

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

POSTAL RATE AND FEE CHANGES, 2006)

Docket No. R2006-1

RESPONSES OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

WITNESS ROBERT W. MITCHELL TO INTERROGATORIES OF
UNITED STATES POSTAL SERVICE (USPS/VP-T1-16-27)

(October 4, 2006)

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

("Valpak") hereby submit responses of witness Robert W. Mitchell to the following interrogatories of the United States Postal Service: USPS/VP-T1-16-27, filed on September 20, 2006. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

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to Interrogatory of USPS**

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).

Response:

The stand-alone questions I am raising relate primarily to saturation mailings, due to the simplicity and low costs of an independent operation that delivers unaddressed pieces.

Private delivery would most likely be by local delivery operators. Mailers would arrange to

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deposit materials with them, and the delivery operators would not maintain a network for handling, transferring, and transporting materials around the country.

a.-c. The stand-alone concept is a fairness notion, developed primarily to test for cross subsidies. Just as it is considered unfair for the presence of product A to cause the rates for product B to be higher than they would otherwise be (indicating that B is cross subsidizing A), it is similarly considered unfair for the rates for a product produced within a joint operation to be higher than they would be if the same product were produced in a separate, stand-alone operation. Two possible reference points on such a stand-alone operation are apparent.

The first possible reference point relates to a Postal Service operation. If the Postal Service *could* set up a separate, independent operation, along the lines of a wholly owned subsidiary with separate management, separate employees, a separate income statement, and a separate balance sheet, and produce a product for 10 cents per piece, it would not be considered fair for it to produce the same product as a joint part of its mother operation and price it at 13 cents. That is, as part of its obligation to serve mailer needs with an economically managed operation adapted to the “needs of the United States” (39 U.S.C. § 3621), under these circumstances, the Postal Service should set up the wholly-owned subsidiary (which should be required to cover all of its costs, variable and fixed,

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as the case may be). And it should not go unnoticed that the lower rate thus made available might result in substantial additional volume.

The second possible reference point relates to private operations. If, within the framework of the normal functioning of the private economy, given whatever behavior competition brings, a private company would be happy to deliver the product for 8 cents, it would be considered unfair to require that the Postal Service carry it for 13 cents. Private firms offering such services would certainly be expected to cover all of their costs, including marketing, overhead, etc. Also, one would not expect a private firm to offer services unless its profit level were at what economists usually refer to as the *normal* level.

The question becomes, then, which of these reference points is relevant? Saturation mail, particularly if the addresses are removed, is not covered by the Private Express Statutes and is therefore in the competitive arena. Under these circumstances, it appears to me that the appropriate reference point is a *private* operation and that the fairness question becomes: "Given that the mailbox is the only means that society has developed to facilitate delivery to residences, is it fair to handicap competition with a mailbox rule, as part of the criminal statutes, with the effect that senders of mail-like materials are precluded from having available the low rates that otherwise unconstrained private operators would most certainly offer?" I contend that the economic answer is *no*. Then, even if the answer to this question is *yes*, the next question becomes: "Is it fair for

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senders of mail-like materials that are part of the competitive arena to be presented with postal rates that are higher than those that would be provided by unconstrained private operators?" I contend, again, that the answer is *no*. And the unfairness becomes more pronounced if the Postal Service's rate is elevated even further on arguments relating to how to compete fairly with competitors, particularly where the competitors are handicapped.

If this answer is accepted, the assignment becomes to examine, in this light, the *Postal Service* rates for saturation mail, focusing specifically on whether they are suitably aligned with accepted and appropriate ratesetting principles and on whether the saturation rates should be reduced, which would better align them with rates that, without the mailbox rule, would be available from private operators. As I explain in my testimony, I believe appropriate rate design for saturation mail leads to saturation rates that are lower than those proposed by the Postal Service and even lower than current rates.

The costs and rates that would result from unconstrained competition from private operators are unknown, as is the volume they would have and the nature of their operations, possibly involving low-cost collation procedures. Nevertheless, as I discuss in my testimony, I believe it is clear that the current rates and those proposed in this case by the Postal Service are above the private level and should be reduced. I have not argued that estimates of the level of stand-alone costs are available or that a specific level of stand-alone cost should

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be adopted and somehow inserted into a rate design scheme. Rather, I have argued that appropriate and accepted rate design principles, when applied to saturation mail, result in lower rates, and that these lower rates reduce a fairness concern that is associated with notions of competition and stand-alone costs.

