Postal Rate Commission
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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
DIRECT MARKETING ASSOCIATION (DMA/VP-T1-1-9)
(August 9, 2005)

Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. hereby submit responses of witness Robert W. Mitchell to the following interrogatories of the Direct Marketing Association: DMA/VP-T1-1-9, filed on July 26, 2005. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

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Response of Valpak Witness Robert W. Mitchell
to Interrogatory of Direct Marketing Association

DMA/VP-T1-1.

Please refer to page 10, lines 2 - 9, of your testimony.

a) Would you agree that the Commission (with the approval of the courts) has implemented the requirements of 39 U.S.C. 3622(b)(3) (i.e., that each class or subclass of mail service bear its "direct and indirect attributable" costs) by determining causal relationships between each class or subclass and various amounts of USPS costs, including operating costs? Please explain in as much detail as possible any negative answer.

b) Would you agree, further, that, in determining these causal relationships, the Commission (with the approval of the courts) has used a form of logical analysis known as "but for causation," i.e., if certain costs would not have been incurred but for the need to provide service to a certain volume of mail (a single additional piece in the case of marginal cost analysis, or a small incremental volume in the case of incremental cost analysis) with certain characteristics, it can be concluded that these costs were caused by the provision of service to such mail (and are therefore "attributable" to such mail under section 3622(b)(3))? Please explain in as much detail as possible any negative answer.

RESPONSE:

(a) In substantial part, yes, as explained further below. I do not understand any distinction you may intend between "various amounts of USPS costs" and "operating costs." It may be that your reference in its entirety is simply to what section 3621 calls "total estimated expenses," which it explains further include "operating expenses, depreciation on capital facilities and equipment, debt service (including interest, amortization of debt discount and expense, and provision for sinking funds or other retirements of obligations to the extent that such provision exceeds applicable depreciation charges), and a reasonable provision for contingencies." These costs are discussed on pages 6 through 9 of my testimony.

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I would agree that the Commission's implementation of section 3622(b)(3) has been causal, inasmuch as it has been pursuant to principles of marginal cost, volume variability, or specific fixed costs. However, I do not agree that appropriate costs automatically flow from just any principle of causation. Using mere causation as a guide can lead to cost estimates that have really bad economic characteristics or that are meaningless. For example, one could argue that transportation costs are caused by our cities being so far apart, rather than by the volume of mail, and therefore that they should not be attributed. This would not make economic sense, but it is arguably causal. Similarly, fully distributed costing ("FDC") techniques are generally presented as being causal, yet their bad economic characteristics and harmful consequences have been explained by economists and business consultants for over 50 years, and were so recognized by the Kappel Commission. In fact, the need for improved product costing was one reason for passage of the Postal Reorganization Act of 1970.

Also, a distinction must be made between costs that are used for pricing and costs that are incremental to a subclass. Marginal costs and volume variable costs focus on the behavior of costs in response to small volume changes and thus relate directly to the resource implications of one rate alternative instead of another. On the other hand, incremental costs, which are certainly causal, are usually defined as the change in total cost when the entire volume of a subclass is withdrawn, and thus relate to the largest possible volume reduction. They are not developed to have a relation to the cost effects of rate alternatives. Accordingly, they do not relate to decisions about pricing. A fundamental reason for engaging in costing exercises is to facilitate attention to the effects of rate alternatives.

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(b) I believe the choice of terms in your question poses difficulties that could lead to confusion. As discussed in my response to part a of this question, economists often refer to the incremental cost of a subclass, defining it as the amount by which costs would decline if the entire volume of the subclass were withdrawn. This is a very large volume change — indeed, as large a volume change in the downward direction as possible. Your question describes incremental cost analysis as involving instead a small volume increment. Nothing is wrong with talking about the cost effects of small increments to volume, so long as the result is identified clearly and used appropriately.

As a practical matter, I do not see any difference between marginal cost analysis and the small-increment cost analysis you reference. In fact, an increment of non-negligible size is suggested by the economic prescription that rate alternatives should be evaluated by looking, possibly among other things, at the effects of one rate instead of another. Changing a rate by a small amount does cause a non-negligible change in volume in almost all cases.

