

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

POSTAL RATE AND FEE CHANGES, 2001

Docket No. R2001-1

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF AMERICAN BANKERS ASSOCIATION &
NATIONAL ASSOCIATION OF PRERSEORT MAILERS
(ABA&NAPM/USPS-T29-1 - 6, 7(e), 8 - 11, 12(a,b), 14, 16 -18, 19(a), 20 - 24,
26(a), 28, 29(b), 30, 31 - 33)

The United States Postal Service hereby provides the responses of witness Robinson to the following interrogatories of ABA&NAPM: ABA&NAPM/USPS-T29-1 - 6, 7(e), 8 - 11, 12(a,b), 14, 16 -18, 19(a), 20 - 24, 26(a), 28, 29(b), 30, 31 - 33), filed on December 10, 2001.

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

ABA&NAPM/USPS-T29-7(a-c), 25, and 27 have been redirected to witness Miller (USPS-T-22) for response. ABA&NAPM/USPS-T29-15, 19(b,c), 26(b,c), and 34 have been redirected to witness Moeller (USPS-T-28) for response. ABA&NAPM/USPS-T29-12(c) and 13 have been redirected to the Postal Service for response. An objection to ABA&NAPM/USPS-T29-29(a) was filed on December 14, 2001.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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December 26, 2001

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.

Michael T. Tidwell

475 L'Enfant Plaza West, S.W.
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December 26, 2001

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF AMERICAN BANKERS ASSOCIATION AND
NATIONAL ASSOCIATION OF PRESORT MAILERS

ABA&NAPM/USPS-T29-1. Please confirm that the Postal Service's proposed rate increases for FCM workshared letters are as follows:

Basic automation:

Mixed AADC letters	+2.9 cents	10%
AADC letters	+2.1 cents	8%
Auto 3-digit letters	+2.5 cents	9%
Auto 5-digit letters	+2.5 cents	10%
Auto carrier route	+3 cents	12%

RESPONSE:

Confirmed. See my response to MMA/USPS-T29-16N.

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ABA&NAPM/USPS-T29-2

- a. In your testimony, you state that the proposed discounts exceed the cost avoidance measured by USPS witness Miller in this case. Is this the only rate case in which the Postal Service has proposed discounts in excess of calculated avoided costs? Please cite all past cases if your answer is in the negative.
- b. Why have you proposed discounts in excess of Postal Service measured cost avoidance in this case? Is it in part because your rate increases are so large, you fear a disruption of mail volume if the discounts are not increased?

RESPONSE:

- a. No. For two examples, see the response to MMA/USPS-T29-2A.
- b. See my testimony, USPS-T-29 at 11-13 and 20-22. While I recognize increasing rates generally reduces the quantity demanded for a product, I would not expect “a disruption of mail volume” due to the proposed rate increases.

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ABA&NAPM/USPS-T29-3. On page 10, lines 1-6, of your testimony, you state that discounts should be set and are set so that there is an incentive for entry by the private sector into mail processing only if they can do the work more cheaply than the Postal Service. Assume as a hypothetical that the fully loaded direct labor cost structure of mail processing labor for the Postal Service is \$30.44/hr before premium pay adjustments, and assume that the corresponding labor cost for mail processing labor in the private sector is \$12.00/hr. Further, assume that capital costs (buildings and equipment) are identical, and that there are no other mail processing costs.

- a. Under such circumstances, should the Postal Service be in the letter mail processing business for FCM at all?
- b. If the circumstances were reversed, would the private sector be in the mail processing business at all?
- c. If mail processing were a fully separable activity with its own market price, instead of a discount from an integrated activities Postal Service as at present, would the USPS be in the mail processing business under the above cost structure?
- d. Were it not for access to the Postal Service's monopoly universal delivery system, do you believe presort bureaus and major mailers would continue to do business with the USPS given the current structure of discounts?

RESPONSE:

To clarify, the cited portion of my testimony reads: "Setting discounts to compensate mailers only for the costs avoided by the Postal Service provides bulk mailers an incentive to presort or apply a barcode only if they can do so a lower cost than the Postal Service." USPS-T29 at 10.

- a. Yes, the mission of the Postal Service has been defined to include origin-to-destination mail service including mail processing, transportation and delivery.

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- b. While I have not studied this question, it would seem that there are some circumstances where a higher-cost provider could successfully provide a product in the marketplace.
- c. While I have not studied this hypothetical, I believe it is likely that the Postal Service would be in the mail processing business if mail processing were a fully separable activity with its own market price.
- d. I have interpreted this question to assume the hypothetical case where other providers have delivery systems in competition with the Postal Service. Yes, while I have not studied this hypothetical, I believe it is likely that presort bureaus and major mailers would continue to do business with the Postal Service.

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ABA&NAPM/USPS-T29-4. Assume the cost structure set forth above in ABA&NAPM/USPS-T29-3. Suppose worksharing discounts were set not to the levels of the avoided costs of the Postal Service, but to the larger social gains from the private sector performing that work.

- a. Please confirm that from a resource allocation standpoint, such discounts would be superior on efficiency grounds than the way discounts are currently set, namely to the avoided costs of the Postal Service.
- b. Please confirm that the loss to the Postal Service would be less than the social welfare gains to consumers under such a reallocation of resources.

RESPONSE:

- a. –b. Not confirmed. I do not understand what “larger social gains” you are referring to.

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ABA&NAPM/USPS-T29-5. Please confirm that without your added discount of 0.5 cents for FCM workshared letters, every rate increase proposed in this case for workshared letters would be three cents or more except for AADC letters.

