

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

POSTAL RATE AND FEE CHANGES
PURSUANT TO PUBLIC LAW 108-18

Docket No. R2005-1

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VAL-PAK [VP/USPS-T27-1-9]
(April 28, 2005)

The United States Postal Service hereby provides the responses of witness Robinson to the above-listed interrogatories of ValPak Direct Marketing Systems, Inc. and ValPak Dealers' Association, Inc., dated April 14, 2005.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.

Chief Counsel, Ratemaking

Michael T. Tidwell

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice and Procedure.

Michael T. Tidwell

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VP/USPS-T27-1.

Please refer to your testimony, USPS-T-27, page 13, where you say that “generally speaking, the resulting rates and fees [from a rate case] are not revisited on a periodic basis absent a Postal Service determination that a rate change request is necessary.”

Please consider a situation where the Commission believes that a new rate relationship is meritorious and should be recommended, but decides to move in **steps** toward that new relationship in order to impose a series of small effects on mailers instead of one large effect. An example might be that a cost coverage should be changed but will be changed in three moderate **steps** instead of a single large one. Another example could be the introduction of a worksharing discount, or surcharge, or some other rate signal (possibly associated with the redesign of a product), which would lead to an increase in efficiency, where recognition of a cost difference associated with the rate signal would proceed in **steps** from a passthrough of 40 percent, to 60 percent, to 80 percent, to 100 percent.

- a. Please provide any examples of which you are aware where the Postal Service has initiated a separate case just to take a **step** of the kind discussed in this question.
- b. Would you agree that there have been previous occasions where Congress has decided to phase in desired changes in a series of steps, and that it specified that a **step** was to be taken each year, regardless of whether a rate case happened to occur at each of the appropriate times? If you agree, please provide examples of such occasions.
- c. Please explain the extent to which it is your position that taking steps toward desirable new positions should be constrained and spaced by the occasioning of the Postal Service making “determination[s] that a rate change request is necessary,” and that, if such determinations should turn out to be made only every five years (due, say, to success in cost control efforts), a four-step adjustment could take as long as 15 years to bring about. If that is not your position, please explain in detail why it is not.
- d. Suppose that the Commission and various mailers share a concern that an inequitable rate situation exists, but that it may not rise to the level of being well-suited for a complaint proceeding. If an omnibus rate case apparently suited to including consideration of the inequitable situation occurs, but the Postal Service decides, for one reason or another, that it should be an across the-board case, please explain the extent to which it is your position that those concerned about the inequitable situation

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should simply be told to wait for as many years as the Postal Service requires to make a "determination that a rate change is necessary."

- e. Suppose, at the end of one of the five-year periods discussed in preceding part c, the Postal Service decides that an across-the board increase should be proposed. Explain whether it then would be your position that the Commission or any mailer interested in taking the next step toward the more desirable position should simply be told to wait another few years for that step to occur.

RESPONSE:

- a. I am unaware of a specific circumstance when the Postal Service has committed to scheduled rate or classification filings to implement predetermined "steps" through separate cases. However, this is not to say, that the Postal Service does not propose rate or classification filings to move in specific directions. Perhaps the most obvious example of a filing to take "steps" towards a previously established goal was Docket No. MC95-1. More typically, the Postal Service moves gradually to adjust rates, classifications, rate design, and cost coverages over time. These adjustments may be made in the context of omnibus rate filings or minor classification cases depending on the scope and magnitude of the change. For example, over time, the Postal Service has indicated that the First-Class Mail nonmachinable (formerly nonstandard) surcharge should be increased to reflect the additional costs of processing this mail. Consequently, the Postal Service proposed increases in the nonmachinable (nonstandard) surcharge in Docket No. R97-1 and Docket No. R2001-1. Some smaller movements towards specified goals have

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been undertaken through smaller, minor classification cases. The Periodicals Copalletization experiments are one example of the Postal Service working to reduce Periodicals costs through the establishment of classifications that encourage copalletization of smaller volume Periodicals.

The decision to request an omnibus rate increase depends on the evaluation of a wide range of financial variables and the need to ensure that the Postal Service meets its statutory mandates in a financially responsible manner. See USPS-T- 6. Secondly, an omnibus rate case can serve as a vehicle for proposing changes in rates, classifications, and rate design that will continue to move products and pricing in preferred directions. As discussed in the testimony of witness Potter (USPS-T-1), the Postal Service has filed this rate request solely to recover the Congressionally-mandated escrow obligation and therefore, has not proposed any changes in classifications or changes in relative rates beyond the requested 5.4 percent across-the-board increase.

- b. Yes. The Revenue Forgone Reform Act of 1993 (RFRA) mandated that rates for preferred classes of mail change in steps. As witness O'Hara explained in Docket No. R97-1:

The RFRA provides that the mark-up for each preferred rate subclass is to be determined from the markup for the most closely corresponding commercial subclass. Over a six-year phasing process, the final year of which will be FY 1999, each preferred rate markup is to rise from one-twelfth the corresponding commercial markup to one-half of the commercial mark-up.

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Docket No. R97-1 USPS-T-30 at 10-11. Under the statute, these rate changes were annual and did not require a Postal Service request for rate changes before the Postal Rate Commission.

- c. This is not my position. The Governors' determinations as to whether and when the Postal Service will request any specific rate or classification change are based on their evaluation at a given time of both the financial needs of the Postal Service, and the most appropriate way to meet these needs consistent with the provisions of the Postal Reorganization Act. While I cannot speak for the Governors, management generally weighs the benefits and costs of a variety of options and presents recommendations to the Governors, based on an assessment of the financial circumstances as well as the relative merits of alternative changes in rates and classifications. In this case, Postal Service management determined that, without the escrow obligation, management would not request substantial changes to the current rate and classification schedule.¹ In addition, management determined that, absent the escrow requirement, the financial position of the Postal Service was such that a general rate increase would not be requested. Faced with these two determinations and the possibility that Congressional action could remove the escrow requirement, witness Potter determined that the

¹ Smaller changes to the classification schedule frequently are requested to address specific issues, for example, the establishment of experimental products, market tests, or other classification issues.

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most reasonable approach was to propose an across-the-board increase in rates and fees. USPS-T-1. Generally, the Postal Service has not proposed changes to rates and classifications that would have a substantial effect on Postal Service revenues outside the framework of an omnibus rate case.² This permits an evaluation of the interdependencies of rate and classification proposals and their effect on the revenue requirement.

This question posits a rigid, deterministic approach to rate and classification changes implying that changes could only be undertaken in a stepwise fashion based on a specified formula. The Postal Service does not generally support such an approach to rate or classification changes. Some changes will take longer to accomplish than others, but the ability to flexibly address specific circumstances and mold a solution to these circumstances – as the Postal Service has done in response to the escrow obligation – will, over the long term, benefit both the Postal Service and its customers.

- d. I do not know what situation you are describing. As described in the response to (c) above, the Postal Service evaluates a variety of financial and other concerns prior to proposing an omnibus rate change. The escrow requirement is a unique circumstance that the Postal Service was required to address. In this case, an across-the-board increase in rates

² One exception was Docket No. MC95-1 which proposed substantial changes in classifications.

