

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 FRONK
TO INTERROGATORIES OF THE NEWSPAPER ASSOCIATION OF AMERICA
(NAA/USPS-T32-1 THROUGH 20)**

The United States Postal Service hereby files the responses of witness Fronk to the following interrogatories of the Newspaper Association of America, filed August 21, 1997: NAA/USPS-T32-1 through 20..

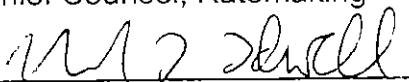
Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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September 4, 1997

RESPONSE OF U.S. POSTAL SERVICE WITNESS FRONK TO
INTERROGATORIES OF NEWSPAPER ASSOCIATION OF AMERICA (NAA)

NAA/USPS-T32-1. Please refer to your testimony at page 23, lines 2-3.

a. Please provide all costs studies and analyses that support a rate of 23 cents for each additional ounce.

b. Did you consider decreasing the additional ounce rate for First-Class Mail? If not, why not? If yes, why did you reject this alternative?

RESPONSE:

(a) The 23-cent rate was implemented in February 1991 as a result of Docket No. R90-1. Cost data in Postal Service Library Reference F-177 were cited by the Postal Service and the Commission in establishing that rate. It is my understanding that there is considerable difficulty in measuring additional ounce costs with precision, especially for heavier pieces with relatively low volume.

In the current proceeding, the Postal Service is proposing to hold the additional-ounce rate at 23 cents per ounce and to increase the difference between the first-ounce rate and the additional-ounce rate from 9 cents to 10 cents (33 cents minus 23 cents). In terms of other analyses that support the proposal of maintaining this rate at 23 cents, see part (b) below.

(b) I did not consider a decrease in the additional-ounce rate. Several considerations went into developing the proposed 23-cent rate, including achieving the revenue requirement and the First-Class Mail cost coverage provided by witness O'Hara. Also, the proposed rate recognizes that the additional-ounce rate is an important source of revenue for the Postal Service. For example, a one-cent decrease in the additional-ounce rate would reduce revenues by close to \$200 million (assuming no volume effects). To make up for a revenue loss of this magnitude would require an increase elsewhere, for example, an approximately one-cent increase in the 3-digit automation rate for First-Class Mail (assuming no volume effects in this example).

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RESPONSE to NAA/USPS-T32-1 (continued)

I would also note that the additional-ounce rate has declined in real terms. In 1991 dollars, the rate has declined from 23 cents in 1991 to approximately 19 cents today (assumes average annual inflation of about 2.9 percent).

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NAA/USPS-T32-2. Please refer to your testimony at page 23, lines 10-12.

- a. How much of the \$4.3 billion in revenue in FY96 from the additional ounces represented a contribution to institutional costs? In other words, by how much did this additional revenue exceed the attributable costs of processing the additional ounces of mail? If exact figures are not available, please provide your best estimate.
- b. In FY98 (after rates), what is the projected revenue from the additional ounces?
- c. Please provide, for FY98 at proposed rates, the contribution to institutional costs:
 1. by the additional ounces in First-Class Mail in the aggregate.
 2. by the additional ounces of First-Class Mail by ounce increment.
 3. Please explain your response.

RESPONSE:

- (a) I am unaware of any data that would allow me to develop such an estimate.
- (b) Approximately \$4.5 billion.
- (c) The requested data are not available.

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NAA/USPS-T32-3. Please refer to Exhibit USPS-32A.

- a. Please confirm that the proposed rate for a carrier-route automation one-ounce letter is 24.6 cents. If you cannot confirm this figure, please provide the correct rate.
- b. Please confirm that the proposed rate for a carrier-route automation two-ounce letter is 47.6 cents. If you cannot confirm this figure, please provide the correct rate.
- c. Please confirm that the proposed rate for the two-ounce letter in part (b) is almost twice (193%) the rate for the one-ounce letter in part (a). If you cannot confirm this difference, please provide the correct figure.
- d. Please confirm that the proposed rate for a four-ounce 3/5 digit automation flat is 97.0 cents. If you cannot confirm this rate, please provide the correct rate.
- e. Please confirm that the proposed rate for an eight-ounce 3/5-digit automation flat is \$1.89. If you cannot confirm this rate, please provide the correct rate.
- f. Please confirm that the proposed rate for the eight-ounce piece in part (e) is almost twice (195%) the rate for the four-ounce piece in part (b). If you cannot confirm this difference, please provide the correct figure.

