

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 JOHN HALDI TO INTERROGATORIES OF  
ADVO, INC. (ADVO/VP-T2-17-26)  
(August 23, 2005)

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

("Valpak") hereby submit responses of witness John Haldi to the following interrogatories of Advo, Inc.: ADVO/VP-T2-17-26, filed on August 9, 2005. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

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**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-17.**

The 2004 billing determinants for commercial ECR saturation letter mail (LR-K-77, "Standard Mail BD2004.xls," pages G 2-2) show that 66.0 percent of saturation letters were dropped shipped to the destination SCF, 21.6 percent to the destination delivery office, and the remaining 12.4 percent at either the destination BMC or no destination entry.

- a. Please confirm that in 2004, 99 percent of Valpak's saturation coupon envelope mail was drop shipped to the destination SCF, and that only a fraction of a percent was entered at a destination delivery office. If not, please provide the correct figures.
- b. Please confirm that Valpak's destination-SCF-entered volume of approximately 500 million pieces constitutes more than one-fourth of the total 1.836 billion commercial saturation letters shown in the 2004 billing determinants as being entered at destination SCFs. If not, please provide the figures you believe to be correct and explain your basis.
- c. Please confirm that, at an average weight of 2.5 ounces per piece as indicated at page 5 of your testimony, Valpak's destination-SCF-entered volume in 2004 weighed approximately 78 million pounds. If not, please provide the average piece weight and total weight of Valpak's saturation letter volume entered at destination SCFs in 2004.
- d. Please confirm that Valpak's destination SCF letters constitute more than two-thirds of the total 114 million pounds of saturation letters shown in the 2004 billing determinants (page G 2-2) as being entered at destination SCFs. If not, please provide the figures you believe to be correct and explain your basis.
- e. Please explain your understanding of the nature of the 21.6 percent of commercial saturation letter volume that is entered at destination delivery units.

**RESPONSE:**

- a. Confirmed.
- b. Confirmed, but see response to part c, below.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

- c. Confirmed. Note, however, that aggregate data and simple averages can be deceptive. When computing and reporting total volume mailed, as in my testimony, Valpak normally does not distinguish between (i) letters that weigh less than 3.3 ounces, (ii) letters that weigh between 3.3 – 3.5 ounces, and (iv) letter-shaped pieces that weigh more than 3.5 ounces. From the perspective of the billing determinants, however, the last category, letter-shaped pieces weighing more than 3.5 ounces pay the non-letter rate and the billing determinants record these pieces as non-letters. Further, it is my impression that the second category, letters that weigh between 3.3 – 3.5 ounces, also are excluded from the volume of letters in the billing determinants (see response to VP/USPS-T2-2, alternative attachment B).

In 2004, the average weight of all of Valpak's letter mail was 2.34 ounces (which is about 6 percent less than the 2.5 ounces for all letter-shaped pieces cited in my testimony), and the total weight was 73.1 million pounds.

- d. Not confirmed. On the assumption that the total weight of 114 million pounds reported in the billing determinants is for letters that weighed less than 3.3 ounces, Valpak's letters under 3.3 ounces weighed 64.2 million pounds, which represented about 56 percent of the total weight.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

- e. Valpak enters about 1.0 percent of its mail at DDUs. By deduction, mailers other than Valpak entered almost all of the 1.376 billion ECR saturation letters (weighing under 3.3 ounces) at DDUs, and that mail weighed approximately 45 million pounds, which is an average weight of 0.5247 ounces. This average weight is between 4 and 12 percent under the average weights of commercial ECR saturation letters entered at DDUs, BMCs, or with no destination entry, which were, respectively, 0.5933 ounces, 0.5692 ounces, and 0.5442 ounces. Beyond these observations, I have no further understanding of non-Valpak ECR saturation letter mail entered at DDUs, as I have not specifically studied DDU-entered ECR saturation letter mail.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-18.**

The 2004 billing determinants for nonprofit ECR saturation letter mail (“Standard Mail BD2004.xls,” page G 4-2) show that (1) 45 percent of nonprofit letters were dropped [sic] shipped to the destination delivery office; (2) such nonprofit letters comprise one-third of all saturation DDU letters; and (3) commercial plus nonprofit DDU letters constitute 26.1 percent of total saturation letters. Please explain your understanding of the nature of the nonprofit saturation letter volume that is entered at destination delivery units.