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and fees is a reasonable approach to recovering the escrow obligation and consistent with the requirements of the Postal Reorganization Act. Under the Act, any change in rates or fees must be initiated through a Postal Service request and the timing of that request is at the Postal Service's discretion.

- e. This is not my position. First, the Commission is the Postal Service's partner in the rate making process; while the Postal Service presents proposals and justifications for its proposals to provide a basis for the Commission's recommended decision, the Commission reaches these decisions independently. Second, the Postal Service develops its request based on an evaluation of the circumstances surrounding the request. In this case, the Postal Service's testimony describes why the across-the-board rate request is reasonable, appropriate and consistent under the pricing provisions of the Postal Reorganization Act.

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VP/USPS-T27-2.

Please refer to your testimony, USPS-T-27, page 13, beginning at line 10, where you say that rates may not be revisited on a periodic basis even though:

The reality of changing input prices, productivity and other factors virtually ensures that recommended cost coverages for a test year will not trace precisely the cost coverages that actually result in that year or in any subsequent year prior to a new rate change request. This result is expected and is not inherently unfair or inequitable. [Footnote omitted.]

- a. You mention input prices, productivity, and other factors possibly changing. Do you agree that over a period of several years, such as the interval since Docket No. R2001-1 (which turned out to be settled), the "other factors" that could change extend to (i) major changes in the mechanization and technology used by the Postal Service to process mail, (ii) changes in postal markets, and (iii) substantial changes in the preparation of mail by mailers? Please explain any extent to which you disagree.
- b. Suppose two different products each had a recommended (and expected) cost coverage of 160 percent. Subsequently, when the test year actually occurs, product one has an actual coverage of 130 percent and product two has an actual coverage of 163 percent. Explain whether you would argue in this case that each product traced the recommended coverage, but that neither product traced it "precisely?" Include in your answer a statement on how close the recommended and actual coverages would have to be before you would argue that the tracing had been "precise."
- c. Consider an actual 130 percent cost coverage that is not even moderately close to the recommended coverage of 160 percent, which would certainly qualify as a failure to "trace precisely." You state in your testimony that this is "not inherently unfair or inequitable." If the Commission recommended cost coverages that it believed were fair and equitable and well-aligned with the Postal Reorganization Act of 1970 ("the Act"), and such immoderate variances occurred, please explain why you believe this is "not inherently unfair or inequitable." In your answer, please draw on and explain all notions of fairness and equity that you had in mind when you made this statement.

RESPONSE:

- a. These are other possible factors that could cause recommended cost coverages to differ from actual cost coverages.

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- b. I would agree that, in this hypothetical, neither of these products tracked the recommended cost coverage precisely. For the cost coverages to track "precisely," I would expect the recommended cost coverage to be exactly equal to the actual cost coverage.
- c. First, I am unaware of where the Postal Service or the Commission has equated "trace precisely" with "fairness and equity." In addition, I have not used the term "immoderate variances" and do not necessarily agree that a change in cost coverage of the size in your hypothetical is necessarily "unfair or inequitable." However, the Postal Service and the Postal Rate Commission do use previous cost coverages as a point of comparison.

I do not discuss any example of a subclass where the Commission recommended a cost coverage of 160 percent in Docket No. R2001-1 and where the actual cost coverage is 130 percent. Reviewing the Commission's R2001-1 decision, the only subclass with a recommended cost coverage of approximately 160 percent is Priority Mail (recommended cost coverage 159.5 percent). PRC Op. Docket No. R2001-1, Appendix G at 1. In FY 2004, the actual cost coverage for Priority Mail was 156.99 percent, in the test year after rates, the proposed cost coverage for Priority Mail is 156.49 percent (145.94 percent on the PRC costing methodology.)

In your hypothetical, I assume that, in recommending a 160 percent cost coverage, the Commission exercised its best judgment, and considered the record evidence before it at the time to recommend a cost

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coverage it considered to be fair and equitable. The fact that hindsight permits us to see what the actual cost coverage turned out to be does not make the Commission's recommended cost coverage unfair and inequitable. If undertaken, a *post hoc* review of additional evidence could lead the Commission to conclude that the 130 percent cost coverage is a fair and equitable result.

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VP/USPS-T27-3.

Please refer to your testimony, USPS-T-27, page 12, beginning at line 9, where you say that it “would be a breach of the financial management responsibilities established under the Postal Reorganization Act” to “ignore” the “Congressionally-mandated escrow requirement.” Immediately following this, you say: “Therefore, we are faced with the necessity of apportioning the escrow expense in a fair and equitable manner.”

- a. The logic of your statement appears to be that because it would be irresponsible to ignore the escrow cost, you (or the Commission) are required to apportion it fairly and equitably. Please state any extent to which you disagree that this is the logic of your statement, focusing specifically on the meaning of the word “therefore.”
- b. Does the fact that it would be irresponsible to ignore the ordinary institutional costs of the Postal Service imply that you (or the Commission) must apportion them fairly and equitably as well? Please explain any answer that is not an unqualified affirmative.
- c. Can you name any costs of the Postal Service that it would be financially responsible to ignore? If yes, please explain what those costs are.
- d. Can you name any costs that the Postal Service ignores when establishing its revenue requirement? If yes, please explain what those costs are.
- e. Can you name any Postal Service costs that should not be apportioned in a fair and equitable manner? If yes, please explain what those costs are and why they should not be apportioned fairly and equitably.
- f. In proposing what you believe to be the most fair and equitable apportionment of the escrow costs or any other costs, would you exclude consideration of any factors in section 3622(b)? If yes, please explain.
- g. In its Opinion and Recommended Decision in Docket No. MC95-1, page iii, the Commission said: “Congress mandated that “[p]ostal rates shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis.” (Emphasis in original.) When the Commission apportions the institutional costs of the Postal Service to the subclasses of mail and special services, do you contend that it does so on any basis other than a fair and equitable basis? If yes, please explain.
- h. If the Commission apportions all other institutional costs of the Postal Service on a fair and equitable basis and you see a need to apportion the

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- escrow costs on a fair and equitable basis, not excluding other factors in section 3622(b), please explain whether you see some fundamental difference between the two pools of costs which suggest that what is fair and equitable for one is different from what is fair and equitable for the other. If you do, please explain (i) what those fundamental differences are, and (ii) how those differences interact with notions of fairness and equity to imply different apportionments, being sure to reference your statement on page 4, lines 6-8, where you state that the escrow funds are "treated as an institutional cost of the Postal Service."
- i. In its Opinion and Recommended Decision in Docket No. R90-1, at pages IV-16 and IV-17, ¶¶ 4059 and 4052, respectively, the Commission said: "We utilize total attributable cost in computing a markup index, which is an important tool in developing fair institutional cost distributions, ..." and "We conclude that it continues to be most appropriate to distribute the relative burden of recovery of institutional costs on the basis of coincident application of the policy factors of the Act, with reference to the markup index." You mention on page 23 that you have some reservations about some uses of the Commission's markup index, and you note that following a set of indexes could have significant effects on mailers. Nevertheless, would you agree that the markup indexes for the subclasses of mail are one reflection of the apportionment of institutional costs that the Commission found to be fair and equitable? Please explain any disagreement.
 - j. Please confirm that, *ceteris paribus* (meaning mainly in this case that the costs remain the same), applying a uniform proportionate increase to all rates, as in an across-the-board increase, systematically distorts toward the average the markup indexes underlying the original rates. If you cannot confirm, please provide a mathematic proof that this is not the case.
 - k. If it is true that an across-the-board proportionate increase systematically distorts the markup indexes of the rates, would it not follow that such an approach is inconsistent with the apportionment of costs that the Commission found fair and equitable? Please explain any extent to which you disagree.

