

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

POSTAL RATE AND FEE CHANGES, 2005)

Docket No. R2005-1

RESPONSES OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
WITNESS ROBERT W. MITCHELL TO INTERROGATORIES OF
ADVO, INC. (ADVO/VP-T1-1-6(a), 7)
(August 5, 2005)

Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc.

("Valpak") hereby submit responses of witness Robert W. Mitchell to the following interrogatories of the Advo, Inc.: ADVO/VP-T1-1-6(a), 7, filed on July 22, 2005. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

William J. Olson
John S. Miles
Jeremiah L. Morgan
WILLIAM J. OLSON, P.C.
8180 Greensboro Drive, Suite 1070
McLean, Virginia 22102-3860
(703) 356-5070

Counsel for:
Valpak Direct Marketing Systems, Inc. and
Valpak Dealers' Association, Inc.

Response of Valpak Witness Robert W. Mitchell to Interrogatory of Advo, Inc.

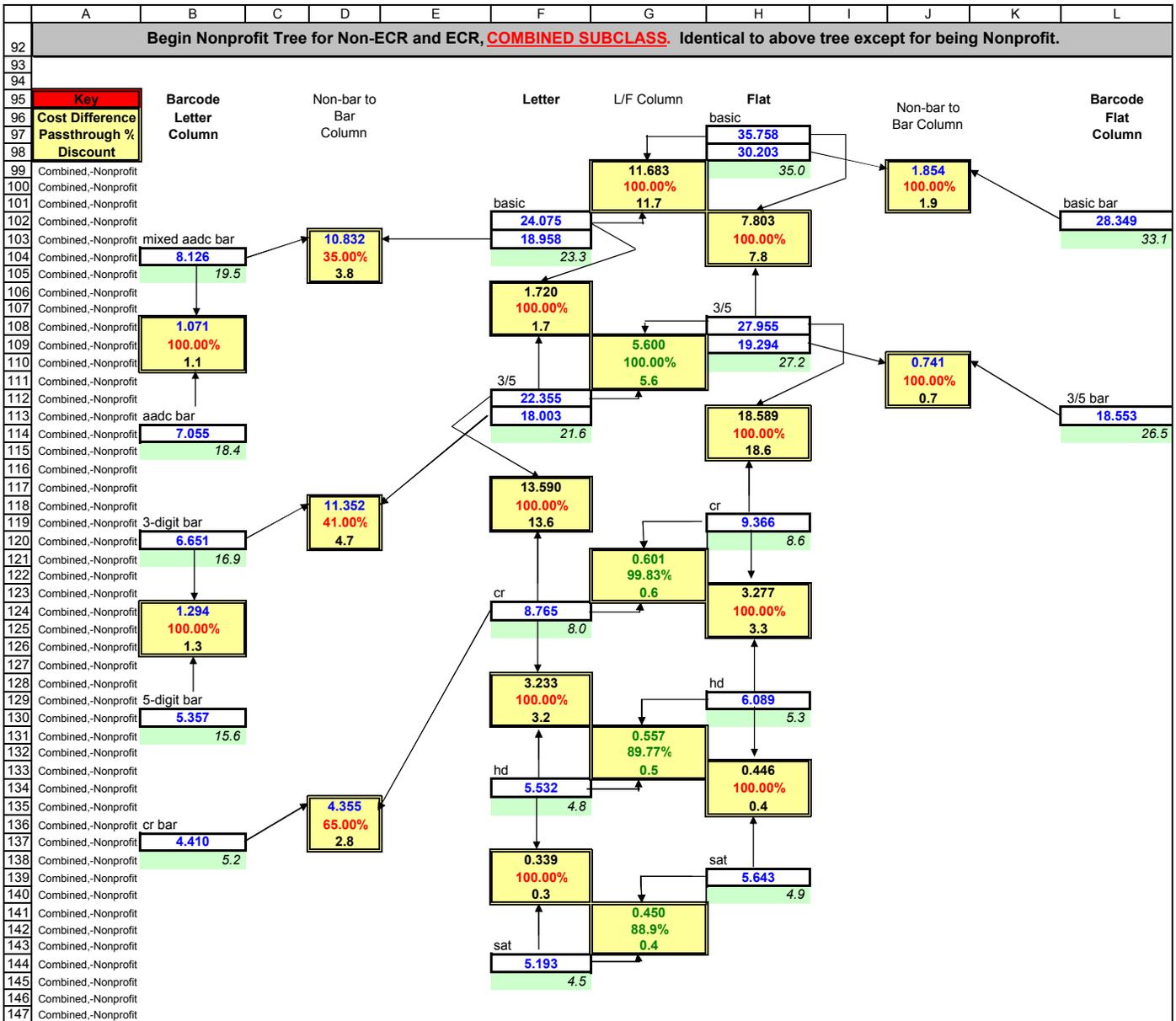
ADVO/VP-T1-1.

