

**BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0111**

Postal Rate Commission
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POSTAL RATE AND FEES CHANGES, 2006

Docket No. R2006-1

**RESPONSE OF MAIL ORDER ASSOCIATION
WITNESS ROGER C. PRESCOTT TO INTERROGATORIES OF
THE UNITED STATES POSTAL SERVICE (USPS/MOAA-T1-1-19)**

The Mail Order Association of America (MOAA) submits the answers of MOAA witness Roger C. Prescott to USPS/MOAA-T1-1-19.

Respectfully submitted,

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**INTERROGATORIES FROM THE UNITED STATES POSTAL SERVICE
TO MAIL ORDER ASSOCIATION OF AMERICA WITNESS PRESCOTT**

- Q. USPS/MOAA-T1-1.** Please refer to your testimony at page 2, lines 7-9, where you quote Postal Service witness O'Hara with regard to contribution per piece and cost coverages for ECR and Standard Regular.
- a. Please confirm that the TYAR markup index for ECR (the ratio of the markup for ECR to the markup for the system as a whole) in the Postal Service's proposal in this docket is 1.14 (please refer to TR. 17/5123). If you do not confirm, please provide the correct markup index.
 - b. Please confirm that the TYAR markup index for Standard Regular in the Postal Service's proposal in this docket is 0.94. If you do not confirm, please provide the correct markup index.
 - c. Please confirm that the markup index for ECR recommended by the Postal Rate Commission in R2005-1 was 1.79. If you do not confirm, please provide the correct markup index.
 - d. Please confirm that the markup index for Standard Regular recommended by the Postal Rate Commission in Docket No. R2005-1 was 0.67. If you do not confirm, please provide the correct markup index.

Response:

- a. Not confirmed. The table referenced at TR. 17/5123 shows the cost coverages for First Class and Standard mail. Then, as requested in the interrogatory, the table "includes a comparison to the system-wide average". As discussed at page 145 of the PRC's Opinion and Recommended Decision in R2005-1, dated November 1, 2005 ("R2005-1 Decision"), the markup is "defined as contribution divided by attributable cost" while cost coverage is "defined as adjusted revenue divided by attributable cost." As shown in Appendix G, Schedule 3 of the R2005-1 Decision, the markup index is the index of the markup for a particular subclass to the overall markup. Library Reference USPS-LR-L-114 in Docket No. R2006-1 also presents the markup index following the same procedure as the R2005-1 Decision. Based on Library Reference USPS-LR-L-174 in Docket No. R2006-1, the markup for ECR equals 1.14 and the system markup equals 0.89. The markup index equals 1.28 (1.14 divided by 0.89).
- b. Not confirmed. As discussed in part (a) to this interrogatory, the markup index is the ratio of the markup for ECR to the system markup. Based on Library Reference 174 in R2006-1, the markup for Standard Regular equals 0.76 and the system markup equals 0.89. The markup index equals 0.85 (0.76 divided by 0.89).

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c. Confirmed.

d. Confirmed.

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- Q. USPS/MOAA-T1-2.** Please refer to your testimony at page 4, lines 16-18, where you state, “The USPS’s analysis of the own-price elasticity has shown that the elasticity of ECR mail has increased over time. This means that increased rates for ECR are having a more substantial impact on volumes today than in past years.” Please confirm that, when developing the Test Year After Rates volume forecast for ECR (the estimated volume that will result after the rates proposed by the Postal Service are implemented), witness Thress already incorporated into the TYAR estimate the impact of the fact that his own-price elasticity estimate is higher in this case than it was in Docket No. R97-1. If you do not confirm, please describe the changes to witness Thress’s forecast that you would recommend.

Response:

Confirmed.

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- Q. USPS/MOAA-T1-3.** Please refer to your testimony at page 4, lines 19-25 where you discuss the coverage ratio implicit in the TYAR rates recommended in Docket Nos. R97-1, R2000-1 and R2001-1. You state, “In those proceedings, the PRC envisioned that coverage ratios for ECR mail would range between 195 percent and 201 percent. The actual coverage ratios for ECR mail ranged between 233 percent and 263 percent.”
- a. Please confirm that the coverage ratios “envisioned” by the PRC were calculated on the basis of “PRC Version” of CRA costing. If you cannot confirm, please identify the basis upon which those coverage ratios were calculated.
 - b. Please confirm that the actual coverage ratios for ECR that you cited as falling between 233 percent and 263 percent were calculated on the basis of “USPS Version” of CRA costing. If you cannot confirm, please identify the basis upon which those coverage ratios were calculated.
 - c. Please confirm that there are several reasons that the actual coverage ratios might end up higher than projections, including:
 1. Unanticipated improvements in efficiency in postal operations
 2. Unanticipated changes in mail mix resulting in a higher proportion of Lower cost mail
 3. Changes to costing methodology

Please explain each response that does not confirm.