RESPONSE:

(a)-(f) Confirmed.

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NAA/USPS-T32-4. Please refer to the testimony of Postal Service witness Moeller (USPS-T-36) at page 24, lines 7-18. Witness Moeller proposes to reduce the pound rate for Standard A Mail. He justifies this proposal, in part, based upon the fact that the Postal Service is not indifferent between processing and delivering two 4-ounce pieces and one 8-ounce piece of Standard A Mail.

a. Given that you are proposing rates for some categories that would result in revenues from two 4-ounce pieces being roughly equivalent to the revenues from one 8-ounce piece, is the Postal Service indifferent between processing two 4-ounce pieces and one 8-ounce piece of First-Class Mail?

b. If your response to part (a) is no, please explain all the reasons why you have not proposed a lower extra ounce rate for First-Class Mail?

RESPONSE:

(a) No.

(b) Please see response to NAA/USPS-T32-1(b).

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NAA/USPS-T32-5. Please refer to your testimony at page 24, lines 5-8.

- a. Please confirm that the proposed rate for a non-standard sized non-presorted one ounce letter or flat is 49 cents.
- b. Please confirm that the proposed rate in part (a) represents a 14 percent rate increase for these pieces of First-Class Mail. If you cannot confirm this figure, please provide the correct figure.
- c. In your view, is 14 percent an excessively high rate increase for this mail? If not, why not?
- d. How many pieces of First-Class Non-presorted Mail are expected to pay the nonstandard surcharge in FY98?
- e. Please confirm that the proposed rate for a nonstandard sized presorted one ounce letter or flat is 42 cents. If you cannot confirm this rate, please provide the correct rate.
- f. Please confirm that the proposed rate in part (e) represents a 21.7 percent increase for these pieces of First-Class Mail. If you cannot confirm this figure, please provide the correct figure.
- g. In your view is 21.7 percent an excessively high rate increase for this mail? If no, why not?
- h. How many pieces of First-Class Presorted Mail are expected to pay the nonstandard surcharge in FY98?

RESPONSE:

(a)-(b) Confirmed.

(c) No. The proposed increases in the nonstandard surcharge for single-piece and presort First-Class Mail were developed to reflect the results of new nonstandard surcharge cost data (see USPS Library Reference H-112, as revised) and to pass through the identifiable cost difference between nonstandard and standard pieces. By passing through additional costs associated with nonstandard pieces, I can send an appropriate signal to mailers.

(d) Approximately 318 million pieces of nonpresort mail are expected to pay the surcharge in the Test Year. This represents 0.6 percent of First-Class nonpresort mail volume.

(e)-(f) Confirmed.

(g) No. See response to part (c) above.

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RESPONSE TO NAA/USPS-T32-5 (continued)

(h) Approximately 74 million pieces of presort mail are expected to pay the surcharge in the Test Year. This represents 0.2 percent of First-Class presort mail volume.

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NAA/USPS-T32-6. Please refer to your testimony at page 27, lines 13-14. Are the somewhat smaller estimated cost savings used in this docket also the result of the proposed new attribution method for mail processing costs? If no, please explain.

RESPONSE: It is my understanding that costs for the bulk metered benchmark and for the automation tiers were only developed using the new attribution method, so that the effect of the change in costing method cannot be isolated.

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NAA/USPS-T32-7. Please refer to your testimony at page 8, lines 14-16. What percentage of institutional cost contribution did First-Class Mail account for in FY 1996?