**RESPONSE:**

I have not specifically studied ECR saturation commercial or nonprofit letter mail entered at DDUs. However, the attached table shows the volumes of commercial and nonprofit letter mail that I derived from the 2004 billing determinants, USPS-LR-K-77. It shows the following:

1. 37 percent of Nonprofit ECR saturation letters were entered at the destination delivery office;
2. Nonprofit ECR saturation letters entered at DDUs comprise only 11.7 percent of all ECR saturation letters entered at DDUs; and
3. Commercial plus Nonprofit ECR saturation letters entered at DDUs constitute 24.4 percent of total ECR saturation letters.

I have no specific knowledge concerning which nonprofit organizations send Nonprofit ECR saturation letter mail, or for what purpose, nor which of those nonprofit organizations opt to use DDU entry for their Nonprofit ECR saturation mail. It would be my expectation, however, that most Nonprofit saturation letters consist generally of solicitations. Further, such solicitations that use the saturation rate presumably would be from nonprofit organizations with

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

broad-based local appeal; *e.g.*, hospitals soliciting donations from within their catchment area.

The fact that much of such mail is generated locally would help explain why 37 percent is entered at DDUs.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

Attachment to Response to ADVO/VP-T2-18

**Standard Mail Commercial and Nonprofit  
Enhanced Carrier Route Subclass**

	<b>Commercial</b>	<b>Nonprofit</b>	<b>TOTAL</b>	<b>Dist.</b>
<b>Saturation</b>				
DDU	1,836,414,126	243,410,942	2,079,825,068	24.41%
<i>Dist (%)</i>	<i>88.30%</i>	<i>11.70%</i>	<i>100.00%</i>	
Other Entry	946,688,948	417,648,166	1,364,337,114	16.01%
Subtotal	2,783,103,075	661,059,108	3,444,162,183	40.42%
<b>High Density</b>	481,876,440	67,510,392	549,386,832	6.45%
<b>Basic</b>				
Nonauto	2,144,903,041	265,916,432	2,410,819,473	28.29%
Auto	1,914,433,081	202,104,310	2,116,537,391	24.84%
Subtotal	4,059,336,122	468,020,742	4,527,356,864	53.13%
<b>TOTAL</b>	<b>7,324,315,637</b>	<b>1,196,590,242</b>	<b>8,520,905,879</b>	<b>100.00%</b>

Percent of nonprofit saturation  
letters dropshipped to DDU = 36.82%

Source: USPS-LR-K-77, file Standard Mail BD2004.xls, pages G-2 1-2 and G-4 1-2.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-19.**

Please assume that on a given day there are no saturation mailings available for delivery on a particular city delivery route. Also, assume for the purpose of this question that all saturation mailings being discussed are lower cost to handle as extra bundles rather than as cased/DPS'd delivery volume. In that circumstance, please confirm that the "marginal" cost to deliver a saturation mailing on that route-day is the extra bundle cost. If you cannot confirm, explain why not.

**RESPONSE:**

Your question concerns the marginal cost of a saturation mailing which you ask me to assume does not exist. The question cannot be answered. However, if such a letter or flat saturation mailing were to materialize, and were to be handled as a third bundle, the marginal cost to deliver it is the cost of delivering it as a third bundle, by definition. Please see my responses to ADVO/VP-T2-20, 21, 22, and 24 for further discussion of issues raised by this question.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-20.**

Please assume that on a given day there is one saturation mailing available for delivery on a particular city delivery route. Also, assume for the purpose of this question that all saturation mailings being discussed are lower cost to handle as extra bundles rather than as cased/DPS'd delivery volume. If a second saturation mailing were added that could be collated with the first or carried out as a second tray, then please confirm that the marginal cost to deliver on that route-day is the extra bundle/tray cost. If you cannot confirm, explain why not.

