirm that the effect of your proposed rate changes on page 27 is to increase revenues per piece by 4.62%, versus Mr. Moeller's 4.94%. If you cannot confirm, please provide the percent increase in revenues per piece corresponding to those rates.

<u>Response</u>:

I can not confirm because I did not find such a computation necessary for my own

rate design, nor have I undertaken it. Please note that the rates on page 27 of my testimony

are **not** my proposed rates; they serve merely as intermediate results used in the derivation

of my proposed rate design. My proposed rates are in Table 7 at page 56.

Response of VP-CW Witness John Haldi to Interrogatory
of Newspaper Association of America

NAA/VP-CW-T1-11.

Please confirm that the effect of your proposed rate changes on page 56 is to increase revenues per piece by 1.28%, versus Mr. Moeller's 4.94%. If you cannot confirm, please provide the percent increase in revenues per piece corresponding to those rates

<u>Response</u>:

I can not confirm because I did not find such a computation necessary for my own rate design, nor have I undertaken it. Since, however, revenue per piece is calculated as the ratio of the revenue target over the volume of mail, it appears reasonable that the increase in revenue per piece would be less with my proposed rate design than with witness Moeller's. Under my proposed rate design, (i) the numerator of the ratio decreases, because my proposed revenue target is 3.35 percent lower than that of witness Moeller; and (ii) the denominator of the ratio volume increases, because my proposed rates are on average lower than those of witness Moeller, which will cause the volumes corresponding to my rates to be somewhat higher than volumes corresponding to witness Moeller's rates.

**Response of VP-CW Witness John Haldi to Interrogatory
of Newspaper Association of America**

NAA/VP-CW-T1-12.

      Please confirm that your proposed rate changes on page 56 include a ECR Basic Letters rate of $0.172, which is **lower** than the Regular 5-digit Automation rate of $0.170 proposed by Mr. Moeller. If you cannot confirm, please explain. Do you find anything anomalous about this particular rate relationship? Please explain.

<u>Response</u>:

      I cannot confirm because the question appears to be mistakenly phrased, with the

two numbers reversed. Assuming that to be the case, and provided that the reversal is

corrected, I confirm that my proposed ECR Basic letter rate is $0.170 and witness

Moeller's proposed Regular 5-digit Automation rate is $0.172.

      I do not find comparisons between witness Moeller's proposed rates and my

proposed rates useful, since we have different revenue targets, but I have these thoughts.

First, my rate design preserves witness Moeller's proposed 1.2 cent difference between

ECR Basic letters and ECR Automation letters (up from 0.6 cents currently). This

differential preserves the increased incentive for ECR Basic letters to convert to ECR

Automation letters. Second, my rate design maintains the Basic ECR letter rate equal to

the Basic ECR flat rate. In view of my proposed rates assuming a revenue target that is

3.35 percent lower than that of witness Moeller, I saw no reason to deny the benefits of

such a reduction to ECR Basic letters and flats. In fact, it struck me that the Fairness and

Equity criterion in § 3622(b)(1) required that these rate cells be treated ratably with respect

to any such reduction. Third, the unit cost for ECR Basic letters is not all that high. It

makes no sense to offer ECR Basic letters as a bona fide rate classification and then use

rate design to eliminate it totally as a realistic alternative (*i.e.*, by having a rate-cost

relationship that is dramatically out of line with other rate-cost relationships within the

subclass).

NAA/VP-CW-T1-13.

Please refer to your testimony at page 29, lines 14-17. Please confirm that the
Postal Service in this case does not propose to use the same costing methodologies as the
Commission used in Docket No. R97-1. Please further confirm that, as a result, the cost
coverages recommended by the Commission in Docket No. R97-1 to those in the testimony
of witness Mayes are not based on a consistent approach.

<u>Response</u>:

I confirm that when underlying cost methodologies differ, some inconsistencies are

bound to occur when comparisons are made between dockets. In my testimony, I have

emphasized the problems that arise in working solely with coverage or markup

percentages, and have suggested that comparisons of unit contributions should also be used

as an important check. For example, unit contributions of Standard A ECR and Regular

Mail (based on Postal Service methodology and CRA costs) project an unambiguous picture

of the relationship between the two subclasses in terms of their institutional contributions

(cents):

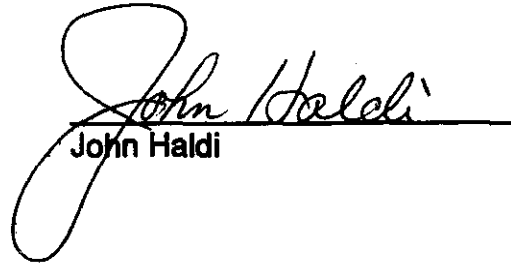|	1998	1999
Standard A ECR Mail	8.7	7.6
Standard A Regular Mail	6.0	5.3
Difference	2.7	2.3

In this particular regard, I would appear to be in agreement with the testimony of

NAA witness Tye in the current docket, in which he states: "It is important to consider unit

contributions. First, they highlight the actual contribution being made by the average

piece."[4]

---

[4]   NAA-T-1, p. 42, ll. 2-3.

DECLARATION

I, John Haldi, declare under penalty of perjury that the foregoing answers are true and correct, to the best of my knowledge, information, and belief.

John Haldi
John Haldi

Dated: June 28, 2000