

ADVO, INC. INTERROGATORIES TO NAA WITNESS SIDAK (NAA-T-1)

ADVO/NAA-T1-1. On pages 9-10 (lines 14 ff) you state:

My understanding of postal ratemaking practice as it has evolved over the years is that the Commission has recognized that economic efficiency is served by accurate pricing signals for each identified worksharing activity (for example, presortation and dropshipping). This recognition enables the work to be done by the lowest-cost provider, whether that is the Postal service, the mailer, or a third-party service vendor to the mailer. To promote such efficiency, the Commission has applied ECP in setting discounts for worksharing such as presortation and destination entry at, ideally, 100 percent of the estimated avoided cost of the activity whose performance the Postal Service avoids. This correct application of ECP advances economic efficiency by providing accurate pricing signals to mailers and the Postal Service. (footnote omitted)

Dropship discounts have been offered in Standard Mail since R90-1 and the cost avoidances supporting those discounts have not been challenged in over ten years. Given this information and your cited comments, do you believe dropshipping discounts should reflect 100 percent of the costs avoided by the Postal Service? Please explain your response.

ADVO/NAA-T1-2. On page 10 (lines 3-6), you state: “Under ECP, accurately measured costs avoided would be passed through at a rate of 100 percent to each particular category of mail responsible for those costs avoided. In this manner, each category of mail would be charged only its incremental costs, and the USPS would achieve break-even pricing.”

- (a) Please provide your definition of incremental costs of a particular category of mail.
- (b) Please provide your definition of “category of mail.” In that definition, please explain how the term “category” relates to postal subclasses.
- (c) Please provide your understanding of how “break-even” pricing applies to development of rates within a particular subclass.

ADVO/NAA-T1-3. On page 10 (line 12-13), you use the terms “opportunity cost,” “access charge,” and “delivery charge.” Please explain how these terms apply to the development of rates for a particular mail category within a postal subclass.

ADVO/NAA-T1-4. On pages 11-12 (lines 9ff), you explain why you believe Efficient Component Pricing is generally not applicable to shape-based rates. You state (lines 22ff): “Although the choice of the shape of mail piece might be considered “optional” in some sense, it is not a choice between the mailer or the Postal Service performing a particular function in the type of scenario to which ECP is intended to apply.”

- (a) Please explain what you mean when you say “the choice of the shape of mail piece might be considered ‘optional’ in some sense....“
- (b) For a postal subclass serving a specific mail demand/market, please explain how you would develop subclass rates to signal to that market the postal costs of mailing a letter shape vs. a flat shape vs. a parcel shape.
- (c) Please explain how your approach in (b) above would ensure that mailers would be able to minimize the total (postal and mailer) mailing cost consistent with their own demand requirements.
- (d) Please explain how your approach in (b) above would ensure that regardless of the market’s selected mix of shapes, the contribution to USPS institutional cost from that market would not substantively change.

ADVO/NAA-T1-5. Please refer to the Direct Testimony of John C. Panzar (PB-T-1). On page 45, lines 9 ff:

More so than in most markets, mailers have the opportunity to “design their own service.” That is, they can choose many of the intrinsic properties of their mailing: its size (one ounce or several); its shape (letter or flat), the time of day at which it enters the mail stream, the location at which it enters the Postal Service network – any many other of their mail’s characteristics. Two aspects of this flexibility are important for rate-making purposes. First, and most importantly, differences in these characteristics may have important impacts on the costs that the mail imposes on the Postal Service. Second, while mailers may have preferences over these characteristics (e.g., a flat may better serve their purposes than a letter), the relative value of shifting from one alternative to another may be dramatically different than the difference in Postal Service costs. Just as with traditional worksharing, an effective way to induce changes in mailer behaviour is through rate differences that reflect cost differences.

The basic economic argument in support of cost-based rate differentials is the same as that for avoided cost worksharing discounts. Mailers can act to minimize end-to-end costs only if the difference in rates for mail with differing characteristics reflects differences in the costs incurred by the Postal Service . . .

- (a) Do you agree with Dr. Panzar? If not, please explain fully why not.
- (b) The current basis for rate differences among ECR Basic, High-Density and Saturation mail (by shape) are their dropship-neutralized mail processing and delivery cost *differences*. Please explain fully whether you believe these differences are strictly worksharing-related and therefore ECP applies to them.
- (c) If you do not believe the mail categories in (b) above to be strictly worksharing-related, please explain how you believe the rate differentials among basic, high-density, and saturation mail should be developed in order to ensure economic efficiency by providing accurate pricing signals to mailers and the Postal Service.

ADVO/NAA-T1-6. On pages 12 and beyond, you discuss several ways to consider and quantify the proposed DAL surcharge. On page 17 (lines 11-13, you state that DALs offer benefits to the mailer not available to high-density mailers that are ineligible to use DALs. In response to VP/USPS-2, the USPS states that for the four-month period of March-June 2006, the following were accompanied by DALs: 7.7% of ECR high-density non-letter DDU pieces, 2.2% of ECR high-density non-letter DSCF pieces, and 2.6% of ECR high density non-letter pieces. This means roughly 4.85% of all ECR high-density non-letters are accompanied by DALs.

- (a) Given that ECR high-density flats also use DALs, do you believe there should be also be a DAL surcharge for high-density flat DALs? Please explain.
- (b) If reliable DAL cost information were available, would you quantify the DAL surcharge on the basis of cost alone? If so and there is a difference in cost between a saturation flat DAL and a high-density flat DAL, should that cost difference be recognized in the two DAL surcharges? Please explain.

ADVO/NAA-T1-7. On pages 15-16 (lines 15 ff), you discuss the possibility of using value-based pricing. On page 17 (lines 14-15) you state that: “. . . another way to view the proposed DAL surcharge is to characterize it as a recapture of revenue displacement.” NAA witness Ingraham, page 2, lines 14-17), notes that

ECR high-density and ECR saturation flat rate categories are competitive with each other. In other words, to achieve Total Market Coverage (TMC), one may distribute one's entire TMC product via the USPS saturation category or one may distribute some of one's TMC product via the USPS high-density category and the remainder via newspaper private delivery. USPS rates for these two categories can have a large impact on the choice.

- (a) With that in mind, do you believe the USPS should price any of the (substitutable) services offered in the TMC market on the basis of "revenue displacement?"
- (b) With that in mind, do you believe that the USPS should price a portion of one (substitutable) TMC service on the basis of "revenue displacement" but not price the other (substitutable) TMC service in the same way?
- (c) Please confirm that if rates for the various (substitutable) TMC services within the ECR subclass were based on Ramsey pricing or developed to maximize institutional cost contribution, then both value of service and revenue displacement would be implicitly reflected in the results.