As explained further in my response to part a of this question, I believe the Commission's cost attribution has been causal but that more guidance is needed to do good costing than principles of causation. Said in a different way, just passing some causal test is not enough. I believe it would be more accurate and more helpful to say that, predominantly, the Commission has used a form of volume variability analysis, and has found it to meet high standards of causation.

Response of Valpak Witness Robert W. Mitchell
to Interrogatory of Direct Marketing Association

DMA/VP-T1-2.

Please refer to page 10, lines 11 - 12 of your testimony, where you state, "But one cannot say that the responsibility for the deficit lies in a certain place." Please refer also to page 11, lines 8 - 11 of your testimony, where you state, "No logical basis supports a conclusion that the deficit projected for FY 2006 is caused more by the escrow payment than by any other expense component, and any relation between their sizes is purely coincidental."

a) Please confirm that, according to the Postal Service's chief policy witness, PMG John Potter, the additional revenues being sought by the Postal Service in this case would not have been needed, and this case would not have been filed, but for the escrow requirements established by Congress in P.L. 108-18?

b) Do you have any reason to question the Postal Service's identification of the moneys required to be paid by the Postal Service into the escrow as "institutional costs?" See USPS-T-10, Exhibit USPS-10H, page C-24. Please explain in as much detail as possible any affirmative answer.

c) Assuming that you answered the preceding question in the negative, would you agree that the estimated $3.1 billion (of operating costs) required by P.L. 108-18 to be paid into the escrow are not attributable to any class or subclass of mail, but rather are caused by a specific act of Congress. Please explain in as much detail as possible any negative answer.

d) Are you aware of any other omnibus rate case under the Postal Reorganization Act where the entire amount of the additional revenues being sought by the Postal Service was caused by a single factor?

e) Are you aware of any other omnibus rate case under the Postal Reorganization Act where the entire amount of the additional revenues being sought by the Postal Service was caused by an act of Congress?

RESPONSE:

(a) The Postmaster General's statements are a matter of record, and speak for themselves. My interpretation of what he said is: (i) absent the projection of a deficit for FY 2006, this case would not have been filed, and (ii) a reduction of approximately $3.1 billion in any cost component or any cost category or any group of costs, including the escrow payment

(as it just happens to be the right size), would bring about a no-deficit projection. The "but for" test to which you refer is passed equally well by all of these possible reductions. Therefore, if the test is used as an indicator of causation, the deficit must be viewed as having a very large number of causes, as many as the number of ways the costs can be assembled into $3.1-billion pools. Note that I do not interpret his statements to mean that factors other than cost reductions (such as an increase in volume that is accommodated without much cost increase) could not also have brought about, or helped to bring about, a no-deficit projection.

This case is based on a contention that the escrow requirement stands out as a kind of Congressional influence that is different from any other Congressional influence, and that therefore the financial burden of it should be borne in a way that is different from other financial burdens, even though Congress declared that the escrow requirement should be considered an operating expense of the Postal Service (as discussed on pages 6 through 8 of my testimony). But even if Congress had not so declared, it would still be clear that the normal ratesetting scheme in the Act is the appropriate way to fund the escrow and that the escrow requirement falls within a continuum of Congressional influence, both positive and negative.

(b) I agree that the escrow costs are not volume variable and should not be attributed. Institutional costs, however, are a residual. Therefore, one "identifies" the level of attributable costs, and finds the institutional costs as the difference between total estimated costs and those attributed. One does not identify and then add up costs that appear to be institutional (although that can sometimes be done). This is a critical difference. To see how the reasoning works, consider a simple firm with two cost pools and three products. The first