RESPONSE:

- a. My testimony states:

Many industry observers have suggested that a Congressionally-mandated escrow requirement expense that is not caused by the provision of mail services is unfair and inequitable. Nevertheless,

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the Postal Service cannot simply ignore its existence. To do so would be a breach of the financial management responsibilities established under the Postal Reorganization Act. Therefore, we are faced with the necessity of apportioning the escrow expense in a fair and equitable manner.

USPS-T-27 at 12 lines 9-15.

The Postal Service does not ignore any costs when it develops rates to meet its revenue requirement for a requested change in rates and fees. In this instance, these costs include the Congressionally-mandated escrow expense. While your paraphrase of my testimony generally captures the logic, my testimony is based on the Governors' determination that a request to change rates and fees is necessary to meet the Postal Service's revenue requirement. This need is discussed fully in the testimony of witness Tayman (USPS-T-6).

I use the word "therefore" as it is commonly used in everyday language. It is defined as:

1a: for that reason: CONSEQUENTLY b: because of that c: on that ground 2: to that end

Merriam-Webster's Collegiate Dictionary, 10th edition. (Springfield MA: Merriam-Webster, Incorporated, 2002) [emphasis in the original].

- b. Yes, in proposing or recommending rates and fees it would be irresponsible to ignore any institutional costs of the Postal Service whether they are associated with the escrow requirement or the provision of postal services.
- c. No.

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- d. No.
- e. No.
- f. No.
- g. No.
- h. I am not sure of what question you are asking. A fundamental difference between the escrow obligation and other institutional costs is that the escrow obligation is a legislative construct and the other institutional costs usually reviewed by the Commission are actually incurred as a result of the operation and administration of the Postal Service. However, if you are asking "can the Postal Service and the Postal Rate Commission arrive at different results in some instances," the answer is yes. By the same token, as depicted in its Docket No. R2001-1 decision, the Commission arrives at different results in different cases based on the particular circumstances in the case. Docket No. R2001-1, PRC Op. Appendix G at 37. I do not believe that means that, in one instance, the Postal Rate Commission apportioned the costs fairly and equitably, and in another instance it failed in that regard.
- i. I would agree that the markup indices are one indication of the relationships embodied in a Commission recommended decision on a Postal Service rate request. However, that recommendation depends on the Commission's determination of the appropriate markup relationships in a specific docket based on its application of the pricing criteria in that

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- docket. I am concerned not with the calculation of the indices for any specific rate decision but with efforts to mechanically apply past relationships to new circumstances.
- j. Confirmed that if costs remain the same both before and after the rate change, that applying a uniform percentage increase to all rates will move the markup indices for individual subclasses closer to the system average markup index.
- k. First the question presupposes that some specific set of markup indices are the only possible "fair and equitable" markup indices. I do not believe this to be the case and believe that all circumstances surrounding a rate request must be considered before a given set of rates, cost coverages and markup indices can be determined to be fair and equitable. Efforts to force fit past coverages to a new case can only succeed if one is compelled to ignore all new information and solely dwell on the past

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VP/USPS-T27-4.

Please refer to your testimony, USPS-T-27, beginning on line 24 of page 5, where you state that “the escrow requirement is a unique financial circumstance that merits a different approach than has been used in prior omnibus rate cases.” (Emphasis in original.)

As a hypothetical, please assume the following outcome occurs. First, suppose an across-the-board increase is implemented as proposed. Second, assume that in FY 2006, after making the required escrow deposit, the Postal Service achieves financial breakeven. Third, to avoid yet another rate increase in FY 2007, assume Congress allows that normal operations in FY 2007 can draw on both the FY 2006 escrow account and the amount that would have been put in escrow in FY 2007, and this in fact allows breakeven in FY 2007.

- a. Would you agree that the rate relationships in FY 2007, which the Act gives the Commission the authority to recommend, should be guided by the factors in section 3622(b) of the Postal Reorganization Act (including any other relevant policies of the Act)? Please explain any disagreement.
- b. Would you agree that the rate relationships existing at the end of FY 2006 would be the result of a prior across-the-board approach, which you characterize as a “different approach,” adopted because of what you refer to as “a unique financial circumstance.” Please explain any disagreement.
- c. Would you agree that carrying the across-the-board rates into FY 2007 would result in rates for that year that were guided by an earlier application of an across-the-board approach instead of by an unencumbered application by the Commission of the 3622(b) factors? Please explain any disagreement.
- d. Under the hypothetical conditions assumed for this question, would you propose that the across-the-board rates be completely withdrawn at the end of FY 2006 and that a new set of rates be implemented, with the same breakeven revenue requirement, and that the new set of rates for FY 2007 be set according to what you call the approach “used in prior omnibus rate cases?” (USPS-T-27, p. 6, l.1.)
- e. If you would not propose the steps outlined in part d of this question, but would instead argue that the approach used to fund the escrow payments in FY 2006 is also the approach that should be used to fund the more-traditional operating requirements of FY 2007, please explain how the escrow approach accommodates what you see as the “unique” difference between the burden associated with the escrow and the burden associated with FY 2007 operations. In other words, how can the escrow

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- approach be something “in contrast to the approach to rate and fee levels usually taken by the Postal Service and the Postal Rate Commission,” justified by unique circumstances, and yet be suitable for the normal operations that warrant “the approach . . . usually taken?” (USPST-27, p. 3, ll. 9-11.)
- f. Under the assumptions of this question, please explain how it would be fair to mailers and consistent with the Postal Reorganization Act for the rates in FY 2006 to be based on a “different approach” and for the same rates in FY 2007 to be suitable for covering the ordinary operating requirements of FY 2007.
 - g. Under the assumptions of this question, if you believe it would be fair to carry the FY 2006 rates into FY 2007, please explain why this does not suggest that there is really no difference between the financial burden of FY 2006 and the financial burden of FY 2007.
 - h. Do you agree that — if the across-the-board proposal is recommended and implemented in this case, and if the rates of that proposal are not rescinded when the “unique” circumstances of the escrow burden no longer apply, but are instead used as a platform relative to which any future rate increases will be proposed — it follows that any consideration given in future cases to the effects of rate increases on mailers will be referenced to a set of rates selected under unique circumstances, and thus would not be referenced to rates set in a normal omnibus case? Please explain any disagreement.

RESPONSE:

This question poses a hypothetical series of events that I have not studied and assumes Congressional actions that may or may not occur. The Postal Service’s proposals in this docket are based on the circumstances and the statutory requirements that currently exist. Witness Potter (USPS-T-1) has stated that the Postal Service will withdraw this request if legislation is enacted that removes the escrow requirement while the request is pending.

