

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 POSTAL SERVICE WITNESS BOZZO
TO INTERROGATORIES OF VALPAK (VP/USPS-T12 -1 - 5)
(June 7, 2005)

The United States Postal Service hereby provides the responses of witness Bozzo to the following interrogatories of ValPak, filed on May 24, 2005: VP/USPS-T12-1

- 5.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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Response of United States Postal Service Witness Bozzo
To Interrogatories of Valpak Direct Marketing Systems, Inc. and
Valpak Dealers' Association, Inc.

VP/USPS-T12-1.

Please assume that a certain postal cost is a function of the volume of two identifiable types of mail, A and B. This can be expressed in mathematical terms as follows:

$$C = F(V_A, V_B, \lambda)$$

where C is the cost, V_A is the volume of mail type A, V_B is the volume of mail type B, and λ is all other factors affecting costs, such as factor prices.

- a. Would you agree that the marginal cost of A is defined by the partial derivative of C with respect to V_A ? That is,

$$\text{Marginal cost of a change in volume A} = \partial C / \partial V_A?$$

If you do not agree, please define the marginal cost of A in the above equation.

- b. Would you agree that the marginal cost of B is defined by the partial derivative of C with respect to V_B ? That is,

$$\text{Marginal cost of a change in volume B} = \partial C / \partial V_B?$$

If you do not agree, please define the marginal cost of B in the above equation.

Response.

- a.-b. Agreed. See USPS-T-12 at 18-22 (especially equation 3, p. 18), and also LR-K-1, Appendix H, for additional discussion of how the Postal Service's cost methodology equates unit volume-variable cost with marginal cost.

Response of United States Postal Service Witness Bozzo
To Interrogatories of Valpak Direct Marketing Systems, Inc. and
Valpak Dealers' Association, Inc.

VP/USPS-T12-2.

Please refer to your testimony (USPS-T-12) at page 3, Table 1. There you indicate that the volume variability for the mail processing cost of manual flats is 0.90.

- a. For the 10 percent of the mail processing cost that is not volume variable under your treatment, please explain the nature of the activities engaged in by those persons manually sorting flat-shaped mail that accounts for this non-volume variable cost. That is, please describe the characteristics that result in this variability of less than 1.00, focusing on reasons why the cost of manually sorting flats does not increase proportionately with volume. If certain activities in the Management Operating Data System ("MODS") cost pool for manual flat sortation (with associated costs) tend not to grow when volume increases, or tend to grow more slowly than volume, please identify these activities and explain why they (and their costs) do not change proportionately with volume.
- b. Please explain how economic theory would classify this non-volume variable cost in the MODS cost pool for manual flat sortation; e.g., as fixed, semi-fixed, avoidable, non-avoidable, common, joint, etc. Please use as many descriptive terms as you believe are appropriate.
- c. Would you agree that it would be appropriate to classify the non-volume variable costs in the MODS cost pool for manual flat sortation as costs that are incremental to the sorting of flats? If you do not agree, please explain fully, and if you consider these costs incremental to some function other than flats sortation, please indicate what that function is.
- d. Instead of a small change in volume, please suppose the system experienced a large increase in the volume of flats, so that, say, the volume to be sorted doubled, and additional capacity (e.g., buildings, equipment, and people) were needed to handle it. Do you agree that the unit additional cost would be larger than the unit volume variable cost you find in your analysis, and that it might well be as large as the unit volume variable cost associated with a finding of 100 percent volume variability in your analysis? If you do not agree, please explain all reasons why you do not agree.

Response.

- a. Please see the response to ABA&NAPM/USPS-T21-2.
- b. Insofar as volume-variable costs are costs causally related to mail volumes in the sense of economic marginal cost, non-volume-variable costs are those costs not causally related to mail volumes in the marginal cost sense.

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- c. If the Postal Service completely eliminated its flat sorting operations, then presumably the total costs of flat sorting operations would be avoidable.
- d. No. In economic theory, relaxing the constraint "quasi-fixed" factors (which is not necessarily a unique feature of "large" versus "small" variations in volume) would offer a firm the ability to realize lower costs than it could otherwise achieve, assuming its adjustments were cost-minimizing (or at least cost reducing).

Response of United States Postal Service Witness Bozzo
To Interrogatories of Valpak Direct Marketing Systems, Inc. and
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VP/USPS-T12-3.

Please refer to your testimony at page 3, Table 1. There you indicate that the volume variability for the mail processing cost of manual letters is 0.87.

- a. For the 13 percent of the mail processing cost that is not volume variable under your treatment, please explain the nature of the activities engaged in by those persons manually sorting letter-shaped mail that accounts for this non-volume variable cost. That is, please describe the characteristics that result in this variability of less than 1.00, focusing on reasons why the cost of manually sorting letters does not increase proportionately with volume. If certain activities in the MODS cost pool for manual letter sortation (with associated costs) tend not to grow when volume increases, or tend to grow more slowly than volume, please identify these activities and explain why they (and their costs) do not change proportionately with volume.
- b. Please explain how economic theory would classify this non-volume variable cost in the MODS cost pool for manual letter sortation; e.g., fixed, semi-fixed, avoidable, non-avoidable, common, joint, etc. Please use as many descriptive terms as you believe are appropriate.
- c. Would you agree that it would be appropriate to classify the non-volume variable costs in the MODS cost pool for manual letter sortation as costs that are incremental to the sorting of letters? If you do not agree, please explain fully, and if you consider these costs incremental to some function other than letter sortation, please indicate what that function is.
- d. Please explain what functions, activities, or other factors cause the non-volume variable cost in the MODS cost pool for manual letters to be 30 percent higher than the non-volume variable cost in the MODS cost pool for manual flats.