cost pool involves a fixed payment of $20 million and the second is an operating pool of $80 million. The total costs of the firm are $100 million. Suppose the cost elasticity of the $20-million pool is zero for all three products, much like the escrow. That is, for a 10 percent increase in the volume of Product A, a 10 percent increase in the volume of Product B, or a 10 percent increase in the volume of Product C, taken individually, one at a time, *ceteris paribus*, the percent change in the number of dollars in the $20-million pool is zero. Now suppose the cost elasticity of the $80-million pool is 0.3 for Product A, 0.5 for Product B, and 0.4 for Product C. This means that the attributable cost of Product A is $24 million (0.3 * $80 million), of Product B is $40 million (0.5 * $80 million), and of Product C is $32 million (0.4 * $80 million).[1] Total attributable cost is $96 million. Institutional cost can now be calculated as $4 million ($100 million - $96 million). It is true that if the $20-million pool were to be removed as a cost burden, institutional cost would be $20 million lower, going in this case to a level of negative $16 million, but it is not true that the $20-million expense resides as an identifiable element in the institutional cost of the firm. Furthermore, although seeking to understand why costs have the variabilities that they do is a laudable undertaking, exercises that focus on the causes of institutional costs are the stock-in-trade of advocates of fully distributed costing. Accordingly, extreme care must be taken in discussing the causes of institutional costs. You may object that the sum of a set of cost elasticities (0.3 + 0.5 + 0.4 = 1.2, in this case) would not normally be expected to exceed 1.0, at least if the firm is

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[1] Note that upon analyzing Product A and finding that $24 million of the $80-million cost pool is attributable to it, one cannot jump to a conclusion that $56 million ($80 million - $24 million) of the pool is institutional.

experiencing scale economies, and I would agree. A theory of costing, however, must be general enough to accommodate all possible outcomes, and the situation posited in this example is both possible and understandable.

(c) As indicated in my response to part b of this question, I agree that the escrow costs are an operating expense (so classified by Congress), do not vary with volume, and should not be attributed. But I take issue with the phrase "but rather are caused by." The fact that costs may be viewed as caused by something other than volume, such as Congressional concern over the funding of health care costs for retirees, or anything else, does not imply that they are unusual or that they are not volume variable. The sum of the costs caused by a set of perfectly sensible causes can easily be greater than the cost itself. As an example, consider carrier costs. We know that all carrier costs are caused by the need to deliver the mail. But one could argue as well that they are caused, at least in substantial part, by a universal service obligation ("USO") and by a decision on how many days a week to deliver and by the weather and by decisions Congress made on the guidelines for collective bargaining. The sum of the costs caused by all of these causes is probably much larger than the total of all carrier costs. In other words, costs cannot necessarily be distributed to their causes, and they can have more than one cause.

(d) Assuming but not agreeing that there is a logical basis for saying that the need for additional revenue (*i.e.*, the deficit) is caused more by one factor than another, I am not aware of any other such rate cases, possibly because I have not examined previous omnibus cases and searched for coincidences between factor sizes and projected deficits. A situation like the

present one, even though brought about in substantial part by the unusual decision to propose a contingency of zero, is probably rare. An alignment of the stars is required for an obvious cost pool to be just the right size. If the Postal Service's recent cost reduction efforts were less successful than they actually were, and the deficit projected for FY 2006 were $5 billion instead of $3 billion, the temptation to assert a link between the escrow and the deficit would be weaker.

(e) Coincidences aside, I don't view the amount of additional revenue being sought in this case as caused any more by an act of Congress than by any other expense that must be paid. All Congress did was to say that payments made in the past would be continued as before, but would now be put into a separate fund, the purpose of which will be designated at some future date. This does not qualify as an overt act that changed financial trends. But let's assume that Congress suddenly and unexpectedly said that all addresses would begin immediately to receive three deliveries per day. Assuming breakeven otherwise, if a rate case were to be filed because of this new requirement, it would be an ordinary rate case. The fact that Congress, in some sense, caused it would be irrelevant. See also my response to other parts of this question.

Response of Valpak Witness Robert W. Mitchell
to Interrogatory of Direct Marketing Association

DMA/VP-T1-3.

