

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  
NEWSPAPER ASSOCIATION OF AMERICA (NAA/VP-T1-1-38)

(October 17, 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 Newspaper Association of America: NAA/VP-T1-1-38, filed on October 3, 2006. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

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**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-1.**

Please refer to your testimony at page 5, lines 12 to 14. Please define what you mean by “low contributions” and by “high contributions.”

Response:

The lines you cite on page 5 are from a summary of my testimony. The sentence that precedes the one you identify says: “Based on accepted principles of ratesetting and appropriate regulatory practice, as well as on precedent established over some years by the Commission, an alternative set of rates for Regular and ECR is proposed, including the Nonprofit subclasses.” In context, then, low and high contributions are defined relative to the principles at issue, as discussed at some length in my testimony. See especially the sections beginning on pages 42, 57, and 63, as well as 94. Details relating to the application of these principles is contained on pages 96 through 188.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-2.**

Please refer to your testimony at page 5, lines 12 to 14. Are Standard mailers making “low contributions” in comparison to any First Class mailers? If so, please explain. If not, why not?

Response:

The lines you cite on page 5 are from a summary of my testimony and do not relate to First-Class. However, see my response to NAA/VP-T1-1. See also my response to USPS/VP-T1-28 and the section beginning on page 94 of my testimony.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-3.**

Please explain your understanding of the proper use of unit contributions per piece in comparing the institutional cost contributions of Standard Mail, of First Class Mail, and of First Class Mail in comparison with Standard Mail.

Response:

As they do not relate to the efficiency of resource allocation or to the extent to which rates are economically efficient, unit contributions are useful only in a limited way. See my response to ADVO/VP-T1-10. This issue is also discussed in the section beginning on page 42 of my testimony.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-4.**

Is it your testimony that the institutional cost contribution (as measured by cost coverages or by cost coverage indices) of Standard Enhanced Carrier Mail has not declined relative to the system-average since Docket No. MC95-1?

Response:

No. For a history of markup indexes, see Docket No. R2005-1, Appendix G,

Schedule 3.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-5.**

Please confirm that in every rate case since Docket No. MC95-1 except for Docket No. R2005-1, the Postal Service has proposed an average rate increase for Standard ECR mail below the system-wide average.

Response:

The proposals of the Postal Service in cases before the Commission are a matter of public record. I would note that its proposed rate increases are expressed sometimes on a revenue-per-piece basis and sometimes as a fixed-weight price index.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-6.**

Is it your testimony that the Postal Service and Postal Rate Commission have not priced ECR mail on the basis of its cost and market characteristics since Docket No. MC95-1, or is your testimony that they have not done so to the extent that you now say that they should have?

Response:

Neither. My testimony concerns the rates that I believe to be appropriate in this case for Regular and ECR mail, and why.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-7.**

Please state whether you believe that the rates for Standard ECR mail recommended by the Postal Rate Commission in the following cases were lawful:

- a. Docket No. R97-1
- b. Docket No. R2000-1
- c. Docket No. R2001-1
- d. Docket No. R2005-1

If you state that any of the rates in those cases were unlawful, please explain why not.

Response:

- a-d. I have not taken a position on whether any of the rates recommended by the Commission are lawful, nor do I believe that I am qualified to do so.

See also my response to NAA/VP-T1-6.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-8.**

Please refer to your testimony at page 53, beginning with line 6. Does your reasoning (that as cost coverages increase, rates get further from marginal costs, and value of mail service gets impaired) apply to First Class Mail as well?

Response:

Yes, it applies to all subclasses and all rates.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-9.**

Have you calculated the stand-alone costs of Standard Regular mail? Of Standard ECR mail? Please provide all calculations that you have made of the stand-alone costs of those subclasses of mail.

Response:

No. See the section of my testimony beginning on page 57 and my response to

USPS/VP-T1-16.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-10.**

Have you examined whether the rates for First-Class Mail exceed the stand-alone costs of First-Class Mail? Why or why not?

Response:

No. I have not proposed any rates for First-Class Mail. Note, however, that the situation surrounding First-Class Mail is different from that surrounding Standard mail. Some of these matters are discussed in the sections of my testimony beginning on pages 57 and 83. See also my response to ADVO/VP-T1-10.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-11.**

Please refer to your testimony at page 59, lines 11 to 14. Please explain your understanding of how private delivery carriers are compensated for their services.

Response:

I do not know “how private delivery carriers are compensated for their services.”

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-12.**

When did Publishers Express cease operations?

