

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, 1997

Docket No. R97-1

**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS O'HARA
TO INTERROGATORIES OF DIRECT MARKETING ASSOCIATION
AND MOTION FOR LATE ACCEPTANCE
(DMA/USPS-T30-1- 3, 7-10)**

The United States Postal Service hereby files the responses of witness O'Hara to the following interrogatories of Direct Marketing Association, dated July 29, 1997: DMA/USPS-T30-1 through T-30-3 and T30-7 through T30-10.

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

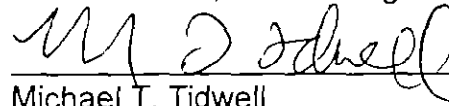
These answers, due August 12, 1997, are responsive to questions which are part of a set which includes interrogatories which have required extensive consultation with other personnel within the Postal Service, some of whom -- because of previous professional and personal commitments -- have been out of the office during this month. Witness O'Hara had tried to keep the set intact in order to file all of the responses together and to maximize administrative efficiency for all concerned, but further efforts to do so would only result in undue delay of responses which are ready now to be filed. Accordingly, witness O'Hara files today the responses listed above. The Postal Service regrets the delay in filing these responses and will fax copies to counsel for DMA today to mitigate the effects of the delay which has transpired to-date.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking

A handwritten signature in black ink, appearing to read "M. T. Tidwell", written over a horizontal line.

Michael T. Tidwell

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202)268-2998/FAX: -5402
August 21, 1997

**RESPONSE OF U.S. POSTAL SERVICE WITNESS O'HARA TO
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DMA/USPS-T30-1. Please compare your discussion of First-Class Letters at pages 22-25 with your discussion of Standard (A) Regular mail at pages 32-34.

- a. Would it be an accurate summarization of your testimony to state that in your view and give the facts of this case, Standard (A) Regular mail should have a cost coverage that is substantially less than the cost coverage of First-Class Letters? Please explain fully.
- b. Is there any statutory pricing criterion the consideration of which, given the facts of this case, would cause you to increase the cost coverage of Standard (A) Regular mail relative to the cost coverage of First-Class Letters, all other things being equal? Please explain any "yes" answer in detail.

RESPONSE:

(a) Yes; given the facts of this case, I am proposing a coverage of 154% for Standard (A) Regular, which I would characterize as "substantially less" than the First-Class Mail letters coverage of 200%.

(b) No, given the facts of this case.

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DMA/USPS-T30-2. In its opinion in Docket No. R94-1, the Commission stated that one of its goals was "to moderate the growth in the differential between the institutional burden of First-Class Mail and third-class mail." (R94-1 RD, ¶5303) In its opinion in Docket No. R90-1, the Commission stated that one of its goals was to bring the cost coverages of First-Class Mail and third-class mail "back into proper balance, by bringing the coverages for First- and third-class closer together, near the systemwide average." (R90-1 RD, ¶ 4055).

- a. Putting aside consideration of the size of relative postal rate increases and the "impact" on mailers (39 U.S.C. §3622(b)(4)), is it your opinion, that, given the facts of this case, the coverages for First-Class Mail and Standard (A) Regular mail should be "close together, near the systemwide average"? Please explain fully.
- b. Putting aside consideration of the size of relative postal rate increases and the "impact" on mailers (39 U.S.C. §3622(b)(4)), is it your opinion, that, given the facts of this case, the coverages for First-Class Mail and Standard (A) ECR mail should be "close together, near the systemwide average?" Please explain fully.

RESPONSE:

a.-b. Yes, at least to the degree indicated in my testimony at page 36, lines 1-9, where I note that, were it not for the effects of rate increases on mailers and the other factors discussed in that paragraph, a lower cost coverage for Standard A ECR would have been appropriate, which would have meant higher rate increases (and coverages) for other subclasses (such as Standard A Regular). Since the ECR coverage is above both that of First-Class Mail letters and the system average while the Regular coverage is below, this would move in the direction indicated in the question, bringing the coverages "closer" together (as in the quote from R90-1), if not necessarily "close" (as in parts a-b of the question).