Please refer, further, to page 11, lines 8 - 11 of your testimony, where you state, "No logical basis supports a conclusion that the deficit projected for FY 2006 is caused more by the escrow payment than by any other expense component, and any relation between their sizes is purely coincidental."

a) Would you agree that a deficit (any deficit) is by definition the result of aggregate calculations, i.e., total expenses being larger than total revenues? Please explain in as much detail as possible any negative answer.

b) Is it your assertion that, in the context of a business with multiple sources of revenues and expenses, it is logically impossible to identify a causal relationship between a subset of these sources and an overall financial deficit (or an overall financial profit, for that matter)? Please explain in as much detail as possible any affirmative answer.

c) Would you agree that conclusions concerning the causes of, or the responsibility for, any specific deficit (or profit) depend on an analysis of the circumstances of that particular situation? Please explain in as much detail as possible any negative answer.

RESPONSE:

(a) Yes. I discuss the residual nature of deficits on pages 10 and 11 of my testimony.

(b) As a practical matter, I would not in all cases so assert, but the logic may not be as unambiguous as you suggest. That is to say, as I discuss in my response to DMA/VP-T1-2(a) and 2(c), a deficit can be said to have multiple causes, at least according to the "but for" reasoning of that interrogatory, and there may not be a way to narrow it down to one cause. The sentence beginning on page 10, line 2 of my testimony says only: "Generally, one would not expect any logical basis for assigning responsibility for a deficit."

I agree that situations exist where the man on the street would view it as logical to say that a deficit was caused by some event. For example, suppose at a time of a balanced budget

and smooth economic sailing, an earthquake destroyed the 12 bridges that were central to a city's economic functioning, and damaged some buildings as well. A deficit in the city's budget could occur. If it did, I am sure everyone would argue that it was caused by the earthquake. However, since the escrow payment is not something that occurred suddenly and unexpectedly, it is not clear that this example applies. All Congress did was say that payments made in the past would continue to be made, but would be put into a different pot, for a purpose to be designated. And even if the earthquake example were taken to apply, the question of the most appropriate way to cover the deficit would still have to be asked.

Things can be placed into better perspective by recognizing, as your question seems to, that deficits are nothing more than negative profits. It might be found that a certain event (possibly a complex development or maybe just a cost that is extraordinary) led to a decrease in profits. For example, suppose an event reduced profits by $400 million, meaning that profits are $400 million lower than they would have been otherwise. The event could have lowered profits from, say, $700 million to $300 million, or from $200 million to negative $200 million, or from negative $100 million to negative $500 million. If the event were sudden and unexpected, and if it just happened to lower profits from zero to negative $400 million, one might be tempted to argue that the event caused the $400 million deficit. But even here, the "but for" form of logic would suggest that the deficit had other causes as well.

(c) Yes, but the analysis required is fraught with difficulties and it should not be presumed that well-defined causes will be identifiable.

Response of Valpak Witness Robert W. Mitchell
to Interrogatory of Direct Marketing Association

DMA/VP-T1-4.

With further reference to your testimony at pages 10 - 11, please assume, hypothetically, that an airline has experienced only modest variations in revenues (including passenger miles) and costs for the past three years, and that this airline has had a modest profit in each of those years. Assume, further, that in the most recent year it experienced a substantial increase in fuel costs and that it also experienced a significant deficit in that year.

a) Is it your position that management of the airline would be illogical in identifying the increase in fuel costs as the "cause" of the current deficit, as opposed, e.g., to a failure to attract more passengers? Please explain fully.

b) Is it your position that management of the airline would be misleading the public if it asserted that its recent deficit was "caused" by the recent increase in fuel costs? Please explain fully.

c) Assuming that the airline has limited financial reserves and that it would take at least six months to conduct a detailed market study in order to determine the relative demand and other competitive factors affecting each of its routes, is it your opinion that management would be acting irrationally to impose an across-the-board "fuel surcharge" to all its fares in order to avoid a deficit? Please explain fully.

d) In your opinion, would it be more economically rational for management to impose surcharges in identical dollar amounts to each ticket sold, or to impose surcharges of an identical percentage on the cost of each ticket sold? Could you identify a third alternative that would be more economically rational than either of these two possible surcharges? Please explain fully.