- a. I agree that, if the Postal Service requests a change in rates and fees at some time following the conclusion of this docket (the assumption of your

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- hypothetical that the “across-the-board increase is implemented as proposed”) and the current statute is still in effect, then the Commission’s recommended decision in that later docket would be guided by the factors in section 3622(b) of the Act and these recommendations would also be based on any other relevant policies of the Act. I have no testimony to offer in this proceeding regarding future rate cases.
- b. If the Commission were to recommend and the Board of Governors were to accept and implement the rates proposed by the Postal Service in this docket prior to October 2006, then I would agree that the rate relationships existing at the end of FY 2006 would be based on the across-the-board rate proposal discussed in my testimony and that of witness Taufique (USPS-T-28). As I discuss in my testimony, this approach to rate design differs from the approach that typically underlies Postal Service rate proposals.
- c. See my response to part b. I would also agree that the reason underlying the across-the-board rate change was because of the existence of the escrow requirement. This requirement is a unique financial circumstance.

I would not agree that the Commission’s application of the 3622(b) factors and its recommendation in any docket – including the present docket -- has been or will be “encumbered” by the Postal Service’s proposals in that docket.

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- d. The Governors of the Postal Service make all decisions as to whether the Postal Service will request a change in rates or fees. If my opinion is solicited by the Governors, at the end of FY 2006, I will assess the facts in front of me at that time and offer my advice. However that is a matter beyond the scope of my testimony.
- e. See response to d.
- f. My testimony concerns a request for rates and fees to be implemented in FY 2006. Speculation about events beyond that period are beyond the scope of my testimony.
- g. See response to part f.
- h. See response to part f.

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VP/USPS-T27-5.

In regard to the cost coverage of ECR mail, please refer to the following statements by Postal Service witnesses. In Docket No. MC95-1, under the heading of "Efficient Mail Pays Disproportionate Contribution," witness McBride said:

Exactly the same situation occurs in bulk regular third class, where the efficient carrier route category has a cost coverage 94 percentage points higher than the other category. [Docket No. MC95-1, USPS-T-1 at 16-17.]

And in that same docket, witness Moeller said:

The creation of the subclasses [in third-class mail] will enable the assignment of markups in a manner which may lead to more equitable rates, [and] if we were starting from a situation where the coverages for the three [third-class] subclasses were equal, **a somewhat lower coverage for Enhanced Carrier Route** relative to the combined coverage for the three new subclasses **could be supported**. [Tr. 11/4135, 4275, respectively, emphasis added.]

In support of a proposed coverage of 228 percent for ECR mail in Docket No. R97-1, witness O'Hara said:

This [percentage rate increase for ECR is somewhat below the system-wide average increase, **reflecting a desire to lower the very high cost coverage of this subclass**. [USPS-T-30 at 34, emphasis added.]

In support of a proposed coverage of 208.8 percent for ECR mail in Docket No. R2000-1, percent, witness Mayes testified:

This [percentage rate increase for ECR] is somewhat below the system-wide average increase, **reflecting a desire to lower the very high cost coverage of this subclass**. [USPS-T-32 at 38, emphasis added.]

And in Docket No. R2001-1, in support of proposed coverages for ECR/NECR mail, witness Moeller said:

The Postal Service is proposing a cost coverage of 217.8 percent over volume variable costs for the ECR/NECR subclass, which results in a 6.2 percent average rate increase for ECR, and a 6.5 percent increase for NECR. These are somewhat below the system average increase, **reflecting a desire to lower the very high cost coverage of this subclass**. [USPS-T-28 at 36, emphasis added.]

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- a. Please explain the extent to which it has been the Postal Service's intention and expectation that over time the "very high cost coverage" on ECR would and should be reduced from its estimated level of 218.1 percent at the time of Docket No. MC95-1. (Op. & Rec. Dec., App. F.)
- b. Would you agree that if the cost coverage of ECR is not reduced over some period of time following its creation, then the creation of ECR as a separate subclass will have failed to achieve "more equitable rates" and to reflect "market characteristics"? (See response of Postal Service witness Moeller, Docket No. MC95-1, Tr. 11/4135 and 4146, respectively.) If you agree, please explain whether a period that is now approaching 10 years should be long enough to see some results. If you do not agree, please state and explain all reasons for your position.
- c. Please explain whether any reduction in the "very high cost coverage" of ECR should be limited to reductions occurring in omnibus rate cases, of which there have been only three since reclassification, one of which was settled due to special circumstances. If you do not believe such reductions in cost coverage should be so limited, please explain what other ways of reducing the coverage should be considered.
- d. Please confirm that, by virtue of the across-the-board proposal in the instant docket, it is the Postal Service's position that yet another opportunity to reduce the "very high cost coverage" of ECR should be lost and that the existing situation should be perpetuated. Please explain fully any failure to confirm.
- e. If a relevant next case (meaning a case candidate for reducing the "very high cost coverage" of ECR) after the instant docket is characterized by important product redesign proposals, please explain whether it would be the Postal Service's position that that next case should not be used as well to adjust relative cost coverages, on the grounds of limiting the effects on mailers.

RESPONSE:

To clarify, the cites to witness Moeller's testimony in Docket No. MC95-1 are:

ANM/USPS-T-18-3

- c. In light of your responses to parts a and b, please explain how creation of the three subclasses will greatly improve equity.

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RESPONSE:

- c. The creation of the subclasses will enable the assignment of markups in a manner which may lead to more equitable rates.

Docket No. MC95-1, Tr. 2/4135; and,

OCA/USPS-T18-18. [As follow up to prior interrogatories]. . . . Those interrogatories asked you to indicate what cost coverage you would recommend for the three subclasses of Standard Mail assuming a systemwide cost coverage of 156.8 percent. The purpose of the interrogatories was to ascertain the relative magnitude of the difference in cost coverage for the three subclasses assuming the constraint of avoiding major rate relationship changes did not exist.

. . . you may also assume that the Standard Mail cost coverage is 150.9 percent, the same as the third-class bulk regular rate coverage in Docket No. R94-1. . . .

- a. How much below the combined coverage for the three new subclasses would you expect the Enhanced Carrier Route cost coverage to be? Would the cost coverage be approximately 10 percent, 20 percent, 30 percent, etc. below the combined cost coverage for the three new subclasses?

RESPONSE:

- a. . . . [I]f we were starting from a situation where the coverages for the three subclasses were equal, a somewhat lower coverage for Enhanced Carrier Route relative to the combined coverage for the three new subclasses could be supported. Even with the waiver of the constraint of avoiding major rate relationship changes, I have insufficient information to speculate as to how much lower of a coverage could be supported, but in the situation you describe it could be as little as 10 percent.

Docket No. MC95-1, Tr. 2/4275-6.

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- a. The Postal Service did not characterize the Commission's Docket No. MC95-1, recommended cost coverage of 218.1 percent as "very high." In that docket, witness Moeller discussed the pricing criteria with respect to the proposed Enhanced Carrier Route subclass. In his testimony witness Moeller concluded that: "The criteria which point to a relatively low cost coverage are outweighed by the desire to avoid major rate relationship changes." Docket No. MC95-1, USPS-T-18 at 8. In the Postal Service's request, the proposed Enhanced Carrier Route subclass cost coverage was 212 percent.