As background, note that the R90-1 quote refers to R87-1 coverages, which the Commission would have preferred to move closer together were it not

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for the whole-cent constraint on the First-Class rate.

Recommended coverages were as follows:

	<u>FCM Ltrs</u>	<u>BRR</u>	<u>Average</u>	<u>FCM vs Avg</u>	<u>BRR vs Avg</u>
R87-1	158%	141%	148%	1.07	0.95
R90-1	162%	146%	150%	1.08	0.97
R94-1	175%	151%	157%	1.11	0.96

Thus, bringing third-class BRR closer to the system average would have meant raising its coverage.

My proposed coverages are

FCM Letters	200%	<u>vs Avg</u> 1.12
Std A Regular	154%	0.86
Std A ECR	228%	1.27
Average	179%	

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DMA/USPS-T30-3. In its opinion in Docket No. R94-1, the Commissions stated:

“The lower markup index for BRR reflects its higher elasticity of demand, the potential for volume diversion to alternative delivery, and the need to set rates which are responsive to the market. The markup index for BRR also reflects the lower intrinsic value of its service standards and service performance.” (R94-1 RD, ¶ 5285).

Do you agree that, in the current postal environment, this statement continues to be applicable to Standard (A) Regular mail? Please explain fully, describing in detail the extent, if any, to which you believe that this statement is not so applicable.

RESPONSE:

The cited R94-1 paragraph compares the Bulk Rate Regular markup index with that of First-Class Mail letters. The elasticity of Standard (A) Regular is higher than that of First-Class Mail letters and its intrinsic value of service is lower.

However, I believe that the “potential for volume diversion to alternate delivery” applies relatively more to the carrier-route portion of the former BRR subclass and relatively less to the portion that is now Standard (A) Regular, so that the statement does not apply as strongly to Standard (A) Regular as it did to BRR.

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DMA/USPS-T30-7. Please refer to your testimony at page 33, lines 8-12, in which you discuss the "impact" on users Standard (A) Regular mail (criterion 4).

- a. In your consideration of criterion 4, did you consider the extent, if any, to which Standard (A) Regular mailers have the ability to pass postal rate increases along to their customers? If so, please describe in detail the factors that you considered, and the impact that these factors had on your consideration of a proposed rate increase for Standard (A) Regular mail.
- b. Please identify all documents available to the Postal Service concerning whether the ability of Standard (A) Regular mailers to pass postal rate increases on to their customers is greater or less than the ability of mailers of other classes (especially First-Class Mail) to pass the postal rate increases along to their customers.

RESPONSE:

- a. No, except as this ability is reflected in the price elasticity.
- b. No such documents have been identified.

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DMA/USPS-T30-8. Please refer to your testimony at page 5, lines 10-13, in which you discuss the "impact" on users of Standard (A) ECR (criterion 4).

- a. In your consideration of criterion 4, did you consider the extent, if any, to which Standard (A) ECR mailers have the ability to pass postal rate increases along to their customers? If so, please describe in detail the factors that you considered, and the impact that these factors had on your consideration of a proposed rate increase for Standard (A) ECR mail.
- b. Please identify all documents available to the Postal Service concerning whether the ability of Standard (A) ECR mailers to pass postal rate increases on to their customers is greater or less than the ability of mailers of other classes (especially First-Class Mail) to pass the postal rate increases along to their customers.

RESPONSE:

- a. No, except as this ability is reflected in the own-price elasticity.
- b. No such documents have been identified.

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DMA/USPS-T30-9. Please refer to your testimony at page 21 where you state that you "view movement of rates in the direction of Ramsey prices to be beneficial" and that "whether a particular rate level would move rates closer to, or farther away from, Ramsey prices was one of the many factors I considered in evaluating potential rate levels."

- a. Would it be an accurate summarization of your testimony to state that, in your view and given the circumstances of this case, the benefits of setting postal rates at or near prices indicated by the Ramsey pricing methodology is small compared to the importance of other factors, including "the Postal Service's desire to keep the increase for all subclasses close to the overall average where possible"? Please explain fully.
- b. Please identify all instances, if any, in which the particular rates that the Postal Service has proposed in this case would have been different were it not for the consideration of Ramsey prices, all other things being equal. Please explain fully.