RESPONSE:

(a) Not inherently, but note should be made that your example involves horizontal trends consistent with a modest profit, and then the occurrence of a sudden and unexpected event.

(b) No, but public relations statements are generally not as carefully scrutinized as representations which have rate consequences.

(c) Not necessarily, in part because you have ruled out alternatives. But your airline could face consequences for not being able to achieve a solution that is better aligned with its costs and the competition it faces. A critical difference between the Postal Service and the airline, however, is that when the airline does decide to move to a well-thought-out position, it can go directly there, even if it involves something as draconian as withdrawing altogether from certain unprofitable routes (an option unavailable to the Postal Service), and it does not need to consider the proximity of the new position to the surcharged-rate position you created for it. When it comes to watching out for the welfare of its customers and the effects on them, the Postal Service is held to a higher standard than are private firms.

(d) Unless I had concerns about whether some of the existing rates were out of line with important guidelines, such as current costs, I believe most notions of economic rationality would be taken to suggest the percentage approach. I have read in recent years, however, about fixed per-ticket charges to cover certain costs. These may have been to cover costs that did not vary with distance. I have not explored alternatives to the approach you suggest and do not consider myself enough a student of airline pricing for sensible alternatives to come easily to mind. One obvious one could include honoring some kind of markup index.

Response of Valpak Witness Robert W. Mitchell
to Interrogatory of Direct Marketing Association

DMA/VP-T1-5.

Please refer to page 16, lines 1 - 2 of your testimony, where you state, in reference to PMG Potter's second justification for the ATB proposal, ". . . increasing the likelihood of achieving a settlement is not one of the non-cost factors in the Act."

a) Would you agree that expediting receipt by the Postal Service of needed additional revenues is a valid goal of the Postal Service and of the Act, and that the Commission has the authority to recognize this goal as an "other factor" under section 3622(b)(9)? Please explain fully.

b) Would you agree that a streamlined request, designed to avoid as much as possible controversies concerning complex costing, classification and rate design issues, such as the Postal Service has filed in this case, is a valid means toward the end of expediting receipt by the Postal Service of needed additional revenues? Please explain fully.

RESPONSE:

(a) My review of previous cases found that the Commission has relied rarely on section 3622(b)(9). See pages 72-73 of my testimony. Nevertheless, aside from the record developed in the case at issue, its own judgment, and the other policies of the Act, I know of no limits on what other factors this section might allow the Commission to consider. However, there may be a reason why expedition is not one of the non-cost factors of the Act, at least not one expressly identified. If needing additional revenue soon trumped other considerations, there would be no ratesetting process at all. That is to say, expedition conflicts with and weakens the review contemplated by the Act. Whether expedition is a valid goal for the Postal Service must be viewed in the context of shortchanging the ratesetting process and the role of the Commission. Viewed in this way, Postal Service steps to expedite may not be a good thing. As explained on lines 6 and 7 of page 16 of my testimony: "Borrowing options are available

to allow flexibility and to smooth things out over time." In the scheme of things, I do not view the financial consequences of one rate case schedule or another to be troublesome or unmanageable.

(b) Certain observations on the question of validity were made in my response to part a above. I agree that the Postal Service has the option of handling things in such a way that the processing time needed at the Commission is likely to be shorter. Whether doing so is a good thing is another question. The nation and its mailers could be the losers if rates are based perpetually on costs that are out of date and if improvements in the efficiency of rates are not made. But whatever decisions the Postal Service makes, I have a hard time imagining Congress putting in a non-cost factor that says: "If, at the time of filing, the Postal Service indicates that it is in a hurry to begin receiving additional revenues, it is OK to jettison all rate improvements, neglect all current costs, and give reduced weight to all of the other ratesetting policies contained herein." A provision like this would not be consistent with good ratesetting by an expert commission, nor would it be fair to mailers.

Response of Valpak Witness Robert W. Mitchell
to Interrogatory of Direct Marketing Association

DMA/VP-T1-6.

