

OFFICIAL TRANSCRIPT OF PROCEEDINGS BEFORE THE POSTAL RATE COMMISSION

In the Matter of:)
POSTAL RATE AND FEE CHANGES) Docket No.: R2006-1

VOLUME #25

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

Date: October 31, 2006
Place: Washington, D.C.
Pages: 8792 through 9102

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C O N T E N T S

WITNESSES APPEARING:
 ROBERT W. MITCHELL
 ROGER C. PRESCOTT
 J. EDWARD SMITH

<u>WITNESSES:</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>	VOIR
Robert W. Mitchell					
By Mr. Olson	8799	--	9034	--	--
By Mr. McLaughlin	--	8949	--	--	--
	--	9029	--	--	--
By Mr. Baker	--	8976	--	--	--
By Ms. McKenzie	--	8997	--	--	--
By Mr. Todd	--	9020	--	--	--
By Mr. McKeever	--	9025	--	--	--
Roger C. Prescott					
By Mr. Todd	9040	--	9081	9085	--
By Mr. Baker	--	9068	--	9085	--
By Mr. McKeever	--	9072	--	9082	--
	--	9080	--	--	--
By Ms. McKenzie	--	--	9081	--	--
J. Edward Smith					
By Mr. Richardson	9087	--	--	--	--

C O N T E N T S

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Designated written cross-examination of Roger C. Prescott, MOAA-T-1	9044
Designated written cross-examination of J. Edward Smith, OCA-T-2	9089

E X H I B I T S

<u>EXHIBITS AND/OR TESTIMONY</u>	<u>IDENTIFIED</u>	<u>RECEIVED</u>
Corrected direct testimony of Robert W. Mitchell on behalf of U.S. Postal Service, VP-T-1	8800	8800
Designated written cross-examination of Robert W. Mitchell, VP-T-1	8802	8802
Corrected direct testimony of Roger C. Prescott on behalf of Mail Order Association of America, MOAA-T-1	9040	9041
Designated written cross-examination of Roger C. Prescott, MOAA-T-1	9043	9043
Corrected direct testimony of J. Edward Smith on behalf of Office of Consumer Advocate, OCA-T-2	9086	9088
Designated written cross-examination of J. Edward Smith, OCA-T-2	9088	9088

P R O C E E D I N G S

(9:35 a.m.)

1
2
3 CHAIRMAN OMAS: Good morning. Today, we
4 continue hearings to receive the direct case of
5 participants other than the Postal Service in Docket
6 No. R2006-1 concerning the Postal Service's request
7 for rate and fee changes.

8 Before we proceed this morning, does anyone
9 have any procedural matters to discuss at this point?

10 (No response.)

11 CHAIRMAN OMAS: There being none, three
12 witnesses are scheduled to appear today. They are
13 Witnesses Mitchell, Prescott, and Smith. Our first
14 witness today has already taken the oath in this
15 proceeding.

16 Mr. Olson, would you like to begin and
17 identify him for the record, please?

18 MR. OLSON: Thank you, Mr. Chairman.
19 William Olson representing Val-Pak and calling to the
20 stand Robert W. Mitchell.

21 Whereupon,

22 ROBERT W. MITCHELL

23 having been previously sworn, was recalled
24 as a witness and was examined and testified further as
25 follows:

1 MR. OLSON: Shall I proceed?

2 CHAIRMAN OMAS: Yes, please.

3 DIRECT EXAMINATION

4 BY MR. OLSON:

5 Q Mr. Mitchell, do you have with you two
6 copies of what is identified as the "Direct Testimony
7 of Robert W. Mitchell Concerning Standard Mail on
8 behalf of Val-Pak Direct Marketing Systems, Inc., and
9 Val-Pak Dealers Association, Inc.," designated as VP-
10 T-1?

11 A Yes, I do.

12 Q And is this testimony as it was originally
13 filed, or have there been errata made?

14 A We filed an errata on the 15th of September,
15 and the only change involved in that errata was that
16 we cleaned up the table of contents. There were not
17 substantive changes to the remainder of the testimony.

18 Q Did you also prepare and file workpapers in
19 this docket?

20 A Yes, I did. I have one work paper, which is
21 contained in Val-Pak Library Reference No. 1.

22 Q And do you adopt this testimony and this
23 library reference as your testimony in this docket?

24 A Yes, I do.

25 MR. OLSON: Mr. Chairman, with that, we

1 would like to move the admission of VP-T-1 and the
2 library reference, **VPLR-1**, into evidence in this
3 proceeding.

4 CHAIRMAN OMAS: Is there any objection?

5 (No response.)

6 CHAIRMAN OMAS: Hearing none, Mr. Olson,
7 would you provide the reporter with two copies of the
8 corrected direct testimony of Robert W. Mitchell?

9 That testimony is received into evidence.
10 However, as is our practice, it will not be
11 transcribed.

12 (The documents referred to
13 were marked for
14 identification as Exhibit
15 Nos. VP-T-1 and **VPLR-1** and
16 were received in evidence.)

17 CHAIRMAN OMAS: Mr. Mitchell, have you had
18 an opportunity to examine the packet of designated
19 written cross-examination provided to you this
20 morning?

21 THE WITNESS: Yes, I have.

22 CHAIRMAN OMAS: If the questions contained
23 in that packet were posed to you today orally, would
24 they be the same as those you previously provided to
25 the Commission?

1 THE WITNESS: With the exception of three
2 small edits that would like to make, the answer is
3 yes. Much to my dismay, we found three small changes.

4 The first one is on Advo No. 19. The first
5 line of my answer in Advo 19 has an extraneous word.
6 The third word in the first sentence is the word
7 "does." I would like to remove that word.

8 The second change that I would like to make
9 is in USPS-17. In USPS-17, the first line of the
10 second paragraph, the sixth word appears as "nations,"
11 and it should be "notions." So we changed the A to an
12 O.

13 The final change is in USPS-20. USPS-20 has
14 an introductory paragraph and then an Item A. At the
15 end of the first line of Item A, the third sentence
16 should say: "One of the things." The word "the"
17 should be inserted between the word "of" and the word
18 "things."

19 CHAIRMAN OMAS: Are there any additional
20 corrections or additions that you would like to make
21 to your answers?

22 THE WITNESS: No.

23 CHAIRMAN OMAS: Counsel, would you please
24 provide two copies of the corrected designated written
25 cross-examination of Witness Mitchell to the reporter?

1 That material is received into evidence, and it is to
2 be transcribed into the record.

3 (The documents referred to,
4 previously identified as
5 Exhibit Nos. VP-T-1 and VPLR-
6 1, were received in
7 evidence.)

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 2006

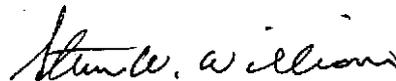
Docket No. R2006-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS ASSOCIATION INC.
WITNESS ROBERT W. MITCHELL
(VP-T-1)

Interrogatories

Advo, Inc.	ADVONP-TI-3, 12, 14-19 USPSNP-TI-5-6, 16
Mail Order Association of America	ADVO/VP-T1-1-2, 4-8, 10-11, 13 NAA/VP-T1-3, 21-23, 27-28. 31-35 USPSNP-TI-1-4, 11, 13, 15, 17-36
Newspaper Association of America	ADVONP-TI-14 NAA/VP-T1-1-4, 6-9, 11-15, 18-19, 21, 23-24, 26- 27. 29-31, 24-35. 37-38 USPS/VP-T1-15-17, 25-26, 28-29, 33
Postal Rate Commission	ADVONP-TI-14. 19 NAA/VP-T1-38 USPSNP-TI-7, 16
United States Postal Service	USPSNP-TI-1-36

Respectfully submitted,



Steven W. Williams
Secretary

INTERROGATORY RESPONSES OF
VALPAK DIRECT MARKETING SYSTEMS, INC. AND VALPAK
DEALERS' ASSOCIATION INC.
WITNESS ROBERT W. MITCHELL (T-1)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