**RESPONSE:**

On those routes or route segments where the second saturation mailing in fact is handled as an extra bundle — *i.e.*, is NOT collated — then the marginal cost would be the extra cost of handling an additional bundle/tray in-office and on the street. Note, however, whenever carriers collate the second saturation mailing with the first, the in-office unit cost of handling two saturation mailings then exceeds by many times the unit in-office cost of handling only one saturation mailing — *i.e.*, by the cost of collating all individual pieces in the two mailings — and in turn that would reflect sharply increasing marginal cost.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-21.**

Please assume that on a given day there is more than one saturation mailing available for delivery on a particular city delivery route. Also, assume for the purpose of this question that all saturation mailings being discussed are lower cost to handle as extra bundles rather than as cased/DPS'd delivery volume. If another saturation mailing were added that day, but which could be deferred for delivery as an extra bundle on the next day when there are otherwise no saturation mailings available for delivery, then please confirm that the marginal cost to deliver that additional saturation mailing is the extra bundle cost. If you cannot confirm, explain why not.

**RESPONSE:**

Confirmed that under the above-stated assumptions, with which I do not take exception, deferral to the next day and extra bundle treatment would be the procedure with the lowest marginal cost, which would be the extra bundle cost. Of course, sometimes the other saturation mailing cannot be deferred to achieve desired levels of service. Also, deferring a saturation mailing to another day can result in multiple third bundles on the next day.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-22.**

On page 35, footnote 44 of your testimony, you state that scarcity rent that can be extracted from a constrained low-cost production option. Please confirm that, in a competitive market system assuming little product differentiation, that [sic] scarcity rent can increase the low-cost producer's product price no more than the price its competitors are charging for the same product. If you cannot, please explain why not.

**RESPONSE:**

The discussion in my testimony, including the footnote which you cite, was in terms of inputs, or factors of production, not products or outputs, which is the subject of this interrogatory. For the sake of clarity and insight into scarcity rent and opportunity cost, I shall address both.

First, let me address scarcity rent for a firm's products, or outputs. Many firms attempt to differentiate their products with the goal of obtaining a higher price, and in an effort to be fully responsive to your question, any such higher price will be considered here as a scarcity rent. Examples would include luxury cars such as Mercedes-Benz, patented prescription pharmaceutical products, *haute couture* fashion designers, and even select upscale restaurants with celebrity chefs. To the extent that such firms succeed at the game of product differentiation, they earn extra profits in the form of scarcity rent. We can contrast markets marked by product differentiation with varying degrees of success to the other extreme, namely, commodity markets. In a commodity market, no product has any meaningful differentiation from similar producers, and no commodity product achieves a higher price or an extra profit based on product differentiation. This can be illustrated by the oil market. Oil comes in different grades, and different grades command different prices. On any given day,

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

however, all oil of the same grade commands the same price. Of late, the demand for oil has exceeded supply, so the price of oil has gone up. This means that all oil producers are receiving extra profits, which can be thought of as a scarcity rent, but no producer receives a price (or scarcity rent) for its product that exceeds the price received by producers of the same grade of oil.

Now let us consider opportunity cost and scarcity rents as these concepts apply to inputs, or factors of production. Even in commodity markets that could be considered perfectly competitive, it is possible for one producer to have some factor of production that enables it to have a lower cost than other producers. Continuing with the example of oil, some producer may be able to pump oil at \$5 a barrel, while the cost of pumping oil to other producers of the same grade is, say, \$20 a barrel. The reason that both producers co-exist, of course, is that the capacity to pump low-cost oil is limited, and the low-cost producer cannot supply the entire market. If capacity of the low-cost producer were not limited, it would supply all the oil. However, since capacity is limited, the low-cost producer will get a scarcity rent of \$15 a barrel over the higher-cost producers, even though there is no product differentiation and both sell their oil for the same price. The fact that some oil is produced at \$5 a barrel is not — and would not be — reflected in the market price so long as the demand for oil causes the price to exceed \$20 a barrel.