Response:

- a. Confirmed.
- b. Confirmed, as shown in USPS’s Witness O’Hara’s sources at TR. 17/5123.
- c. Confirmed “that actual coverage ratios might end up higher than projections”. The specific reason(s) for those differences has not been identified and may include the reasons listed in this interrogatory or other reasons.

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- Q. USPS/MOAA-T1-4.** Please refer to your testimony at page 4, lines 26-29, where you project the coverage ratio for ECR in TYAR 2008. Please clarify whether your projections are based on PRC Version or USPS Version CRA costing methodology.

Response:

The development of the values shown at page 4, lines 26 to 29 is shown at pages 16 to 18 of my testimony. The values in column (3) of Table 2 on page 17 of my testimony are based on Appendix G of the PRC's Opinion and Recommended Decision in R97-1 and R2001-1. The actual coverage ratios in column (4) of Table 2 of my testimony are taken from Witness O'Hara's response to VP/USPS-T31-9, which he sources to the USPS's CRA.

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Q. USPS/MOAA-T1-5. Please refer to your testimony at page 7, line 22. Please define “market-based pricing” as you have used the term.

Response:

As I have used the term, “market-based” pricing should reflect pricing that is responsive to the needs of the market for ECR mail and is responsive to the signals sent by the market so that prices are set efficiently for the mailers and the USPS. “Market-based” pricing would allow mailers to make decisions related to the postal product purchased (e.g., which subclass to utilize and to what extent to utilize worksharing discounts). “Market-based” pricing would promote the setting of rates so that the USPS would be able to enhance its ability to fulfill its obligation to all mailers and also meet its obligations to ECR mailers in a dynamic marketplace.

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Q. USPS/MOAA-T1-6. Please refer to your testimony at page 7, lines 23-24. Please provide the basis of your statement that the establishment of the ECR subclass was to “help preserve or increase mail volumes for the Third Class Bulk Rate Regular carrier route mail that became the ECR subclass.”

Response:

The PRC’s Opinion and Recommended Decision in R2005-1 (“R2005-1 Decision”) recognized the legitimacy of the policy goal of “maintaining and increasing mail volumes” as presented by the USPS in Docket No. 94-1 (R2005-1 Decision, page 93). Since the Postal Service’s policy goal related to all mail categories, I believe that this goal encompasses the ECR subclass.

In Docket No. MC95-1, the USPS’s Witness Charles C. McBride stated the following regarding establishing the ECR subclass as a way to respond to competition for advertising mail:

As the Postal Service is faced with increasing competition for hard copy delivery, the most likely incursions into the existing customer and volume base will occur in those areas where the unit cost for delivery is less than the average but is not adequately reflected in price, giving competitors an opportunity to price their services to attract the lower cost Postal Service products out of the mailstream. The Enhanced Carrier Route subclass is a first step to counter that competitive strategy. (Docket No. MC95-1, USPS-T-1, page 29)

Furthermore, the PRC stated in the Docket No. MC95-1 Opinion and Recommended Decision that:

The Commission agrees that a more equitable rate schedule will result from the establishment of an Enhanced Carrier Route subclass within Standard Mail. The driving factor for the definition of the subclass, however, is the perceived differences in demand as well as costs, and the corroborating evidence of Postal Service and mailer support. (MC95-1 Decision, page V-197)

It is the demand that generates the volume for ECR mail. It is illogical to think that the USPS (or the PRC) sought to establish the ECR subclass so that it would not promote the use of the subclass. Therefore, the objective would be to keep the volume or, hopefully, increase the volume of mail in the subclass.

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Q. USPS/MOAA-T1-7. Please refer to your testimony at page 8, lines 15-17. Please explain the relevance of this quote to the ECR subclass.

Response:

The quote indicates that competition for delivery services has increased and the USPS needs to be responsive to market forces if it is to maintain volumes.

