

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

Postal Rate and Fee Changes, 2006

Docket No. R2006-1

**NEWSPAPER ASSOCIATION OF AMERICA  
WITNESS ALLAN T. INGRAHAM  
ANSWERS TO INTERROGATORIES OF  
ADVO, INC. (ADVO/NAA-T2-1-9)  
October 5, 2006**

The Newspaper Association of America hereby provides the responses of witness Dr. Allan T. Ingraham (NAA-T-2) to the interrogatories of ADVO, Inc. filed on September 21, 2006. Each interrogatory is stated verbatim and is followed by the answer.

Respectfully submitted,

NEWSPAPER ASSOCIATION OF AMERICA

By: William B. Baker  
William B. Baker  
WILEY, REIN & FIELDING LLP  
1776 K Street, N.W.  
Washington, DC 20006-2304  
(202) 719-7255

**CERTIFICATE OF SERVICE**

I hereby certify that I have this date served the instant document on all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

October 5, 2006

William B. Baker  
William B. Baker

NEWSPAPER ASSOCIATION OF AMERICA  
WITNESS ALLAN T. INGRAHAM  
ANSWERS TO INTERROGATORIES OF  
ADVO, INC. (ADVO/NAA-T2-1-9)

**ADVO/NAA-T2-1.** Please confirm that, in your rate design:

- (a) The ECR revenue requirement in your DAL\_Conversion\_to\_On-Piece (75% Conversion) worksheet does not reflect any DAL cost savings from the conversion to on-piece addressing. If this is incorrect, please explain.
- (b) The saturation flat costs you used to develop the non-surcharged saturation flat rate is an average of the costs for all saturation flats plus all associated saturation flat DALs assumed to be in the system. If this is incorrect, please explain.
- (c) You did not adjust your second set of rates to achieve the USPS original goal of 213% cost coverage (or \$3,142,857,985 in contribution to institutional cost -- per the original LR L-36). If this is incorrect, please explain.
- (d) The NECR rates in both of your rate design spreadsheets are simply derived from your ECR rate changes. You have made no specific adjustments directly purely at the NECR rates. If this is incorrect, please identify and explain the rationale for the specific adjustments you deliberately made to NECR rates.

Answer:

(a) Confirmed.

(b) Confirmed.

(c) Confirmed that it was not my goal to achieve precisely the cost coverage presented in witness Kiefer's original version of LR L-36. Rather, I recognized that any rate design I proposed would have to achieve cost coverage that was at least reasonably consistent with the range of cost coverages implied by Kiefer's original and amended workpapers. I should note, however, that the upper bound of that "range"—that is, the cost coverage implied in Kiefer's revised version of LR L-36, is unrealistic. In

NEWSPAPER ASSOCIATION OF AMERICA  
WITNESS ALLAN T. INGRAHAM  
ANSWERS TO INTERROGATORIES OF  
ADVO, INC. (ADVO/NAA-T2-1-9)

particular, Kiefer's revised testimony assumes that with a 1.5 cent DAL surcharge there would be no conversion to on-piece addressing by ECR saturation mailers. As I described on page 14 of my testimony, this is an unrealistic assumption.

(d) Confirmed.

NEWSPAPER ASSOCIATION OF AMERICA  
WITNESS ALLAN T. INGRAHAM  
ANSWERS TO INTERROGATORIES OF  
ADVO, INC. (ADVO/NAA-T2-1-9)

**ADVO/NAA-T2-2.** On page 16 (lines 11-12), you cite the principle of Efficient Component Pricing (ECP) as your basis for applying 100% passthroughs of density-related cost differentials to the comparable rate differentials (with the exception of basic to high-density letters and the parcel rates).

- (a) Do you agree with the principle of ECP as described by witness Sidak? Please explain.
- (b) Do you believe that the cost differences between ECR basic, high-density, and saturation (by shape), used in your rate development, are due to entirely to differences in worksharing activities? Please explain.
- (c) Is it your understanding that ECP ensures that each service being priced (under the ECP concept) generates an equal per unit contribution? Please explain.

Answer:

(a) Yes. As a matter of principle I believe that Efficient Component Pricing can be used to accurately set worksharing discounts.

(b) I take this question to mean that within a specific grouping of mail, such as ECR, cost differences between shapes are likely due to factors other than worksharing. If the question goes to different presort levels of the same shape, my understanding is that these are due to worksharing.

(c) For the purposes of this response I presume “contribution” to refer to the service’s contribution to institutional cost.

NEWSPAPER ASSOCIATION OF AMERICA  
WITNESS ALLAN T. INGRAHAM  
ANSWERS TO INTERROGATORIES OF  
ADVO, INC. (ADVO/NAA-T2-1-9)

As I understand the question, I believe this is correct when the opportunity costs of the separate services are equal. In particular, ECP is the sum of the input's direct per unit incremental cost and the opportunity cost to the monopolist of the sale of an additional unit of the service. Because the service's contribution to institutional cost would be its revenues less its volume variable costs, the contribution to institutional costs would equal the opportunity cost of that service to the monopolist.