Please provide the workpapers used to develop the results presented in Figure 3 on page 51 of your testimony.

RESPONSE:

The workpapers are provided as an attachment to this response, and are identified as VP-T1-Workpapers.xls. Decision inputs are on the 'Inputs' sheet. Figure 3 is on the 'Schedule' sheet, beginning at line 67.

	A	B	C	D	E	F	G	H	I	J	K	L	
1	This sheet contains inputs to run the programs; fees, costs, avoidances												
2	Sheet contains all cost coverages and passthroughs, and selected rates. The breakpoint of 3.3 ounces is assumed and hard wired.												
3	All figures which must be selected by the operator are in red type.												
4													
5													
6	Contingency	not used			Regular	ECR	Combined						
7	TYBR Cost w/ Cont.				9,586,215,578	2,753,033,152	12,339,248,730				Enter fees here		
8	TYAR Cost w/ Cont.				9,516,099,654	2,671,194,778	12,187,294,432				TYAR fees @ BR volume levels		
9	Fees tybr				71,762,320	23,968,131	95,730,451			reg comm	reg np	ecr comm	ecr np
10	Fees tyar	BR vol level, profit & nonprofit combined			61,981,241	25,396,127	87,377,368			18115181	58108354.4	10594910.21	14801216.61
11	Coverage				152.79%	226.37%	169.21%			=Weighted average or select as an input.			
12	Revenue Adj Factor, Commercial				1.000237	1.000145					Same fees @ AR volume levels		
13	Revenue Adj Factor, NP				1.000146	1.000128				17953968	57797552.7	10231941.93	14715070.91
14		Average weighted by TYBR revenue			1.000226	1.000144	1.000205509	All Calculated					
15	Non-mach Ltr Surcharge, Commercial				0.042	none	0.042						
16	Non-mach Ltr Surcharge, Nonprofit				0.021	none	0.021						
17	Residual shape surcharge, Commercial				0.242	0.211							
18	Residual shape surcharge, Nonprofit				0.242	0.211							
19	Barcode discount for qualifying RSS pieces				0.030	none	0.030	No Change					
20													
21	Pound rate, Commercial				0.746	0.643							
22	Pound rate, Nonprofit				0.616	0.390							
23													
24	Nonprofit as % of For Profit				60.000%	60.000%							
25													
26													
27	Dropship Discounts	Pct. rel to R2001	\$/Lb	Passthrough	\$/lb Rounded		\$/pc @ bp	Passthrough	\$/pc Round				
28	Avoidance DBMC	12.88%	0.1332	85.00%	0.113		0.0275	85.00%	0.023				
29	Avoidance DSCF	17.35%	0.1738	84.50%	0.147		0.0358	84.40%	0.030				
30	Avoidance DDU	13.13%	0.2111	84.00%	0.177		0.0435	84.00%	0.037				
31			LR-K-112				Calculated						
32													