RESPONSE: 65 percent (derived using USPS Library Reference H-2, page 1).

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NAA/USPS-T32-8. Please refer to your testimony at page 8, lines 16-17. What percentage of institutional cost contribution did single-piece, non-presorted First-Class Mail account for in FY 1996?

RESPONSE: 32 percent (derived using USPS Library Reference H-2, page 10).

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NAA/USPS-T32-9. Please refer to your testimony at page 16, lines 5-7. What percentage of *First-Class delivery-point barcoded letters* are eligible for the carrier route rate?

RESPONSE: In the Test Year at proposed rates, there will be an estimated 36,178 million automated, presorted First-Class letters, including 1,217 million carrier route letters. Thus, carrier route letters comprise 3.4 percent of the automated, presorted letters.

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NAA/USPS-T32-10. Please refer to page 20, lines 7-9. Does the cited language imply that a pass-through in a discount of 100 percent of the estimated costs avoided by the Postal Service by the discounted function is optimal rate design?

RESPONSE: Not necessarily. The cited portion of my testimony reads as follows:

Setting discounts to compensate mailers only for the costs avoided by the Postal Service provides the bulk mailer an incentive to presort or apply a barcode only if it can do so at lower cost than the Postal Service.

In the next paragraph, however, I state the following:

In developing the bulk presort/automation discounts for letters and cards, I have focused on the costs avoided by successive degrees of presorting and automation capability. I have not blindly followed this approach, however, because the statutory pricing criteria call for a balanced consideration of a number of factors, including fairness and equity, the effect of the rate increase on mailers, and simplicity in the rate structure.

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NAA/USPS-T32-11. Is a pass-through of 100 percent of the difference in USPS cost between two categories of mail generally desirable as a matter of rate design on the ground that doing so allows a mailer to select the category most desirable to it on the basis of cost difference and service? Please explain.

RESPONSE: Please see my response to NAA/USPS-T32-10.

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NAA/USPS-T32-12. Please refer to your testimony at page 21, lines 6-7, which can be read in the past tense. Is it still a goal of the Postal Service to "work toward a mailstream that is as barcoded as practicable"?

RESPONSE: Yes.

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NAA/USPS-T32-13. Please refer to your testimony at page 24, lines 1-3, where you state that you reduced the nonautomated presort discount (which you propose to set at 90 percent of the measured costs avoided) "to increase the incentive for mailers to prebarcode their mail and thus to further the automation goals of the Postal Service."

- a. Is this reduction consistent with the principle of Efficient Component Pricing?
- b. Does a tension exist in this instance between ECP and the Postal Service's automation program?

RESPONSE:

(a) Because the proposed discount takes into account costs avoided by the worksharing, it is generally consistent with the principle of Efficient Component Pricing.

(b) I would not characterize this situation as a "tension." Postal ratemaking requires a careful consideration of a number of factors, and strict application of a theoretical pricing strategy in all instances is unlikely to be consistent with the statutory pricing criteria. As the Commission stated in its Opinion and Recommended Decision in Docket No. R94-1 (Appendix F, paragraph 102):

All parties, however, acknowledge that postal ratemaking under the Act cannot, and should not, be a mechanistic process without any significant judgmental component. They recognize that it is the Commission's duty to recommend rates that are consistent with the diverse criteria of the Act, and that application of those criteria requires judgment. None of the [pricing proposals of the parties], therefore, advocate that the Commission strictly apply any of the theoretical pricing strategies in its pricing decisions.

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NAA/USPS-T32-14. Please confirm that the proposed monthly and annual fees for Prepaid Reply Mail will tend to limit the number of businesses that will find it economical to offer PRM envelopes/cards to their correspondents. If you cannot confirm, please explain why not.

RESPONSE: Confirmed, though the annual permit fee of \$100 is unlikely to be much of a factor.