RESPONSE:

Not confirmed. The proposed discounts for Nonautomation Presort and Automation Carrier Route Letters equal the current discounts. A determination that an alternate set of discounts for workshared Letters should be proposed would require a complete reassessment of the First-Class Mail Letters and Sealed Parcels subclass rates; this would not necessarily result in a rate structure where “every rate increase . . . for workshared letters would be three cents or more except for AADC letters.”

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ABA&NAPM/USPS-T29-6. On page 5, lines 20-22, you assert the Postal Service's goal of increasing the automation compatibility of letter shaped FCM has been accomplished through the design of the rate structure. Witness Miller emphasizes that those cost reduction efforts have been targeted largely toward the non-prebarcoded single piece mailstream (USPS-T-22, revised, p. 4, lines 3-14). Please explain how the rate design for single piece mail has caused an increase in automation compatibility.

RESPONSE:

My statement (USPS-T-29 at 5) that:

the Postal Service's goal of increasing the automation compatibility of First-Class Mail (particularly of letter-shaped pieces) has been implemented largely through the rate structure

refers to the use of rate design to create incentives for mailers to barcode, presort and prepare letter-shaped mail in order to qualify for worksharing discounts. These incentives have been a major factor in the growth of First-Class Mail workshared Letters through the 1990s. Much of this growth has been from mailers choosing to barcode, presort and prepare mail in response to the worksharing discounts offered by the Postal Service.

The Qualified Business Reply Mail postage discount provides an incentive for bulk recipients to prepare business reply envelopes in a format that is automation compatible. The proposed Nonmachinable Surcharge (and, to a lesser degree, the current Nonstandard Surcharge) also are structured to encourage single-piece as well as presort mailers to prepare mailpieces that are automation compatible. In addition, through

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its mail preparation requirements, the Postal Service requires any reply envelopes or cards enclosed in an automation rate mailing to be automation compatible, including having a Facing Identification Mark (FIM) and barcode.

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ABA&NAPM/USPS-T29-7

- a. Do you agree that in the history of worksharing discounts for FCM letters, there have been (at least) three distinct philosophies for what constitutes the benchmark you refer to starting at page 9, line 15 of your testimony? Namely, the Commission's "Appendix F" method based on cost differences between actual mailstreams, single piece and presort; the Postal Service's "identical piece" method based on comparisons between a hypothetical construct and an actual piece of mail, a mailpiece identical in every respect to a presort letter except for the presort versus a presorted letter; and finally the "most likely conversion" method based on comparisons between bulk and metered mail and prebarcoded/presorted letters.
- b. Would you agree that the Commission's Appendix F methodology generally provided a basis for larger discounts than the Postal Service's identical piece methodology?
- c. Would you agree that the Commission's 100% volume variability methodology generally provides a basis for larger discounts than the Postal Service's less-than-100% volume variability methodology, albeit using the same benchmark?
- d. Please see the Postal Service response to interrogatory ABA & NAPM/USPS-T22-4 where the Postal Service calculated cost avoidance for automated FCLM mixed AADC (7.835 cents), AADC (8.918 cents), 3-Digit (9.280 cents) and 5-Digit (10.552 cents), using the PRC methodology of R2000-1, including the use of non-automated presort as proxy for bulk metered mail to calculate delivery costs. Compare these cost avoidance findings to those found by the Commission in R2000-1 using this methodology [(see page 243 of PRC Rec. Dec. and Op. in R2000-1: automated FCLM Basic (6.2 cents), 3-Digit (7.3 cents) and 5-Digit (8.7 cents)]. Please confirm that under this apples-to-apples comparison, automated FCLM workshare savings have increased from R2000-1 to R2001-1. Please confirm that the above-listed PRC version-derived cost avoidance figures for R2001-1 exceed the discounts which you have proposed for automated FCLM mixed AADC, AADC, 3-Digit and 5-Digit.
- e. When the limits of converting further mail to worksharing are approached in FCM, as they may be now, does it make any sense to use as a benchmark for setting discounts a philosophy which has as its rationale that it comes closest to being candidate mail for further conversion? Wouldn't it make more sense, to set discounts which would grow the volume of that mailstream directly, rather than through conversion mail?

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RESPONSE:

- a. Redirected to witness Miller.
- b. Redirected to witness Miller.
- c. Redirected to witness Miller.
- d. Redirected to the Postal Service.
- e. Your question requires me to assume that “the limits of converting further mail to worksharing are approached in FCM.” While there has been a significant conversion of mail from single-piece to workshare in the last ten years, I believe that there is still mail that can be converted from single-piece to worksharing. The Postal Service (and the Postal Rate Commission) currently set discounts based on the estimated cost avoidances to the Postal Service if a mailer ‘workshares’ or performs mail processing activities that would otherwise be performed by the Postal Service. This is a reasonable approach designed to minimize the combined costs of the Postal Service and the mailer. It was not my intent in designing First-Class Mail rates to “grow the volume of [workshared First-Class Mail.]” My intent was to design First-Class Mail rates that met the various statutory requirements and policy goals.

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ABA&NAPM/USPS-T29-8

- a. If FCM workshared letter mail were a distinct subclass within FCM, please confirm it would make no sense to have a BMM or any other benchmark for setting workshared rates.
- b. If the situation posited in a. were true, please confirm that it would not hinder any further conversion of candidate-worksharing mail from converting.
- c. Please confirm if the situation posited in b. were true, it might further encourage conversion to worksharing if true cost based (i.e., bottom-up) rates were lower than discount based (i.e., top-down) rates.

