

BEFORE THE  
POSTAL RATE COMMISSION

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OFFICE OF THE SECRETARY

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POSTAL RATE AND FEE CHANGES, 1997

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DOCKET NO. R97-1

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**SIXTH SET OF INTERROGATORIES AND REQUESTS FOR  
PRODUCTION OF DOCUMENTS FROM UNITED PARCEL SERVICE  
TO UNITED STATES POSTAL SERVICE WITNESS O'HARA  
(UPS/USPS-T30-9 through 17)**

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(September 12, 1997)

Pursuant to the Commission's Rules of Practice, United Parcel Service hereby serves the following interrogatories and requests for production of documents directed to United States Postal Service witness O'Hara (UPS/USPS-T30-9 through 17).

Respectfully submitted,



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Of Counsel.

**INTERROGATORIES OF UNITED PARCEL SERVICE  
TO UNITED STATES POSTAL SERVICE WITNESS O'HARA**

**UPS/USPS-T30-9.** Please refer to your answers to UPS/USPS-T30-7 and UPS/USPS-T30-8 in this proceeding. You there state that it would be unacceptable to the Postal Service for any subclass of mail to have an FY 1998 after-rates ratio of revenue to incremental cost that was less than one "during the test year."

(a) Does this imply that it would be acceptable to the Postal Service for a subclass of mail to have a ratio of revenue to incremental cost less than one in any year after the test year?

(b) If the answer to (a) is yes, please explain why such a price would be economically efficient, cross-subsidy free, and, generally, fair and equitable.

(c) If the answer to (a) is no, (e.g., that in a year other than a test year it would be unacceptable to have a subclass with a rate that resulted in a ratio of revenue to incremental cost less than one), please explain how the rates that you propose in your testimony guard against such a result.

(d) If the answer to (a) is no, please explain how such a result is consistent with the testimony of witness Panzar in this proceeding. In your answer, please address (but not be limited to) Professor Panzar's principle stated on page 7, lines 13 through 21, that avoiding economic inefficiency requires not providing services that customers value less than the cost of the resources used to produce them. Please also address (but not be limited to) the statement by Professor Panzar, on page 8 of his testimony, that fair and reasonable postal prices require cross-subsidy free rates and

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therefore that prices cover incremental costs. Also, please address (but do not limit your answer to) Professor Panzar's conclusion on page 9, line 6, that prices which meet the incremental cost test also have a role to play in obtaining economic efficiency.

(e) Does Professor Panzar's principle that prices which meet the incremental cost test also have a role to play in obtaining economic efficiency apply only to the test year. If yes, why?

**UPS/USPS-T30-10.** Please refer to page 8 of your testimony and the example of the effect of worksharing on the recovery of non-attributed costs at lines 8 through 19 and the example on page 9, lines 1 through 12. Please confirm that the total contribution to the recovery of non-attributed costs provided by some type of mail before and after a change in total attributed costs is a way to evaluate fairness and equity. If not confirmed, please explain.

**UPS/USPS-T30-11.** Please refer to page 13, lines 7 and 8 of your testimony, where you state that "[i]f revenue from a subclass equals or exceeds its incremental cost, then there is no cross-subsidy," and to your answers to interrogatories UPS/USPS-T30-7 and UPS/USPS-T30-8 in this proceeding. Does your testimony apply only to test years? Please explain your answer, including but not limited to an explanation as to how in some year other than a test year, a postal rate that is less than the incremental cost to provide that service would not involve a cross-subsidy to users of the applicable subclass of mail.

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**UPS/USPS-T30-12.** Please refer to Section E, "Mark-ups and Coverages After A Reduction in Measured Cost," on pages 16-20 of your testimony. Please confirm that in prior proceedings when the Postal Rate Commission has utilized previously developed rates as a starting point for developing new rates, the Commission has used a mark-up index rather than a cost-coverage index. If not confirmed, please explain.

**UPS/USPS-T30-13.** Please refer to Table E-1 on page 18 of your testimony.

(a) Please confirm that if a column were added that showed the percentage contribution made by Products A and B to recovery of non-volume variable costs, the revised table would be as follows:

**Table E-1. Effect of Holding Mark-Up Index or Coverage Index Constant,  
With Changes in Measured Volume-Variable Costs**

**I. Initial Situation, Before Changes in Cost Measurement**

Product	Volume-Variable Cost	Contribution	Percentage Contribution	Revenue	Coverage	Mark-Up	Coverage Index	Mark-Up Index
A	33.3	22.2	66.7%	55.6	167%	67%	1.11	1.33
B	33.3	11.1	33.3%	44.4	133%	33%	0.89	0.67
Total	66.7	33.3	100.0%	100.0	150%	50%	1.00	1.00
Revenue Requirement				100.0				

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**II. Equal Reduction in Measured Costs, Previous Mark-Up Index Applied**

Product	Volume-Variable Cost	Contribution	Percentage Contribution	Revenue	Coverage	Mark-Up	Coverage Index	Mark-Up Index = Initial
A	25.0	33.3	66.7%	58.3	233%	133%	1.17	1.33
B	25.0	16.7	33.4%	41.7	167%	67%	0.83	0.67
Total	50.0	50.0	100.1%	100.0	200%	100%	1.00	1.00

**III. Equal Reduction in Measured Costs, Previous Coverage Index Applied**

Product	Volume-Variable Cost	Contribution	Percentage Contribution	Revenue	Coverage	Mark-Up	Coverage Index = Initial	Mark-Up Index
A	25.0	30.6	61.2%	55.6	222%	122%	1.11	1.22
B	25.0	19.4	38.8%	44.4	178%	78%	0.89	0.78
Total	50.0	50.0	100.0%	100.0	200%	100%	1.00	1.00

If not confirmed, please explain.

(b) Please confirm that using the hypothetical example that is the basis for your Table E-1, a mark-up index would result in each product making the same percentage contribution to the recovery of non-volume-variable costs before and after the reduction in volume-variable costs. If not confirmed, please explain.

**UPS/USPS-T30-14.** You state on page 17 of your testimony, lines 7 and 8, that it is a "natural question" as to whether previously developed mark-ups and cost coverages could be used as "a starting point, at least" for developing new rate levels.

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(a) Did you use previously-developed mark-ups and cost coverages as a starting point for your rate recommendations in this proceeding?

(b) Did you use previously-developed mark-ups and cost coverages as more than a starting point? Please explain.

**UPS/USPS-T30-15.** Please refer to your testimony, page 19, lines 15-17. Leaving aside the issue of whether the cost-coverage index or the mark-up index is the better way to adjust current rates to reflect cost-pool changes, please confirm that you assert that the development of new rates should begin by using the previously-developed cost coverages or mark-ups as a base. If not confirmed, please explain.

**UPS/USPS-T30-16.** Please explain your belief, as stated on page 19, lines 6 and 7 of your testimony, that fairness and equity require equal rate increases for Products A and B in the example embodied in your Table E-1, page 18.

**UPS/USPS-T30-17.** Please refer to page 20 of your testimony, lines 11-15. Please explain why you believe Ramsey pricing provides a useful framework for demonstrating the effects of different pricing decisions and provides a sense of direction for postal pricing.

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with section 12 of the Commission's Rules of Practice.

  
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Albert P. Parker

Dated: September 12, 1997  
Philadelphia, Pa.