InterrogatoryDesignatina Parties

ADVO/VP-T1-1	MOAA
AOVONP-T1-2	MOAA
ADVO/VP-T1-3	Advo
ADVO/VP-T1-4	MOAA
ADVONP-TI-5	MOAA
ADVONP-TI-6	MOAA
ADVONP-TI-7	MOAA
ADVO/VP-T1-8	MOAA
ADVONP-TI-10	MOAA
ADVO/VP-T1-11	MOAA
ADVONP-TI-12	Advo
ADVONP-TI-13	MOAA
ADVONP-TI-14	Advo. NAA. PRC
ADVONP-TI-15	Advo
ADVONP-TI-16	Advo
ADVO/VP-T1-17	Advo
ADVO/VP-T1-18	Advo
AOVONP-TI-19	Advo. PRC
NAANP-TI-1	NAA
NAANP-TI-2	NAA
NAA/VP-T1-3	MOAA. NAA
NAA/VP-T1-4	NAA
NAA/VP-T1-6	NAA
NAA/VP-T1-7	NAA
NAA/VP-T1-8	NAA
NAA/VP-T1-9	NAA
NAANP-TI-11	NAA
NAA/VP-T1-12	NAA
NAANP-TI-13	NAA
NAANP-TI-14	NAA
NAA/VP-T1-15	NAA
NAA/VP-T1-18	NAA

Interrogatory

NAA/VP-T1-19
 NAA/VP-T1-21
 NAA/VP-T1-22
 NAA/VP-T1-23
 NAANP-TI-24
 NAA/VP-T1-26
 NAA/VP-T1-27
 NAA/VP-T1-28
 NAANP-TI-29
 NAANP-T1-30
 NAANP-TI-31
 NAA/VP-T1-32
 NAANP-TI-33
 NAA/VP-T1-34
 NAANP-TI-35
 NAANP-TI-37
 NAA/VP-T1-38
 USPSNP-TI-1
 USPSNP-TI-2
 USPSNP-TI-3
 USPSNP-TI-4
 USPSNP-TI-5
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Designating Parties

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 MOAA, USPS

Interrogatory

USPS/VP-T1-20
USPSNP-TI-21
USPSNP-TI-22
USPSNP-TI-23
USPSNP-TI-24
USPSNP-TI-25
USPS/VP-T1-26
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Designating Parties

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Response of **Valpak** Witness Mitchell
to Interrogatory **of** Advo, Inc.

ADVO/VP-T1-1.

On pages 42ff, you discuss economic efficiency and the recognition of value in ratemaking. On page 44 (lines 13 ff), you state that: "The concept of value, as developed to a high level of agreement through economic writings beginning as early as 1850, is central to explaining and understanding the decisions made by consumers, whether individuals or **firms**."

- (a) Please explain whether the term "value" as you use it could also be called "utility."
- (b) Please explain whether the term "[consumer] surplus" (e.g., page 46, line 19) can also be termed as total utility minus total consumer cost **at** a particular price point.

Response:

- (a) Basically, yes. Several observations may be helpful

When attention is directed to notions of economic efficiency, the usual formulation is to say that U is a function of the quantities of the goods consumed. That is, the utility (or the happiness level, or the value received) depends on how much of good A is consumed, how much of good B, and so on. Then a budget constraint is imposed, under the presumption that buyers have limitations on what they can spend. This constraint is very simple; it just says that the sum of the price of A times the quantity of A, the price of B times the quantity of B. ... , and so on, is equal to the total number of dollars available to spend. This is a very general and very basic formulation, with which no one could argue.

Given this formulation, simple though it may **be**, it is possible, using the logic of mathematics, to maximize U, subject to the budget

Response of Valpak Witness Mitchell
to Interrogatory of Advo, Inc.

constraint, **and** see if there are implications for what the prices should be. Fortunately, implications exist and they turn out to be reasonably simple, at least in concept, even though they do include cross elasticities. Specifically, the implications are that the prices should bear a well-defined relation to the ordinary market demand curve and its elasticities. In the case where the cross elasticities are zero, or, as a practical matter, low, the implication is that the distance of the prices above marginal costs should be inversely related to the absolute value of the own-price elasticities, the relationships involved being commonly referred to as following the inverse elasticity rule. Importantly, the distance of the prices above the **marginal** costs must be measured in percentage terms. This was essentially noted, for **example**, in the footnote of Professor Stigler referenced on page 105 of my testimony, lines 17 and 18.

Once it becomes clear that demand curves are important to maximizing utility, two refinements to thinking become possible. The first is **that** the demand curves, being a quantification of how much the market actually would purchase **at** various prices, allows the utility to be measured in dollars, with the area under the curves (from 0 up to the quantity purchased) usually referred to as the **value** received by the buyers. The second is that **some** of the buyers are **firms** instead of individuals. Since **firms** are **inanimate** objects, it is common to think of

Response of Valpak Witness Mitchell
to Interrogatory of Advo, Inc.

the benefits to them as involving dollars instead of utility. Assuming competition in the economy, the fact that benefits accrue to firms is not a limitation on the theory, because benefits to firms make their way to final consumers. (Almost no one argues that an agency like the Postal Service should make presumptions about how the private economy should work, look for flaws of one kind or another, and attempt to correct for those flaws by moving prices in one direction or the other from their otherwise appropriate level.)

- (b) Yes. If a consumer receives value of \$150 from purchasing an item, but must pay with \$98 during the purchase, the consumer's **surplus** is **\$52**. Similarly, a **firm** can receive **surplus**, generally referred to as producer surplus, which, *ceteris paribus*, adds to profits, whether profits are positive or negative.

Response of Valpak Witness Mitchell
to Interrogatory of Advo, Inc.

ADVO/VP-T1-2.

On pages 73 ff, you discuss "value of the mail service actually provided each class or type of mail service . . ."

- (a) Please confirm that at a particular price point, the marginal utility of the mail to a mailer determines price sensitivity at that price point. If **you** cannot, please explain your response.
- (b) Please **confirm** that, **at** a particular price point, demand (marginal utility) determines that mailer's price sensitivity at that price point. If you cannot, please explain your response.
- (c) Please **confirm** that the greater the price sensitivity of the mailer at a particular price point (ceterus paribus), the more consumer total utility and surplus (total utility minus total cost) increase as price decreases. If you cannot, please explain your response.
- (d) Please confirm that, the lower **the** price sensitivity of a mailer at a particular price point (ceterus paribus), the less consumer utility **and** surplus (total utility minus total cost) decline as price increases. **If** you cannot, please explain your response

Resoonse:

- (a-d) I believe all of these can be confirmed, although it might in some cases be better to refer to percentage changes instead of to absolute changes. In applying them to actual situations, I reserve judgment on whether the implications of particular terms would require clarification. **For** example, one could argue that a "mailer's price sensitivity" determines demand, instead of the other way **around**. **Also**, the market demand **curve** is a collection of the behavior of both actual buyers and potential buyers, making it important to keep in mind that **(1)** it is just as important to recognize new buyers **as** it is to **think** about existing buyers that might change the quantity they purchase, and **(2)** no one would

**Response of Valpak Witness Mitchell
to Interrogatory of Advo, Inc.**

expect all buyers **in a** market to behave in the same way. **See also** my
response to ADVO/VP-T1-1

Response of Valpak Witness Mitchell
to Interrogatory of Advo, Inc.

ADVO/VP-T1-3.

On pages 59-60, you discuss private delivery alternatives and describe the large number of free community newspapers that are delivered privately now and the number of private carriers that you have spoken with. On page 82 (lines **22-26**), you state: "Much of the mail that is candidate for being handled by alternative carriers weighs **more** than 3.3 ounces, and therefore pays the pound rates **of** either ECK or Regular. Private carriers have less difficulty competing for relatively heavy mail than for relatively light mail." On pages 84-85, you discuss the types of Standard mail that may be carried by private competitors: merchandise, pieces over 24 pages, and saturation pieces whose addresses can be removed.

- (a) Based on your experience, please describe the extent to which the free papers are letter-shaped (**as** opposed to flat-shaped).
- (b) Based on your experience, please describe the extent to which private carriers deliver individual letter-shaped pieces (as opposed to flat-shaped pieces or letter-shaped pieces within a flat-shaped piece).
- (c) Please confirm that the private delivery exception for pieces over **24** pages applies to "books and catalogs consisting of **24** or more bound pages" (See 39 **C.F.R.** §310.1(a)(7)(v)).
- (d) Based on your experience, please describe the extent to which books and catalogs with **24** or more bound pages are letter-shaped (as opposed to flat-shaped), and the extent to which any such letter-shaped **books** and catalogs are delivered privately.