RESPONSE:

- a. Not confirmed. First-Class Mail workshared letter mail is not a distinct subclass within First-Class Mail. I am unaware of any Postal Service study that has evaluated whether or not bulk metered mail or any other benchmark, reference point, or other point of comparison would be appropriate to use in setting workshare First-Class Mail letter rates under this hypothetical.
- b. Not confirmed. I have not studied the conversion of mail to workshare First-Class Mail under this hypothetical.
- c. Not confirmed. I am unaware of any study that compares “bottom up” and “top down” rates for First-Class Mail under this hypothetical.

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ABA&NAPM/USPS-T29-9. On page 11, lines 11 - 12 of your testimony, what do you mean by the phrase “reduced overall operating costs for mailers”? Do you mean USPS is responsible for the operating costs of private sector mail processing operations and changes therein? Do you mean that rates paid by major mailers in FCM have gone down since the advent of the automation era in mail processing?

RESPONSE:

The “overall operating costs by for mailers” in my testimony refers to the combined cost of mail preparation and postage. One reason mailers participate in the workshare program is to reduce their combined cost of mail preparation and postage as compared to the costs that would be incurred if they mailed at the single-piece rates.

I do not believe that the Postal Service is responsible for the operating costs of private sector mail processing operations or changes therein. At the same time, the Postal Service recognizes that its decisions, particularly with regard to rates and classifications, has a bearing on the operations of its customers. Therefore, as I indicated in USPS-T-29 at 12, “the Postal Service is concerned about the impact [of rate decisions] on those customers whose efforts have played a part in the success of our automation program.” Therefore, as discussed in my testimony, I have considered the impact on customers of the various rate proposals presented in this docket.

The rates paid by mailers of 5-Digit Automation Letters have declined since the rates implemented as a result of Docket No. R94-1 in January 1995. See my response to MMA/USPS-T29-3C.

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ABA&NAPM/USPS-T29-10 On page 12, line 5, of your testimony you refer to the high implicit cost coverage of FCM workshared letter mail of 281.6% in the base year (2000) for this case.

- a. Do you understand this to be a mark-up above variable costs?
- b. Is it your belief that this high mark-up indicates the impact of the private express statutes, namely the statutory monopoly, on FCM workshared rates? Please explain your answer completely.
- c. Where monopolists in the private sector engage in technological innovation which lower variable costs, do they tend to capture the value of the innovation in greater profitability as a result of their monopoly power? Cite empirical evidence in support of your answer.

RESPONSE:

- a. It is my understanding that this implicit cost coverage is calculated based on volume variable costs. See USPS-T-11, Exhibit USPS-11C at 1. Note: The associated markup is 181.6 percent.
- b. As I understand the question, the answer is no. The cited implicit cost coverage is not the result of an effort to exploit the statutory monopoly. In fact, although I am not the policy witness, my understanding of the statutory pricing criteria indicates that this is prohibited. Instead, the base year implicit cost coverage is the result of policies of the Postal Rate Commission and the Postal Service to reflect the avoided cost due to worksharing in discounts for the workshared mail. This is a “top-down” rather than a “bottom-up” approach, as the question infers. I have already discussed the potential of other avoided costs not currently measured and its effect on the rate design along with the effect of other factors. See my response to

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ABA&NAPM/USPS-T29-11(d). It was this approach, rather than an effort to take advantage of the statutory monopoly, that leads to the implicit cost coverage figures that you cite.

- c. Not necessarily. Profits are equal to the total revenue less the sum of variable costs and fixed costs. It would appear that if the fixed (non-volume-variable) cost of a technological innovation were sufficiently large, it would outweigh any reduction in the volume variable costs. I have not performed any empirical study of this question.

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ABA&NAPM/USPS-T29-11 Regarding your discussion on page 13, lines 1-7 please answer the following questions.

- a. What do you mean by the long-term? One year?
- b. Is this discussion simply code word language for the expected reclassification case the USPS will likely file after this case, in which subclass status for FCM workshared mail will be proposed?
- c. With regard to your statement that avoided costs appear to decline, reconcile this statement with your response to ABA & NAPM/USPS-T29-(7)(d) above.
- d. Is it your position that not disrupting the current rate structure for FCM workshared letters is more important than retaining the concept of avoided costs and discounts, if as you suggest, the two goals appear to be increasingly contradictory?
- e. Doesn't the situation referenced in c. indicate that the concept of avoided costs is perhaps an entirely obsolete basis for rate setting for FCM workshared mail?

RESPONSE:

- a. By "long term" I meant "at some time after the conclusion of Docket No. R2001-1." I am not defining "long term" as one year or any other specified time period.
- b. No. As indicated in my response to GCA/USPS-T29-3, "[n]o decision has been made as to whether the existing First-Class Mail subclasses will be restructured."
- c. My statement is based on cost avoidances estimated using the Postal Service's costing methodology. See my response to MMA/USPS-T29-6. The hypothetical case presented in ABA&NAPM/USPS-T29-7(d) purports to be

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based on the Postal Rate Commission costing methodology which was not used in developing the Postal Service's proposed First-Class Mail rates.

d. No. The cited portion of my testimony states:

The treatment of workshare discounts in instances where they have been an important component in controlling costs is an issue ripe for longer-term investigation in First-Class Mail rate design. As efforts to encourage worksharing are successful, avoided costs appear to decline. The result is larger rate increases (on a percentage basis) for customers who have been critical to the Postal Service's success. This must be addressed, in the long-term, as well as the more traditional workshare signals sent through the discount structure.

USPS-T-29 at 13.

This does not mean that "not disrupting the current rate structure for FCM workshared letters is more important than retaining the concept of avoided costs and discounts." The Postal Service considers the impact on its customers of any rate change. In some circumstances, this consideration results in a mitigation of rate changes, if it is appropriate, given cost, operational and other data. As I indicated in my testimony, the high implicit cost coverages for workshared First-Class Mail and the falling cost avoidances suggest that there may be some factors that reduce Postal Service costs that are not being captured by the estimated cost avoidance. I believe that a full evaluation of the current cost methodology is appropriate to determine if any such factors exist and whether it is appropriate to include them in any estimated cost avoidances.