Sheet Calculates Rates using data from other sheets, for combined subclasse, tybr basis.							
---	--	--	--	--	--	--	--

Variables and special subtotals used			Combined				Combined	
	Regular	ECR	Regular	ECR	Reg	ECR	Reg	ECR
Total piece volume, Commercial	56,985,773,113	33,328,906,103	56,985,773,113	33,328,906,103				
Total piece volume, Nonprofit	12,355,554,381	3,147,174,541	12,355,554,381	3,147,174,541				
Pieces paying min/pc rate, Commercial	50,205,510,054	21,992,810,397	50,205,510,054	21,992,810,397				
Pieces paying min/pc rate, Nonprofit	11,721,328,922	2,860,871,713	11,721,328,922	2,860,871,713				
Pieces paying pound rate, Commercial	6,780,263,059	11,336,095,706	6,780,263,059	11,336,095,706				
Pieces paying pound rate, Nonprofit	634,225,459	286,302,828	634,225,459	286,302,828				
Pounds paying pound rate, Commercial	2,524,474,543	3,624,232,795	2,524,474,543	3,624,232,795				
Pounds paying pound rate, Nonprofit	212,394,350	87,117,656	212,394,350	87,117,656				
Leakages, Commercial			11,757,985,239	10,687,419,097				
Leakages, Nonprofit	Not Used		2,097,981,662	145,429,354				
Cost, tybr	9,586,215,578	2,753,033,152	12,339,248,730					
Coverage	152.79%	226.37%	169.21%					
Total Revenue less fees & other adj	14,581,801,390	6,205,877,499	20,778,552,407					

		Combined	
Reg	ECR	Reg	ECR

Rounded Key Rates			
--------------------------	--	--	--

Reference min/pc rate, Profit, key rate

Piece rate intercept for reference pound rate, Profit

Total revenue, Commercial

Total revenue, Nonprofit

0.437 0.437

0.283 0.304

Reference min/pc rate, Nonprofit, key rate

Piece rate intercept for reference pound rate, NP

Revenue per piece, Commercial w/o fees

Revenue per piece, Nonprofit w/o fees

0.313 0.127

0.186 0.047

Sub values for solving combined

Phi 1	0.1538625	
Phi 2	0.13261875	
Phi 3	0.12705	
Phi 4	0.0804375	
Phi 5	0.130090937	
Phi 6	0.056656667	
Phi 7	-9874727230	
Phi 8	-1967146742	
Phi 9	-8357037410	
Phi 10	-111453468.3	
k	0.20625	
Theta	0.6	
R1	0.437035929	
R1 Nonprofit Alpha	0.31300018	
R1 Nonprofit Beta	0.127441818	Rounded
Differential for Nonprofit Alpha	0.124035749	0.124
Differential for Nonprofit Beta	0.309594111	0.310
Intercepts		
Profit Alpha	0.283173429	
Profit Beta	0.304417179	
Nonprofit Alpha	0.18595018	
Nonprofit Beta	0.047004318	