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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.

Response:

Note: The sentence on page 77, beginning on line 7, actually reads: “I do not see that any notions of intrinsic value of service are relevant to determining cost coverages for Regular, for ECR, or for any other subclass.”

Yes, as to how these nations have been previously considered. As I discuss in my testimony, in the section you cite, notions of intrinsic value, as they have been explained in the past, focusing as they do on listing and acknowledging *characteristics* of products, have no well-defined or reliable linkage to understood and accepted concepts of value that are meaningful for ratemaking. I do not mean that the characteristics of products are unimportant *per se*, or that they are irrelevant. Every product has characteristics, and a list of them could be long and striking. Nevertheless, the product may not present value suited to supporting higher price levels. The test of whether such value exists centers in all cases on the price elasticity of demand, which is determined by the market’s assessment of the product, characteristics and all. The elasticity cannot be inferred from an *a priori* review of the product’s characteristics. That is, the market may recognize the characteristics as having value and it may present an inelastic demand relationship, but the way to find this out is to look at the product’s elasticity, not at a list of the product’s characteristics.

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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.

Response:

- a. I know of none.
- b. In checklist form, the Act directs the Commission not to fail to consider the factors listed in § 3622(b), and to honor other policies as well, such as that undue discrimination be avoided, but it does not say that the factors listed are the *only* factors to be considered and it does not contain, as far as I know, a list of factors that should *not* be considered. Moreover, the last factor listed requires the Commission to consider “such other factors as the Commission deems appropriate,” and I see no way of arguing that issues relating to pending legislation are not appropriate for consideration.

As a practical matter, the Commission gives weight to a wide range of factors it believes relevant, most having to do with the reality that presents itself, many of which are not specifically mentioned in the Act, and many of

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which relate to conditions that are expected to exist in a future period. The basic notion of a test year itself is testimony that the conditions in a future period are viewed as relevant, although the Act does not require that attention center on such a period.

I understand that the Commission is to make decisions on a record developed during proceedings, consistent with the Act. But in doing this, I know of nothing that restricts the Commission from bringing to bear its general understanding of regulatory ratesetting principles or its knowledge of other matters it believes relevant, particularly if that knowledge is derived from widely understood and widely available information. In the situation at issue, it seems worthy of note that, in recent years, the entire postal community has directed considerable attention to the importance and possible need for a final rate case to align rates in a way suitable for a rate-cap platform, even if such a requirement is not spelled out in the most recent version of the postal reform legislation being considered. Therefore, a concern of this kind is widely understood, and I find it difficult to understand any basis for arguing it to be irrelevant to ratesetting.

The rates I propose are based on accepted ratesetting principles, not on some requirement that might or might not be in legislation. I discuss the possibility of legislation to suggest that some importance attaches to getting to

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preferred rate positions in one step, because the opportunity for a second step may not occur.

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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.

Response:

Note: This question does not have a part a. The part-designations in my response align with those in the question.

- b. Confirmed.
- c. My general view would be that the Commission is expected to recommend rates that it believes to be in the best interests of the American people, pursuant to the

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ratesetting policies of the Act, drawing on accepted regulatory ratesetting principles. Doing this requires attention to all mailers, including potential mailers and non-mailers. Mailers and mailing organizations are given an opportunity to enrich the record on their situations and on how these policies and principles should be applied, but they do not necessarily get a vote. If there were evidence that intervening parties were not representing the interests of their members, were not representing the interests of segments of the market that they claim to represent, that should be taken into consideration, consistent with the logic behind the need for a Consumer Advocate.

- d. On its face, the Commission must do as you suggest, but it does not need to do so blindly and it does not need to neglect setting and history. Suppose the following interchange took place: **Commission:** “We are very concerned about backing away from costs and full consideration of all aspects of the situation at hand.” **USPS and Mailers:** “We understand, but for certain reasons we think it is better to put that off and catch up later.” **Commission:** “This could cause big steps in the future to true things up.” **USPS and Mailers:** “That is OK.” It seems to me that to say that the statute would require the Commission to neglect such history is to say that the Commission exceeded its statutory discretion when it acquiesced to the scheme that created the history in question.