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e. No.

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ABA&NAPM/USPS-T29-12 On page 14, lines 10-12 of your testimony, you claim any smaller increase in the first ounce rate for single piece FCM letters would impose unreasonably large increases on other classes of mail.

- a. Are you aware that before advertising mail became a large business for the Postal Service, FCM shouldered almost the entire cost burden of the universal delivery mandate?
- b. Are you aware that when advertising mail first became priced within postal services, it was priced at its marginal cost, with very little or no reference to covering any portion of the delivery costs of the Postal Service?
- c. Please state what your understanding is of the allocation, currently, of total delivery costs (not so-called volume variable costs and not so-called “attributable” costs) across the major mail subclasses.

RESPONSE:

- a. No. It is my understanding that advertising mail existed prior to the Postal Reorganization Act. I do not know what time period you are referring to and am unable to determine what you mean by “the entire cost burden of the universal delivery mandate.”
- b. No. Advertising mail can be sent using First-Class Mail, Standard Mail and other classes of mail. “[W]hen advertising mail first became priced within postal services” easily predates the Postal Reorganization Act.
- c. Redirected to the Postal Service.

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ABA&NAPM/USPS-T29-14 On page 14, lines 14-17, you suggest that the general public could not handle a single piece first ounce FCLM rate in other than whole cents.

- a. Cite all studies or other information you relied on in rendering this opinion.
- b. Do you think the general public would mind buying even numbers of say a 36.5 cent stamp at a time if they could save a penny for every two stamps?

RESPONSE:

To clarify, I do not state that “the general public could not handle a single piece first ounce FCLM rate in other than whole cents.” The cited portion of my testimony states:

For administrative ease and to avoid unnecessary complexity for the mailing public, the Postal Service considers that rates widely used by the general public should continue to be priced in whole cents.

USPS-T-29 at 14, lines 14-17.

- a. I am unaware of any studies evaluating the general public’s view of a rate structure that resulted in the single-piece, first-ounce stamp priced in other than whole cent increments. However, the Postal Service has conducted market research to evaluate the public’s view of a discount for bulk purchases of stamps that implicitly assume other-than-integer rates for the single-piece, first-ounce, First-Class Mail rate. See USPS-LR-J-196.
- b. The example of a 36.5-cent stamp has not been studied.

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ABA&NAPM/USPS-T29-16

Please refer to pages 7-9 of your testimony regarding the methodology you chose to forecast the additional ounce volume. You discuss two methods (Method 1 and Method 2) that you considered. However, you state that in evaluating them you found that Method 1 underestimates while Method 2 overestimates the additional ounce volume. Thus, “. . .due to the short time available to prepare the Postal Service’s proposal for this case . . .” and “Faced with the choice between two imperfect methods, . . .” you decided to choose Method 1 with an adjustment of 1% to correct for underestimation.

- a. On what basis did you choose 1% adjustment? Why didn’t you choose 2% or 3%? If you conducted any analyses in order to arrive at the 1% number, please provide those analyses. Otherwise, please state if it was based on your personal experience or hunch.
- b. If one method underestimates whereas the other method overestimates the forecast, why didn’t you consider the average of the two? Wouldn’t that have been easier and less controversial?
- c. If you had chosen the average of the two methods, what would have been the forecast for the additional ounce volume? How would have this affected the amount of revenue USPS would have generated due to this forecast?

RESPONSE:

- a. See USPS-LR-J-130. In determining that the 1 percent adjustment factor was appropriate, I estimated the number of additional ounces using three different base periods: FY 1998, FY 1999, and PQ3FY99 to PQ2FY00. In only one case (Method 2 using FY1998 as a base to estimate FY2000 – difference vs. actuals equals 2.28 percent) did either method differ by more than 2 percent in absolute value from the billing determinant number of additional ounces. Therefore, adjustment factors of over 2 percent were clearly inappropriate.
- b. I considered averaging the two methods. However, I did not do this because I could not logically explain what the resulting number of additional ounces

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would mean. In addition, I believe my method is computationally easier; test-year-after-rates additional ounces must be reprojected in each rate iteration following the provision of the test-year-after-rates volume forecast by witnesses Thress and Tolley. Using an averaging methodology would have at least doubled the number of computations needed to determine the test-year-after-rates number of additional ounces.

- c. I have not performed this analysis. However, based on the results from USPS-LR-J-130, I believe the estimated number of additional ounces would not be significantly different from those presented in my testimony.

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ABA&NAPM/USPS-T29-17

Please refer to page 10 of your testimony. You state that “Benchmarked cost avoidances provide important data on the Postal Service’s avoided costs; however, they do not necessarily form a complete picture of the Postal Service’s cost structure.”

- a. Please provide in detail the “complete picture of the Postal Service’s cost structure” pertinent to benchmarked cost avoidance.
- b. How would the knowledge of “complete picture of the Postal Service’s cost structure” affect the calculations of cost avoidances?

RESPONSE:

- a. In developing the First-Class Mail rate proposals, I considered the relatively high implicit cost coverage for workshared First-Class Mail. This suggests that there may be unknown factors that affect the Postal Service’s costs for workshared Letters. See my response to MMA/USPS-T29-3.
- b. Until such a study is completed, I cannot determine the impact on the estimated cost avoidances.

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ABA&NAPM/USPS-T29-18

Please refer to pages 11-12 of your testimony. You state “Witness Miller’s cost avoidance estimates . . . are designed to capture the costs of avoided Postal Service operations and his estimates may not reflect factors such as mail characteristics or additional activities that the Postal Service does not perform (and thus cannot be “avoided), but which do provide a benefit to the Postal Service.”