	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O
3															
4	COMBINED SUBCLASS														
5															
6	Commercial					Proposed Taufique	Nonprofit					Proposed Taufique			
7															
8	Letter Size Piece Rates				Rates		Letter Size Piece Rates				Rates				
9		Basic			0.320	0.282		Basic			0.196	0.174			
10			Mix aadc Bar		0.231	0.231		Mix aadc Bar			0.158	0.152			
11			aadc Bar		0.220	0.223		aadc Bar			0.147	0.143			
12		3/5			0.303	0.261		3/5			0.179	0.161			
13			3-d Bar		0.216	0.214		3-d Bar			0.132	0.136			
14			5-d Bar		0.203	0.200		5-d Bar			0.119	0.120			
15															
16	Destination Entry Discounts, per-piece						Destination Entry Discounts, per-piece								
17			DBMC		0.023	0.022		DBMC			0.023	0.022			
18			DSCF		0.030	0.027		DSCF			0.030	0.027			
19															
20	Non-Letter Size Piece rates						Non-Letter Size Piece rates								
21		Basic			0.437	0.363		Basic			0.313	0.242			
22			Basic Bar		0.418	0.316		Basic Bar			0.294	0.199			
23		3/5			0.359	0.304		3/5			0.235	0.193			
24			3/5 Bar		0.352	0.275		3/5 Bar			0.228	0.175			
25															
26	Destination Entry Discounts, same as above						Destination Entry Discounts, same as above								
27	Begin Pound Rates						Begin Pound Rates								
28	Non-Letter Basic Pound Rate < cr				0.746	0.746	Non-Letter Basic Pound Rate < cr				0.616	0.616			
29	Per-piece add ons:						Per-piece add ons:								
30		Basic			0.283	0.209		Basic			0.186	0.116			
31			Basic Bar		0.264	0.162		Basic Bar			0.167	0.073			
32		3/5			0.205	0.150		3/5			0.108	0.066			
33			3/5 Bar		0.198	0.121		3/5 Bar			0.101	0.048			
34															
35	Destination Entry Discounts, per-pound						Destination Entry Discounts, per-pound								
36			DBMC		0.113	0.105		DBMC			0.113	0.105			
37			DSCF		0.147	0.132		DSCF			0.147	0.132			
38															
39	Begin Categories now in ECR			Hypothetical	USPS	Begin Categories now in ECR									
40	Rates in Dollars			Combined	Proposed	Rates									
41	Letter Piece Rates			Subclass	Rates	Letter Piece Rates									
42		Basic CR		0.167	0.204		Basic CR		0.121	0.133					
43		CR Bar		0.133	0.180		CR Bar		0.093	0.117					
44		High density		0.135	0.173		High density		0.089	0.108					
45		Saturation		0.132	0.160		Saturation		0.086	0.100					
46	Non-Letter piece rates					Non-Letter piece rates									
47		Basic CR		0.173	0.204		Basic CR		0.127	0.133					
48		High density		0.140	0.178		High density		0.094	0.116					
49		Saturation		0.136	0.169		Saturation		0.090	0.110					
50	Destination Entry Discounts, per piece					Destination Entry Discounts, per piece									
51			DBMC		0.023	0.022		DBMC		0.023	0.022				
52			DSCF		0.030	0.027		DSCF		0.030	0.027				
53			DDU		0.037	0.033		DDU		0.037	0.033				
54	Begin Pound Rates					Begin Pound Rates									
55	Pound Rate, cr & finer			0.643	0.643	Pound Rate, cr & finer			0.390	0.390					
56	Per-piece Add Ons					Per-piece Add Ons									
57		Basic CR		0.040	0.072		Basic CR		0.047	0.053					
58		High Density		0.007	0.045		High Density		0.014	0.036					
59		Saturation		0.003	0.036		Saturation		0.010	0.030					
60	Destination Entry Discounts, per-pound					Destination Entry Discounts, per-pound									
61			DBMC		0.113	0.105		DBMC		0.113	0.105				
62			DSCF		0.147	0.132		DSCF		0.147	0.132				
63			DDU		0.177	0.166		DDU		0.177	0.166				

Response of Valpak Witness Robert W. Mitchell to Interrogatory of Advo, Inc.

ADVO/VP-T1-2.

Please provide the workpapers used to develop the estimate on page 80 of your testimony that a reduction of 10 percentage points (of cost coverage) would give ECR mailers little if any rate increase.