The Postal Service is in a similar situation with respect to its low-cost, extra-bundle option for handling saturation mail. So long as the volume of saturation mailings is less than the extra-bundle capacity, all saturation mailings of letters, flats and parcels should be taken

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

directly to the street. When the extra-bundle capacity is exceeded, however, and it is no longer possible to take all saturation mailings directly to the street. At that point, an opportunity cost arises from using the limited capacity of the low-cost option for a subset of the available saturation mailings, and the limited capacity of the low-cost option should command a scarcity rent.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-23.**

On pages 37-38 of your testimony, you state: “Every saturation mailing is presorted by line of travel or walk sequence, and therefore qualifies for extra bundle delivery, regardless of whether the mailing consists of letters, addressed flats, flats/covers with DALs, or parcels with DALs.” On page 39, you use the term “qualified candidates for the extra-bundle option. . . .” Please explain what you mean by the terms “qualifies” and “qualified.”

**RESPONSE:**

Let me suggest an alternative way to state this proposition. For “qualifies,” as it appears in the above-quoted statement on pages 37-38, you could substitute “is a potential candidate.” For “qualified,” as it appears in the above-quoted statement on page 39, you could substitute “potential,” so that the beginning of my statement would read, “Among the potential candidates for the extra-bundle option . . . .”

The first statement which you quote defines the set of mailings that, at least potentially, could be taken directly to the street using the extra-bundle option. That is, every mailing in this set satisfies both the density and the presort requirements that enable carriers to assemble mail efficiently from extra bundles for final delivery into an addressee’s mailbox. The chief distinction between mailings that qualify — or are potential candidates — for extra bundle treatment is the density requirement. Mailings that fail to meet the minimum density requirement must, perforce, be cased.

The extra-bundle option, when utilized, is the Postal Service’s lowest cost procedure for handling mail that is a potential candidate — or qualifies — for extra-bundle treatment. Absent any understanding of constraints on the extra-bundle option, one could expect that **all** saturation mail **always** would be taken directly to the street and **never be cased (or DPS’d)**.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

The evidence does not support any such expectation in a world without capacity constraints, however, because a reasonable interpretation of the fact that the Postal Service records some casing costs for both saturation letters and flats is that some bundles (or trays) of saturation mail are cased (or collated) by carriers rather than being taken directly to the street. The fact that all saturation mailings of the four different types described **could** be taken directly to the street using the extra bundle option does not mean that all saturation mailings of the different types described **will be** taken directly to the street using the extra bundle option. For mail **not** taken directly to the street, the cost consequences of course are quite different, and that is why it is necessary to distinguish between what could occur, based on the potential qualification, and what does occur as a result of real world capacity constraints.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-24.**

On Table 4 of your testimony you calculate a [sic] marginal city carrier direct costs for saturation letters and flats.

- (a) Please confirm that your estimated “marginal” costs for letters and flats are the costs for mail that is manually cased by the carrier and taken out as cased mail. If you cannot, please explain why not.
  
- (b) Since these are the costs for manually cased mail, does that mean you believe that, during BY2004, if an additional (i.e., “marginal”) saturation letter or flat mailing had been added to any city route on any delivery day of the year, the carrier would have been required to case the mailing due to lack of capacity to handle another bundle or tray on any portion of the route either on that day or by deferral to the next day? Please explain.

**RESPONSE:**

- a. Confirmed.
  
- b. No. Any one of several possible outcomes could occur. First, since the Postal Service incurred casing costs for both saturation letters and flats in Base Year 2004, one distinct possibility is that the Postal Service indeed might find it necessary to incur the additional cost necessary to case an additional saturation letter or flat mailing such as that stipulated in your question, which I will refer to here as Mailing X. A second possibility is that Mailing X can and would be taken directly to the street, **but only if** Mailing X is given priority over some other saturation mailing — Y, say — that then must be cased (or DPS'd if Mailing Y consists of saturation letters), in which event the Postal Service would find it necessary to incur an additional cost to case (or DPS) Mailing Y

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

on account of Mailing X. Yet a third possibility is that Mailing X might be collated with some other Mailing Y, if the additional cost of collation is less expensive than the additional cost of casing either Mailing X or Y and taking the other mailing directly to the street. A fourth possibility is, as you suggest, that, on some city routes on some delivery days, Mailing X might be taken directly to the street as an extra bundle, either on the day it arrives at the DDU or after being deferred, without either bumping any other mailing or being collated with any other mailing. In this last case, delivery of the additional Mailing X on those routes and on that particular delivery day would incur a low marginal cost.

