

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

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POSTAL RATE AND FEE CHANGES, 1997

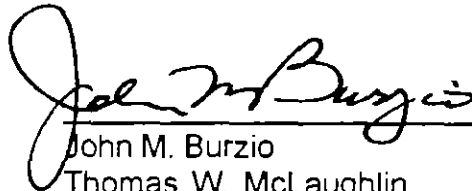
Docket No. R97-1

POSTAL RATE COMMISSION  
OFFICE OF THE SECRETARY

INTERROGATORIES OF ADVO, INC.  
TO UNITED STATES POSTAL SERVICE WITNESS  
JOHN C. PANZAR (ADVO/USPS-T11-1-8)

Pursuant to sections 25 and 26 of the Rules of Practice, Advo, Inc. (Advo) directs the following interrogatories to United States Postal Service witness John C. Panzar. If the witness is unable to respond to any interrogatory, we request that a response be provided by appropriate USPS witness capable of providing an answer.

Respectfully submitted,



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CERTIFICATE OF SERVICE

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

  
Thomas W. McLaughlin

September 15, 1997

## ADVO, INC INTERROGATORIES TO USPS WITNESS PANZAR

ADVO/USPS-T11-1. On page 4, you state that:

“There are two especially natural types of [volume] changes to consider. The first is an increment of one unit of mail volume of a particular subclass of service . . . the second type of volume change to consider is that of an entire mail subclass.”

Within a particular subclass of service, assume that (1) the final (end-to-end) service to the mailer/consumer can be supplied by two intermediate input services (e.g., transportation and delivery) and (2) one of the input services can be provided by either the USPS or a competitor.

- (a) Should the input services be considered separately in the generation of efficient rates? Please explain.
- (b) If the USPS faces competition in providing both input services (*i.e.*, neither input service is perfectly inelastic), how should it price those services in order to generate efficient rates and still breakeven financially?

ADVO/USPS-T11-2. On page 7, you state:

“In addition, the marginal cost pricing floor plays an important role in allocating output among firms when there are multiple providers of a service. Competitive rivals of the Postal Service would maximize their profits by selecting their output levels to equate their marginal costs to the market price. If that price were below the marginal cost of the Postal Service, productive efficiency could be improved by shifting output from the Postal Service to its rival(s).”

- (a) Assume scale and scope economies for a multi-product firm and no perfectly inelastic service demands. Under what circumstances should one of the firm's services be efficiently priced at marginal cost (rather than average incremental cost) when the firm has competitors which provide equivalent, substitutable services? Please explain your response fully.
- (b) For your response to (a), please explain whether the circumstances identified (pricing one service at marginal cost) would generate a cross-subsidy and, if so, (2) how a cross-subsidy would be compatible with efficient pricing.

ADVO/USPS-T11-3. On page 8, you describe the incremental cost test and state:

“ . . . if a service’s revenues do not cover the additional costs the enterprise incurs in providing it, the users of that service are receiving a subsidy from the enterprise’s other customers.”

- (a) Does the incremental cost test also apply to USPS services which may be considered intermediate inputs (1) to a final (end-to-end) service which both the USPS and its competitors provide and (2) which competitors may separately produce or purchase from the USPS (e.g., transportation or sortation)? Please explain your response fully.
- (b) For an intermediate input service which either the USPS or a competitor can produce (e.g., transportation or sortation), is the efficient comparison between (1) the competitor’s stand-alone cost for that input service and (2) the USPS’s incremental cost for that same input service? Please explain your response fully.
- (c) Please describe the conditions under which it would be economically efficient for the USPS to price an intermediate input service (to a competitor who could also produce that input service) at marginal cost, when its marginal cost is less than its incremental cost.

ADVO/USPS-T11-4. On page 9, you state:

“It is certainly possible, in principle to calculate the incremental costs of providing certain service quality attributes, such as daily delivery. While the results may be important for decision-making purposes, they have nothing directly to say about whether or not a service with given quality attributes is being subsidized.”

Please clarify this statement. If the level of service quality for a particular subclass causes non-volume-variable costs which can be avoided if that subclass is eliminated, are those costs considered incremental to that subclass? Please explain fully.

ADVO/USPS-T11-5. On page 9, you state:

“From a social point of view, stand-alone provision would be desirable whenever the *stand alone costs of independent provision of a mail service (or group of mail*

services) are less than the Postal Service's incremental costs of that service (or group of services)."

- (a) Within a particular geographic area, assume there is volume which a mailer can enter at either the USPS delivery office or at a competitive delivery carrier's office. And, assume the competitor's stand-alone delivery cost/rate is less than the USPS delivery rate. In that event, is the USPS rate for delivery of mail entered at the destination delivery office greater than the relevant stand-alone cost? Please explain.
- (b) Please describe the conditions which are required in order to properly compare the Postal Service's service incremental cost/rate to the standalone cost/rate of a competitor. (For example, would the competitor have to provide the same geographic service coverage, the same level of service quality, the same worksharing discounts, etc.)

ADVO/USPS-T11-6. On pages 10-11, you state:

"Yet monopoly tariffs can still play an efficiency enhancing, signaling role by satisfying the constraints imposed by the incremental cost test. If the monopolist's prices are set below per unit incremental costs, firms with superior productive techniques would be inefficiently deterred from entering the market. Their entry would necessarily improve social efficiency by decreasing the total resource cost of providing industry services. In addition, the monopoly could be required to lower prices on its remaining services and still break even."

Does this statement apply also to prices for services which are intermediate inputs (e.g., transportation or sortation) to final (end-to-end) products? If not, why not?

ADVO/USPS-T11-7. In evaluating the incremental costs of a subclass, is it ever appropriate to consider the costs that could be eliminated by reconfiguring the system in the absence of that subclass. Please explain your answer, including a description of the kinds of circumstances where it would and would not be appropriate to consider such reconfiguration savings as incremental costs.

ADVO/USPS-T11-8. Assume that there are functions or operations in the postal system that are used predominantly, but not exclusively, by a single subclass of mail. Further assume that these functions or operations are not essential to maintaining the quality of service afforded to other subclasses, and that the system could be reconfigured to eliminate such functions in the absence of that subclass. In that circumstance, would it be appropriate to treat the non-volume-variable costs of such functions as incremental to that subclass? Explain your answer.