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- Q. USPS/MOAA-T1-8.** Please refer to page 10, lines 4-8, of your testimony where you quote Postal Service witness Bernstein's R2001-1 testimony regarding the relationships between markups and elasticities.
- a. Please confirm that in that paragraph, witness Bernstein was describing the implications of the construct of Ramsey Pricing. If you do not confirm, please explain.
 - b. Please confirm that the Postal Service did not propose Ramsey prices in Docket No. R2001-1. If you do not confirm, please explain.
 - c. Please confirm that the Postal Service is not proposing Ramsey prices in this current docket. If you do not confirm, please explain.

Response:

- a. Not confirmed. Witness Bernstein referred to "Demand-based pricing, or Ramsey pricing..."(R2001-1, USPS-T-10, page 67). The quote is applicable to general economic theory as well as the theory of Ramsey Pricing.
- b. Confirmed.
- c. Confirmed.

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- Q. USPS/MOAA-T1-9.** Please refer to your testimony at page 11, lines 1-4, where you state, “The increasing elasticity means that rate increases in R2006-1 will create a greater decline in volume than caused by the increased rates in R97-1. This increased sensitivity should caution the PRC to *avoid an increase in rates for ECR mail.*”[emphasis added]
- a. Please confirm that the impact of the proposed rates as reflected in the higher own-price elasticity for ECR is already incorporated into the volume forecast for ECR in TYAR by USPS witness Thress. If you do not confirm, please explain.
 - b. Is it your testimony that the PRC should not raise ECR rates at all? Please explain fully.

Response:

- a. Confirmed.
- b. My testimony is not that the PRC should not approve rates that increase the overall prices to ECR mail. The point of the sentence quoted was to suggest that the PRC should exercise caution in approving increases in rates for a subclass where competition is increasing and profitable mail may be driven away from USPS service.

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Q. USPS/MOAA-T1-10. Please refer to your testimony at page 13, lines 1-8. Please explain the source of your understanding that witness O'Hara *first* set the contribution per piece target for ECR and *then* raised the contribution per piece for Standard Regular to meet the contribution per piece for ECR.

Response:

My testimony does not propose the two steps postulated in this interrogatory. My testimony responds to Witness O'Hara's statement that he has equalized the contribution per piece for Standard Regular and ECR mail. I did not suggest a methodology as put forth in this interrogatory. The point of my testimony was that: 1) the equal contribution metric was not utilized for any other subclass and 2) that the results of the equalization were unfair to both the Standard Regular and ECR subclasses.

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Q. USPS/MOAA-T1-11. Please refer to your testimony at page 13, lines 1-8. Is it your testimony that the cost coverage for Standard Regular was inflated in order to meet the ECR goal of contribution per piece? Please explain fully.

Response:

The question seems to ask whether the coverage ratio was set to meet the contribution per piece objective or whether the resulting contribution per piece determined the coverage ratio. I do not suggest which methodology was followed by the USPS because my testimony addresses the results of the USPS's proposed rate structure. I do not know the motivation of the USPS regarding which calculation was performed first. The cost coverage and contribution per piece for Standard Regular mail are both derived from the rate levels and costs associated with the Standard Regular mail subclass. My testimony demonstrates that Witness O'Hara attempts to give the appearance of balance based on his use of the contribution per piece metric. This metric can't be justified because it is based on rates that are too high for ECR mail and then increasing Standard Regular mail to the level of ECR.

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- Q. USPS/MOAA-T1-12.** Please refer to your testimony at page 13, lines 10-11, and explain the relevance of the reference to the PRC statement that “no attention was given to the implicit contribution of any individual piece.” Please explain how this quote, referring to implicit contribution of individual pieces, should be understood to support your testimony regarding the cost coverage for a subclass.

Response:

In the Docket No. R94-1 Opinion and Recommended Decision, the sentence immediately prior to the one quoted in my testimony reads “Rates are then designed to generate an appropriate amount of subclass revenue” (Docket No. R94-1 Decision, page V-95). The PRC’s decision Docket No. R94-1 did not rely on the contribution per piece for the subclass as the basis for showing that the rate levels are reasonable. Regarding the phrase “...of any individual piece” in the quote on page 13 of my testimony, it is the rates and the costs for all off the individual pieces that make-up the contribution for the subclass. Therefore, in my opinion, the PRC does not rely on the contribution per piece for the individual pieces of mail, or the aggregated contribution per piece for all of the mail in the subclass as the basis for setting the rate levels.