Assuming, *arguendo*, that the four above-described possibilities encompass all possible ways of handling an additional saturation Mailing X, I have no way of estimating the likelihood that any of the four possibilities described will turn out to be the way that such an additional mailing is in fact handled. Furthermore, even if such likelihoods could be estimated, multiplying the cost of each possible handling procedure by the applicable likelihood and then summing would result in a weighted average expected cost. The fact that the Postal Service consistently records some casing costs for both saturation letters and flats, and frequently does not take all available saturation mail directly to the street, suggests that the Postal Service does have an effective capacity constraint

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

on the low-cost extra bundle option, and, in consequence thereof, it is faced with an increasing marginal cost. A weighted average cost such as that just described should not be construed as any sort of marginal cost that I would advocate using when establishing rates for the different categories of saturation mail, and neither the possibility nor the likelihood of handling an additional saturation mailing in the manner described is a pertinent consideration.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-25.**

Please refer to your response to ADVO/VP-T2-1, part (c), where you discuss your Attachment 2.

- a. You state that “the total combined volume of letters and DALs delivered by city and rural carriers, 6.795 billion in cell F12, reflects exactly the volume of DALs as estimated by the Postal Service in USPS-LR-K-67 – nothing more, and nothing less.” Please explain how the 3.375 billion USPS estimate of DALs (cited at page 15 of your testimony), and your 5.4 billion estimate of DALs at page 76 of your testimony, relates to the 6.795 billion DALs cited in your response.
- b. You also state that “. . . the totals in column F are not any kind of control totals derived from RPW (or any other reliable independent source). . . .” Please explain what your criteria are for a “control total” or “other reliable independent source” for determining the sum of saturation letter-shapes that are delivered on city and rural routes.

**RESPONSE:**

- a. I find your question confusing in several respects. First, my response to ADVO/VP-T2-1 does not have any attachments, and I assume that you intended to refer to ADVO/VP-T2-2. Second, the portion of the sentence which you cite refers to Attachment **1** in my response to ADVO/VP-T2-1, **not** Attachment **2**. The sentence cited begins with the (omitted) phrase “As Attachment 1 clearly shows, . . .” Third, the figure of 6.795 billion is found in cell F12 of Attachment 1 (**not** Attachment 2), and in Attachment 2 referred to in your introduction, the figure in corresponding cell F12 is 9.229 billion; the figure 6.795 billion is **not** contained anywhere in Attachment 2. Fourth, my response does **not** cite to 6.795 billion DALs, as your final sentence seem to suggest. It

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

explicitly refers to a **combined** total of 6.795 billion **letters and DALs**, and 6.795 billion is the **sum of** 3.883 billion **letters** (in cell C12) and 2.912 billion **DALs** (in cell D12).

The “3.375 billion USPS estimate of DALs” referred to in your question can be found in cell D19 of Attachment **1**, which also contains the 6.795 billion figure in cell F12. The 5.4 billion estimate of DALs at page 76 of my testimony is found in cell D19 of Attachment **2**, which neither contains nor refers to the combined figure of 6.795 billion letters and DALs. My estimate of 5.4 billion DALs and the combined figure of 6.795 billion letters and DALs appear in separate attachments and are not related.

- b. For most classes, subclasses and rate categories of mail, a close, essentially one-to-one, correspondence exists between (i) the number of pieces recorded by the RPW System when the mail is entered, (ii) the number of pieces processed, and (iii) the number of pieces subsequently delivered to addressees. In other words, after the RPW System records a piece of bulk mail as having been entered, that piece typically receives (i) more or less processing (depending on the degree of presortation), (ii) more or less transportation (depending on the point of entry), and (iii) delivery to the addressee, via one of the customary delivery modes (*i.e.*, by a city, rural or highway contract carrier, or to a P.O. Box). This close

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

correspondence with respect to pieces recorded on entry, pieces processed and pieces delivered is so basic that sometimes it may be taken for granted.