Response:

The items I mentioned on page **84**, lines 4-5 of my testimony were intended to be examples of items which are excluded from the Private Express Statutes, not an exhaustive list. Further, I note that the **use** of the word "letter" in the Private Express Statutes is likely not the same as "letter" or "letter shaped" **as** used in mail classification.

- (a) My experience suggests that almost all "free papers" are flat-shaped.

Also, the free papers I have seen tended to be relatively heavy and could

Response of Valpak Witness Mitchell
to Interrogatory of Advo, Inc.

not be converted into letter-shaped pieces. I have seen some free papers that weigh over 16 ounces, specifically in the case of harvest editions, which are published in the fall. I represent my experience for what it is, not as a comprehensive market survey

- (b) My experience suggests that the private delivery of letter-shaped pieces is limited, perhaps very limited. This does not mean that more would not be delivered if there were a change in the mailbox rule.
- (c) Your statement appears to be generally correct, but omits reference to telephone directories and I note there is no clear definition of "bound" in the regulation. I have **not** presented myself as an expert on how the Private Express Statutes should be interpreted and applied; instead, I have simply presented my understanding of these matters, as applicable to rate development. I note that § 310.1(a)(7) lists items that "are not letters within the meaning of" the Private Express Statutes, but it does not say that all items **not in** the list *are* letters. A footnote at the beginning of this section begins: "Several of the items enumerated in this paragraph (a)(7) do not self-evidently lie outside of the definition of 'letter.'" I would presume it to be the case, whether the Postal Service has determined it or not, that some items **not** enumerated also lie outside of the definition, whether self-evident or not

**Response of Valpak Witness Mitchell
to Interrogatory of Advo, Inc.**

- (d) I have no experience to suggest that a significant proportion of books and catalogs with 24 or more bound pages are letter-shaped. although I have seen a number of booklets that are letter-shaped and that, when sent through the mail, are tabbed. Whether some of these are delivered privately, I do not know.

Response of Valpak Witness Mitchell
to Interrogatory of Advo, Inc.

ADVOIVP-T1-4.

Please explain the difference between the TYBR attributable ECRINECR cost of \$3,189,042,000 in cell E8 of sheet "Inputs" of VP-RWM-Workpaper-8 and the USPS witness Waterbury D report (TYBR PRC Version) of \$3,189,157,000 in ECR/NECR costs.

Response:

In checking into your question, I found that the original D Report, contained in USPS-LR-L-96, was supplemented by an addendum D Report, contained in USPS-LR-L-169, on August 15, 2006, in response to a Commission 'request to witness Waterbury for corrected library references ...that 'include the corrections to the APC cost reduction and the corrections to the periodical air transportation' figures." Notice Concerning LR-L-169, et al., August 15, 2006. The D Report in the addendum shows a cost of \$3,189,175,000, which, except for what might be a reversal of two digits, appears to be the number referenced in your question. I found that putting the "addendum" figure into my worksheet does not change any of the rates.

Response of Valpak ~~Witness~~ Mitchell
to Interrogatory of Advo, Inc.

ADVONP-T1-5.

On page **118**, you state that: ". . .the difference between them [letters and flats within the same subclass] is not a matter of worksharing. The default recognition for a cost difference under these conditions is the subclass cost coverage, but certainly at least **100 percent**." On pages **183-184** (lines 20 ff), you assert that the **ECR** letter-flat rate differential should **be** based on a passthrough of the full letter-flat cost differential (adjusted to reflect origin entry) multiplied by the subclass cost coverage. On Page **178** (lines **13-14**), you state: "This [**100%** passthrough of the Basic letter-flat origin cost difference] is far less than a passthrough equal to the subclass **cost** coverage, which, in theory, I see no reason should not be the default prescription for letters and flats, which are for all practical purposes separate products."

- (a) Please confirm that your concept is that 100% of the total origin cost difference between different "products" (within the same subclass) multiplied by subclass cost coverage should be the basis for the rate difference between ~~the~~ two "products." If this is incorrect, please provide the **correct** explanation.
- (b) Please explain why the product markup is based on total origin cost when the subclass markup **is** based on total actual cost, and origin cost is a non-existent cost for a majority of the pieces in each of the "products?"
- (c) Under your theoretical design of rates for separate "products" within a subclass, is there a cost coverage objective for each product individually relative to the cost coverage for the entire subclass? Please explain fully.
- (d) Please provide all economic documentation you have that supports your above-cited concept ("theory") of ~~the~~ appropriate way to develop rate differences between two "products" within the same subclass.

Response:

- (a) Confirmed, with comment. I have referred to this as the *default* passthrough. This means that reasons may be found for deviating from it. These reasons should be stated.
- (b) I have focused on the origin passthrough because it abstracts from questions relating to the dropship discounts, which should be considered a separate subject.

Response of Valpak Witness Mitchell
to Interrogatory of Advo, Inc.

- (c) No. As long as two categories that are essentially separate products are in the same subclass, I tend to look at the subclass markup as applicable to each **of** them, at least as a default position. The way I have applied this is to operate at the basic level, origin entered. This allows separate questions to be asked about **presort** discounts and dropship discounts, as noted in part (b) above.
- (d) Perspectives on postal rates have **evolved** before the Commission. with inputs from the courts and a number of intervenors, the latter providing testimony and analysis from a considerable range **of** experts. I draw heavily on this evolution and feel like my understanding has evolved along with it. Application of a coverage factor has been standard fare in many situations, including rates differentiated by weight and zone in Parcel Post and Priority Mail. In Standard mail. a conclusion has been that costs relating to weight should receive a markup, in the same way. The question of letters and flats in Standard was a new issue in Docket No. R90-1, and has taken several turns since. Particularly in sections beginning on pages **114, 156, and 178** of my testimony, this issue is discussed at some length.

Response of Valpak **Witness** Mitchell
to Interrogatory of **Advo**, Inc.

ADVONP-T1-6.

On page 118 (lines 5-8), you state that: "Letters and flats tend to be separate products with separate processing streams . . . the difference between them is not a matter of worksharing." On page 178 (lines 13-16), you state that ECR letters and flats " . . . are for all practical purposes separate products."

- (a) Please explain what you mean by "product" and clearly differentiate that term from the traditional postal terms of "subclass" and "rate category."
- (b) Please provide your understanding of how much difference there must be between two "products" in order to call them "separate" and apply separate cost coverages to their origin costs while keeping them within the same subclass.
- (c) Please provide your understanding of how much difference there **must** be between two "products" in order to separate them into two separate **subclasses**.
- (d) Please identify all the separate "products" in the Standard Regular subclass.

Response:

- (a) Please see my discussion of deaveraging beginning on page 10 of my testimony. **Also**, accept the term *category* as a generic one, useful for referring to some kind of grouping, which may receive **separate** rate recognition, may **be** a product, and/or may be a subclass. Usually, the terms "rate cell" **and** "rate element" are used to refer to something finer than a category, but I know of no rule that this must be the case.

As if there were such a thing as a concept of a product that should be applied everywhere, the question of what is a product has received attention from time to time. My view of the matter is that if two categories tend to look like separate products, to be processed in

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separate mailstreams, to have different costs. to be purchased in markets that are arguably different, and to have relatively low cross elasticities, they tend to be separate products. When separate products or categories should be identified **as** separate subclasses is, of course, a subject that has been the source of a great deal of contention in rate proceedings. My view of how categories tending to be products should **be** handled in setting rates makes the subclass question a small additional step, instead of a large one. This in and of itself makes sense; major discontinuities in relationships between alternatives are not generally good things.

- (b-c) I find it difficult to describe degrees of differences of the kind of you seek, and to set up decision rules that identify critical levels that say: once you reach this hurdle, all relevant things change. If we had several hundred potential products to consider, guidelines might become more important. As it is, we have **only** a few. The best way to deal with them is to rely on testimony and deliberation before the Commission. The principal goal should be the development of paths that help lead us to fair and equitable rates.
- (d) Roughly, I would think that letters, flats, and parcels look like separate products.

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ADVO/VP-T1-7.

Are all ECR letters one "product" as you define ~~the~~ term?

- (a) If so, is it your belief **that** the only difference between basic ECR letters (with as few as 10 pieces per carrier route) and saturation letters is the degree of worksharing? Explain the basis for your answer.
- (b) If so, is it your belief that basic ECR letters (with as few as 10 pieces per carrier route) serve *the* same market and have the same price sensitivity as saturation letters? Explain the basis for your answer.
- (c) If not, please identify the number of separate letter "products" in ECR.