Response.

- a. Please see the response to ABA&NAPM/USPS-T21-2.
- b. Please see the response to VP/USPS-T12-2(b).
- c. Please see the response to VP/USPS-T12-2(c).
- d. Given the standard errors of the variabilities for manual letters and manual flats, the three percentage point difference is not statistically significant.

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To Interrogatories of Valpak Direct Marketing Systems, Inc. and
Valpak Dealers' Association, Inc.

VP/USPS-T12-4.

Please refer to your testimony at page 3, Table 1. There you indicate that the volume variability for the mail processing cost of manual parcels is 0.78.

- a. For the 22 percent of the mail processing cost that is not volume variable under your treatment, please explain the nature of the activities engaged in by those persons manually sorting parcels that accounts for this non-volume variable cost.
- b. Please explain how economic theory would classify this non-volume variable cost in the MODS cost pool for manual parcels; *e.g.*, fixed, semi-fixed, avoidable, non-avoidable, common, joint, etc. Please use as many descriptive terms as you believe are appropriate.
- c. Would you agree that it would be appropriate to classify the non-volume variable costs in the MODS cost pool for manual parcels as costs that are incremental to the sorting of parcels? If you do not agree, please explain fully, and if you consider these costs incremental to some function other than parcel sortation, please indicate what that function is.
- d. Please explain what functions, activities, or other factors cause the non-volume variable cost in the MODS cost pool for manual parcels to be 120 percent higher than the non-volume variable cost in the MODS cost pool for manual flats.

Response.

- a. Please see the response to ABA&NAPM/USPS-T21-2.
- b. Please see the response to VP/USPS-T12-2(b).
- c. Please see the response to VP/USPS-T12-2(c).
- d. Please see Docket No. R2000-1, USPS-T-16 at 43-44 and 52-53 for a discussion of the differences between the manual flats and manual parcels cost pools.

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To Interrogatories of Valpak Direct Marketing Systems, Inc. and
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VP/USPS-T12-5.

Please refer to your testimony at page 3, Table 1. There you indicate that the volume variability for the mail processing cost of manual Priority Mail is 0.76.

- a. For the 24 percent of the mail processing cost that is not volume variable under your treatment, please explain the nature of the activities engaged in by those persons manually sorting Priority Mail that accounts for this non-volume variable cost. That is, please describe the characteristics that result in this variability of less than 1.00, focusing on reasons why the cost of manually sorting Priority Mail does not increase proportionately with volume. If certain activities in the MODS cost pool for manual Priority Mail sortation (with associated costs) tend not to grow when volume increases, or tend to grow more slowly than volume, please identify these activities and explain why they (and their costs) do not change proportionately with volume.
- b. Please explain how economic theory would classify this non-volume variable cost in the MODS cost pool for manual Priority Mail; *e.g.*, fixed, semi-fixed, avoidable, non-avoidable, common, joint, etc. Please use as many descriptive terms as you believe are appropriate.
- c. Would you agree that it would be appropriate to classify the non-volume variable costs in the MODS cost pool for manual Priority Mail as costs that are incremental to the sorting of Priority Mail? If you do not agree, please explain fully, and if you consider these costs incremental to some function other than sortation of Priority Mail, please indicate what that function is.
- d. What percentage of the pieces sorted in the MODS cost pool for manual Priority Mail are flat-shaped, and what percentage are parcel-shaped?
- e. Please explain what functions, activities, or other factors cause the non-volume variable cost in the MODS cost pool for manual Priority Mail to be 140 percent higher than the non-volume variable cost in the MODS cost pool for manual flats.

Response.

- a. Please see the response to ABA&NAPM/USPS-T21-2.
- b. Insofar as volume-variable costs are costs causally related to mail volumes in the sense of economic marginal cost, non-volume-variable costs are those costs not causally related to mail volumes in the marginal cost sense.
- c. Yes. According to witness Kay's testimony, these costs are treated as product-specific costs of Priority Mail in the Postal Service's incremental

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cost model. See USPS-T-18 at 18 and the "ProdSpec" sheet of file IC3-1.xls, USPS-LR-K-72.

- d. The MODS piece handlings for the manual Priority Mail sorting operations are not recorded by shape. However, my understanding is that the Priority Mail element of the distribution key for the manual Priority Mail cost pool, by shape, is 1% letters, 28% flats, and 71% parcels. Note, this indicates the proportions of sorting time by shape.
- e. Please see the response to VP/USPS-T12-4(d). I believe a more appropriate comparison is with manual parcels, for which the 2 percentage point difference in variabilities is not statistically significant.

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.

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