NEWSPAPER ASSOCIATION OF AMERICA  
WITNESS ALLAN T. INGRAHAM  
ANSWERS TO INTERROGATORIES OF  
ADVO, INC. (ADVO/NAA-T2-1-9)

**ADVO/NAA-T2-3.** In several portions of your testimony, you refer to the use of DALs as an option or optional mail feature (page 3, line 8; page 6, line 13; page 12, line 14; page 16, line 2).

- (a) In the USPS rate design, do you believe the saturation flat rate is to be applied only to on-piece addressed flats? If not please explain.
- (b) In the USPS rate design, do you believe that saturation flats with DALs are supposed to pay both the saturation flat rate plus the DAL surcharge? Please explain.
- (c) In your rate design, is the saturation flat rate to be applied only to on-piece addressed flats? Please explain.
- (d) In your rate design, are saturation flats with DALs to pay both the saturation flat rate plus the DAL surcharge? Please explain.
- (e) Under ECP, when there is a separate rate for an optional feature, is it appropriate for the ratepayers not taking that option to cover the costs of that option in their rates? Please explain.

Answer:

- (a) No. It would be applied to all ECR saturation flats.
- (b) Yes. They would pay both.
- (c) No. It would be applied to both on-piece addressed flats and flats with DAL, just as in the USPS rate design.
- (d) Yes. They would pay both.

NEWSPAPER ASSOCIATION OF AMERICA  
WITNESS ALLAN T. INGRAHAM  
ANSWERS TO INTERROGATORIES OF  
ADVO, INC. (ADVO/NAA-T2-1-9)

(e) As a general rule of thumb, no, it is not. This was the purpose of my second rate design, which reduces the rate of saturation ECR flats with on-piece addressing based on an estimate of the costs avoided from DALs mailers that would adopt on-piece addressing.

NEWSPAPER ASSOCIATION OF AMERICA  
WITNESS ALLAN T. INGRAHAM  
ANSWERS TO INTERROGATORIES OF  
ADVO, INC. (ADVO/NAA-T2-1-9)

**ADVO/NAA-T2-4.** On page 18 (lines 8-11), you state that you “. . . used [in your rate design] the current pound charge of 64.3 cents instead of the Postal Services proposed 64.1 cents, because to my knowledge witness Kiefer nowhere specifically explained why he proposed to change this charge.”

- (a) Did NAA ask witness Kiefer anything about his proposed pound charge? Please explain.
- (b) In this case, did NAA obtain any data on weight-related ECR costs?
- (c) Did you, in any way, attempt to determine the extent of weight-related ECR flat costs? Please explain.

Answer:

- (a) & (b) Redirected to NAA.
- (c) No.

NEWSPAPER ASSOCIATION OF AMERICA  
WITNESS ALLAN T. INGRAHAM  
ANSWERS TO INTERROGATORIES OF  
ADVO, INC. (ADVO/NAA-T2-1-9)

**ADVO/NAA-T2-5.** On pages 8 ff, you take issue with the fact that the USPS did not de-average the basic/high density flat delivery cost for use in its rate design. You state (page 10, lines 9-12): “. . .an appropriate rate design for ECR mail should use the data estimating the cost differences between the high-density and saturation flats worksharing tiers.

- (a) Please confirm that neither the USPS nor you used a de-averaged high-density/saturation flat mail processing cost in rate design. If this is incorrect, please explain.
- (b) Please confirm that NAA did not request de-averaging of the high-density/saturation flat mail processing cost for rate design purposes. If this is incorrect, please explain.
- (c) Under ECP, when there are separate rates for separate services, is it appropriate to base the rate differential on a cost differential that, in part, ignores service cost differences associated with a major cost category?

Answer:

- (a) Confirmed.
- (b) Redirected to NAA.
- (c) Theoretically, one would prefer to base differences on any cost difference in a competitive category of activity. However, when applying theory in the real world, if one is not able to measure those cost differences with sufficient statistical accuracy, then one has no statistically valid cost differences to use when setting rates.

NEWSPAPER ASSOCIATION OF AMERICA  
WITNESS ALLAN T. INGRAHAM  
ANSWERS TO INTERROGATORIES OF  
ADVO, INC. (ADVO/NAA-T2-1-9)

**ADVO/NAA-T2-6.** On page 21, you state that: “. . . I have calculated the incremental cost of a DAL to be 0.75 1 cents per DAL. Therefore my proposed DAL surcharge recovers that incremental cost and also would include an optional or value component.”

- (a) Please explain your concept of DAL incremental cost that led to this figure.
- (b) Please explain whether the 0.751-cent incremental cost applies to each of your two alternative rate designs.
- (c) Please explain why only that amount of “incremental cost” must be recovered in your second alternative set of ECR rates and the remainder of the 1.4-cent surcharge is an optional or value component.