Response:

I do not know.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-13.**

What effect, if any, did the Commission's decision in Docket No. MC95-1 have on the private delivery industry?

Response:

I do not know.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-14.**

Please refer to your testimony at page 60, line 16. Who are the “handicapped competitors” to which you refer?

Response:

I contend that a competitor or potential competitor wishing to provide private delivery services, and believing that it can be done at a price that will be attractive to mailers, who is statutorily precluded from using the only means society has developed to facilitate leaving mail-like materials at residences, is thereby handicapped.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-15.**

Do you believe that reducing rates for Standard ECR mail will improve the ability of private delivery firms to “make a go of it”?

Response:

No.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-16.**

Please refer to your testimony regarding the setting of Standard Nonprofit rates, beginning at page 61 of your testimony. Is it your belief that current Standard Nonprofit rates fail to comply with the Act?

Response:

Whether current Nonprofit rates in Standard comply with the Act is a legal question, not addressed in my testimony. I do propose Nonprofit rates, along with others, and I provide justification for those rates. See the section beginning on page 110 of my testimony. See also my response to USPS/VP-T1-22 and 30.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-17.**

Do the implicit markups for presort First-Class Mail deprive the nation of the full benefit of that low-cost mailstream? Please explain any negative answer.

Response:

If the Postal Service, by virtue of its strengths and all that it is, is in a position to offer a service that has low costs, which in many cases it is, and it sets a price for such a service that is unduly high, I say it has “depriv[ed] the nation of the full benefit of that low-cost mailstream.” The question then becomes: when is a rate unduly high? In some detail, my testimony addresses rates for Standard mail. It does not address First-Class. Nevertheless, some observations on First-Class are provided. See the sections of my testimony beginning on pages 78 and 94. See also my responses to USPS/VP-T1-28 and ADVO/VP-T1-10.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-18.**

Consider an advertiser participating in a shared mailing such as mailed by ValPak or Advo. Please confirm that the price that advertiser will pay to participate in the mailing is different from the postage price faced by ValPak or Advo. If you cannot confirm, please explain why not.

Response:

I have no way of addressing with any degree of specificity the prices that advertisers do (or will in the future) pay to “participate” in shared mail programs.

Note that the functions performed by various shared mailers may be different.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-19.**

Does the existence of the Private Express Statutes affect the estimated own-price elasticity of subclasses of mail that are subject to them? If so, what consideration should the Commission give to that effect?

Response:

All demand relationships faced by firms or that exist for markets are for the situation that actually exists. The Private Express Statutes are an important aspect of that situation for the Postal Service. Therefore, they would be expected to affect the demand relationships, in the sense that if subject Statutes were not there, the relationships would be different. Several things should be noted. (1) One cannot presume that if subject Private Express Statutes were not there, and a different mail system had evolved, it would differ from the current one in ways that involve nothing more than an adjustment in the position or slope of a demand curve or two. Instead, the situation might be different in broad and extensive ways. (2) Whatever the demand relationship is, that is what it is. If a certain level of value exists, then that is the level that exists, and one cannot just presume that it is different. And if a rate change has a certain effect on mailers and the Postal Service, then that is the effect that it has.

Stating that the effect would be different without the Private Express Statutes does not make the effect go away. On the question of the consideration that should be given to subject Private Express Statutes in setting rates, at least for the subclasses addressed in my testimony, see the sections of my testimony beginning on pages 57, 80, and 94.

See also my responses to USPS/VP-T1-16 and 28, and ADVO/VP-T1-3.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-20.**

Please refer to your testimony at page 80, line 13. Who comprises the “general public” to which you refer?

Response:

The term “general public” is contained in section 3622(b)(4) of the Act, cited just above the line you reference. I am not an expert on statutory construction, but particularly since (b)(4) mentions “business mail users” separately, I would interpret “general public” rather broadly. It is not clear to me that anyone is excluded.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-21.**

Please refer to your Table 1 at page 84. In the row labelled "Letters," are the percentages a fraction of the line labelled "Non-Saturation"? For example, in the ECR Comm column, does the 24.1% represent 24.1% of 43.2%, or of 100%?

Response:

It represents 24.1 percent of the 56.8 percent of the pieces that are non-saturation.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-22.**

Should criterion 5 (39 U.S.C. §3622(b)(5)) have a greater impact on the rates for Standard Regular or for Standard ECR mail? Please explain your answer.