Response:

Basically, yes.

- (a) I do not know if any analysis **has** ever been done to determine whether 10pieces per route is the optimum cutoff, or the most appropriate. When saturation rates were first proposed in Docket No. R90-1, saturation mail had a walksequence requirement, which amounted to *optional* preparation, while basic pieces did not. Now, all of the pieces have a *line-of-travel* or walk-sequence requirement, essentially removing anything optional. Still, if cased, saturation letters would be cased faster **than** basic letters, suggesting work that does not need to be done. **On** the other hand, automation compatibility was not an issue at that time, particularly for carrier route mail, but both high-density and saturation must now be automation compatible, though not basic. The section beginning on page **123** of my testimony discusses this issue. Therefore,

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there **are** worksharing differences, but **I** do not contend that there are not other differences as well, **as** discussed in part (b) of your question.

- (b) I have no evidence that could support an answer. My presumption would be, depending in part **on** how the term **market** is defined, that the markets differ and **that** the elasticity of saturation letters is higher than the elasticity of basic letters.
- (c) My testimony, of course, treats all ECR letters as one product, and adopts notions of **ECP** to recognize cost differences. Beyond this, I have not taken a position on whether there are, so to speak, sub-products of letters. However, a case could be made for giving separate recognition in rates to saturation letters, in part for competitive reasons.

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ADVO/VP-T1-8.

Are all ECR flats one "product" as you define the term?

- (a) If so, is it your belief that the only difference between basic ECR flats (with as few as 10 pieces per carrier route) and saturation flats is the degree of worksharing? Explain the basis for your answer.
- (b) If so, is it your belief that basic ECR flats (with as few as 10 pieces per carrier route) serve ~~the~~ same market and have the same price sensitivity as saturation flats? Explain the basis for your answer.
- (c) If not, please identify the number of separate flat "products" in ECR.

Response:

Basically, **yes**.

- (a) I do not know if any analysis has ever **been** done to determine whether 10 pieces per route is the optimum cutoff. or the most appropriate. When saturation rates were first proposed in Docket No. R90-1, saturation mail had a walksequence requirement, which amounted **to** *optional* preparation, while basic pieces did not. Now, all of the pieces have a line-of-travel or walk-sequence requirement. essentially removing anything optional. Still, if cased, saturation flats would be cased faster than basic flats, suggesting work ~~that~~ does not need to be done. Therefore, there **are** worksharing differences, but I do not contend that there are not other differences as well, as discussed in part (b) of your question.
- (b) I have no evidence that could support an answer. My presumption would be, depending in part on how the term **market** is defined, that the

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markets differ and that the elasticity of saturation flats is higher than the elasticity of basic flats.

- (c) My testimony, of course, treats all ECR flats as one product. and adopts notions of ECP to recognize cost differences. Beyond this, I have not taken a position on whether there are, **so to speak**, sub-products of flats. However, a case could be made for giving separate rate recognition to saturation flats, in pan for competitive reasons.

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ADVO/VP-T1-10.

On page 5, lines 4-6, you state that: "The design of rates within subclasses should also be guided by principles, including notions of worksharing, efficient component pricing, cost-based rates, the efficiency of signals sent to mailers, and fairness." Please refer to the Direct Testimony of John C. Panzar (PB-T-1) where he states that the principles supporting efficient component pricing also apply to basing rate differences - other than worksharing discounts - on cost differences. On page 45, lines 9 ff, he states:

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

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

- (a) Do you agree with Dr. Panzar? If not, please explain fully why not.
- (a) Please identify the ECR rate categories/elements for which you would develop rates on the basis of efficient component pricing

ResDonse:

- (a) I agree that we should all be working together to improve our understanding of these issues and our ability to apply that understanding;

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but at this point, I disagree respectfully with Dr. Panzar. A range of considerations is involved in these matters, which probably explains why it is easy for opinions to differ on implementation. My position is that there should be limits to the strict adherence to **ECP** (sometimes **ECPR** [R = Rule]) principles and that one of the limits should involve identifiable and separate categories within subclasses, particularly categories that can easily be viewed as separate products.

In a broad sense, an interest in the efficiency of resource allocation in the economy suggests that the distance of rates from marginal costs, measured in percentage terms, is critically important. As rates are moved further and further from costs, or as some rates are moved further from costs than other rates are from costs, the efficiency tends to decline, **unless** there are elasticity reasons for the disparities. On this basis alone, then, any approach to ratesetting that neglects elasticities and places some rates closer to costs than other rates are to costs is suspect, and this is precisely what **ECP** does.

The **standard** mail subclasses include a range of categories that differ significantly in terms of cost. Under these conditions, an approach that focuses on per-piece markups, **as ECP** does, is a prescription that turns attention away from the percentage relationships known to be relevant, and that leads invariably to some rates being relatively far from

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costs and to other rates being relatively near costs. Therefore, in this setting, ECP raises questions that need to be addressed. Specifically, if per-piece contributions are to receive attention, there needs to be a justification for doing so.

The justification for emphasis on per-piece contributions can be looked at in two ways. The first is to look at reasons why attention to the elasticity relationships, as commonly particularized in the Ramsey formulas, presents difficulties. Dr. Panzar has a section discussing this issue. The second is to focus positively on the merits of the ECP approach, which Dr. Panzar also addresses. I will discuss both of these ways.

In explaining why giving weight to the elasticities, and therefore to the Ramsey formulas, presents difficulties, Dr. Panzar presents four considerations. The first consideration is:

First, Ramsey Pricing requires precise information about production costs and **consumer** demands. **ECPR** requires only information about **cost** differences at the margin. **Thus** a system of prices that provide incentives for **efficient** worksharing can be put in place **using** only the costing systems of the Postal Service. **Estimates** of demand elasticities **are** not required. [PB-T-1, p. 49, beginning on l. 6.]

As a practical matter, I do not see that these issues present difficulties, for several reasons. (1) I do not see that the cost information required

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for Ramsey pricing need be any more "precise" or accurate than the cost information required for ECPR. (2) I do not see the cost information required for ECPR as being less demanding than the costs required for Ramsey. For the most part, the cost differences required for ECPR have been found by faking the difference between two category costs, so the costs needed for Ramsey are known. (3) In cases where ECPR focuses on costs of a benchmark ~~that~~ is different from the costs available for the categories involved, I see ECPR casts as more demanding than Ramsey, not less. (4) The question of whether a special "margin" is needed for ECPR is an open one, but is **not** considered a relevant issue in Standard mail. One can argue ~~that~~ a margin associated with the cost of the next piece that would move to a workshare category, under a slight increase in the discount, should be used, **and** estimates of such a cost have been used in some cases, but this ~~again~~ makes greater demands on the costing, not less. Also, Dr. **Panzar** argues that the "theoretically correct approach" ~~to~~ estimating costs avoided is to use attributable costs, which is not a cost at a margin relating ~~to the~~ propensity to move to the workshare category (p. 29, ll. 1-2). (5) It is true that the use of Ramsey requires information on the elasticities involved, although I see no reason why ~~this~~ information has to be particularly "precise." However, elasticities are available at the subclass level and, absent evidence

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suggesting otherwise, I see no reason why the subclass elasticity should not be assumed and used for major components in the subclass. I believe we understand that cross elasticities are relatively unimportant if they are small; if they are large, I believe we understand that they move the Ramsey solution toward the ECPR solution, but not all the way. In short, none of the reasons discussed in this first consideration support adopting a direct application of ECPR and neglecting notions of economic efficiency. Some judgment may be required in dealing with these matters, but judgment is always required in ratesetting exercises.

Dr. Panzar's second reason for preferring ECPR to Ramsey is:

Second, Ramsey Pricing does not automatically ensure that prices are free of cross-subsidization. That is, it must be verified that the prices of each product are at least as large as the associated average incremental costs. This is much less likely to be a problem for worksharing discounts set in accordance with ECPR. Intuitively, as long as the base, non work-shared price covers its average incremental cost, application of ECPR will ensure that all of the associated discounted prices are also free of cross subsidy. [PB-T-1, p. 49, beginning on l. 11, footnotes omitted.]

