

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

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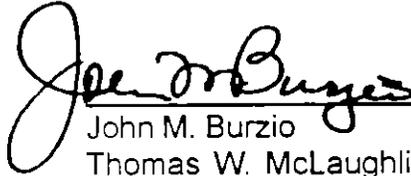
Docket No. R97-1  
POSTAL RATE COMMISSION  
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 1997

INTERROGATORIES OF ADVO, INC.  
TO UNITED STATES POSTAL SERVICE WITNESS  
JOHN C. PANZAR (ADVO/USPS-T11-9-14)

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.

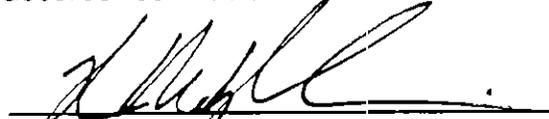
Respectfully submitted,



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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 17, 1997

## INTERROGATORIES OF ADVO INC. TO USPS WITNESS PANZAR

ADVO/USPS-T11-9. To the extent that the non-volume-variability of a cost component is due to the peaking characteristics of a particular mail class (e.g., requiring reserve labor capacity or causing imperfect matches between capacity and volume), could some or all of the non-volume-variable costs be considered incremental to that class? Please explain your answer, and describe any additional information or factors that would affect your answer.

ADVO/USPS-T11-10. For purposes of this question, the term "gateway" activity refers to an early-entry activity such as the facer/canceler operation that must be staffed and ready to receive and process mail as it comes into the stream in order to prepare it for subsequent processing, as described by witness Bradley at pages 57-58 of USPS-T-14. To the extent that the non-volume-variability of a cost component is due to its function as a "gateway" activity primarily for the subsequent processing and dispatch of a particular mail class, could some or all of the non-volume-variable costs be considered incremental to that class? Please explain your answer, and describe any additional information or factors that would affect your answer.

ADVO/USPS-T11-11. To the extent that the non-volume-variability of a cost component is due to personnel staffing designed to meet delivery standards or achieve high delivery performance for a particular mail class, could some or all of the non-volume-variable costs be considered incremental to that class? Please explain your answer, and describe any additional information or factors that would affect your answer.

ADVO/USPS-T11-12. On page 9 of your testimony you state:

"The incremental costs which the Postal Service incurs in providing a mail service measures the costs to society of having that particular service provided as part of the larger Postal Service enterprise. In many cases, alternative supply

arrangements may be possible. . . . From a social point of view, stand-alone provision would be desirable whenever the stand alone costs of independent provision of mail service (or group of mail services) are less than the Postal Service's incremental costs of that service (or group of services)."

Please consider a simplified example of a mail subclass used by one mailer only.

There is one level of sortation required before delivery of this mail by the USPS and sort operations are subject to worksharing. Assume that USPS sorting costs for this mailer (subclass) are captured by the cost function  $C(V)$ , where  $C(V)$  defines total avoidable USPS sorting costs at any volume level ( $V$ ) if sorting is performed by the mailer. Also assume that  $V_s$  is the mailer (subclass) volume level processed by the USPS if sorting is conducted by the USPS. (For simplicity, please assume there are no other subclasses that use this particular sortation operation and there are no scope economies associated with the costs of this operation.)

- (a) Please confirm that  $C(V_s)$  is the total avoidable cost by the USPS if the mailer were to perform sort operations. If you cannot, please explain why.
- (b) Please confirm that if the mailer's total worksharing sortation costs are less than  $C(V_s)$  at this volume level, then efficiency requires that the mailer undertake sorting operations as the least cost provider. If you cannot, please explain why.

ADVO/USPS-T11-13. Continuing with the example in Interrogatory 12 above, please assume that the mailer's total sort costs are explained by the function  $C(V)\lambda$ , where  $0 < \lambda < 1$ . In other words, at any given volume level mailer sort costs will be  $(1 - \lambda)*100$  percent less than the USPS cost.

- (a) Please confirm that at USPS worksharing discount level,  $D1$ , the mailer will evaluate  $V_s * D1 - C(V_s)\lambda$  in determining whether to workshare or not. Furthermore, please verify that a positive value for this difference is the mailer's savings from worksharing. If you cannot, please explain why.
- (b) Please confirm that if  $D1 = C(V_s)/V_s$ , then the mailer will always make the correct choice as required by efficiency, for then  $V_s * D1 - C(V_s)\lambda = C(V_s)*(1 - \lambda) > 0$ . Mailer

savings from worksharing and the actual cost difference from mailer and USPS sorting operations will be equal and positive. If you cannot, please explain why.

- (c) Please confirm that D1 in this case is set at the average total cost for sorting operations, or  $D1 = AC(Vs) = C(Vs)/Vs$ . If you cannot, please explain why.

ADVO/USPS-T11-14. Continuing with the example in Interrogatories 12 and 13 above:

- (a) Please confirm that the total volume variability of USPS sorting costs at the mailer's volume level can be calculated as:

$$VAR = MC(Vs)/AC(Vs)$$

where  $MC(Vs)$  is USPS marginal sortation costs at  $(Vs)$  and  $VAR$  is volume variability of USPS sortation cost  $(C)$  at  $Vs$ . If you cannot confirm, please explain why.

- (b) Please confirm that the efficient USPS discount value, D1, can be calculated as:

$$\begin{aligned} D1 &= AC(Vs) \\ &= MC(Vs)/VAR \end{aligned}$$

If you cannot confirm, please explain fully.

- (c) Please confirm that if the volume variability  $VAR$  is less than one, then the efficient discount value, D1, would be higher than the sortation marginal cost  $MC(Vs)$ . If you cannot confirm, please explain.
- (d) Please confirm that if D1 is set at the USPS marginal cost, then the mailer will violate the least cost principle and continue to choose USPS sorting operations when it could workshare at a lower total cost. If you cannot confirm, please explain.