And when the above-discussed close correspondence obtains, as it does most of the time, an estimate of the number of pieces delivered by each mode can be checked against the number of pieces recorded by the RPW as having been entered. Similarly, an estimate of pieces processed in different ways also can be checked against the number of pieces recorded by the RPW as having been entered. It is not uncommon to use the RPW data as a “control total,” and see slight adjustments made in other independent estimates in order to conform to the RPW data.

Unfortunately, the above-described situation, which is so common for most categories of mail, is not applicable to DALs. It is undisputed that each year the Postal Service receives billions of DALs, all of which must be (i) handled separately when cased or DPS'd, and (ii) fingered separately when delivered with the accompanying cover, yet the Postal Service's RPW System has absolutely no record of how many DALs are entered. And, although the Postal Service maintains various records on the number of pieces of mail processed in various ways, it is equally unfortunate that the Postal Service has no records or data concerning the number of DALs that are cased, DPS'd, or taken directly to

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

the street. Moreover, even if the Postal Service did have some crude estimates of the volume of DALs processed in each possible manner, those estimates clearly could not be checked against, or compared with, a non-existent RPW total. Finally, the estimated volume of DALs delivered by each of the various possible modes is dealt with in my two attachments that accompanied my response to ADVO/VP-T2-2.

Attachment 1 shows the Postal Service's estimate of the volume of DALs delivered by each mode, Attachment 2 shows my estimate of the volume of DALs delivered by each mode, and Attachment 3, which is being submitted as errata to my response to ADVO/VP-T2-2, shows my revised estimate of the volume of DALs and letters delivered by each mode. In Attachment 1, the entries in cells F9 and F10 presumably are derived, respectively, from the few weeks of sample data in the CCS and RCS that have been expanded (or "blown up") to an annual basis. Responses to VP/ADVO-1-3 make it abundantly clear that (i) the USPS figures in cells F9 and F10 of Attachment 1 are not correct, and (ii) an independent check, or control total, on such estimates is very much needed. As RPW data on the volume of DALs is non-existent, however, the RPW cannot serve as an independent check, or control total, on the estimated volume delivered by each mode. To sum up, in order for the Postal Service to meet my criteria for a "control total" or "other reliable independent source" for

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

determining the sum of saturation letter-shaped pieces (*i.e.*, letters and DALs) that are delivered on city and rural routes, it needs to have a reliable estimate of the number of DALs that are entered. I have urged the Postal Service to modify the forms used for entering bulk mail so as to record whether the volume entered is accompanied by DALs, but as of yet this advice has not been taken.

**Response of Valpak Witness John Haldi  
to Interrogatory of Advo, Inc.**

**ADVO/VP-T2-26.**

Please refer to your discussion at pages 75-76 and Table A-8 of your testimony.

- a. Your Table A-8 shows separate entries and volumes for “Mail South” and “Others, allied with Advo.” Is it your belief that MailSouth is not a part of the A.N.N.E. network of regional shared mail companies discussed at page 74 of your testimony, whose volumes you estimated under the caption “Others, allied with Advo.”
- b. If MailSouth is and has been, in fact, a part of the A.N.N.E. network, please confirm that your inclusion of a separate estimate of MailSouth’s volumes in your Table A-8 would double-count its volumes with those you estimated under “Others, allied with Advo.” If you cannot confirm, explain why not.

**RESPONSE:**

- a. The MailSouth press release that I received said nothing about MailSouth being a participant in Advo’s A.N.N.E network. To the best of my knowledge, Advo’s Form 10-K does not list the other independent firms that are part of Advo’s A.N.N.E. network. Consequently, based on this, I opted to treat MailSouth as an independent that is not part of “Others, allied with Advo.”
- b. Confirmed, if MailSouth in fact is and has been a part of the A.N.N.E. network.