

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

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE TO
VALPAK DIRECT MARKETING ASSOCIATION, INC. AND VALPAK DEALERS'
ASSOCIATION, INC. WITNESS MITCHELL
(USPS/VP-T1-16-27)

Pursuant to Rules 25 and 26 of the Commission's Rules of Practice and Procedure, the United States Postal Service directs the above-referenced interrogatories to Valpak Direct Marketing Association, Inc. and Valpak Dealer's Association, Inc. witness Mitchell.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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USPS/VP-T1-16 Please refer to the following portions of your testimony:

Page 59, lines 5-8:

[A]s the cost coverage for a product increases, so that its rate becomes far above the cost, the likelihood increases that a stand-alone operation could carry that product at a lower rate and make a profit. I contend that for saturation mail, we are at or above that point now.

Page 88, lines 4-6:

ECR rates are already above stand-alone costs.

Page 89, lines 4-6

Rates for ECR, particularly those of the saturation categories, are above stand-alone costs now. . .

- a. Please explain fully your understanding of the term “stand-alone costs.” In your explanation, please identify all types of costs (e.g., institutional or “overhead” costs, volume variable costs, etc.) that should be estimated in establishing stand-alone costs for a subclass or type of mail, such as ECR.
- b. Please provide your estimate of the stand-alone per piece costs for ECR. Please include in your analysis a breakout of cost components (e.g. in-office costs, delivery costs, transportation costs, etc.) and the source of your costs. In developing your estimate, please assume the current level of service (e.g. 6 day a week delivery to every address).
- c. Please provide your estimate of the stand-alone per piece costs for Saturation mail. Please include in your analysis a breakout of cost components (e.g. in-office costs, delivery costs, transportation costs, etc.) and the source of your costs. In developing your estimate, please

assume the current level of service (e.g. 6 day a week delivery to every address).

USPS/VP-T1-17. Please refer to page 77 of your testimony where you state “I do not see any notions of intrinsic value of service are relevant to determining cost coverages for Reg. ECR or any other subclass.” Is it your contention that the Commission should ignore intrinsic value of service when determining rates? Please explain your answer fully.

USPS/VP-T1-18. Please refer to your discussion of the need to bring markups and rates into appropriate alignment with ratesetting principles given the possibility of in the near future that a regime of price caps will be imposed by legislation. See page 4, lines 3-7; page 9, lines 16 and footnote 2; page 80, lines 21-22.

- a. Please cite all Commission statements in prior dockets of which you are aware concerning the effect of the impact of potential legislation on the evaluation and recommendation of postal rates.
- b. Please identify and discuss fully the ratesetting principles in the Postal Reorganization Act that direct the Commission to consider pending legislation when setting postage rates.

USPS/VP-T1-19. Please refer to the following sections of your testimony where you discuss Non-cost Factor Number 4, Section 3622(b)(4), which “focus[es] on . . . what is commonly referred to as rate shock.”

Page 80, lines 12-14:

“[T]he admonition to consider effects on the ‘general public’ does not apply, since users of Regular and ECR are business mailers.”

Pages 80, line 22 to page 81, line 5:

In the instant docket, . . . the attention given to this factor should be soft pedaled, or muted entirely. . . . [I]n support of the across-the-board nature of

Docket No. R2005-1, the last omnibus rate case, the settling parties that otherwise might be concerned about any effects associated with large rate adjustments knowingly waived their right to claim benefit from this factor. The Commission recognized this development in its Opinion. See Docket No. R2005-1, Op. & Rec. Dec., p. ii and ¶¶5030 and 5032.

- b. Please confirm that Section 3622(b)(4) applies to business mailers. If you do not confirm, please explain fully.
- c. In applying this factor, should the Commission consider the effect on all business mailers, whether or not they have intervened in this or the previous case? Please explain your answer fully.
- d. Please confirm that, regardless of whether any or all mailers have “waived” consideration of a specific pricing criterion, the Commission must under the statute apply all nine pricing criteria in developing the rates it recommends.