- a. Please describe in detail all those characteristics or additional activities that provide benefit to the Postal Service. Please be specific as to the nature of those activities.
- b. Please provide some dollar estimates of those benefits. If such estimates do not exist, please explain why USPS has not yet estimated the dollar values of such benefits which can be useful in rates design.

RESPONSE:

- a. See my response to MMA/USPS-T29-3.
- b. As these characteristics or benefits have not been studied, I cannot estimate the dollar value, if any, of those benefits. While I am not an expert in the development of cost models, for this Docket, a decision to update existing cost models rather than perform extensive engineering studies needed to materially change the models was made due to time and resource constraints.

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ABA&NAPM/USPS-T29-19

- a. Please confirm that you have presented the following pass through values for FCM at page 20 of your testimony:

Mixed AADC	119%
AADC	115%
3-Digit	121%
5-Digit	121%

- b. Please confirm that the Postal Service is proposing the following pass through values for Standard Mail, and if you do not confirm, please provide the correct pass through values as well as the unit cost savings and proposed discounts:

Mixed AADC	194%
AADC	169%
3-Digit	142%
5-Digit	139%

- c. Explain in detail and provide any studies or analyses conducted to justify the reasons the pass through values (proposed discounts relative to work-sharing related savings) for Standard Mail are substantially larger than those for First-Class Mail.

RESPONSE:

- a. Confirmed. However, witness Miller has revised the estimated cost avoidances. Based on witness Miller's revised (11/16/2001) cost estimates, the calculated passthroughs for mixed AADC Letters would be 120 percent and the calculated passthrough for AADC letters would be 116 percent. The passthroughs for 3-Digit and 5-Digit Automation Letters remain at 121 percent.
- b. Redirected to witness Moeller.
- c. Redirected to witness Moeller.

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ABA&NAPM/USPS-T29-20 In response to MMA/USPS-T29-2.c. and again at your response to MMA/USPS-T29-4.b., you state that your 1/2 cent increase discount proposal balances the issue of pass-throughs of cost avoidance with the issue of implicit cost coverage creep within FCM workshared letters.

- a. Please quantify why that balance would be achieved at just a 0.5 cent increase, as opposed to a 0.6, 0.7, 0.8, 0.9 and 1.0 cent increase.
- b. In fact, isn't your apparent "balance" made possible by the fact that you are raising all rates for the FCM letters subclass by 3 cents, which then makes it possible for a larger giveback of 1/2 cent (or more)?

RESPONSE:

- a. My decision to increase automation discounts by 0.5 cents considered, in part, witness Moeller's (USPS-T-28) proposed cost coverage for the Letters subclass, the resulting rate relationships, the rate changes at differing weight increments, the high implicit cost coverage for workshared Letters, and the resulting degree of rate complexity. Based on my assessment of these factors, I determined that a 0.5-cent increase in the automation discounts was appropriate.
- b. No. The proposed increase in the First-Class Mail first-ounce rate is explained in my testimony. USPS-T-29 at 14. I do not consider the increase in the automation discounts to be a "give-back" funded by the single-piece, first-ounce First-Class Mail rate.

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ABA&NAPM/USPS-T29-21 In response to MMA/USPS-T29-3.c. you show the recent history of a single rate category (FCM workshared letters, 5D), but date the comparison from R94-1. Please provide the information for all workshared letter rate categories, FCM and Standard A, using MC95-1 as the benchmark start date and R2000-1 (7/1/01) as the end date.

RESPONSE:

The comparison of the current rates to the rates resulting from Docket No. R94-1 was designed to indicate the rate incentives established in the Postal Service's rates for automation-compatible mail. Comparing to Docket No. R94-1, is appropriate because the MC95-1 rate change established many of these rate incentives.

First-Class Mail

Automation Letters	R94-1 Rates (1/1/95)	MC95-1 Rates (7/1/96)	R2000-1 Rates (7/1/01)	R2000-1 Difference vs. R94-1	R2000-1 Difference vs. MC95-1
Nonauto Presort	27.4	29.5	32.2	4.8	2.7
Basic Automation	N/A	26.1	28.0	N/A	1.9
3-D Automation	26.4	25.4	26.9	0.5	1.5
5-D Automation	25.8	23.8	25.5	-0.3	1.7
Carrier Route	25.4	23.0	24.5	-1.1	1.5

Source: USPS-LR-J-90

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In order to respond to this question, witness Moeller (USPS-T-32) has provided me with the following table:

Standard Mail Regular

Per Piece Rate Letters	R94-1 Rates (1/1/95)	MC95-1 Rates (7/1/96)	R2000-1 Rates (7/1/01)	R2000-1 Difference vs. R94-1	R2000-1 Difference vs. MC95-1
Nonauto Basic	22.6	25.6	25.3	2.7	-0.3
Nonauto 3/5	18.8	20.9	23.3	4.5	1.4
Basic Automation	20.4	18.3	20.0	-0.4	1.7
3-D Automation	17.5	17.5	19.0	1.5	1.5
5-D Automation	16.6	15.5	17.7	1.1	2.2

Source: USPS-LR-J-90

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ABA&NAPM/USPS-T29-22 In response to MMA/USPS-T29-4.a., you state “I was also reluctant to increase the discounts further given the lack of data on the reasons underlying the high implicit cost coverages observed for workshare mail.”