Please refer to pages 17 - 18 of your testimony, where you refer to witness Robinson comparing the escrow burden to a "tax."

a) On page 18, lines 6 - 8, you allege that the Postal Service "has not presented any plan to remove the ATB increase . . . [and] it is clear without question that no such plan is feasible and that if the ATB increase is implemented, the next rate increase will be built on top of the ATB rates." Is it not the case that the Postal Service has stated that it plans to file another omnibus postal rate case (referred to hereinafter as "R2006-1") soon after the conclusion of this case and that R2006-1 will involve a complete consideration of the full panoply of postal costing, pricing and rate design issues? Please explain fully.

b) Further, you state on page 18, line 13 through page 19, line 1, that ". . . future rates built on an ATB platform would be different from future rates built on a more traditional platform." Beyond the differences in test-year-before-rates revenues (which clearly will be higher if the ATB rates are implemented in the interim), on what grounds do you believe that rates implemented following the R2006-1 case will be different depending on whether ATB rates are in place during the base year of such a case. Please explain fully.

c) Do you believe that, if the rates for Standard ECR mail implemented following this case reflect an increase of less than 5.4%, there will be a substantial chance that the rates for Standard ECR mail implemented following R2006-1 will be lower than if the rates for Standard ECR mail implemented following this case reflect an increase of 5.4%, as proposed by the Postal Service? In what ways would the arguments made by representatives of Standard ECR mail in the former situation be stronger than the arguments that they would be able to make in the latter situation? Please explain fully.

RESPONSE:

(a) Yes, it is true that the Postal Service has stated plans to file a case you refer to as R2006-1. But whether that case is actually filed, and when it is filed, may not be so certain. For example, no one expected the settlement rates of Docket No. R2001-1 to stay in effect for 3 1/2 years. Also, postal reform legislation may affect the next case.

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(b) This issue is discussed in Sections II-6 and II-7 of my testimony, beginning on pages 22 and 24, respectively. For the case you call R2006-1, in the unlikely event that neither the Commission nor the Postal Service, nor any parties presenting evidence or writing briefs, give any attention or weight to rate shock or other **effects** of the rate increases on mailers, then the rates recommended in R2006-1 would not depend on the rates recommended in the current docket. It bears noting in this regard, however, that the option to neglect the effects of rate increases on mailers is of questionable legality; section 3622(b)(4) of the Act requires attention to effects. Incidentally, FY 2006 is not likely to be the base year for R2006-1.

(c) My response to the first part of your question is yes. In regard to the second part, it is not that the arguments would be stronger *per se,* but rather that they may be less effective. As discussed in my response to part b of this question and extensively in my testimony, section 3622(b)(4) of the Act requires that the Commission consider the effects on mailers of any rate increases recommended, and my experience has been that the Commission does this. When this is done, it is quite often the case that new rate positions are reached in several steps instead of one step. I believe this case should be the first step. It has been 10 years since ECR was created as a subclass. Further delay in responding to what you call "the arguments made by representatives of Standard ECR mail" is not an attractive alternative. It is time to begin making some changes.

Response of Valpak Witness Robert W. Mitchell
to Interrogatory of Direct Marketing Association

DMA/VP-T1-7.

Please refer to your testimony at page 23, lines 2 - 6 and at page 30, lines 3 - 5.

a) Please explain what you mean by a "meritorious" rate position.

b) Is it a correct interpretation of these portions of your testimony that, unless some rate relief is granted to Standard ECR mailers in this case, it will be more difficult for the Commission in the next case to give Standard ECR mailers the rate relief they would like to have, because such rate relief would involve a shift of revenues from Standard ECR mail to other mail so substantial that it would cause "rate shock" to the mailers of other mail to such an extent that the Commission would be reluctant to recommend such a shift? Please explain fully.

c) Is this what you mean when you state, on page 30, lines 3 - 4, ". . . an ATB case . . . can result in disruptive rate patterns and excess effects on mailers in future cases."? Please explain fully.

RESPONSE:

(a) In context, the reference to a meritorious rate position means a preferred set of rates, selected by the Commission, based on the Act, the record, and its judgment, without giving any weight to non-cost factor No. 4 (that being the factor relating to the effects of rate increases on mailers).