I do not see that there is any meaningful likelihood of Ramsey pricing causing a cross subsidy. Unless there are significant differences in elasticity, which is not known to be the case among the categories in either Regular or ECR mail, a Ramsey solution goes in the direction of equal percentage markups over costs, which assures that each price is

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well above costs. On the other hand, ECPR produces different percentage markups, and is thus more likely than Ramsey to get into cross-subsidization territory. And, in Standard mail in particular, the markups are reasonably high, making it unlikely that even ECPR would lead to a cost-subsidy test being failed. Therefore, to the extent that concern over the matter of cross-subsidization exists, it cuts in favor of Ramsey, not ECPR.

Dr. Panzar's third reason for preferring ECPR to Ramsey is:

Third, Ramsey Pricing weighs surplus dollars equally. While appealing to economists, this neutrality does not allow for the Commission to exercise independent judgment with respect to the non cost factors specified by the Postal Reorganization Act. It is true that Ramsey Pricing principles could be applied using unequal welfare weights. However, ECPR facilitates the application of non cost factors on a subclass by subclass basis while maintaining incentives for efficient worksharing within a subclass. [PB-T-1, p. 49, beginning on l. 18.1

Equating the recognition of social policy to the application of "welfare weights," I agree that consideration is sometimes given to social policy in setting rates. However, this is most often done as a matter between subclasses. With the exception of First-class, the extent to which social policy is a factor within subclasses is more limited, and I do not see much role for it within Standard, a bulk subclass serving the business needs of firms and other organizations. For example, I do not see any

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social policy reasons to favor flats with a relatively low markup, compared to letters. In any event, I do not see any way in which the freedom **or** the latitude to consider social policy **among** subclasses is “facilitate[d]” by emphasis *within* subclasses on ECPR instead of economic efficiency. Similarly, I do not see any way in which the freedom or latitude to consider social policy within subclasses is constrained by a default position that emphasizes economic efficiency instead of ECPR. Both Ramsey and ECPR point to default positions but neither precludes recognition of other factors.

Dr. Panzar's fourth reason for preferring ECPR to Ramsey is:

Finally, and most importantly, ~~the~~ use of ECPR is much better suited to a constantly changing and evolving postal industry. In particular, it allows relatively straightforward adjustments to reflect changing worksharing technology without the need to obtain information on changing demand elasticities. [PB-T-I, p. 50, beginning on l. 4.]

Changes in the "postal industry" fall neatly into two camps. The first involves changes in markets, which could change the elasticities faced. The second involves changes in technology and factor prices, which could change Postal Service costs. ~~The~~ relation of ECPR to these differs.

In the first camp, changes in postal markets do occur, even though it is sometimes difficult to get a handle on them. When postal

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markets and associated elasticities change, the Ramsey model advises on how rates should be adjusted; ECPR does not. To say that ECPR is preferred as a guideline because it does not require information on elasticities is a *nun sequitur*, it justifies honoring an inferior guideline by pointing to the very reason it is inferior — that it cannot advise on how elasticities should be recognized or on how to adjust to changes in them. It is true, of course, that information on elasticities is hard to come by, and might be qualitative at best, but that is no reason to recommend sitting in the wrong place.

The second camp involves changes in Postal Service costs. The “particular” Dr. Panzar provides is that “worksharing technology” might change and that ~~this~~ might call for a corresponding adjustment in the rates. I do not see that “the use of ECPR” instead of Ramsey makes it any easier to make any needed adjustments. The facts are that changes **in** costs **can** be recognized under either approach. If new information on demand elasticities is not available, the elasticity effect underlying the current rates can be continued. If qualitative perspectives on elasticities ~~seem~~ reliable, they too can be considered. **As** noted above, some judgment may be required, but that is to be expected.

Combining all four of these considerations does not, in my opinion, add up to a conclusion **that** notions relating to economic

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efficiency should be viewed as either inapplicable or unduly difficult to apply within subclasses, and that ECPR should therefore be preferred.

This leaves the question of whether the positive attributes of ECPR argue for its broad or exclusive application within subclasses.

Dr. Panzar's "inclusive definition" of worksharing is that it "refers to any private sector *activity* which reduces the *costs* of the Postal Service" (p. 7, ll. 4-6, emphasis in original). This may be somewhat broad, **as** it includes the activity of not mailing at all and it makes everything hinge on how the word *activity* is defined. My preference is the slightly less inclusive definition that worksharing relates to mail preparation alternatives **faced** by mailers that allow mail to be entered further downstream, thereby allowing reduced Postal Service costs. This comports clearly with non-cost factor number 6 in the Act (39 U.S.C. § 3622(b)), which requires consideration of "the degree of preparation of mail."

Now, let's begin from a **base** position in which no worksharing is being done. From such a position, allowing worksharing discounts **has** several noteworthy characteristics. (1) So long **as** the discount is not larger than the unit incremental cost avoided, the discount can be offered without increasing the rates of any other mailers, so ~~that~~ the movement to the provision of a discount is a Pareto improvement, at least from the

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point of view of mailers. Such improvements are generally viewed favorably. (2) Under this same proviso, offering the discount does not make the Postal Service any worse off financially. Unless the Postal Service prefers a large payroll to a small one, which should not be a goal, the Postal Service should be indifferent to such a change. (3) If the cost to the mailer of the added preparation is less than the cost to the Postal Service of doing the work avoided, there is a net increase in efficiency, a reduction in combined cost, a lower net rate for the mailer, and the possibility that the mailer might enter more mail than before, due to elasticity. The potential gain here is very large. For example, having mailers presort 50 billion addresses on a computer for 1 cent per piece. so ~~that~~ the Postal Service ~~can~~ avoid sorts costing 4 cents each, would be a net savings to the nation of \$1.5 billion — not small on any scale. (4) Mailers moving from a non-workshared position to a workshared position would maintain their per-piece contribution to ~~fixed~~ costs (and therefore, by extension, to the costs of providing universal service). There may or may not be a policy preference for requiring that mailers beginning to workshare maintain their contribution. (5) If the cross elasticities between the workshare levels are reasonably high, as in mailers deciding to workshare on the basis of the discount, the discount under ECPR becomes close to one that would exist if the focus had been

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purely on economic efficiency instead. (6) Allowing a discount equal to the cost savings puts the Postal Service into the position of being able to say to the mailer that is unable to change the preparation of his mail:

“We are only charging you the *extra* cost of your mail, relative to the **cost** of workshared mail.” Charging only the extra cost is a rather high form of consideration. **As** a matter of social policy, this could be an attractive feature. (7) Worksharing **tends** to recognize a very important aspect of reality, that mailers, through the use of technology, planning, controlling, scheduling, and other decisions they make regularly are often well-positioned to prepare mail in ways that reduce overall combined costs, but they have no incentive to do this (in fact, it would cost them *extra*) without the discounts.

I do not see that any of these considerations, involving social policy or other matters, argues in any persuasive way that ECPR should be applied to the difference between categories like letters and flats. In fact, I **think** that the Postal Service is at its most basic level a carrier of letters **and** that nothing should be done to limit the extent to which mailers **are** permitted to avail themselves of the Postal Service’s letter-delivery facility. Also, ~~the~~ cross elasticity between letters and flats is generally considered to be low, meaning that the Ramsey solution might not be close to the ECP solution **and** that the gains from Ramsey might

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be reasonably large. In this regard, it is interesting that Dr. Panzar suggests in his discussion **of** letters and flats that the value of using flats instead of letters might "be dramatically different than the difference in Postal Service costs" (p. 45. ll. 18-19). This suggests, to me, that the cross elasticity may **be low**.

No reason is thus found to lean toward ECP considerations for the rate difference between letters and flats. The guideline of choice should be emphasis on concepts of economic efficiency, even though honoring such concepts does **not** represent an unmixed assignment in terms of simplicity **and** achieving agreement among all parties involved.

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ADVO/VP-T1-11.

On page 116 (lines 5-6), you state that you know of no evidence that the sensitivity of volume to price is much greater for ECR flats than for ECR letters.

- (a) Please provide all evidence you have that the price sensitivities of all the flat and letter "products" in Standard Regular are similar.
- (b) Please provide all evidence you have that the price sensitivities of all the flat and letter "products" in ECR are similar.
- (c) Are there any cross-price sensitivities among the "products" in Standard Regular? If so, please provide any information you may have.
- (d) Are there any cross-price sensitivities among the "products" in ECR? If so, please provide any information you may have.