USPS/VP-T1-20. Please refer to the following section of your testimony which discusses rate shock, the pricing factor found at 39 U.S.C. §3622(b)(4):

In the instant docket, . . . the attention given to this factor should be soft pedaled, or muted entirely. . . . [I]n support of the across-the-board nature of Docket No. R2005-1, the last omnibus rate case, the settling parties that otherwise might be concerned about any effects associated with large rate adjustments knowingly waived their right to claim benefit from this factor. The Commission recognized this development in its Opinion. See Docket No. R2005-1, Op. & Rec. Dec., p. ii and ¶¶5030 and 5032.

Also, please refer to the cited sections from the Commission’s Opinion and Recommended Decision in Docket No. R2005-1.

Page ii:

After careful consideration, the Commission agrees that under these unique circumstances, small equal increases now, to be followed by a proceeding to “true-up” rates after a thorough examination of postal costs, is consistent with sound public policy. The Commission’s preference is to

develop rates that accurately reward mailers' worksharing. It is concerned that the delay in recognizing the impact of recent innovations and improvements in postal operations, coupled with the passage of time, will probably result in unusually disproportionate increases and decreases in different rates in the next case. The Postal Service and mailers seem prepared for that possibility as they too recognize that proper cost-based rates foster efficiency and promote a healthy postal system.

Page 92:

[5030] On brief, Valpak argues that adoption of the proposed rates may have an unsettling effect in the next rate case since they "would likely exacerbate future instances of rate shock." Valpak Brief at II-13. Apart from the fact that the comment is necessarily speculative, it does highlight a risk that settling parties run, one presumably considered and deemed acceptable.⁴³ The implicit message appears to be that rate shock should have less weight as a mitigating factor in the next case if it is the result of rate increases *not* adopted in this case.

. . . .

[5032] Rate shock arguments are often raised in rate proceedings. They are likely to be raised in the next proceeding as well, in which case the Commission will assess their merits based on the record developed in that proceeding. Parties should be aware that the Commission will seek to obtain economically efficient cost-based rates and appropriate allocation of institutional burdens. The discussion of rate design in the following chapter highlights several problematic areas deserving of closer examination in the next proceeding.

⁴³Participants were made fully aware of the scope of problems in this area by Presiding Officer's Information Request No. 1, issued April 22, 2005, that identified the extent to which proposed rates varied from economically efficient component prices.

- a. Please confirm that the Commission's discussion of rate shock in the Docket No. R2005-1 decision concerned the extent to which the proposed rates varied from economically efficient component prices. If you do not confirm, please explain your answer fully.
- b. In your testimony on behalf of Valpak in Docket No. R2005-1, when you advocated that the Commission should address costs and rates by class and subclass individually, rather than adopting the Postal Service's across-the-board pricing approach in that case, was it your opinion that it should have fully considered all

ratemaking criteria and policies embodied in the Postal Reorganization Act, including factor (4) in section 3622(b)? If your answer is anything but an unqualified yes, please explain fully.

- c. In your current testimony you state that, in considering the effects of rate increases on the general public and business mailers, the Commission “might decide to get to the desired rate position in two or three steps instead of one.” See page 80. In recommending, for all intents and purpose, that the Commission disregard its responsibility to consider the effects on the general public and business mailers in the current proceeding, did you consider that, had it followed your advice in Docket No. R2005-1 and found that the effects of lowering the cost coverage for ECR required getting to the preferred rate position in multiple steps, the application of factor (4) could justify continued mitigation of the effects of the change through at least one and possibly more rounds of ratemaking? Please explain on your answer.
- d. Is it your view that your rate proposals for ECR and Standard Regular Mail in the current proceeding will have no adverse, or “rate shock,” effects on mailers other than Valpak? If your answer is no, please identify the mailers and discuss the possible effects.
- e. Many of your rate proposals result in increases for Standard Regular mail that exceed 50 percent and some exceed 200 percent. If there is some level at which the effects of percentage increases of rates on other mailers would justify mitigating the increase, either in a single proceeding, or by achieving the change to the preferred rate position in multiple subsequent stages, in your opinion, what level would support that result? Please comment fully. Please include an explanation of any continuum or gradation of effects and results, if your answer is, in effect, “it depends.”