Response:

This matter is discussed in the section of my testimony beginning on page 83. My conclusion is that it should not have a greater impact on one than the other. First, even though a somewhat greater portion of ECR than Regular can be handled privately, it still has a substantial portion of mail that cannot, including a great deal of Nonprofit volume. In fact, not even the *saturation* category of Nonprofit is at present a candidate for private delivery, and it seems doubtful to me that Congress intended that its rate should be increased to the point where it would be. Further, it does not seem fair to me for the ratesetting authorities to be in the position of saying to ECR mailers that are constrained by the Private Express Statutes: “We understand that your rate is unduly above costs, but you are in a subclass with some mail that can be carried privately, and we want high rates for that mail.” Second, making mail services available at reasonable rates does not involve elevating those rates so that potential mailers see private delivery as the best alternative.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-23.**

Is it your testimony that the Postal Service has, since Docket No. MC95-1, continued “the historic cost coverages of Regular and ECR, case after case” (page 93, line 9-10)?

Response:

Basically, yes, by proposing rates designed to bring about increases and decreases that are little different from the average increase. Such an approach does not deal with any fundamental merits of the rates and is a prescription for maintaining the status quo.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-24.**

Please refer to your testimony at page 94, beginning with subsection “K”. Please confirm that at the time of Docket No. R90-1, First Class Mail was the largest class of mail in the postal system by volume, and that it constituted a majority of the mailstream.

Response:

In the instant docket, the Postal Service provided a revenue and volume history in USPS-LR-L-74. Whether “majority” is defined in terms of either revenue or volume, I believe that library reference confirms your statement.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-25.**

Please refer to your testimony at page 94, beginning with subsection “K”. Please confirm that at the time of Docket No. R94-1, First Class Mail was the largest class of mail in the postal system by volume, and that it constituted a majority of the mailstream.

Response:

Please see my response to NAA/VP-T1-24.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-26.**

Please refer to your testimony at page 95 and the following pages. Please assume that Dr. Clifton (GCA-T-1) has correctly estimated the own-price elasticities of First Class single-piece and Standard Regular mail as -0.602 and -0.276, respectively. What implications would that have on your view that the cost coverage of Standard Regular should be somewhat below that of First-Class Mail?

Response:

Please see my response to USPS/VP-T1-28. Except in a limited way, my testimony does not address the rates for First-Class. It should be noted, however, that considerations beyond elasticity are involved.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-27.**

Please refer to page 97, lines 11 to 16. What would be the average rate changes for Standard Regular and for ECR with your alternative recommended cost coverages?

Response:

Standard Regular would receive a rate increase of 14.08 percent, and ECR would receive a rate decrease of 1.12 percent.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-28.**

Are you advocating a 100 percent recognition of the cost differences between letters and flats at the Standard ECR high-density and saturation levels? Please explain any negative answer.

Response:

No. The development of the high-density and saturation rates in ECR, both for letters and flats, is discussed in considerable detail, step by step, including reasoning and justification, on pages 169 through 186 of my testimony. All rates are explained fully.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-29.**

In connection with the proposed DAL surcharge and your suggestion for a surcharge for non-automation and/or non-machinable Standard ECR basic letters, please state your understanding of the role of a surcharge in postal rates?

Response:

Generally, a surcharge is no different from a discount, which is no different from a rate difference. It just depends on your point of view. The DAL surcharge moves in the direction of recognizing cost differences associated with mailers' preparation options, which seems a fair thing to do. Assuming some mailer response, increases in efficiency would be expected. Similar statements could be made about a surcharge for non-machinability or non-automation-compatibility.

Note that I do not view the purpose of the DAL surcharge as being to get mailers to stop using DALs. If mail with DALs is priced properly, based on its costs, I see no reason why mailers should not be allowed this option. I do not see an agency like the Postal Service as being in a position where it can say: "We like one kind of mail but do not like some other kind of mail, so we will either prohibit the other kind or set its price so high that it will go away." As long as each type of mail is priced properly, the Postal Service should be pleased to have all that mailers want to send.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-30.**

Please refer to page 129, lines 7-8 of your testimony. Please provide a citation for your statement that Mr. Kelley has estimated the Test Year cost of DALs to be \$165 million.

Response:

The reference is provided on line 13 of page 129 of my testimony, the same page 129 that you reference.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-31.**

Please refer to page 174 of your testimony. Did you perform any analysis to determine the basis for the estimated difference between Standard basic and high-density flats reported by the Postal Service? If so, please provide that analysis. If not, why not?