At its base, considering *effects* on mailers can be considered an exercise in fairness. Under financial breakeven, whenever one rate needs to be adjusted

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upward, it is generally the case that some other rate needs to be adjusted downward. It seems unfair to the second group of mailers to put off that adjustment. Each mailer in the first group is saying: "How much longer do I get to keep this benefit?" Each mailer in the second group is saying: "How much longer do I have to keep paying more to support lower rates for the mailers in the other group?" The mailers in the second group would seem to have much more "standing" to support changes than the mailers in the first group would in support of further delays. It does not seem reasonable for mailers receiving a preference at variance with appropriate principles to say: "It is unfair to take away the preferential treatment that has been bestowed upon me."

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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

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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.

⁴³ Participants 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

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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.”

Response:

Note: The site for one of the quotations in the question is to page 92 of the Commission’s Opinion in Docket No. R2005-1. This is the page number in the electronic version. In the printed version handed out at the press conference following that docket, the same page is numbered 90. My answer refers to page 92.

- a. Not confirmed. The Commission’s Opinion speaks for itself. One of things it says is, according to your quote: “the Commission will seek to obtain economically efficient cost based rates” It does not refer to what you ask about, “economically efficient component prices,” which I find to be a somewhat awkward and unclear phrase. References to efficient component pricing (“ECP”) or the efficient component pricing rule (“ECPR”) have become quite common in rate proceedings. Similarly, it is common to refer to notions of economic efficiency or to prices that are economically efficient (sometimes referred to as Ramsey prices). The question, however, is a strange mixture of the two concepts. In the next two paragraphs, I assume your intended reference is to prices based on the ECPR.

Second, it is clear that the Commission refers on page ii to “worksharing” (a term sometimes used to cover a wide range), but it also notes

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in the same paragraph “that proper cost-based rates foster efficiency and promote a healthy postal system.” I would interpret this reference broadly. Also, the paragraph quoted is from a brief summary and prudence would suggest guarding against reading too much into it.

Third, the second quote, from page 92, refers specifically to “obtain[ing] economically efficient cost-based rates *and appropriate allocation of institutional burdens*” (emphasis added). This also is a broad reference, and the mention of institutional burdens would seem to go toward subclass questions.

- b. Yes.
- c. Yes. Please see the paragraph beginning on page 97, line 11 of my testimony. [Note: The fourth comma in the first sentence of the referenced paragraph is unnecessary.]
- d. At the rates I propose, outcomes that would be viewed as favorable by affected mailers extend much more broadly than just to Valpak. Assuming no changes in mailing patterns, the effects in terms of percentage increases are shown on Chart 1 (pp. 192-93) and Chart 3 (p. 196) of my testimony.
- e. Under origin entry, only two categories of Regular commercial flats have increases over 50 percent — namely, minimum-per-piece automation flats at the mixed ADC level (56.3 percent) and the 3-digit level (54.9 percent). The issue of deaveraging these categories is discussed in my response to USPS/VP-T1-11. Questions relating to the automation discount are discussed at length in a section

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beginning on page 148 of my testimony. All increases higher than these are for parcels, which follow very closely the proposal of the Postal Service.

Consider minimum-per-piece machinable flats at the mixed ADC level, which have an increase of 41.6 percent, a portion of which is due, again, to the deaveraging. Otherwise, this increase may be thought of as due to two factors. The first is the subclass cost coverage, discussed in section c above. The second is the letter-flat passthrough of 95 percent, which, as discussed in sections beginning on pages 114 and 156 of my testimony, is significantly above the passthrough of 58.4 percent proposed by the Postal Service, at its costing. As discussed in my testimony, the passthrough of 95 percent has already been held down, due to several considerations. I understand that if future rate cases are viewed as likely, the Commission could lower it somewhat. (By changing the figure in cell Y9 of the 'Inputs' sheet of my workpapers, this is easy to do.)

The question of how quickly or slowly to move toward preferred rate positions is an important one. If changes had been made in Docket No. R2005-1, as you suggest in part c above, the level in this case could easily be within range of 95 percent without large percentage increases in this docket. As I discuss further in my response to USPS/VP-T1-19, I believe the change has been needed for too long and that at minimum a substantial step needs to be taken now.

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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%

Response:

Confirmed.

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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.

Response:

- a. Not confirmed. The differences arise from several factors, including the levels of the costs themselves, the way the levels are recognized, the levels of corresponding costs in the past, and the way they were recognized in the past. Part of the problem is that the costs of the Postal Service of handling flats are relatively high and have not been recognized adequately in the past.
- b.-c. Please see the section on Nonprofit rates beginning on page 110 of my testimony, where these issues are discussed at some length. I am not sure what you mean by “always fair” in part c. In footnote 42 of my testimony, page 111,

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I discuss a situation where consideration might be given to a different letter-flat rate differential for Nonprofit mail.