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NAA/USPS-T32-15. Please refer to your testimony at page 39, lines 8-10, where you state that "[e]ach participating business would need to maintain a certified, high-quality, easily-audited system for determining the amount of [PRM] mail received." Please provide your best understanding of what the cost to a business will be to maintain such a system and identify all documents or information upon which you rely as a basis for that understanding.

RESPONSE: I do not have an estimate of those costs. It is my understanding, however, that billing and remittance systems routinely capture information about how many bills go out, how many remittances come in, and similar data.

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NAA/USPS-T32-16. Please refer to your testimony at page 43, lines 1-4. In estimating the break-even BRM volume needed to make the monthly PRM fee less expensive than the per-piece BRM fees, did you take into account the costs to the businesses of maintaining the necessary PRM system? If so, please explain how you did so. If not, please explain why not.

RESPONSE: The breakeven calculation in my testimony is based on postage rates and fees only. As I note on page 45 of my testimony (lines 10-14), "whether an organization is interested in QBRM or PRM will depend on a number of factors, including the willingness to prepay the postage and whether it finds the PRM monthly fee of \$1,000 or a per-piece fee of 6 cents more advantageous financially." I did not have an estimate of the costs to a business of maintaining the necessary PRM system. I also did not quantify the potential float advantages associated with getting remittances back sooner or the increased customer goodwill that can accrue to a participating organization.

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NAA/USPS-T32-17. Please refer to your testimony at page 43, lines 5-6. What is the "limited information" that the Postal Service has regarding how much courtesy reply mail might switch to PRM? Does the Postal Service have information other than the Household Diary Study cited in your testimony?

RESPONSE: The "limited information" in my testimony refers to the Household Diary Study you cite and the Postal Service's experience with introducing a barcode discount in the late 1980s (page 43 of my testimony).

The Postal Service also has information contained in Library Reference H-226 (which is a report on interviews with a few businesses).

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NAA/USPS-T32-18. Do your estimated volumes for PRM and QBRM take into account any volume increase in response to the rate discount? Please explain.

RESPONSE: For QBRM, I note on page 47 (lines 1-3) of my testimony that, "it is possible that the new QBRM rate will attract new volume in the future, but this volume is uncertain and I have not attempted to quantify it in this analysis." Note that QBRM will pay a per-piece Business Reply Mail fee of 6 cents, so that the total per-piece postage and fee will be 36 cents (30 cent PRM rate plus 6-cent PRM fee). Also, per my testimony (page 46, lines 13-16), QBRM in the Test Year will come from Business Reply Mail that is currently barcoded and meets the requirements for the current 2-cent per-piece BRM fee. Thus, the QBRM candidate mail presently pays 34 cents per-piece (32 cents plus 2-cent BRM fee).

For PRM, I have not included any estimate of increased volume for the Test Year. As a new postal product, I viewed PRM as converting a portion of existing courtesy reply mail in the Test Year, rather than attracting new volume.

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NAA/USPS-T32-19. Please refer to your testimony at page 43, lines 13-14.

Does this mean that you are estimating that up to 10 percent of the courtesy reply mail sent by credit card companies and utilities will switch to PRM? What is the basis for this estimate?

RESPONSE: Yes. See response to OCA/USPS-T32-22.

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NAA/USPS-T32-20. Please confirm that the revenue "leakage" from the PRM and QBRM proposals can be calculated by multiplying the estimated volumes for those two categories by 3 cents per piece. If you cannot confirm, please provide the proper calculation.

RESPONSE: I am unsure what revenue leakage means in this context. Your statement is correct in the sense that the PRM and QBRM rate proposals of 30 cents per piece represent a 3-cent discount from the proposed single-piece rate of 33 cents per piece. However, this postage calculation fails to take into account the overall impact on revenue because it ignores the monthly PRM fees and the per-piece fee of 6 cents that QBRM pieces will pay. Also, please see response to NAA/USPS-T32-18.

DECLARATION

I, David R. Fronk, 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.

A handwritten signature in cursive script, appearing to read "David R. Fronk", written over a horizontal line.

David R. Fronk

9-4-97
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

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September 4, 1997