Answer:

(a) Incremental cost of a service over any range of production is the total cost to the firm including the production of that service (at some pre-selected level) less the total cost to the firm including some different (presumably lower) level of production of that service.

(b) That cost calculation was used in my second rate design.

(c) With an incremental cost of 0.751 cents, a surcharge of 1.4 cents per DAL would exceed the incremental cost of the DAL. Because the surcharge exceeds the incremental cost, the remainder could be considered a value price for an optional product, which is what I understand DALs to be.

NEWSPAPER ASSOCIATION OF AMERICA  
WITNESS ALLAN T. INGRAHAM  
ANSWERS TO INTERROGATORIES OF  
ADVO, INC. (ADVO/NAA-T2-1-9)

**ADVO/NAA-T2-7.** 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) Do the high-density flat costs you use in your rate design include the costs of DALs associated with high-density flats? Please explain.
- (b) Do the DAL conversions in your worksheet DAL\_Conversion\_to\_On\_Piece also reflect any high-density DAL conversions? Please explain.
- (c) In your first set of rates you propose the USPS proposed DAL surcharge of 1.5 cents. In the second set of rates you propose a surcharge of 1.4 cents. The USPS surcharge is intended for saturation DALs. Do your alternative proposed surcharges also apply only to saturation DALs? Please explain.

Answer:

(a) The high density flat delivery costs used in my analysis were provided by witness Kelley in NAA/USPS-T30-7 and ADVO/USPS-T30-1. To the extent that those figures include delivery costs for any DAL associated with high-density non-letters, then yes.

(b) No. They affect saturation DALs.

(c) They would apply only to saturation DALs, as does the USPS proposal.

Furthermore, it is my understanding that postal regulations do not permit high-density mailers to use DALs.

NEWSPAPER ASSOCIATION OF AMERICA  
WITNESS ALLAN T. INGRAHAM  
ANSWERS TO INTERROGATORIES OF  
ADVO, INC. (ADVO/NAA-T2-1-9)

**ADVO/NAA-T2-8.** Witness Sidak states (pages 9-10, lines 19ff): “To promote such [economic] 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 A deviation of pass-through rates from 100 percent would result in postal rates that are inconsistent with the general principles of ECP.”

- (d) If you agree with the principle of ECP, please explain why you did not pass through 100% of the dropship-related cost avoidances to the dropship discounts.
- (e) Please confirm that by not passing through 100% of the dropship cost avoidances to the discounts, the more discounted mail pieces are paying a greater per piece contribution than the less discounted mail pieces. If you cannot, please explain why not.

Answer:

(a) As stated on pages 8-9 and 13-14 of my testimony, the purpose of my testimony was to correct what I believed to be the two largest shortcomings in the postal services rate design. Those were (1) the unprecedented pass-through of delivery costs for ECR saturation flats of 2200 percent and (2) the flawed implementation of the DAL surcharge in the rate design. I designed my rates to correct these shortcomings, which were the focus of my testimony.

NEWSPAPER ASSOCIATION OF AMERICA  
WITNESS ALLAN T. INGRAHAM  
ANSWERS TO INTERROGATORIES OF  
ADVO, INC. (ADVO/NAA-T2-1-9)

Although I recognized that USPS witness Kiefer passed-through in some instances only 85 percent of the calculated cost-savings from drop-shipping, I concluded that correcting the drop-shipping pass-through percents would have introduced a third issue that would distracted my testimony from its two most important goals. My not adjusting the dropship discount allows for a straightforward comparison of my rate designs to those of the Postal Service, which changing the dropship discounts would have obscured. As a practical matter, the deviation of 85 percent from 100 percent, in my opinion, pales in comparison to either the deviation of 2200 percent from 100 percent or the lack of even a simple cost model used in the determination of the DAL surcharge.

(b) Presuming that costs avoided are measured accurately and the discounts set appropriately, then yes.

NEWSPAPER ASSOCIATION OF AMERICA  
WITNESS ALLAN T. INGRAHAM  
ANSWERS TO INTERROGATORIES OF  
ADVO, INC. (ADVO/NAA-T2-1-9)

**ADVO/NAA-T2-9.** On page 21, lines 1-2, you state of your second alternative rate design: ". . .under this proposal, the most common saturation flat (entered at the DDU) would pay no more than under Kiefer's design. . . ." Please confirm that on page 6, the DDU saturation flat rate proposed by the USPS is listed as 14.0 cents while your second alternative DDU saturation flat rate is 14.1 cents. If this is incorrect, please explain why.

Answer:

This line of text was meant to refer to saturation flats with DALs. When my recommended DAL surcharge of 1.4 cents is considered, the prices of ECR saturation flats with DALs entered at the DDU are equal to those in Kiefer.