In addition, the particulars of this case are informative. For the minimum-per-piece rates, Mixed AADC and Mixed ADC levels, automation, your table shows an increase for letters of 1.4 percent and for flats of 102.6 percent. According to the costs shown on the 'Inputs' sheet of my workpapers, the cost of letters is 9.703 cents and the cost of flats is 34.073 cents, including mail process and delivery costs only. The rate proposed by the Postal Service for letters is 16.2 cents and for flats is 24.5 cents. This means that, as proposed by the Postal Service, according to the best cost information available, the flats are making a *negative* contribution of 9.573 cents (-9.573) and the letters are making a *positive* contribution of 6.497 cents (+6.497). Even if the cost of the flats is somewhat lower than this, due to the effects of weight, something is badly out of kilter. On the other hand, under the rates I propose, these contributions are, in the same order, *positive* 5.430 cents and *positive* 5.297 cents. Nonprofit letter mailers, such as the Flute Network, which has intervened in this case, have every right to ask why their rates are so high, even when they are a preferred mailer.

- d. The page-110 section of my testimony referenced above discusses this issue, mentioning in particular the question of whether the NESS decision (or the logic of it) applies. As I recall, the Postal Service responded immediately and fully to

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the NESS decision when it was issued. It is clear that mailers of Nonprofit letters have every right to be concerned about the markup on their mail (as discussed above) and about discounts available to Regular mailers that are not available to them. I leave it to the Commission and our community of lawyers to decide how much freedom the Commission has and how that freedom should be used in this case.

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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 Automation	56.3%	58.2%	58.5%
5-digit Automation	38.5%	39.1%	39.1%

Response:

Confirmed. For any particular column, note that the differences between the two figures for flats (Mixed ADC and 5-digit Automation) is due largely to the deaveraging being proposed by the Postal Service. Mixed ADC is the category that would be expected to benefit least by the deaveraging and 5-digit is the category that would be expected to benefit the most. Also, most mailings have pieces in more than one category, making Mixed ADC a residual category. Only 0.56 percent of automation flats fall into the Mixed ADC category.

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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.

Response:

- a. Not confirmed. The differences arise from several factors, including the levels of the costs themselves, the way the levels are recognized, the levels of corresponding costs in the past, and the way they were recognized in the past. Part of the problem is that the Postal Service costs of handling flats are relatively high and have not been adequately recognized in the past.
- b. Much of my testimony is directed to why I think the rates I propose are fair and should be recommended. A section on fairness begins on page 67. See also my response to USPS/VP-T1-19.
- c. The rates I propose are not based on a process of full recognition of all cost differences. My testimony discusses each rate, along with its history and the relevant costs, and explains my proposal. Fairness is one consideration.

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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.

Response:

Yes. I discuss this issue at some length in my testimony, particularly in sections beginning on pages 114, 156, and 178, including explaining that the cost basis for the rate difference between them should be more expansive than just workshare-related costs. See also my response to ADVO/VP-T1-10, when it is filed.

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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?

Response:

Yes, but there are differences in *how* costs should be recognized, one way being appropriate for categories like letters and flats and another way being appropriate for categories inherently involving worksharing, as discussed further in my response to ADVO/VP-T1-10, when it is filed. These may not be the only distinctions. There are also differences in the nature of the costs that are appropriate. In my testimony, I discuss a range of factors, including history and notions of fairness, as well as costs. In some cases, matters of social policy may be relevant. In all cases, however, considerable attention to the relevant costs should be paid. The costs should be known and recognized, and a decision on some defensible basis should be made on what to do with them. I realize that opinions may differ on what is defensible and what is not. What is important is that serious, thorough, deliberate efforts be made to gather relevant information, to evaluate how that information should be used, and then to make recommendations consistent with that process.

**Response of Valpak Witness Mitchell
to Interrogatory of USPS**

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?

Response:

No. It may be decided that some of the non-cost factors are not relevant to some such rate differences, or that some should not be given much weight or do not point in well-defined directions, but all of the non-cost factors relate to potentially important matters. I think most or all of them would be on a list of meaningful things to consider, even if they were not specified expressly in the Act.