RESPONSE:

No workpapers are required to reach the conclusion you cite, and I relied on none. The reasoning is straightforward. USPS-LR-K-115, file USPST28Aspreadsheets.xls, sheet '2006 BR' shows the TYBR revenue of ECR to be \$5,931,918,263, including fees. USPS-LR-K-95, folder R2005_RollFwd_Model2_ForFiling, folder R2005OutputRpt, folder PRC_R2005_Filing_Output, file R2005,FY2006BRC_DRpt.PRC.AMX.xls, sheet 'DReport' shows the cost of Standard ECR mail to be \$2,753,033,152, including a contingency of zero. This implies a cost coverage of 215.47 percent. To keep things easy, it is convenient to think in terms of a cost of \$100 and a revenue of \$215.47. With a 5.4 percent increase, this revenue becomes \$227.10 (*i.e.*, $1.054 * \$215.47$), which is a coverage of 227.10 percent. The volume effect can be neglected since in going from TYBR to TYAR the volumes and costs move together, or very nearly so. If 10 percentage points of cost coverage were removed, which means removing 10 percent of \$100, or \$10, the revenue would be \$217.10, which is a coverage of 217.10 percent. Since 217.10 percent is not far above 215.47 percent, I said little if any rate increase (p. 80, l. 13).

Part of my reasoning for the phrase "little if any rate increase" is that, in the end, the Commission will be working with actual numbers. It will therefore have to deal with rounding effects, mix effects in the volume forecast (which depend on the mix of rates selected), any extent to which the percentage change in cost in going to TYAR is not exactly equal to the

Response of Valpak Witness Robert W. Mitchell to Interrogatory of Advo, Inc.

percentage change in volume, with the fees recommended, and with whether any rate increase is to be measured by the change in average per-piece revenue or with a fixed-weight index. I was not able to deal with some of these matters. But since all of the associated effects are small, I felt comfortable with the phrase I used.

Response of Valpak Witness Robert W. Mitchell to Interrogatory of Advo, Inc.

ADVO/VP-T1-3.

Referring to the letter-flat cost differential discussed on page 81 of your testimony, please confirm that you mean the differential between ECR Basic letters and Basic flats. If not, please explain.

RESPONSE:

Confirmed. Rate differences, cost differences, and, therefore, passthroughs exist at the high density and saturation levels as well, of course, and the passthroughs at those levels might be called implicit. Calling them implicit, however, does not make them any less real. When all of the passthroughs in the presort tree are 100 percent, it makes no difference which levels are specified and which are implicit. If the letter-flat passthrough at the basic level is not 100 percent, but the passthroughs between the adjacent letter categories and between the adjacent flat categories are 100 percent, the implicit letter-flat passthroughs will be different from the passthrough at the basic level, although it is not possible to say in general whether they will be above or below it.

Response of Valpak Witness Robert W. Mitchell to Interrogatory of Advo, Inc.

ADVO/VP-T1-4.

At page 82 of your testimony in footnote 36, you refer to the Commission's Docket R90-1 decision concerning implementation of a saturation letter-flat rate differential and state:

[The Commission] also said "We . . . note that the letter discounts we are recommending are not worksharing discounts in the sense this term is used on the record; however, our recognition of shape at the saturation level introduces the possibility that some mailers may decide to convert their mailings." *Ibid.*, p. V-305, ¶ 6076. Mailers should not be restricted from choosing the products that suit them best, given appropriate rate differences.

- (a) Are you aware of any ECR saturation flat mailers that, since the Commission's decision in Docket R90-1, have converted their mailings to letter size? If so, please identify them.
- (b) Do you have any knowledge or information on the percentage of total ECR saturation flat volume (if any) that, since the Commission's R90-1 decision, has converted to letter size? If so, please provide it, including all sources.
- (c) Please confirm that the last sentence in your footnote 36, quoted above, is your statement and not the Commission's.
- (d) Is it your contention that, absent a 100 percent or greater passthrough of the ECR saturation letter-flat cost differential, saturation mailers are "restricted from choosing the products that suit them best"? If so, please identify the saturation mailers, or types of saturation mail programs, that are so "restricted" from choosing the products that suit them best, and explain how they are restricted.
- (e) Based on your knowledge of the ECR saturation mail industry, is it your belief that the choice of saturation shopper publications and shared mailers to utilize a flat-size format is influenced in any respect by the magnitude of the letter-flat cost passthrough (i.e., that a change in the passthrough might cause them to switch from a flat-size to a letter-size format)? If so, please explain the basis for your belief.
- (f) Based on your knowledge of the ECR saturation mail industry, please list the factors, in order of importance, that you believe influence the choice of ECR saturation shopper publications and shared mailers to utilize a flat-size format, rather than a letter-size format.