Postal Service proposals (and Commission recommended decisions), propose rate levels and cost coverages based on the application of the pricing criteria of the Postal Reorganization Act. This process involves a balancing of many conflicting considerations to arrive at a proposed cost coverage. Simply because a cost coverage is "high" in relative terms, does not necessarily mean that it is inappropriate, given all of the factors that must be considered. In fact, in each case that you cite, the Postal Service witness reached the conclusion that, while the ECR cost coverage could be characterized as "very high" relative to the cost coverages of other subclasses, that cost coverage was appropriate and consistent with the requirements of the Postal Reorganization Act. In these dockets, the Commission has reached similar conclusions recommending cost coverages that were not substantially dissimilar to the

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Postal Services proposals, once costing methodology differences are considered.

- b. No. The Enhanced Carrier Route subclass provides options for customers mailing geographically targeted advertising that are not available in the Standard Regular subclass. By creating a separate ECR subclass, market and demand differences were recognized not only in the rate structure, but also to a greater extent in the classification structure. While subclass level cost coverages are not fully independent due to the break-even constraint, subclass status provides opportunities for re-evaluating coverages and rates with fewer constraints than may otherwise exist if ECR has not been created as a separate subclass.
- c. For any fiscal year, the cost coverage for ECR can be computed, and this cost coverage will change depending on the mail mix and operational results for that year. One obvious, but not desirable, way to reduce the cost coverage for ECR is for the Postal Service to become less efficient in handling this mail. Another way to reduce calculated cost coverages would be to change the underlying costing methodology. However, neither of these changes in cost coverage would affect the actual rates that customers pay – and could occur even if, as has been the case since 2002, ECR rates declined in real terms (did not change in nominal terms).

Within the context of an omnibus case, the evaluation of cost coverage for ECR should and is based on the application of the pricing

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- criteria. In this case, and in prior dockets, while noting relatively high cost coverages for ECR and for other categories of mail, the Postal Service has determined that these cost coverages and the associated rates can and are supported by a reasoned application of the pricing criteria.
- d. Not confirmed. The Postal Service has proposed the across-the-board increase as the most appropriate way to incorporate the Congressionally-mandated escrow requirement into rates in a circumstance where the Postal Service would not otherwise have filed a rate request and rates would not otherwise be changed. In addition, if, as your questions seem to suggest, the rate proposal favored ECR and a smaller rate increase was proposed, then that revenue must be recovered from some other class of mail. ECR contribution will increase by approximately \$205 million dollars between the test-year-before rates and the test-year-after-rates. As compared to the rates that are proposed by the Postal Service, eliminating the incremental contribution from ECR would roughly equate to an additional increase of approximately one-cent in the First-Class Mail additional ounce rates; an additional 9 percent increase in Periodicals revenue; over a 3.7 percent increase in Standard Mail Regular after-rates contribution; or, a need to find additional contribution equal to 80 of the Parcel Post after-rates contribution.
- e. To my knowledge, this possibility has not been considered.

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VP/USPS-T27-6.

Please consider the proposed cost coverage for ECR Standard Mail.

- a. Please identify, by page and line references, the specific places in your testimony where you discuss the proposed cost coverage for ECR mail.
- b. Please clarify whether your assessment of the proposed ECR cost coverage focused on the suitability of its absolute level (in view of the section 3622(b) factors) or on the proximity to the cost coverage recommended in Docket No. R2001-1, the latter of which seems to be suggested by your discussion of markup indexes beginning on line 7 of page 23 of your testimony, USPS-T-27.
- c. USPS-LR-K-114 shows the proposed markup index for ECR to be 1.622 (under Commission costing) and the corresponding markup index of Docket No.R2001-1 to be 1.560.
 - (i) Please explain whether the increase from 1.560 to 1.622 is one of the comparisons you had in mind when you said on line 1 of page 24 of your testimony that “most of the relative relationships resulting from the prior docket are maintained.”
 - (ii) Please state whether it would be your proposal that the index level of 1.622 should become part of the “cumulative evaluation of the ratemaking criteria and the relative weightings of each” to which you refer beginning on line 11 of page 23 of your testimony.
 - (a) If you believe it should become part of the “cumulative evaluation,” please explain how it is fair to ECR mailers for all of their future rates to receive a step increase based on what you refer to in other places as a unique circumstance in this case.
 - (b) If you do not believe it should become part of the “cumulative evaluation,” please explain how its effect should be removed.
- d. Please refer to Exhibit USPS-27D in your testimony, showing a rate increase for ECR mail of 5.5 percent and for ECR Nonprofit mail of 6.0 percent, and to witness Taufique’s testimony, USPS-T-28, page 11, lines 17-18, proposing rate increases for the same categories of 5.6 percent and 5.9 percent. Please explain which of these figures is correct, or present the correct figures.
- e. In evaluating the effects of the proposed cost coverage of ECR on mailers, please explain the consideration you gave to the apparent fact that, under

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- your proposal, Nonprofit ECR mailers are to receive a larger increase than commercial ECR mailers.
- f. Suppose Public Law 106-384 were interpreted to require that Nonprofit ECR mailers must receive a rate increase of 13 percent, as referred to by witness Taufique (USPS-T-28) on pages 11–12 of his testimony.
- (i) Please explain whether you would regard an increase of 13 percent for the preferred category of Nonprofit ECR to be fair and equitable and to be acceptable under the unique circumstances of this case.
 - (ii) If you would not regard the 13-percent increase to be acceptable, please explain what steps you would recommend to reduce that effect.
 - (iii) If reducing the effect on Nonprofit ECR mailers were seen to be a desirable goal, please explain why reducing the cost coverage on ECR mail would not be an acceptable way to accomplish that goal, especially in view of the fact that the cost coverage of ECR is extremely high and that the proposal is to increase its markup index, as discussed in part c of this question.

RESPONSE:

- a. My testimony discusses why I believe that the across-the-board approach used in this case results in rate levels that are consistent with the pricing criteria of the Postal Reorganization Act. While I do not discuss the application of the pricing criteria to Enhanced Carrier Route Standard Mail explicitly, I believe that the resulting cost coverage for ECR (as well as the coverages for all other subclasses and special services) are consistent with the requirements of the Postal Reorganization Act.
- b. My assessment of the proposed ECR cost coverage (as well as the cost coverages of the other subclasses and special services) focused on the absolute level of the cost coverage, the change in cost coverage from those recommended in Docket No. R2001-1, as well as the other statutory

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considerations of the Postal Reorganization Act. The use of markup indices provides one indication of changes in relative cost coverages but does not, in and of itself, necessarily indicate that a cost coverage for a specific subclass is too high or too low. The relative markup index for a subclass could, for example, change when the underlying cost coverage for that class does not change due to shifts in the application of the pricing criteria to other subclasses of mail.

c.