(b) The sections of my testimony to which you refer are general and relate to patterns of rate adjustments over time. Focusing only on this case and the next one, your question is whether "rate relief" for ECR mailers can be provided more easily in two small steps (as in a relatively small increase in both this case and the next one) than in one large step (as in an average increase in this case and no increase in the next one). My answer is yes.

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(c) Yes, in part, as explained further in my response to parts a and b of this question and in the section you quote. Note that problems can occur not only between subclasses but also within subclasses.

Response of Valpak Witness Robert W. Mitchell
to Interrogatory of Direct Marketing Association

DMA/VP-T1-8.

Please refer to your testimony beginning on page 24 at line 4 and continuing to page 30, line 5.

a) Is the essence of your testimony that the Postal Service should have presented a full-blown case in this proceeding?

b) Is it your position that the Postal Service violated some applicable principle or principles of law by filing the case that it did? Please explain fully, specifically identifying each principle of law that, in your opinion, was violated by the USPS filing.

c) Is it your position that the Postal Service violated some applicable economic principle or principles by filing the case that it did? Please explain fully, specifically identifying each economic principle that, in your opinion, was violated by the USPS filing.

d) Please explain as completely as possible the ways in which the violations, if any, identified in your responses to the preceding questions should impact the Commission's consideration of this case.

RESPONSE:

(a) Of the section you cite, yes.

(b) Nothing in the section of my testimony you cite argues that any specific principle of law has been violated. However, it is my view that the case does not appropriately honor the regulatory scheme that has evolved under the Act and that I believe to be encompassed by the Act. For example, I believe it is better to use current costs than historic costs to set rates, a view the Commission has expressed in the past. *See* Docket No. R94-1, *Op. & Rec. Dec.*, p. I-5, ¶ 1017.

(c) Yes. This is explained in considerable detail in my testimony (*see especially* Sections II-2 through II-8, pp. 10-33), and a summary might not do it justice. I believe one of

the most fundamental principles of fairness is that costs should be current and should be recognized in appropriate and defensible ways. This case virtually neglects costs and proposes rates based on the costs of Docket No. R2001-1. I also believe that efficient rates are desirable and that this case, instead of improving efficiency, makes it worse. In addition, this case makes no improvements in rates or in the signals sent to mailers, and improvements are needed. And it is not just a matter of the nation having to endure a year or two of rates that are out of kilter, it is a matter as well that the effects of this case will be around for a much longer period.

(d) The Commission should recognize current costs and other current conditions, in a detailed way, and recommend rates in accordance with the policies in the Act, its rules, and its judgment, consistent with the regulatory scheme it has helped develop.

Response of Valpak Witness Robert W. Mitchell
to Interrogatory of Direct Marketing Association

DMA/VP-T1-9.

Please refer to your testimony beginning on page 35, line 21, where you state, "The ATB approach fails also as a special assessment, because no procedure exists for withdrawing it when the need has been met."

a) Would you agree that the ATB approach would qualify as a special assessment if a plan did exist for withdrawing it when the need for it has been met? Please explain fully.

b) Other than the absence of such an "exit strategy", are there any other reasons why, in your opinion, the ATB approach would not qualify as a valid special assessment? Please explain fully, describing each such reason, if any, in as much detail as possible.

RESPONSE:

(a) Basically, yes, but a special assessment still might not be the best way to cover the deficit. Aside from the concern that it might be possible during the next year or two to have a better set of rates, the problem is that I don't think there is a way to withdraw it. At the time the next omnibus rate case is filed, there appears to be no choice but for mailers to be paying the rates that come out of this case. Therefore, the effects of the rate increases of that case will be considered relative to those rates. We can't really change the fact that section 3622(b)(4) of the Act says to consider the effects of rate increases (from the current rates) on mailers.

(b) In context, I suppose it would qualify as a special assessment, but there would still be the question of whether a special assessment is the best approach, and if so, whether this one is the best special assessment that could be designed. The Act outlines a range of factors that are important to consider when additional revenue is needed and, except in a perfunctory way, the Postal Service proposal considers none of them.