Response of Valpak Witness Robert W. Mitchell to Interrogatory of Advo, Inc.

RESPONSE:

(a) No.

(b) Using the workpapers presented by the Postal Service in Docket No. R90-1 and the current billing determinants, certain aggregate comparisons could be made, but it would not be possible to infer how much of the growth (or decline) in a category (such as saturation letters or saturation flats) has been due to the inherent growth (or decline) in that category and how much has been due to mailers shifting from one category to another. We do know, of course, that prior to Docket No. R90-1, the rates were the same for letters and flats, so mailers had no reason to consider postage in their decisions on shape. It also should be noted that even if the relative sizes of two categories remained the same, it would be possible that some mailers moved one way and some the other.

(c) Confirmed, since the sentence to which you refer is not enclosed in quotation marks and comes after the citation for the quote. I do not see any ambiguity. However, I would note that the formatting of your question could lead some readers to suspect that my introduction to the quotes from the Commission, the actual quotes themselves, and the “last sentence” at issue are together in my text as a single-spaced, double-indented quotation, which is not the case. Footnote 36 in its entirety is ordinary text. (Also, the question omits a colon after the word “said.”)

(d) No. I know of no restrictions on mailers’ freedom to choose, except obvious ones such as that flats must pay the rates for flats and that letters must be the size of letters. The sentence you cite might be clearer if it said that mailers, when choosing the products that suit them best, should be presented with appropriate rate differences. Alternatively, one could say

Response of Valpak Witness Robert W. Mitchell to Interrogatory of Advo, Inc.

that mailers should not be put into the position of having to, or being allowed to, select from among products that have inappropriate rate differences.

(e) It would be a strong statement to say that mailers of the kind you reference are not influenced “in any respect” by the rate alternatives they face, and I would not make such a statement, not even for rate differences in the neighborhood of the current ones. To say this would imply a cross elasticity of absolutely zero. I have learned to expect some sensitivity at the margin between such related product categories. Letter-size pieces can be as large as 6 1/8 inches high and 11 1/2 inches wide, and one way to achieve such pieces is to fold a flat. I do not view such pieces as being small or uninteresting. But the importance of setting appropriate rates for these categories depends only partially on the possibility of some mailers switching. For example, consider how it would sound for the Postal Service to make the following statement to letter mailers: “We know you believe it would be fair for your costs to be recognized in your rates and that you would like a not-unreasonable markup over those costs, but we have found that holding your rate down does not cause flats to convert to letters, so we are going to elevate your rate and use the revenue to help hold down the rate for flats, thereby giving them a smaller percentage markup than you.”

(f) Actually, my guess is that different mailers would identify different influential factors, that the descriptions of these factors would differ, and that there would be differences in their order of importance. I doubt if anyone can present such a list “in order of importance,” not even if it were agreed that the levels of any relevant variables were not to stray far from their current levels. That is, paper prices might not be influential now but might

Response of Valpak Witness Robert W. Mitchell to Interrogatory of Advo, Inc.

be very influential at twice their current level. I have no analysis (information?) available that would allow me to answer this question.

As a practical matter, I believe “shopper publications and shared mailers” pursue a product concept that they believe makes business sense, and that they have an understanding of the information (and its form) that they wish to provide, the associated production and handling costs, the postage, the markets in which they will sell their services, and, importantly, recipient response rates. This does not preclude the possibility that lower costs and a slightly lower response rate could lead to higher profits. Considering a run-of-press product would be different from considering one that accepts inserts provided by the advertiser. The preferences and interests of customers (including potential customers) are always important. Early on, providers of advertising services might have more than one product concept in mind. Once a concept is selected and found to work, they would need to have a pretty good reason to alter it.