- (i) Yes. Generally, those subclasses of mail which had high markup indices in Docket No. R2001-1 have high markup indexes under the Postal Service's current proposal.
- (ii) The cumulative evaluation of the rate-making criteria and the relative weightings of these criteria have resulted in the rate structure that exists today. If the Postal Service's proposal in this docket were recommended by the Commission and approved by the Governors and implemented by the Board of Governors, the across-the-board treatment of the escrow requirement would be incorporated in the resulting rates.
 - (a) While the rates at any time reflect the cumulative evaluation to that point of the rate making criteria and the relative weightings of the criteria in prior Commission recommended decisions, the Commission may choose to

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change these weightings if it considers this to be appropriate. As I have previously indicated, the Commission's markup index suggests that it does reassess and respond to new circumstances as appropriate. Given the circumstances underlying this case, the Postal Service has determined that it would not otherwise change rates and fees and is doing so solely to recover the escrow requirement. My testimony provides the rationale and recommendations that the Postal Service believes are appropriate for addressing these new circumstances..

(b) See (a)

- d. The two sets of numbers reflect different methods of calculating a change in rates. I have calculated percent changes keeping volume and mail mix constant, this more accurately shows the actual changes in rates that would be paid as a result of the Postal Service's proposal. Witness Taufique informs me that the percent changes calculated in his testimony reflect changes between the test-year-before-rates and the test-year-after-rates allowing the volume and mail mix to change.
- e. In preparing my testimony I was aware that the proposed rate increase for Nonprofit ECR customers is higher than the proposed rate increase for commercial ECR customers. It is my understanding that the proposed

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- rates for both ECR and NECR were developed by applying the same 5.4% increase to each rate element. The difference in the final percentage rate increase between ECR and NECR can be explained by the need to apply the customary one-tenth of a cent rounding constraints and the need to make several minor adjustments to the preliminary rates to preserve the uniform sizes of workshare discounts and the residual shape surcharge across presort levels and Standard Mail subclasses.
- f. The provisions of section 3626 establish requirements affecting the relationship between the rates for the nonprofit and commercial Enhanced Carrier Route subclasses. These provisions were established to ensure preferential rate treatment for nonprofit subclasses as compared to their commercial counterparts. These requirements are imposed on the results of the rate design for nonprofit subclasses and their commercial counterparts.
- (i) If the statute required a 13 percent increase in NECR rates, the Postal Service would have proposed rates that met this requirement. Meeting this assumed requirement would be similar to the case of Registered Mail where the statutory requirements led to a 70 percent proposed fee increase. In this case, the Postal Service determined that the proposed 6 percent increase was fair and equitable and was consistent with the requirement that the NECR average revenue per piece be nearly as practicable equal to

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60 percent of the average revenue per piece for ECR. See USPS-T-28 at 11-12.

- (ii) See response to part (i). In evaluating the cost coverages and the rates resulting from the application of the across-the-board increase, it was determined that the current proposal met the requirements of the Act.
- (iii) It may be possible that some alternative rate design could reduce the overall cost coverage of the combined ECR and NECR subclasses, reduce ECR rates as compared to the current proposal, and result in the average revenue for NECR being exactly equal to 60 percent of the average revenue per piece for ECR. However, granting ECR preferential treatment – a lower rate increase – would effectively penalize non ECR subclasses through a higher percentage rate increase. Given the lack of association of the escrow requirement with the provision of postal services, I do not believe that it would be fair and equitable to exempt any subclass – either partially or totally – from an equal share in this Congressionally-mandated burden.

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VP/USPS-T27-7.

Please refer to the following statements from the Opinion and Recommended Decision in Docket No. MC95-1.

Quantitative and qualitative evidence in the record does support a finding that there are **market differences** between carrier route and noncarrier route Standard Mail. The Commission recommends the creation of an Enhanced Carrier Route subclass to reflect this. [p. I-7, ¶ 1017, emphasis added.]

The Commission adheres to the view that the classes should only be subdivided when a valid reason to do so exists, such as to allow better application of the statutory ratemaking criteria. [p. III-8, ¶ 3019.]

Large differences in own-price elasticities are clearly important evidence supporting separate treatment under § 3622(b)(2). [p. III-45, ¶ 3120, emphasis added.]

The Commission is satisfied that the proposed Enhanced Carrier Route subclass has **distinct demand characteristics** which indicate differences in value to senders. [p. III-46, ¶ 3121, emphasis added.]

The Commission concludes, based on this record, that the only benefit of disaggregating subclasses further would be the ability **to reflect differences in demand** or other non-cost factors of the Act in separate markups." [p. IV-115, ¶ 4253, emphasis added.]

Fourth, the **own-price elasticities and other demand characteristics** of carrier route and noncarrier route mailers are sufficiently different so that separate rates and discounts for carrier route and noncarrier route mail should improve the equity and economic efficiency of the postal rate structure. [p. V-189, ¶5460, emphasis added.]

Please refer also to the following statement from the Opinion and Recommended Decision in Docket No. R77-1:

If presorted first-class constitutes a 'class of mail' or 'type of service' for purposes of [§ 3622(b)], it follows that the rate adopted must be based on an **independent application of the § 3622(b) factors**. [Op. & Rec. Dec., Docket No. R77-1 at 241, fn. 1,7, emphasis added.]

In addition, please note that the own-price elasticity of quantity demanded of ECR is estimated by witness Thress to be -1.093 (42 percent more elastic than

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the corresponding estimate of -0.770 in Docket No. R2001-1, see USPS-T-8, p. 50). In the instant docket, see USPS-T-7, Table 1, p. 9.

- a. Please state whether, in your opinion, the current rate relationships, which the across-the-board proposal would perpetuate, adequately and acceptably recognize the "market differences" between ECR and Standard Regular mail, the "[l]arge differences in own-price elasticities" between these two subclasses, and the "distinct demand characteristics" of ECR mail, all emphasized by the Commission as items of importance in its decision to recommend the ECR subclass.
- b. If the answer to preceding part a is affirmative or in part affirmative, please explain in detail how (i) the market differences, elasticity differences, and demand differences between ECR and Standard Regular mail are recognized in the existing rates and unit contributions to institutional costs, and (ii) how these factors are recognized in the proposal in this docket for an across-the-board rate increase.
- c. Unless your answer to part a is an unqualified affirmation, please explain the time frame and the steps which should be taken to recognize adequately the market differences, elasticity differences, and demand differences between ECR and Standard Regular mail.
- d. If the answer to part a is less than an unqualified affirmation and the answer to part c is explicitly or implicitly that no steps should be taken in this case, please explain whether it is in effect the Postal Service's position that the unique circumstances of this case justify the perpetuation of relationships that do not properly recognize the market differences, elasticity differences, and demand differences between ECR and Standard Regular mail.
- e. If the Postal Service believes that some benefits from disaggregating have been realized since Docket No. MC95-1, please list separately (i) each benefit realized, and (ii) which subclass of mail has realized each benefit.

RESPONSE

a-e The across-the-board rate proposal maintains the rate relationships embodied in the current rates and these rate relationships recognize the underlying cost and demand differences between ECR and Standard Regular Mail. The Enhanced Carrier Route rates and rate design reflect

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market differences, elasticity differences and demand differences between ECR and Standard Regular by having rate structures which reflect the differences in the purposes for which these two subclasses are used. Advertising mailed using ECR rates is typically targeted customers who are more highly concentrated within specific geographic markets. Conversely, Standard Regular is typically used for advertising messages which are not as geographically targeted. This is reflected in the rate structure for ECR which offers rate options for high density and saturation advertising that are lower than those offered for Standard Mail Regular.

