

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

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS KIEFER
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.,
(VP/USPS-T36-10 (a)-(d), (f)-(g), and 11)

The United States Postal Service hereby files the responses of witness Kiefer to above-listed interrogatories, filed on June 20, 2006. Interrogatory subpart 10 (e) has been redirected to witness Page.

The interrogatories are stated verbatim and are followed by the responses.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking

Nan K. McKenzie

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-3089; Fax -5402
July 5, 2006

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIEFER TO
INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T36-10.

Please refer to USPS-LR-L-36, workbooks WP-STDECR.xls and WP-STDREG.xls (hereinafter the "ECR" and the "REG" workbooks, respectively) and, unless otherwise specified, to the tab 'Revenues @ TYBR Vols.' in each workbook.

- a. Cell D7 in the ECR workbook does not appear to account for the volume of Commercial ECR Basic Automation letters, nor does cell D11 (5-digit Automation letters) in the REG workbook. A similar observation could be made for Nonprofit ECR Basic Automation letters (regarding cell D27 and cell D73, respectively). Please explain how Commercial ECR and Nonprofit ECR Basic Automation letters are accounted for on these TYBR sheets.
- b. On the ECR sheet, cells I7 through Q7 for the Commercial category and cells I27 through Q27 for the Nonprofit category appear to account for volumes for Basic letters weighing between 3.3 and 3.5 ounces per piece ("heavy letters"), even though heavy letters are required to be Automation letters. The same observation applies to the same cells on tab 'Revenues @ TYAR Vols.' Please explain the origin and the role of these volumes.
- c. Cells D58 and D59 in the ECR workbook and D137 and D138 in the REG workbook appear to account for fees on a TYBR basis. Please explain whether these fees should be TYAR fees adjusted to TYBR volume levels. If you do not believe they should, please discuss the apparent inconsistency in the sheet due to all **rates** being at proposed levels and all **fees** being at current levels.
- d. Please confirm that the positive volumes and revenues shown in cells D50 and D51 of the ECR workbook and cells D129 and D130 of the REG workbook are volume and revenue losses to ECR and Standard, respectively, attendant to existing Negotiated Service Agreements ("NSAs"). If you do not confirm, please explain what these entries represent.
- e. Corresponding to any volume and revenue losses associated with NSAs, as discussed in part d of this question, please explain where any cost adjustments are made and provide the level of such adjustments.
- f. Please outline all adjustments that have been made to (1) TYBR costs and (2) TYAR costs, including any for NSAs, as they are shown on the 'Inputs' tab of both subject workbooks.
- g. P.L. 106-384 requires that the average per-piece revenues of the Nonprofit categories be equal, as nearly as practicable, to 60 percent of the corresponding average per-piece revenues of the Commercial categories, based on TYBR volume projections.
 - (i) Please explain whether you believe this Nonprofit proportion should apply before or after fees are recognized.
 - (ii) Please provide your reasoning on how issues surrounding ECR Basic Automation letters and heavy letters, including those raised in earlier parts of this question, should be handled in calculating the Nonprofit proportion.
 - (iii) Please explain whether the revenues and volumes used in calculating the Nonprofit proportions should be before or after any adjustment for NSAs, and outline what (1) revenues and (2) volumes you used in your calculations.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIEFER TO
INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

- h. Please explain whether any fees you use in the calculation of the Nonprofit proportion should be adjusted to align with your handling of the ECR Basic Automation letters.

RESPONSE to VP/USPS-T36-10:

- a. These volumes are not accounted for on the Revenues @ TYBR Vols. Worksheets. In the workbook for Standard Mail Regular, no Automation Basic volume is assumed to have migrated in the test year before rates. In the Standard Mail ECR workbook, while there is "before rates" Automation Basic volume in ECR, there is no new proposed "rate" to apply to it, other than the Basic letter rate. Using the Basic letter rate did not seem to make sense in light of the assumption that these pieces would migrate out of ECR.
- b. Please see my response to VP/USPS-T36-3, subpart (d). As I pointed out in that response, heavy letters were kept in the ECR model for analytical simplicity since they are forecast as part of ECR nonletters volume (unlike piece-rated Automation Basic letters which are forecast separately). Although heavy letters are required to be automation compatible, they could remain in ECR and pay heavy letter rates based on Basic flat and Basic letter rates via the well-known heavy letter rate formula. An alternative assumption would be that these pieces would migrate to Standard Mail Regular, like their minimum per-piece Automation Basic counterparts.

The role of these heavy letter pieces in the ECR version of the Revenues @ TYBR Vols. and Revenues @ TYAR Vols. worksheets is to estimate revenues. If they were assumed to migrate to Standard Mail Regular, both their revenue and volume would be removed from both of the ECR revenue estimation worksheets and would appear in the Standard Mail Regular TYAR revenue estimation worksheet. Since, the ECR Basic heavy letter volumes are relatively small, amounting to only about

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIEFER TO
INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

0.01% of ECR TYBR volumes (excluding piece-rated Automation Basic commercial pieces), assuming that they migrate would not have much impact on ECR average revenues.