Response of Valpak Witness Robert W. Mitchell to Interrogatory of Advo, Inc.

ADVO/VP-T1-5.

- (a) Do you have any knowledge or understanding of any differences in the typical frequency of mailing (e.g., weekly, monthly, less-than-monthly) between ECR saturation letter mailings and ECR saturation flat mailings? If so, please state your understanding and provide sources.
- (b) Are you aware of any ECR saturation letter mail programs that are mailed in a market on a regular weekly basis? If so, please identify the mailers and the markets, and quantify the volumes of such weekly-frequency saturation letter mail.
- (c) Are you aware of any ECR saturation letter mail programs that are mailed in a market on a more-frequently-than-monthly basis, i.e., more than 12 times per year? If so,
 - (i) please identify the mailers and the markets, and quantify the volumes of such saturation letter mail;
 - (ii) please state whether distribution more frequently than monthly is either commonplace, the exception, or nonexistent for saturation letter mail.
- (d) To the extent you believe there are differences in the typical frequency of mailing between ECR saturation letter mailings and saturation flat mailings, please describe the factors that you believe may account for the differences.

RESPONSE:

(a) Other than that many frequencies exist, and that mailers sometimes change their frequency, I have no basis for saying what is typical, including the proportion of users of particular rate categories that have one frequency or another. I am aware that a number of saturation flat mailings are weekly, but I receive some at my house that are less frequent. I also am aware that a number of saturation letter mailings are less frequent than weekly, but I have not studied the distribution of their frequencies.

(b) No.

(c) No.

(i) Not applicable.

Response of Valpak Witness Robert W. Mitchell to Interrogatory of Advo, Inc.

(ii) Not applicable.

(d) I would be surprised if a study did not show differences in typical frequency. It seems likely that many saturation flat mailers have a basic business model that is different from that of many saturation letter mailers. Most classifications of mail seem to have many different kinds of users. At the same time, it is not uncommon for one or two types of users to account for a large portion of the volume of a subclass or category.

Response of Valpak Witness Robert W. Mitchell to Interrogatory of Advo, Inc.

ADVO/VP-T1-6.

At page 67 of your testimony, you state that “most materials in ECR cannot be sent privately.”

- (a) Please confirm that saturation letters could be sent privately if unaddressed.
- (b) Are any of Val-Pak’s letter-size enveloped coupons distributed by private delivery, not mail? If so, please provide the following:
 - (i) the total volume of such privately-delivered pieces in 2004 and an estimate for 2005;
 - (ii) the percentage of Val-Pak’s total enveloped coupon volume that is delivered privately; and
 - (iii) identify the markets where private delivery is used, and for each market identify the private delivery company used.

RESPONSE:

(a) Confirmed. However, note that my understanding of this issue is rather general and does not rise to the level of a legal opinion.

(b) Redirected to Valpak.

Response of Valpak Witness Robert W. Mitchell to Interrogatory of Advo, Inc.

ADVO/VP-T1-7.

At pages 83-84 of your testimony, you advocate that the passthrough of the letter-flat cost differential “should be over 100 percent, but certainly at least 100 percent.” Do you believe that the passthroughs of the Automation-Basic Letters, Basic-High Density, and High Density-Saturation total cost differences (for both letters and non-letters) should also be a minimum of 100 percent? If not, explain why not.

RESPONSE:

It may be that the passthrough of the cost difference for automation-basic letters in ECR, which are viewed as workshared mail, should be well under 100 percent, because the cost difference of record goes far beyond that appropriate for any concept of worksharing. Passthroughs for the other categories referenced in your question are usually based on a review of a range of considerations. My preference for 100 percent is stated on page 87 of my testimony, lines 3 through 5.