Response:

- (a-b) I know of no evidence of comparative price sensitivity. In order to act, some evidence is usually required. If no evidence is available, the usual response is not to act as though it were
- (c-d) So far as I know, the conventional wisdom on this question is that the cross elasticities in question are reasonably low. In this regard, it is interesting that Postal Service witness Thress did not put a rate difference into his letter-flat share equations. See USPS-T-7, pp. 365-397. Many flats could not in any reasonable way be converted into a letter. Others are part of a business model that would not be served by a letter instead of a flat. Decisions to change format are often accompanied by other changes as well, such as a different quality or thickness of paper or the inclusion of art or photographs.

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ADVO/VP-T1-12.

On lines 11-13 of page 118, you state: "No theory of which I am aware suggests that two products, even though related, should have the same per-piece markups . . . "

- (a) Please explain what you mean by this statement.
- (b) Please explain what **you** mean by "related" and specify whether it involves to any extent cross-price sensitivities between the two "relations."
- (c) Please explain fully your criteria for determining how "related" products must be before they must (or must not) have the same per-piece markups.

Response:

- (a) The lines cited are part of a section that discusses the letter-flat rate differential. They mean that two products (like letters and flats) would be expected to have percentage markups, that the two percentage markups might or might not be the same, that having the same per-piece markups would be a special case of different percentage markups, and that **I know** of no theory of efficient resource allocation suggesting that this special case has any special properties to commend it.
- (b) For purposes of my response to this question, I **am** assuming that related products can be viewed **as relations**, in the same sense that a person might say "my relations are coming for dinner." The subject here, as noted in part (a) above, is letters and flats. Even if not suggested by the fact that they are in the same subclass, my reference *to* them being related is based on little more than that they are bulk categories used

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primarily for advertising purposes. Part of their relatedness is historical in that Congress created a hulk category that would pay pound rates, and did not distinguish between letters and flats. I did not mean to suggest high cross elasticities. If the cross elasticities were meaningfully high, the extent to which they are separate products would be reduced and the economically efficient rate differences would move downward toward the cost differences.

- (c) Assuming emphasis is placed on developing economically efficient prices, the cross elasticities would have to be reasonably high for the per-piece markups to be the same. I do not know a way to specify what the critical levels might be.

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ADVOIVP-T1-13.

Please refer to your discussion on pages 20 ff on the guidelines for de-averaging existing subclasses into two or more separate subclasses and refer again to your statement on page 118 (lines **5-8**) that letters and flats have separate processing streams.

- (a) Do you agree with the Commission that products within subclasses should be homogenous with respect to both cost and marker factors? Please explain.
- (b) Is it your opinion that Standard letters and flats no longer have common cost characteristics and that the cost characteristics within Standard are no longer homogenous? Please explain.
- (c) Is it your opinion that ECR letters and flats no longer have common cost characteristics and that the cost characteristics within ECR are no longer homogenous? Please explain.
- (d) Is it your opinion that ECR letters and flats have intrinsic cost differences because of their mail characteristics? Please explain.

Response:

- (a) Basically, yes, but **some comment** is needed. If subclasses were constructed to accord with strict homogeneity, "with respect to both cost and market factors," there would be a really large number of subclasses, and no discounts, no rate categories. and no rate cells would be needed. Short of rhat, the application of the principle you cite has been to select subclasses based on market factors, broad product lines, and costs generally, and then **to go further** in the direction of recognizing costs by establishing such rate features as rate categories, worksharing discounts, surcharges, zones, and weight cells.
- (b) See my response to part (a) above. My proposal is to recognize the cost differences between letters and flats, without dividing them in to separate

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subclasses. I do not know whether the degree of homogeneity, however that might be measured, **has** changed. I do not accept the "no longer" assumption in your question.

- (c) See my response to parts (a) and (b) of this question.
- (d) The subject of *intrinsic* cost differences has been a difficult one. Usually it means that cost differences are innate or inherent, and are difficult to attribute to particular separable characteristics such as the degree of presortation or dropshipping. Cost differences due to the bulk nature of the product, which would be greatest for saturation mail, would **be** an example of an intrinsic cost difference. The cost differences between letters and flats are due primarily to specific operations for flats costing more than corresponding operations for letters. Thus, there are differences in the costs of letters and flats, and the differences occur "because of their mail characteristics." I do not see anything critical that depends on the extent to which they are considered intrinsic.

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ADVO/VP-T1-14.

On page 176, you state that: "With the exception discussed above for high-density flats, setting rates in this way honors all of the costs in the tree."

- (a) Please explain fully what you mean by "honors."
- (b) Please explain fully how "honoring costs in the tree" comports with your concept of product pricing and economic efficiency.

Response:

- (a) The section you cite discusses setting the saturation discount relative to high-density. for flats. Since a limitation was placed on the high-density discount (relative to basic, as discussed in the section beginning on page 173), the section explains that the saturation discount was set in such a way that saturation mail was not disadvantaged by that limitation. My thinking in using the word *honor* was to say that the saturation costs were recognized in full, in this case as though the discount were given from the basic level instead of the highdensity level.
- (b) Recognizing costs in this way is consistent with notions of efficient component pricing, as they have been applied in developing discounts for saturation flats. I have not proposed any changes in this approach. If it were decided to place greater emphasis on economic efficiency, attention would have to be given to the various elasticities and cross elasticities involved, of which no estimates are available. If it is true, as I suspect, that the cross elasticities are small and that the own-price elasticity of

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saturation mail is relatively high, the **passthrough would** turn out to be over 100 percent.

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ADVO/VP-T1-15.

- (a) Do you have any knowledge or understanding of any differences in the typical frequency of mailing (e.g., weekly, monthly, less-than-monthly) between ECR saturation letter mailings and ECR saturation flat mailings? If so, please state your understanding and provide sources.
- (b) Are you aware of any **ECK** saturation letter mail programs that are mailed in a market on a regular weekly basis? If so, please identify the mailers and the markets, and quantify the volumes of such weekly-frequency saturation letter mail.
- (c) Are you aware of any ECR saturation letter mail programs that are mailed in a market on a more-frequently-than-monthly basis, i.e., more than 12 times per year? If so,
 - (i) please identify the mailers and the markets, and quantify the volumes of such saturation letter mail;
 - (ii) please state whether distribution more frequently than monthly is either commonplace, the exception, or nonexistent for saturation letter mail.
- (d) To the extent you believe there are differences in the typical frequency of mailing between **ECR** saturation letter mailings and saturation flat mailings, please describe the factors that you believe may account for the differences.

Response:

- (a) As stated in the testimony of witness Haldi: "Most [Valpak] franchisees mail at least 10 times per year, with the majority of offices mailing on a monthly schedule." VP-T-2, p. 7, ll. 1-2. These are all letter-size mailings. I receive other saturation letters at my home that appear to be monthly. I also receive several saturation *flats* mailings, some of which are weekly and some of which are monthly. I believe most weekly mailings that are saturation tend to flats. I have no basis for providing proportions that are representative of the entire postal market

**Response of Valpak Witness Mitchell
to Interrogatory of Advo, Inc.**

- (b) No.
- (c) No
- (d) Please see my response to ADVO/VP-T1-18(a).

**Response of Valpak Witness Mitchell
to Interrogatory of Advo, Inc.**

ADVO/VP-T1-16.

At page 84 of your testimony, you state that "limited portions of the mail matter in Regular and ECR can be carried by private competitors...."

- (a) Please confirm that ECR saturation letters could be sent privately if unaddressed.
- (b) Are any of Val-Pak's letter-size enveloped coupons distributed by private delivery, *not* mail? If **so**, please provide the following:
 - (i) the total volume of such privately-delivered pieces in 2005 and an estimate **for 2006**;
 - (ii) the percentage of Val-Pak's total enveloped coupon volume that is delivered privately; and
 - (iii) identify the markets where private delivery is used, and for each market identify the private delivery company used.

Response:

- (a) Confirmed, to the extent **of** my understanding
- (b) I am informed that they **are** not.

Response of Valpak Witness Mitchell
to Interrogatory of Advo, Inc.

ADVO/VP-T1-17.

Do you agree that the great majority of multi-page preprinted advertising circulars currently can be distributed either as inserts in newspapers, or as inserts in shopper publications or shared mail programs (which can be delivered either privately or via mail), without any change to the format of the preprint. If you disagree, please explain your understanding of the format and characteristics of such circulars, and how they differ between newspapers and mail and private delivery.