- c. The correct fees should be the proposed fees using TYBR volumes. Witness Berkeley (USPS-T-39) informs me that the correct fees for Standard Mail using proposed rates and TYBR volumes are as follows (in thousands): Regular, \$63,654; Nonprofit Regular, \$29,866; ECR, \$33,971, Nonprofit ECR, \$6,479. Using these fee estimates, instead of the ones I used in the Revenues @ TYBR Vols. sheet in my ECR and Regular workbooks, would not materially change the nonprofit / commercial average unit revenue ratio.
- d. Confirmed.
- e. Redirected to witness Page (USPS-T-23).
- f. All of the adjustments to costs are fully reflected in the total cost numbers shown on the Inputs tabs in my workbooks. Besides adjustments for NSAs, I understand there were cost adjustments that reflect (i) mail mix changes between the base year and the test year and, (ii) the assumed migration of piece-rated ECR Automation Basic letters to Regular.
- g. (i) The ratio should include fees in both the numerator and the denominator.
(ii) My calculations exclude the migrating Automation Basic minimum per piece volumes, but leave the Basic heavy letter volumes in ECR. The reasoning was as follows:

Regular subclasses: Migrating minimum per piece ECR Automation Basic pieces and ECR Basic heavy letters were excluded from the calculation (at TYBR volumes) since they were not part of the Regular subclasses in the test year before rates.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIEFER TO
INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

ECR subclasses: Migrating minimum per piece ECR Automation Basic pieces were excluded from the calculation since there was no appropriate rate in ECR to calculate their contribution to average revenue. Assuming that they would pay the Basic letter rate was not a reasonable alternative for such a large volume of letters in light of the migration assumption. ECR Basic heavy letters were assumed to stay in ECR and pay the Basic letter rate for purposes of analytical simplicity since they were few in number. This is consistent with the way I treated them for overall revenue estimation purposes. Please also see my response to part (b) above.

- (iii) The appropriate volumes and revenues for calculating the nonprofit-commercial ratio should include NSA adjustments. The reason why the adjustments were needed is that the NSAs in question were not reflected in the base year volumes, so their impacts were not then carried forward in the volume forecasts. Had these items been in the base year volume and revenue figures, no volume, cost or revenue adjustments would have been needed: the NSA impacts would have been in the total volume, revenue and cost projections. My calculations for the nonprofit-commercial average revenue ratio contained the NSA adjusted revenues and volumes, including fees. These calculations excluded volumes and revenues from pieces that were assumed to be migrating from ECR for the reasons discussed in my response to subpart (g)(ii) of this question.
- h. Yes, they should. Please see my response to subpart (g)(ii). My calculation of the nonprofit to commercial revenue per piece ratios for both Regular and ECR excluded the piece rated Automation Basic volume that I assumed would migrate. Since there was no migrated Automation Basic in the Regular subclasses' TYBR volumes, the fees for Regular and Nonprofit Regular subclasses presented in my response to subpart (c) would need no further adjustment to be consistent with my

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIEFER TO
INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

treatment of Automation Basic volumes. On the other hand, to be fully consistent with my NECR / ECR revenue per piece ratio, the ECR and NECR fees presented in part (c) would have to be adjusted by some amount to exclude fees associated with the migrating Automation Basic letter volume. If one were to take a simple percentage reduction in the fees based on the volume of ECR and NECR assumed to migrate, the "adjusted" fees would then be very close to the fees I originally used in my worksheets (i.e., the TYBR fees). On that basis I conclude that the adjustment suggested by the question would not have a material impact on the average revenue per piece ratio shown in my ECR workbook.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIEFER TO
INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T36-11.

Please refer to USPS-LR-L-36, workbook WP-STDREG.xls, tab 'Proposed Rates,' cell F161, which contains the rate for Customized Market Mail.

- a. Please state what rule or convention you followed in selecting this rate.
- b. Please state whether this rule or convention is a change from the past.
- c. If this rule or convention is a change from the past, please state whether this change should be viewed as a classification change, and explain in detail your reasoning.

RESPONSE:

- a. The current rate was tied to the minimum rate a non-drop-shipped parcel would pay by using the RSS. In the proposed rate design, the minimum price for a parcel will rise significantly and, in my view, this rate is not a suitable reference price for CMM. For the purposes of proposing a price for CMM in this case, I chose a price that is the same as an origin-entered 5-digit presorted NFM . This procedure was followed in both the Regular and Nonprofit Regular subclasses.
- b. Yes. See my response to part (a).
- c. I am not an attorney, so I can only answer this question from the perspective of a pricing Economist. The proposed change seems to me to have aspects of both a rate change and a classification change. There is no change in the requirements or eligibility for CMM. Only the rate paid is proposed to change. On the other hand, the proposed rate change is effected through a change in the DMCS.

Whether or not this change is deemed a classification change, it meets the classification criteria, as did the original classification. CMM enhances the value as an advertising medium for Standard Mail, a classification that does not require a high degree of reliability and speed of delivery (criterion 4). CMM gives mailers the opportunity to enter advertising mail with unique and attractive shapes, thereby increasing the value of mail. This makes CMM desirable from the perspectives of both the Postal Service and mailers. My proposed change away from a price that is pegged to parcels is desirable since, as I point out in my testimony, CMM is unlike

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIEFER TO
INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

typical Standard Mail parcels in that it undergoes no upstream mail processing. On the other hand, CMM has a nonstandard shape which excludes it from processing it in the normal flats mail stream, making a price pegged to flats rates undesirable. The NFM price seemed a reasonable compromise between the two. The choice of the 5-digit rate as the reference point also desirably reflects the presorted nature of CMM (see criteria 2 and 5). The proposed change in reference pricing recognizes that CMM is not handled through the mail stream like parcels, while also recognizing the workshared nature of CMM. On the whole the proposed change is fair and equitable (criterion 1).

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

Nan K. McKenzie

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
July 5, 2006