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- Q. USPS/MOAA-T1-13.** Please refer to your testimony at page 13, lines 12-13, where you state, “In R2001-1, the PRC stated that the measure of the institutional burden for any subclass should be determined based on the coverage ratios and mark-up indexes.”
- a. Please confirm that the ECR markup index based on the Postal Service’s proposed rates in this docket is 1.14 for TYAR 2008. If you do not confirm, please provide the correct markup index.
 - b. Please confirm that the markup index projected for TYAR 2008 is lower than all markup indices since 1994, as shown at Tr. 17/5123.

Response:

- a. Not Confirmed. The markup index for ECR equals 1.28. See my response to USPS/MOAA-T1-1.
- b. Not confirmed. For the reasons explained in my response to USPS/MOAA-T1-1, the table shown on TR. 17/5123 does not present markup indexes.

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- Q. USPS/MOAA-T1-14.** Please refer to your testimony at page 14, footnote 22, where you note that the coverage ratio for ECR mail was 204 percent.
- a. Please confirm that the coverage ratio cited is developed based on USPS Version of CRA costing. If you do not confirm, please explain.
 - b. Please confirm that the 204 coverage ratio shown for FY 2005 is the lowest coverage ratio for ECR since FY 1994, with the exception of FY 1999. If you do not confirm, please explain.
 - c. Please confirm that the coverage ratio of 214 shown as the anticipated coverage ratio for ECR in TYAR 2008 is the lowest coverage ratio for ECR since FY 1994 with the exceptions of FY 1999, FY 2005 and TYBR 2006. If you do not confirm, please explain.

Response:

- a. Confirmed.
- b. Confirmed.
- c. Confirmed.

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- Q. USPS/MOAA-T1-15.** Please refer to your testimony at page 14, lines 5-7, where you note that the contribution per piece for ECR equaled 8.4 cents per piece. Please confirm that this figure is for FY 2005, PRC Version of CRA costing. If you do not confirm, please explain what this figure represents.

Response:

Not Confirmed. At TR. 17/5125, which is Witness O'Hara's response to NAA/USPS-T31-9, the source for the 2005 value is shown as "USPS Cost and Revenue Analyses & Cost Segments and Components reports for the indicated years".

**INTERROGATORIES FROM THE UNITED STATES POSTAL SERVICE
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Q. USPS/MOAA-T1-16. Please refer to your testimony at page 17. Please confirm that the coverage ratios cited in your column (3) of Table 2 were developed using PRC Version CRA costing, whereas the coverages shown in your column (4) were developed using USPS Version CRA costing. If not confirmed, please explain.

Response:

Confirmed. See my response to USPS/MOAA-T1-4.

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Q. USPS/MOAA-T1-17. Please refer to your testimony at page 18, lines 5-7.

- a. Please confirm that the calculations that were used to develop your estimated range of projected coverage ratios in TYAR were performed by dividing a USPS Version actual cost coverage by a PRC Version target coverage in each case. If not confirmed, please explain.
- b. Please explain how any other factors – such as changes in mail mix, changes in use of dropship, etc. – that might affect the average revenue per piece could have influenced the actual cost coverages resulting from the three dockets to which you refer, and whether the effects that you describe will also be expected to present the same impact on TYAR revenue per piece estimates in this docket.

Response:

- a. Confirmed.
- b. There are numerous reasons for the differences between the projected and actual coverage ratios. The specific causes have not been identified or presented in this proceeding and are outside the scope of my testimony. My testimony is only presenting the results that have occurred. As to the projection of the future differences, I have presented a simple extrapolation based on historical results. While the actual data cannot be known until the time period has passed, the historical trend should provide reason to exercise caution in determining future rates.

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Q. USPS/MOAA-T1-18. Please refer to your testimony at page 19 where you note that ECR volume in 2005 was 6 percent lower than ECR volume in 1998. Please describe any non-postal rate factors that would have contributed to the decline in ECR volume, for example, the impact of the Internet.

Response:

The use of the term “non-postal rate factors” in this question is unclear. For example, I do see the “impact of the internet” as a “rate factor.” However, I believe all parties recognize that changes in ECR volumes result from a host of factors, both postal and non-postal. The USPS, in this proceeding has estimated volumes for ECR mail based on the elasticities calculated by Witness Thress (USPS-T-7). At page 117 of his testimony, Witness Thress states that “ECR mail volume was primarily affected...” by 1) retail sales, 2) investment, 3) price of newspaper advertising, 4) price of direct mail advertising, 5) internet advertising expenditures, 6) the time trend and 7) price of ECR mail. Witness Thress’ statement that the seven factors shown above are the factors that “primarily” affect ECR mail volume is an indication that other factors exist.