Response:

Although there could be differences in the range of addresses covered and the days on which service is available, I believe what you say is basically the case. I do not know what the relative charges would be or if the response rates of the recipients would be the same in each case.

Response of Valpak Witness Mitchell
to Interrogatory of Advo, Inc.

ADVOIVP-TI-18.

With respect to your statements that saturation letters and flats can be viewed as “separate products,”

- (a) Explain your understanding of why saturation shoppers and shared mail programs choose a flat-sized rather than letter-sized format for their mailing programs.
- (b) To what extent do you believe that their choice of format is dictated by competitive considerations (e.g., that reformatting their mailings to letter-size would impair their ability to compete for preprinted advertising circulars)?

Response:

- (a) **All** businesses are based on product or service concepts that the entrepreneur (or entrepreneurial organization) thinks are attractive. Support for specific product concepts is usually provided by an analysis that focuses on such things as alternative concepts, concept variations, postal rates, costs of production, the needs of customers, how those needs can be met effectively, and what related products are already being offered, including those by competitors. Although it is clear that some “saturation shoppers and shared mail programs” that use “flat-sized rather than letter-sized format[s]” have evolved, I know of no way to point to one or two factors and say: “this is why flats instead of letters are used.” This outline of the origins of products and services should not be taken to suggest that adjustments in the concepts are not made over time.

**Response of Valpak Witness Mitchell
to Interrogatory of Advo, Inc.**

- (b) I would presume that they have considered letter formats and have decided against them, with an eye toward profitability. The decision would be expected to recognize “competitive considerations,” among others.

Response of Valpak Witness Mitchell
to Interrogatory of Advo, Inc.

ADVO/VP-T1-19.

Currently, the rate for ECR basic letters is "linked" to the rates for the Standard A Regular subclass by being set higher than the rate for 5-digit automation letters. With this linkage to rates for the Regular subclass, if the rates for other categories within the ECR subclass are then set on the basis of cost differences, how does this result differ conceptually from the circumstance where ECR mail were treated as rate categories of Standard A Regular rather than as a separate subclass'?

Response:

It may ~~does~~ not differ conceptually, but the actual outcome depends on how the link is accomplished. For example, it could be accomplished by increasing the markup on ECR, which would affect all ECR rates. Alternatively, it could be accomplished by selecting disparate or extreme passthroughs within ECR, such as zero, in which case some categories might be affected more than others. In practice, a combination of both approaches could be used.

In my testimony (VP-T-1) in Docket No. R2005-1, I showed on reasonable assumptions that the rates for ECR materials would be lower if third class had not been deaveraged into two subclasses. The analysis is not simple, of course, in part because of the revised approach selected by Congress for developing the Nonprofit rates. Several observations on my analysis were made during the case. Postal Service rebuttal witness Kiefer said that I had written an "alternative history" about what "would have" happened. USPS-RT-1, p. 28, l. 11 and p. 29, l. 1, respectively, emphasis in original. It is true that I addressed the question of where things would stand if the deaveraging had not occurred — that was the point of the exercise — but all of the data

Response of **Valpak** Witness Mitchell
to Interrogatory of **Advo, Inc.**

I used were current, I honored all current costs and the Postal Service proposed revenue requirement for Standard mail, the rate development was **in line with** accepted principles, and no showing was made that any of my assumptions were unreasonable or unlikely. In its Opinion, the Commission reviewed this issue briefly and pointed to the relation between current cost coverages and those in Docket No. R90-1. (Docket No. R2005-1, *Op. & Rec. Dec.*, p. 97. ¶ 5046.) However, my analysis relied entirely on current costs and the cost coverages proposed **by** the **Postal Service** in Docket No. R2005-1.

Response of Valpak Witness Mitchell
to Newspaper Association of America

NAANP-TI-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.

Resuonse:

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-T1-6.

Is it your testimony that the Postal Service and Postal Rate Commission have not priced **ECR** mail on the basis of its cost and marker 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?

Resuonse:

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

NAAIVP-TI-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.

Resuonse:

- 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?

Resoonse:

Yes, it applies to all subclasses and all rates.

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

NAAIVP-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

USPSIVP-TI-16.

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?

Resoonse:

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

NAAIVP-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**

NAAIVP-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"?

Resoonse:

No.

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.

ResDonse:

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-T1-21.

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%?

Resuonse:

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 docs 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)?

Resuonse:

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.

Resoonse:

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

NAAIVP-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.

Resuonse:

No. The development of the highdensity 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 highdensity flats reported by the Postal Service? If so, please provide that analysis. If not, why not?

Resuonse:

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 \$32,982, 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 highdensity flats are delivered on rural routes. The comparison you make just means that proportionately more saturation flats are delivered on rural routes than highdensity 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.

ResDonse:

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 confiied.

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 highdensity 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 highdensity 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-T1-37.

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.)

Response of Valpak Witness Mitchell
to Interrogatory of USPS

USPS/VP-T1-1.

- (a) Please confirm that, under your proposed pricing a Standard Mail Regular automation 5-digit piece-rated letter entered at the DSCF would pay 18.2 cents per piece. If not confirmed, please supply the correct proposed rate.
- (b) Please confirm that, under your proposed pricing a Standard Mail ECR Basic piece-rated letter entered at the DSCF would pay 14.9 cents per piece. **If** not confirmed, please supply the correct proposed rate.
- (c) Please confirm that the rate difference between the above two letters is 3.3 cents per letter. **If** not confirmed, please supply the correct difference.
- (d) Is it your view that the rate difference confirmed or supplied **in** part (c) would be sufficient to cause some letters to migrate from Standard Mail automation to ECR basic if the mail preparation rules are the same as they are today? **If you do** not agree, please explain fully why you think that no letters would migrate.
- (e) If your response to part (d) is other than an unqualified negative, please explain what the revenue, cost and contribution impacts of this migration would be and describe how you took these impacts into account in preparing your alternative rate proposals.

Response:

- (a) Confirmed.
- (b) Confirmed.
- (c) Confirmed.
- (d-e) Certainly "some" letters would migrate. However, consistent with the testimony of Postal Service witness Tolley in Docker No. MC95-1, the cross elasticity between Regular and ECR is generally considered to be low. This was one of the factors considered when the ECR subclass was created. See the discussion of the Commission in its Opinion in that case, p. V-174, ¶ 5425.

The usual approach is to set rates on defensible bases, typically involving costs and the ratesetting policies of the **Act**, as developed and applied by the

Response of Valpak Witness Mitchell
to Interrogatory of USPS

Commission, and then to allow mailers to choose what is best for them.

Developing rates with an eye to keeping mailers in one category or another runs counter to **the** reasoning that should underlie the rates, and is not acceptable practice. See the Commission's discussion of this matter in its Opinion in Docket No. MC95-1, pp. V-161-62, ¶ 5388.

Some pieces once using carrier route rates have undoubtedly migrated to the 5-digit automation category in Regular, due to lower rates there, and some of the same pieces might migrate back, without finding the density requirement to be a hurdle. If sufficient information were available on the number of these pieces and their cost characteristics, I agree that adjustments could be made, as is sometimes done. Short of that, as is also done, the rates are developed based on current billing determinants and the future is allowed to occur. **New** volumes and estimates of new costs will become available to support realignment later.

In the instant docket, a considerable number of rate and classification adjustments are on the table. Detailed estimates of mailer responses and cost effects are sometimes rough and sometimes unavailable. Some changes will improve the Postal Service's finances and some will not. The net effect **can** be recognized in the next omnibus case. This reduces somewhat the accuracy of the breakeven estimate for any specific test year, but it is not inconsistent with

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

any notion of longer-term breakeven. We should be very careful not to let an interest in this type of accuracy stop progress toward improved rates.

Response of Valpak Witness Mitchell
to Interrogatory of USPS

USPS/VP-T1-2.