RESPONSE:

(a) Not precisely. I would prefer to say that a joint consideration of all the statutory criteria led to a set of proposed rate levels that deviate significantly from the set of rate levels indicated by Ramsey pricing.

(b) As noted in my testimony at page 21, no formal use of Ramsey prices was made in selecting the Postal Service's proposed rate levels. However, relative price elasticities, which are an important input to the derivation of Ramsey prices, were considered under criterion 2.

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DMA/USPS-T30-10. Please refer to your testimony at page 13, line 20 through page 14, line 9, where you refer to Dr. Panzar's testimony and state that "the ratio of revenue to volume-variable cost is the more appropriate cost concept for this purpose [i.e. evaluating rate levels with respect to the criteria of the Act]."

- a. Given the facts of this case, would your views concerning the applicability of the statutory pricing criteria to the relative cost coverages of First-Class Mail and Standard (A) Regular and ECR mail be different if for legal or other reasons it were determined that "incremental costs" (or some cost concept other than volume-variable costs) were the cost levels to which revenue levels were to be compared? Please explain fully.

- b. Given the facts of this case, would your views concerning the applicability of statutory pricing criteria to the relative cost coverages of First-Class Mail and Standard (A) Regular and ECR mail be different if a comparison with the cost coverages from prior cases were measured using a mark-up index as opposed to the coverage index that you prefer? See your testimony at page 19, lines 15-17. Please explain fully.

RESPONSE: Yes; undoubtedly I would have recommended different cost coverages relative to incremental cost than those I actually recommended relative to volume-variable cost. In the first place, the average coverage level needed to generate the required revenue would have been different, but I also would very probably have recommended different coverages relative to this average. For example, since incremental cost for First-Class Mail letters is about 9% more than volume-variable cost, the application of an unchanged relative coverage for First-Class Mail letters ($200\%/179\% = 1.12$) would probably have resulted in a rate increase that I would have judged to have an undesirable effect on its users. If so, I would have lowered its relative coverage to mitigate this effect and would have increased the relative coverage of one or more other subclasses, quite possibly including Standard (A) Regular and/or ECR. I cannot,

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however, in this hypothetical situation judge whether or not the degree of mitigation would have been enough to hold the increase for First-Class Mail letters to that actually proposed.

In addition, I believe that the relationship of revenue to volume-variable cost is important because of the signal it sends mailers, as discussed in my testimony (p.15, line 18 through p.16, line 8). Even if it were determined for legal or other reasons that the ratio of revenue to incremental cost was to be the primary basis for application of the statutory pricing criteria, I would argue that the ratio of revenue to volume-variable cost would also deserve significant consideration, under fairness and equity (criterion 1); see my testimony at page 14, line 17 through page 15, line17.


b. As explained in my testimony (page 18, line 43 through p.19, line 14), a consideration of fairness and equity (criterion 1) is precisely what leads me to prefer the use of a previous coverage index, rather than a previous mark-up index, in the situation where there has been a change in measured costs due to an improvement in costing methodology. In fact, I began my consideration of how to adjust previous rate-levels to the situation under the new costing method by using the mark-up index; it was only after arriving at results similar to those in Panel II of Table E-1 (p.18) that I came to understand the short-comings of the mark-up index in this situation. Therefore, the best answer I can give to your question (which I note does not postulate a legal requirement to use a mark-up

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index) is that I would do what I have already recommended: use the previous coverage index as a starting point because it better accords with the criteria. That is, it is not so much that the application of the criteria would be different given the use of the mark-up index as that in this situation the criteria themselves lead to the use of the coverage index.

DECLARATION

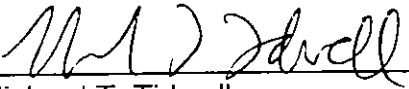
I, Donald J. O'Hara, hereby declare, under penalty of perjury, that the foregoing Docket No. R97-1 interrogatory responses are true to the best of my knowledge, information, and belief.


Donald J. O'Hara

8-21-97
Date

CERTIFICATE OF SERVICE

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



Michael T. Tidwell

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1145
August 21, 1997