- a. Please confirm that in past rate cases through R2000-1, USPS rate design (and other) witnesses have alleged that the sole reason for these high and growing “implicit” cost coverages for FCM workshered are the reduced costs of mail processing from more highly prepared mail entering the system. (See, e.g. R2000-1, USPS-T32, page 10, lines 1-14, witness Mayes, discussing the cost criteria of section 3622.b.)
- b. Please confirm that in this case, USPS rate design witness Moeller (USPS-T28) does not raise the issue raised by witness Mayes in a. above in his discussion of section 3622.b. cost criteria.
- c. In light of your answers to a. and b. above, has the Postal Service recanted its previous position in favor of this view that cost coverage creep is an issue whose causes need to be studied?
- d. Do they need to be studied before any contemplated reclassification of FCM letters subclass?
- e. Are any studies of this issue now underway, or contemplated?
- f. Please confirm that in a private market, if costs for a product or service go down, but prices do not, or do not in the same proportion, then profits go up.
- g. Please confirm that in a private market, if costs go down but prices do not, that is an indication of a degree of market power possessed by the seller in such a market.

RESPONSE:

- a. Not confirmed. In Docket No. R2000-1, witness Mayes does not state that the “sole” reason for increasing implicit cost coverages is increased mail preparation. The cited portion of witness Mayes’ Docket No. R2000-1 testimony reads:

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The more highly-prepared the mail, the lower the postal cost attributed to that category of mail. The lower the costs attributed to that category of mail, the lower the cost base to which the rate level is applied. If the same cost coverage is assigned to two categories of mail differing only in the degree to which the mailer has prepared the mail, the more highly-prepared mail would have a reduced unit contribution. Thus, as the degree of preparation increases over time, all else equal, the coverage required to obtain the same contribution also increases. This has implications for the systemwide cost coverage, as well, given that institutional costs must, nevertheless, be recovered from postage and fees charged for postal services. Worksharing removes attributable costs but leaves institutional costs unchanged. Thus, as the overall level of worksharing increases, the percentage of total cost that is attributable can be expected to shrink and the required system-average cost coverage will increase, all else equal.

Docket No. R2000-1, USPS-T-32 at 10.

b. Not confirmed. Witness Moeller's testimony states:

The more highly-prepared the mail, the lower the postal cost attributed to that category of mail. The lower the costs attributed to a category of mail, the lower the cost base to which the rate level is applied. If the same cost coverage is assigned to two categories of mail differing only in the degree to which the mailer has prepared the mail, the more highly-prepared mail would have a reduced unit contribution. Thus, as the degree of preparation increases over time, all else equal, the coverage required to obtain the same contribution also increases. This has implications for the systemwide cost coverage, as well, given that institutional costs must, nevertheless, be recovered from postage and fees charged for postal services. Worksharing removes attributable costs but leaves institutional costs unchanged. Thus, as the overall level of worksharing increases, the percentage of total cost that is attributable can be expected to shrink and the required system-wide average cost coverage will increase, all else equal.

USPS-T-28 at 10.

c. No.

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- d. No decision has been made as to whether the existing First-Class Mail subclasses will be restructured. If such a decision were to be made, the type of studies required to support any resulting proposal would be determined at that time.
- e. Not to my knowledge.
- f. To respond to this question, I assume that that fixed costs are constant and the quantity sold by a firm does not change. Confirmed that if unit variable costs fall and price does not change, then profits increase. Not confirmed that if unit variable costs fall and price falls by a lower proportion, then profits will always increase. Consider the following simplified example.

In each case: Fixed Costs = 0 and Quantity Sold = 1

Case 1:

Price = 100

Unit Variable Cost = 10

Profits = Total Revenue – Variable Cost – Fixed Cost

$$= (1)(100) - (1)(10) - 0$$

$$= 100 - 10 = 90$$

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Case 2: Assume price falls by 10 percent and unit variable costs fall by 20 percent.

$$\text{Price} = 100 * (1 - 10\%) = 90$$

$$\text{Unit Variable Cost} = 10 * (1 - 20\%) = 8$$

$$\text{Profits} = \text{Total Revenue} - \text{Variable Cost} - \text{Fixed Cost}$$

$$= (1)(90) - (1)(8) - 0$$

$$= 90 - 8 = 82$$

- g. Confirmed. If a firm's unit costs fall and the price it receives for its product does not, that is an indication that the firm has no market power, i.e., that the market is "perfectly competitive."

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ABA&NAPM/USPS-T29-23 In response to MMA/USPS-T29-4.d. you state that “I am not recommending an implicit cost coverage for First Class Mail workshared letters.” Yet, in response to MMA/USPS-T29-4.c. you state “I chose to mitigate the impact on automation rates by increasing discounts by 0.5 cents.”

- a. Please confirm that your choice on discounts leads to a set of rates for workshared letters within the overall FCM rate design for the letters subclass.
- b. Please confirm that “implicit” cost coverages for workshared letters within the FCM letters subclass are determined once workshared letter rates are set.
- c. Please confirm that in your rate design proposal for FCM letters, you were aware at all stages of the process what impact your discount and rate options for FCM workshared letters would have on implicit cost coverages for workshared letters, either from your own calculations or in discussion with other USPS witnesses and analysts.
- d. If your answer to c. is other than an unqualified confirmed, please explain why you would not have considered cost coverage implications from the different rates and discounts you contemplated.
- e. Please confirm that had you “chosen” a different increase for discounts than $\frac{1}{2}$ cent, the implicit cost coverage would have been different than the TY2003 after rates 294.1% that necessarily follows from your discounts choice.
- f. When you say “I chose to mitigate,” is it not also true that you had the free will, for example, to say “I chose to mitigate the impact on automation rates by increasing discounts by 0.6 cents.” If the answer is anything other than an unqualified “Yes”, please explain in complete detail why you “chose” 0.5 cents and not 0.6 cents.
- g. Please confirm that the two factors you “balanced” in arriving at your discounts for FCM workshared letters, namely cost avoidance, and cost coverage creep, are both exact, quantified magnitudes, i.e. numbers, and that your discount increase choice is also an exact number, namely 0.5 cents.
- h. If your choice of an increase in discounts was not in fact somewhat arbitrary, as many of your comments would appear to suggest, please explain fully why your “choice” of a 0.5 cent increase in discounts was not arbitrary.[E. G., please state exactly the mathematical relationship you used in balancing these two factors to arrive at a 0.5 cent increase in discounts, (I. E., the weight you assigned each of your two stated considerations)].