USPS/VP-T1-21 Please refer to Table USPS/VP-T1-A, below.

Please confirm that your proposed rates would produce the percentage rate increases shown in the table. If you do not confirm, please supply the correct percentage increases implied by your proposed rates.

Table USPS/VP-T1-A			
Percentage Rate Increases Proposed by Valpak for Selected Minimum-Per-Piece-Rated Nonprofit Regular Categories			
	Origin	DBMC	DSCF
Letters			
Mixed AADC Automation	1.4%	-4.0%	-5.8%
5-digit Automation	0.8%	-6.3%	-8.8%
Flats			
Mixed ADC Automation	102.6%	111.6%	113.7%
5-digit Automation	64.9%	69.8%	70.8%

USPS/VP-T1-22 Please refer to page 161 of your testimony where you discuss your Nonprofit Regular rate proposals, and to Table USPS/VP-T1-A, as amended in response to the previous question.

- a. Please confirm that the disparate rate changes between letters and flats shown in the table arise primarily from the way you treated cost

differences between various categories of mail in your rate design. If you do not confirm, please explain fully.

- b. Please explain why you believe that the disparate rate impacts shown in the table are fair.
- c. Please explain whether it is your view that the rates produced by the full reflection of cost differences are always fair.
- d. Please explain whether it is appropriate for the Commission to modify the rates that would be produced by full recognition of cost differences in the Standard Mail Nonprofit Regular rate categories in order to ensure that the resulting rates or rate changes are fair.

USPS/VP-T1-23 Please refer to Table USPS/VP-T1-B, below.

Please confirm that your proposed rates would produce the percentage rate increases shown in the table. If you do not confirm, please supply the correct percentage increases implied by your proposed rates.

Table USPS/VP-T1-B			
Percentage Rate Increases Proposed by Valpak for Selected Minimum-Per-Piece-Rated Regular Categories			
	Origin	DBMC	DSCF
Letters			
Mixed AADC Automation	7.8%	5.3%	4.4%
5-digit Automation	9.0%	6.2%	5.2%
Flats			
Mixed ADC	56.3%	58.2%	58.5%

Automation			
5-digit Automation	38.5%	39.1%	39.1%

USPS/VP-T1-24. Please refer to Table USPS/VP-T1-B, as amended in response to the previous question.

- a. Please confirm that the disparate rate changes between letters and flats shown in the table arise primarily from the way you treated cost differences between various categories of mail in your rate design. If you do not confirm, please explain fully.
- b. Please explain why you believe that the disparate rate impacts shown in the table are fair.
- c. Please explain whether it is appropriate for the Commission to modify the rates that would be produced by full recognition of cost differences in the Standard Mail Regular rate categories in order to ensure that the resulting rates or rate changes are fair.

USPS/VP-T1-25 Do you agree with witness Sidak’s statement on page 11 of his testimony (NAA-T-1) in this case that the efficient component-pricing rule “is not an appropriate concept to use in calculating shape-based rates in the same manner that would be used to determine worksharing discounts.” If you do not agree, please explain fully.

USPS/VP-T1-26 Is it your view that, once the cost coverage has been established for a subclass, rate differences within the subclass should only be based on cost differences, assuming that cost differences are available and accurately estimated?

USPS/VP-T1-27 Is it your view that it is inappropriate for the Commission to apply the non-cost factors of the Postal Reorganization Act to develop rate

differences between categories within a subclass assuming that cost differences between the categories are available and accurately estimated?