Response:

I performed no analysis beyond the discussion in my testimony, in the section beginning on page 173, which you cite. Note that the sources of all of the costs on which I rely are provided in my workpapers, on the 'Inputs' sheet, cells K171 to M185.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-32.**

Please confirm that, according to USPS witness Kelley (NAA/USPS-T30-8), Standard ECR high-density flats are estimated to have lower unit rural delivery costs than saturation flats in the Test Year.

Response:

Not confirmed. Witness Kelley should be the one to explain the costs he presents. In the interrogatory response you cite, I see a total (city and rural) volume of high-density flats of 1,886,024, a rural cost of \$32,882, and a rural unit cost (the quotient of these two numbers) of 1.743 cents. To the extent that this number is considered to be low, it is because a relatively small proportion of high-density flats are delivered on rural routes. The comparison you make just means that proportionately more saturation flats are delivered on rural routes than high-density flats.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-33.**

Please confirm that, according to USPS witness Kelley (NAA[USPS-T30-7), the city delivery unit costs of ECR high-density flats are projected to increase less between the Base Year and the Test Year than is the case for ECR saturation flats.

Response:

Not confirmed. Witness Kelley should be the one to explain any cost comparisons he presents. However, the column headings in the interrogatory response you cite suggest that the comparison shown is between the test year in Docket No. R2005-1 and the test year in the instant docket. Taking the headings at face value, then, they would seem to contain no information relating to the statement you wish to have confirmed.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-34.**

Other than your reference to “historical levels,” do you have any reasons to question the accuracy of the city and rural delivery unit costs for ECR high-density flats provided by the Postal Service? If so, please state those reasons.

Response:

Yes. The phrase “historical levels” appears on page 174, line 5, of my testimony. On the same page, line 2 refers to the small volume behind the estimate and lines 5 through 8 comment on the “casing advantage” associated with high-density flats.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-35.**

Please refer to your testimony at page 174, line 9. Please confirm that you have no basis in the data in this case for crediting 1.4 cents of high density cost savings to saturation mail. If you cannot confirm, please provide full citations to that data.

Response:

Not confirmed. I have not credited 1.4 cents of “high-density cost savings to saturation mail.” The sentence in my testimony after the one you quote explains what is happening.

As a simple example, consider a subclass with no markup, so that the rates are equal to the costs. Suppose the cost of basic is 10 cents, the cost of high-density is 6.6 cents, and the cost of saturation is 5 cents. Absent special considerations, these would be the rates. However, if a decision were made to set the high-density rate at 8 cents, 1.4 cents higher than 6.6 cents, this would not provide a reason to change the rate of saturation from its level of 5 cents. The reference to *transferring* derives from a schematic involving a vertical column in a presort tree.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-36.**

Please refer to pages 174-175 of your testimony. Explain fully how crediting saturation flats with 1.4 cents of cost savings attributed by the Postal Service to high-density flats will allow saturation flats rates “to be based on its costs.”

Response:

Please see my response to NAA/VP-T1-35.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-37.**

Please refer to page 176, line 7 of your testimony. Do you believe that 41.4 percent of saturation flats will use DALs in the Test Year? Why?

Response:

Not necessarily. I know of no way to project the proportion of saturation flats that will use DALs in the test year.

**Response of Valpak Witness Mitchell  
to Newspaper Association of America**

**NAA/VP-T1-38.**

Assume that there is credible reason to believe that the proportion of saturation flats using DALs in the Test Year will be substantially less than 41.4 percent. How should your rate proposal be modified to accommodate that scenario?

Response:

Adjusting rate proposals for changes in billing determinants between the base year and the test year is a complex process and is not done often. It requires not only volume estimates, sometimes developed from quantitative marketing research, but also associated cost estimates.

In this particular case, what is being proposed by the Postal Service may be quite reasonable. Assume that the rates are designed appropriately, based on unchanged billing determinants. If some pieces with DALs convert to pieces with on-piece addresses, there will be a reduction in the volume of DALs. Witness Kelley has suggested that there may be some "offset" in terms of the time taken to deliver flats with on-piece addresses being higher than the time taken to deliver flats with DALs (with the cost of the DALs themselves left out of this comparison). Without this offset, and probably even with the offset, the savings associated with the conversion is probably larger than 1.5 cents. However, capturing the savings will require route adjustments, which may take some time. Thus, the savings in the test year could be higher or lower than 1.5 cents. Given all of this, it may be better not to attempt adjustments now, and to recognize new volumes and costs in a future case. (The offset is discussed on page 129 of my testimony.)