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- i. If you did not use a mathematical relationship, please state to what degree your own choice for increasing discounts was subjective or intuitive?

RESPONSE:

- a. Confirmed.
- b. Confirmed.
- c. Confirmed, that the implicit cost coverage could be calculated at the end of any rate iteration. However, “awareness” of the resulting implicit cost coverage is not the same as “recommending” an implicit cost coverage.
- d. I was not recommending an implicit cost coverage, my analysis was focussed on developing First-Class Mail rates that were reasonable and met various policy and operational goals.
- e. Not confirmed. It is possible that some other combination of rate elements would have resulted in an implicit cost coverage for workshared Letters of 294.1 percent.
- f. No. As the First-Class Mail pricing witness, it was my decision to increase the First-Class Mail automation discounts by 0.5 cents. I was never directed by Postal Service management to increase the automation discounts by 0.5 cents. My decision to increase the automation discounts by 0.5 cents (as opposed to establishing any other discounts) as compared to the current discount was based on witness Moeller’s (USPS-T-28) proposed cost coverage for the First-Class Mail Letters and Sealed Parcels subclass,

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witness Miller's estimated cost avoidances, the resulting rate relationships, and the relative rate changes.

- g. Confirmed that (1) the estimated cost avoidances presented by witness Miller are exact numbers; (2) the implicit cost coverages in the test-year-before-rates and the test-year-after-rates are exact numbers; and (3) that the proposed discounts are exact numbers. However, in the Letters subclass, the discounts were increased 0.5 cents for Automation Letters and Automation Flats, they were not increased for Nonautomation Presort and Carrier Route Letters.
- h. My decision to increase the automation discounts by 0.5 cents was subjective; I did not use a "mathematical relationship" to determine what the discounts should be.
- i. As indicated in my response to ABA&NAPM/USPS-T29-23(h), this decision was subjective.

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ABA&NAPM/USPS-T29-24 On page 13, lines 3-4, of your testimony you state that “[as] efforts to encourage worksharing are successful, avoided costs appear to decline.”

- a. Are you asserting cause and effect? If so please fully explain.
- b. Are you asserting statistical correlation? If so please provide any data you have.
- c. Would you agree that the Postal Service’s labor agreements with clerks might give it an incentive to produce cost studies showing a reduction in avoided costs in an effort to keep work in house?
- d. Would you agree that the Postal Service has an inherent conflict between encouraging work sharing on the one hand, and providing job security to mail processing clerks on the other?
- e. Are you aware of the term “labor refugees” introduced by witness Halstein Stralberg in prior rate cases in reference to the impact of automation on the need for mail processing clerks?
- f. In your view, would keeping more of the mail processing work in house for FCM workshared letter mail result in a higher dollar value contribution to USPS institutional costs and fewer attributable costs and higher cost coverages for Automated FCLM than would greater outsourcing? Or would the contribution levels be about the same dollar wise? Please provide all necessary calculations needed to answer the question.

RESPONSE:

- a. No.
- b. No.
- c. No. It is my understanding that Postal Service cost studies are designed to estimate the cost avoidances from worksharing. At the same time, my understanding is that mail processing employees and union officials have expressed the belief that the discounts are too large in an attempt to limit the opportunity for long-term employment. I presume that the concerns

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expressed in the question and their concerns are natural given their circumstances.

- d. No, while I have not studied this issue, I believe that the mail processing employees' long-term employment prospects are best served by offering reasonably-priced postal products. Therefore, I do not see an inherent conflict.
- e. No. However, a quick search of the Postal Rate Commission's web site reveals that witness Halstein Stralberg used the term "automation refugees" to refer to "employees formerly used for letter sorting, either manually or on LSM's, but no longer needed for those tasks, except, perhaps, during short surge periods before some critical dispatches." Docket No. R97-1, TW-T-1 at 7.
- f. I have not studied this question.

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ABA&NAPM/USPS-T29-26 In response to MMA/USPS-T29-5, you speak of “low relative First Class mail rate increases since the mid-1990s”.

- a. Is the rate increase for FCM in this rate increase, therefore, large, namely 3 cents compared to the 1 cent increase in R2000-1?
- b. Would you agree that relatively, Standard A mail rates have been kept even lower than FCM mail rates?
- c. If your answer to b. is in the affirmative, please explain why since the same mailer preparation activities apply to both classes.

RESPONSE:

- a. The proposed first-ounce, single-piece First-Class Mail Letter rate increase of 3 cents from 34 cents to 37 cents is larger than the one-cent increase proposed in Docket No. R2000-1.
- b. Redirected to witness Moeller.
- c. Redirected to witness Moeller.

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ABA&NAPM/USPS-T29-28 You propose an expanded definition of the single piece nonstandard surcharge in your testimony.

- a. Is this a precursor to reclassification of the letters subclass of FCM?
- b. Please confirm that projected volumes of FCM workshared letters are now or shortly will exceed those of single piece letters.
- c. Would the change in b. be a legitimate reason for redefining the FCM letters subclass?
- d. Under such a hypothetical reclassification, would there be a surcharge for FCM collection mail? For facing and canceling?