While the Postal Service has indicated in the past a desire to reduce the relative cost coverage for Enhanced Carrier Route over time, it does not intend to do this without fully considering the circumstances which surround each rate request. The process of adjusting ECR's relative cost coverage has been and will continue to be a gradual approach that will be influenced not only by measured costs, and cost coverages, but also rates, rate relationships and rate changes. This approach is consistent with the Postal Service's approach to rate design and rate levels for all classes of mail, not just ECR.

In this case, the Postal Service determined that projected revenues would be sufficient to meet its revenue requirement absent the escrow obligation. Consequently, the Postal Service would not have instituted a rate request if it were not for the escrow requirement. ECR rates would

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not have changed relative to either Standard Regular rates or the rates of any other subclass. Facing this situation, I believe it would be inequitable to increase, say, Standard Regular or First-Class Mail rates disproportionately solely because the escrow requirement has been imposed. Effectively, the non-ECR subclasses would bear more of the burden of the escrow requirement.

The existing rate structure embodies the balancing of the nine pricing criteria since reorganization. This balancing has included the creation of the ECR subclass following Docket No. MC95-1 and the establishment of rates to address the needs of a specific segment of Standard Mail. While some additional adjustments may become necessary, this is not the time to undertake adjustments to rate relationships or rate designs. The potential for Congressional action removing the escrow requirement must be considered. The proposed across-the-board rate increase permits the Commission to separate the escrow obligation from other issues in rate design that would not otherwise be raised by the Postal Service.

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VP/USPS-T27-8.

On page 4 of your testimony, USPS-T-27, you refer to section 3622(b) of the Postal Reorganization Act, which requires attention to, among other things, section 3622(b)(3), which is:

the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributed to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type....

On page 16 of your testimony you discuss this requirement as “specifying that each class of mail must at least bear the direct and indirect postal costs attributed to that class.” In the rest of the associated subsection of your testimony, you discuss incremental costs and the costs for Registered Mail. See subsection “C. Cost,” beginning on page 16 and ending on page 17.

- a. Please confirm that you believe a statement that each subclass must at least bear its attributable costs is essentially the same as, and captures virtually the full meaning of, a statement (in the law) that each subclass must bear the “direct and indirect postal costs attributed to that [sub]class or type plus that portion of all other costs of the Postal Service reasonably assignable to such [sub]class or type.” If you do not confirm, please explain what you see as the differences between the two statements.
- b. Please discuss whether it is basically your position that the requirement of section 3622(b)(3) can be met by setting rates in neglect of attributable costs and then checking ex post to see if those rates “at least” cover their associated attributable costs. If this is not your position, please clarify in step-by-step fashion how you believe the cost recognition of this section should be carried out.
- c. Please consider the simple restatement that section 3622(b)(3) requires that the rates for a subclass recognize the costs of the subclass and then be based on those costs.
 - (i) Is it your position that there is essentially no difference between this restatement and your statement that the rates for a subclass must “at least” cover the costs of the subclass? Please explain any answer that is not an unqualified affirmative, and how you see the two statements to be substantially different.
 - (ii) The term “cost-based” rates can be used to refer to rates which are based upon the costs of the mail in question being known and acknowledged, with a markup over such costs (in line with a

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rational, defensible decision as to what the markup should be) to arrive at the rates. Do you agree with this definition? If you do not, please explain any disagreement and provide your own definition of "cost-based" rates.

- (iii) In general, is it your position that when the Postal Service recognizes current costs in appropriate ways it can meet mailer needs more efficiently and effectively? Please explain any disagreement. Also, please explain any terms in your answer that you believe will not be appropriately understood.
- d. Please suppose the following: (1) rates are set in the instant case in an across-the-board approach in neglect of current costs, with an after-the-fact check to see if the costs are covered in a degree that seems within bounds (as you appear to do in your discussion surrounding "Table 3" on pages 22 through 24 of your testimony); (2) the rates in the rate case immediately following this case are set by looking directly at then-current costs and deciding on an appropriate markup (as the Commission normally does); (3) the next rate case also makes some product redesign changes (along the lines that currently are known to be under consideration); and (4) cost estimates change from Docket No. R2001-1 to this docket to the next docket (as the Postal Service's costs normally do, especially when there are changes in technology and other improvements in the system).
- (i) Under these conditions, do you think it likely that mailers would see no changes in relative rates in this case and large changes in relative rates in the next case, due to the need to catch up from making no changes in this case? If you do not think this is likely, please explain all reasons why it is unlikely.
 - (ii) Please confirm that in recent years there has been discussion in postal circles and various newsletters about a desire by mailers for smaller, more frequent rate changes instead of larger and less frequent rate changes. If you do not confirm, please discuss the pros and cons of those two approaches to ratesetting.
 - (iii) If greater recognition of costs occurred in this case, along lines that you refer to as "traditional" on line 16 of page 20 of your testimony, do you believe that any rate adjustments viewed as needed in the next case could be smaller? Please explain any answer not in the affirmative.

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- (iv) If large rate adjustments were found to be needed in the next case, but were tempered in recognition of the effects on mailers, do you agree that this would further prolong the time needed to reach desired rate positions, prolonging it until such time as the Postal Service makes a "determination that a rate request is necessary?" (USPS-T-27, p. 13, ll. 9-10.) Please discuss any disagreement.
- (v) Please provide your assessment of the possibility that in the rate case immediately following the instant case the Postal Service will be juggling the need for large rate adjustments to recognize then-current costs and the need for adjustments to implement product redesign changes, and that concern over the former will slow progress on the latter, leading to a less efficient Postal Service than would be possible if adjustments were made in this case to recognize current costs more fully.

RESPONSE:

- a. Criterion 3 imposes an attributable cost floor in "the requirement that each class or type of mail service bear the direct and indirect postal costs attributable to that class or type." Criterion 3 also imposes a requirement that the total revenue from the Commission's recommended rates and fees be sufficient to recover "all other costs of the Postal Service." This second requirement is met through the assignment of institutional costs among the various subclasses and special services. PRC Op. Docket No. R2000-1 at 194-5. Confirmed that the inclusion of the phrase "at least" is intended to reflect the second part of the section 3622(b)(3) criterion addressing the assignment of institutional costs to the various subclasses.
- b. No, this is not my position. For each subclass and special service, the rates recommended by the Commission must cover attributable costs.

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This is a requirement placed on the outcome of the Commission's deliberations. Section 3622 does not impose an "ordering" on consideration of the nine pricing criteria requiring that criterion 3 be considered first, last, or in any other position relative to the consideration of the other eight criteria.

The assignment of institutional costs to the subclasses of mail and special services is accomplished through the application of the eight (non-cost) criteria of section 3622(b). This process involves weighing potentially conflicting factors to reach a fair and equitable rate level proposal. This process is inherently judgmental and therefore cannot be described in a formulaic manner. The Act gives the Commission sufficient discretion to consider "public interest considerations" and to consider potential "tradeoffs designed to address these public interest issues." PRC Op., Docket No. R2001-1 at 46. The Postal Service's rate level proposal is based on witness Potter's judgment that the circumstances surrounding the escrow requirement and the need to recover the escrow through an increase in the Postal Service's revenue requirement were best met through an across-the-board increase in rates and fee. My testimony describes how this approach is consistent not only with the section 3622(b)(3) requirement that attributable costs are covered but also with the other eight pricing criteria.