RESPONSE:

- a. No. As described in my testimony, I am proposing to expand and rename the current nonstandard surcharge as the proposed nonmachinable surcharge.

This expanded definition is designed to signal mailers about the costs of processing nonmachinable mail.
- b. Confirmed that in the test-year-after-rates, the volume of workshared Letters is greater than the volume of single-piece Letters. USPS-T-7.
- c. I do not know, I have not studied this issue.
- d. I do not know, I have not studied this issue.

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ABA&NAPM/USPS-T29-29 In response to MMA/USPS-T29-11.b., you state the issue of advertising included with FCM letters being priced higher than advertising included in Standard A letters “does not present a “problem.”” You so state, arguing it gives mailers additional choices and that there are other cost factors involved for the mailers in making such a choice.

- a. In fact, is not the example MMA presents an overt case of price discrimination as defined in various antitrust statutes?
- b. Is it not a fact that the other cost factors you mention are precisely what enables the Postal service to so price discriminate, i.e. except for those higher mailer costs to prepare two pieces of mail rather than one, they would always choose the Standard A rate option for the ad mail given the two tiers in pricing noted in the MMA interrogatory?

RESPONSE:

- a. Objection filed.
- b. [Partial objection filed.] I will respond to the question to the extent possible without accepting your premise that price discrimination exists or knowing your definition of price discrimination.

As I indicated in my response to MMA/USPS-T29-11C, there may be other, noncost factors -- such as “the expected response rates from an advertising piece enclosed with an invoice versus a stand-alone advertising piece, and differing service standards for First-Class Mail and Standard Mail” -- that would result in the mailer choosing to combine an advertising piece with an invoice in one two-ounce First-Class Mail piece rather than mailing two pieces.

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ABA&NAPM/USPS-T29-30 In response to MMA/USPS-T29-12 you state that “marginal cost estimates by ounce increment are problematic”.

- a. Which weight cell increments are problematic?
- b. How can lumping problematic weight cells into an overall group create an accurate measure of extra ounce costs?

RESPONSE:

- a. As has been noted by witness Schenk, (see response to ABA&NAPM/USPS-T43-14(c) and 15(b)), the costs by weight distributions are designed to provide a general indication of the relationship between weight and cost, and do not control for other factors, such as machinability, presort level, and other piece characteristics. In addition, I am informed that lightly populated weight cell increments (typically the heavier weight increments) are potentially problematic, in that the cost estimates for those weight increments can be subject to more sampling variation. See witness Schenk’s response to ABA&NAPM/USPS-T43-14(c).
- b. See witness Schenk’s response to POIR No. 5, Question 12.

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ABA&NAPM/USPS-T29-31 In response to GCA/USPS-T29-18, you state that “some mailers have expended resources to participate in the workshare program.”

- a. Please confirm that all mailers who participate in the workshare program expend resources, i.e. have capital costs for automation equipment, labor costs, management costs, etc.
- b. If your answer to a. is other than an unqualified “Yes.,” please explain how any worksharing mailer could participate in the program without “expended resources”.

RESPONSE:

- a. Not confirmed. My intent in the quoted response was to indicate that some mailers have chosen to participate in the workshare program and some mailers have opted not to participate in the workshare program.
- b. When a workshare program is instituted, there may be mailers who had been preparing mail in a way that complies with the new workshare program’s requirements. These mailers would not need to expend additional resources in order to receive a discount.

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ABA&NAPM/USPS-T29-32 In response to GCA/USPS-T29-9, you appear to imply that the Postal Service is no longer setting FCM worksharing letters discounts to encourage greater volume of such letters in order to drive costs out of the Service.

- a. Does your answer imply that there has been a fundamental shift in the philosophy?
- b. Is the USPS counting on processing all or nearly all remaining non-automation mail on its own systems?
- c. If your answer to b. is anything other than an unqualified “No.,” please explain what sense or legitimacy a metered mail benchmark has for setting worksharing discounts, if in fact this is no longer considered candidate mail for conversion to worksharing if the USPS is going to process this mail in house.

RESPONSE:

- a. No. The intent of my response was to indicate that the goal of the proposed discounts was not to “grow volume” above and beyond the level resulting from the economic signals the Postal Service costs that are conveyed through the proposed discounts.
- b. Yes. By definition, mail that is presented by mailers as “nonautomated” will be processed by the Postal Service. The letter mail that was most easily automated has taken advantage of the existing discount structure since the implementation of Docket No. MC95-1. Therefore, it is unlikely that the Postal Service will see the growth rates in Automation letter volume that occurred in the last ten years. However, this does not mean that “candidate mail” for conversion to worksharing does not exist.

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- c. Bulk metered mail is the mail whose characteristics make it most likely to convert to worksharing. Witness Miller provides examples of bulk metered mail that is “candidate mail” for conversion to worksharing. USPS-T-22 at 19.

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ABA&NAPM/USPS-T29-33 Suppose there were no further candidate mail for conversion to worksharing (i.e. the primary volume growth driver), as your answer to GCA/USPS-T29-9 seems to imply.

- a. How would the USPS set discounts for FCM worksharing letters?
- b. What factors would be used to define a benchmark and why?
- c. Would such a situation increase the likelihood that subclass status would be warranted for such workshared letter mail?

RESPONSE:

As indicated in my response to ABA&NAPM/USPS-T29-33, I do not believe that there is “no further candidate mail for conversion to worksharing.”

- a. – c As indicated in my response to ABA&NAPM/USPS-T29-33, I do not believe that there is “no further candidate mail for conversion to worksharing.”
Therefore, I have not studied these questions, nor am I aware of the Postal Service conducting any such studies.