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c.

- (i) No. Section 3622(b)(3) requires that the revenue resulting from each subclass be sufficient to cover the direct and indirect costs of that subclass. While there is a relationship between the requirement that revenue cover costs on a subclass basis, and the individual proposed rates, the pricing criteria – including criterion 3 – are applied at the subclass level not at the level of the individual rates.
- (ii) I would agree that the term “cost-based rates” could be used to refer to rates for any product which are based upon the costs of that product plus some markup over those costs. However, I would disagree with the implication that “cost-based rates” is a complete description of postal rates and fees developed under the pricing criteria of the Postal Reorganization Act.

Congress did not limit pricing considerations under the Postal Reorganization Act to the construction of “cost-based” rates. Individual pricing criterion, examined in isolation, could be used to argue that the Postal Reorganization requires not only “cost-based rates” (criterion 3); but, also, “value-based rates” (criterion 2), “rates based on operational requirements” (criterion 6); or “social policy-based rates” (criterion 8). While consideration of costs is important – and the Postal Service’s

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proposal in this case meets the cost coverage requirements of criterion 3 – it is not the only criterion specified in the Act. The Postal Service in its proposal and the Commission in its recommendation must balance all nine pricing criteria to meet the objective of a rate structure that not only results in rate levels that cover costs at the subclass level but also meets the other objectives set out in the Postal Reorganization Act.

- (iii) The Postal Service's goal in designing rates is to reflect the costs of providing mail services, to encourage specific customer behavior, and to offer customers alternatives that meet their needs in ways that are consistent with the pricing criteria of the Act. While efficiency in operations is a goal of the Postal Service, it is not the sole goal of rate design and may conflict with other statutory requirements. For example, the requirement that rates for Media Mail and Library Mail do not vary with distance may not be consistent with the full recognition of costs; however, it is required by the statute. Similarly, social policy considerations affecting preferred classes of mail may result in rates that are lower than those that would result from a purely efficiency-driven approach to rate design. Lastly, some rate elements such as nonmachinable surcharges are designed to compensate the Postal Service for a portion of the costs of

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handling less efficient mail. However, in some instances, the full cost differentials between machinable and nonmachinable mail have not yet been recognized due to consideration of other factors including the mitigation of the effect on customers.

d. This question assumes a hypothetical regarding not only the outcome of this case but also the Postal Service's approach to pricing and classification in a subsequent case as well as an assumed pattern of cost changes between Docket No. R2001-1 and the next case following Docket No. R2005-1. I am not able to offer testimony regarding the Postal Service's proposals in any future rate case.

- (i) I cannot predict what mailers will see when the Postal Service files its next omnibus rate request.
- (ii) Confirmed. See, for example, the transcript of the "Rate Making Summit" May 28, 2002 and June 27, 2002; available on the PRC website.
- (iii) To clarify, my testimony on page 20, lines 15-16 states:

As witness Taufique (USPS-T-28) explains, the across-the-board approach does not use the same approach to rate design that is traditionally employed.

USPS-T-27 at 20, lines 15-16.

Otherwise, I am not able to predict what the next omnibus rate request may contain or how it may be viewed.

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- (iv) It is beyond the scope of my testimony to speculate about how some rate increases in the next omnibus rate case may be viewed in relation to any preconceived "desired rate positions."
- (v) I would expect, that in any subsequent rate proposal, as has been the case in the preparation of this proposal and previous proposals, that the Postal Service will need to balance (1) the need to meet a revenue requirement; (2) rate relationship and rate design considerations; (3) cost coverage issues; (4) operational requirements; and, (5) product design and classification issues. While certainly not easy, as was done in this case (and described in my testimony), this will be accomplished through the balancing of the pricing criteria in section 3622(b) as well as other relevant statutory provisions of the Postal Reorganization Act. See also the response to (iv).

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VP/USPS-T27-9.

Please refer to your statement on page 9, beginning on line 1, of your testimony, USPS-T-27:

While some may view the decision to use an across-the-board approach as a missed opportunity to re-open long-standing debates over rate design, classifications, and costing proposals, this view would inaccurately characterize where we would be now if the escrow obligation did not exist.

- a. Is it your view that the interests of parties intervening in Commission proceedings can be fairly characterized essentially as not wanting to miss an "opportunity to re-open long-standing debates"? Please explain.
- b. Is it your view that the process of review and examination that occurs before the Commission can be fairly characterized essentially as one of debating issues, many of which are of long standing? Please explain.
- c. Do you think it likely that some of the parties intervening before the Commission are interested in examining and requesting proper recognition up-to-date costs for the subclasses they use? Please explain.
- d. Do you think it would be reasonable for parties intervening before the Commission to be concerned if an opportunity were lost to update Postal Service costs and to assess the extent to which the rates they pay are appropriately based on those costs? Please explain.
- e. Do you view an opportunity lost because a rate case is filed in an across-the board approach as essentially the same (and as of equal moment) as an opportunity lost when a case is not filed at all? Please explain.

RESPONSE:

- a. It is my view that parties intervening before the Commission do so because they are interested in providing guidance to the Commission on potential rates and classifications that would likely be beneficial to those parties' economic interests. This generally results in similar issues concerning rate design, classifications, and costing being discussed

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- before the Commission in a series of rate cases. I do not view parties' interventions to be for the sole purpose of engaging in debate.
- b. Yes. It is my view that the Commission bases its decisions in an omnibus rate case on the record which does include debate over the merits of various positions. Some of these issues have been raised and discussed over a series of omnibus rate cases.
- c. Yes, in past cases, I have testified on rate design for Priority Mail and First-Class Mail. In both those cases, some parties raised costing issues for the Commission's consideration. However, raising a costing issue does not necessarily mean that the advocated position is consistent with "proper recognition [of] . . . costs."
- d. Although the Postal Service has proposed an across-the-board rate increase, the opportunity to "update Postal Service costs" has not been lost in this case. The Postal Service has provided an array of cost studies with its rate request.
- e. Your statement does not appropriately portray the Postal Service's decision to file an across-the-board rate case. Serious consideration was given to the decision to file an across-the-board proposal, including the potential effects on not proposing a variety of rate and classification changes that may otherwise have been proposed. However, the decision to file an across-the-board rate increase hinged on two facts: (1) the Congressionally-mandated escrow obligation; and (2) the reality that, if the

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escrow obligation did not exist, the Postal Service would not have requested any changes in rates and fees. As explained in my testimony, an across-the-board approach fairly distributes the escrow burden – which is not associated with the provision of any mail product or service – without unduly burdening any one group of customers. The escrow requirement could have been funded through the increase in rates that was disproportionately focused on one or a few subclass. In this example, customers in those subclasses could reasonably have questioned the reasonableness of this allocation – they did not “cause” the escrow requirement and do not differ in that respect from customers who did not face the burden of increased rates. Distributing the escrow burden disproportionately to subclasses with low cost coverages – perhaps those where either the Postal Service or the Commission has previously indicated that it would like to increase the coverage – while possibly appealing, does not address the central concern that prior determinations about appropriate coverages are not associated with the imposition of the escrow requirement.