- (a) Please confirm that, under your proposed pricing a Standard Mail Regular automation 5-digit piece-rated flat entered at the DSCF would pay **34.5** cents per piece. If not confirmed, please supply the correct proposed rate.
- (b) Please confirm that, under your proposed pricing a Standard Mail ECR Basic piece-rated flat entered at the DSCF would pay **17.2** cents per piece. If not confirmed, please supply the correct proposed rate.
- (c) Please confirm that the rate difference between the above two flats is **17.3** cents per flat. If not confirmed, please supply the correct difference.
- (d) Is it your view that the rate difference confirmed or supplied in part (c) might induce some mailers to migrate the flats from Standard Mail automation to ECR Basic by sending duplicate mail pieces or otherwise padding their mailing lists to qualify for the ECR rates? If you do not agree, please explain fully why you think that no pieces would migrate.
- (e) If your response to part (d) is other than an unqualified negative, please state whether you believe that all migrating flats possess the demand and market characteristics that the Commission had in mind when it recommended ECR as a separate subclass. Please explain your answer.
- (f) If your response to part (d) is other than an unqualified negative, please state whether you believe that expanding the number of small carrier route bundles will increase or reduce Postal Service costs if the Postal Service transitions to automated flat sequencing? Please explain your answer.
- (g) If your response to part (d) is other than an unqualified negative, please explain what the revenue, cost and contribution impacts of this migration would be and describe how you took these impacts into account in preparing your alternative rate proposals.

Response:

- (a) Confirmed.
- (b) Confirmed.
- (c) Confirmed.
- (d) In response to any schedule of rates, mailers can be expected to make adjustments, including the possibility of gaming the system. Some mailers might be in a position to do the latter here. Several things can be said.

Response of Valpak Witness Mitchell
to Interrogatory of USPS

(1) Mailers generally have far more invested in a piece of mail than just the postage. One mailer told me that he had about 70 cents in each mailpiece, making postage a lesser consideration. (2) ECK pieces have line-of-travel requirements. The Postal Service considers now, and would consider in the future, how these requirements are written and applied. It might choose not to allow duplicate pieces to the same address. **Also**, mailers might have no interest in having recipients receive duplicates. (3) Mailers could seek out addresses not currently on their list. These could be more likely to be undeliverable. In addition, the response rates might be non-existent for such addresses and some mailers might have a preference against non-target recipients receiving their mailpieces. Similarly, some recipients might be averse to receiving such materials. (4) The Postal Service would have to evaluate the profitability of the additional pieces. Usually, firms and organizations *are* happy to have more business. Whether the Postal Service would assume the migrating pieces have the average costs of their categories, as it has done in some NSAs, is open to question, but the costs available for **ECR** flats are much lower than the costs for 5-digit automation flats. Another factor would involve the question of elasticities — some of the mailers receiving lower postage could decide to mail even more pieces, resulting in a net gain. In short, the problem may not exist in significant degree, and it could be a good thing instead of a bad one.

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- (e) I agree that the demand and market characteristics, on average, of 5-digit automation flats might be different from the demand and market characteristics, on average, of ECR flats. In fact, they might be *expected* to be different, since they are components of larger categories that are understood to be different. A lack of perfect uniformity always exists, however, in any classification scheme. The fact that it might exist here should not stop otherwise appropriate ratesetting.
- (f) The question of what happens under flats sequencing is an interesting one, but one on which no data and very little analysis are available. See responses of Postal Service witness Coombs to **AMZ/USPS-T44-1(c)**, **VP/USPS-T44-4(c)**, 14, and 18(d), and **NAA/USPS-T44-8**, 9, 10, and 11. Both costs and preparation requirements would be expected to change, making a great deal of current data inapplicable. I have no assessment to provide.
- (g) Please see my discussion of a similar issue in **USPS/VP-T1-1(d-e)**

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USPS/VP-T1-3.

- (a) Please confirm that, under your proposed pricing a Standard Mail Regular automation 5-digit piece-rated letter entered at the DSCF would pay 18.2 cents per piece. If not confirmed, please supply the correct proposed rate.
- (b) Please confirm that, under your proposed pricing a Standard Mail ECR Automation Basic piece-rated letter entered at the DSCF would pay **12.9** cents per piece. If not confirmed, please supply the correct proposed rate.
- (c) Please confirm that the rate difference between the above two letters is 5.3 cents per letter. If not confirmed, please supply the correct difference.
- (d) Please confirm that you propose that the Commission recommend that Standard Mail ECR Automation Basic rates be available to otherwise qualified letters addressed to all ZIP Codes and not be restricted to specific destinations as is currently the case.
- (e) Is it your view that the rate difference confirmed or supplied in part (c) would be sufficient to cause some letters to migrate from Standard Mail automation to ECR basic if the mail preparation rules are the same as they are today? **If you** do not agree, please explain fully why you think that no letters would migrate.
- (f) If your response to part (e) is other than an unqualified negative, please state whether you believe that the volume of migrating letters would be large relative to the current volume of ECR Automation Basic letters? **If you** did not estimate the volume of letters that would migrate **as** the result of your alternative rate proposals, explain why not.
- (g) **If** your response to part (e) is other than an unqualified negative, please explain what the revenue, cost and contribution impacts of this migration would be **and** describe how you took these impacts into account in preparing your alternative rate proposals.

ResDonse:

- (a) Confirmed.
- (b) Confirmed.
- (c) Confirmed.
- (d) Not confirmed. Please see page **126** of my testimony, **VP-T-1**, lines **12-21**. My suggestion is that the Commission "consider" such a classification, but I do not propose that the Commission recommend it. My hope is that if the Commission

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finds potential merit in such a classification. it will note such, and the Postal

Service will consider it further

(e, f, and g) **Not applicable.**

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USPS/VP-T1-4.

Please confirm that your proposed rates produce the percentage rate increases for the sample Standard Mail pieces shown in the table below;

	3 ounce	5 ounce	8 ounce	14 ounce
Standard Mail Regular				
Automation 5-digit , DSCF Letter	5.2%			
Automation 5-digit, DSCF Flat	39.1%	29.8%	19.7%	10.2%
Nonmachinable 3-digit DSCF Parcel	55.9%	49.9%	41.9%	31.9%
Machinable DBMC Parcel— Barcoded			73.4%	62.2%
NFM--3-digit DSCF	169.0%	141.7%	113.0%	85.7%
Standard Mail ECR				
Basic DSCF Letter	-15.8%			
Saturation DSCF Letter	-24.8%			
Basic DSCF Flat	-2.8%	-3.5%	-4.9%	-6.1%
Saturation DSCF Flat (On-piece Addressed)	-14.2%	-12.3%	-11.0%	-9.9%

Resoonse:

With three exceptions, I confirm the data in your table. For saturation 3-ounce flats (with address on piece), I get -14.8 percent. For the line for machinable parcels entered at the DBMC (barcoded), you do not specify the presort level. Under the assumption that the pieces are BMC presorted, are currently paying the basic rate, and are currently paying the residual shape surcharge, I get 53.4 percent for the 8-ounce pieces and 47.9 percent for the 14-ounce pieces

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USPS/VP-T1-5.

Please refer to page 105 of **your** testimony.

- (f) Please explain if your use of the term “Stigler’s second definition” of price discrimination is intended to assert that Professor Stigler adopted this definition in his work, or endorsed this definition’s use in preference to “Stigler’s first definition” of price discrimination in some or all applications.
- (g) If you do assert that Professor Stigler adopted or endorsed the second definition in preference to the first for some purposes, please give examples and citations of this preferred **use**.

Response:

Note: The original question contains a section f and a section g, but no other sections.

Those designations are maintained here.

- (f-g) The reference is to Professor Stigler’s introductory text, *The Theory of Price*.

As part of a discussion of prices differing from costs, he tightens the dialogue somewhat by dropping a footnote, with equations. He says “[o]ur definition of discrimination turns upon the” question of whether the ratios of price to marginal cost (the cost coverages, in postal parlance) are the same. Then, in the same footnote, in what I called his “second definition,” he says “[s]ome economists prefer the slightly different definition ~~that~~ prices are discriminatory if the difference in price is not equal **to the** difference in marginal cost,” which is the same **as** the products having the same per-piece contribution. He goes on to point out that the first definition has implications concerning the efficiency of resource allocation, which **is** an important issue throughout his book.

Otherwise, there is no particular sense in which he “adopts” one definition or

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the other, and he does not **specify** conditions **under** which the second one might be more relevant.

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USPS/VP-T1-6.

Please refer to pages 105 and 106 of your testimony. Please confirm that your use of the two definitions of price discrimination described in Professor Stigler's book to apply differentially to shape-based cost differences and worksharing cost differences represents your own opinion and is not based on any explicit or analogous usage of the two definitions by Professor Stigler in published work. If you do not confirm, please supply examples and citations to published work where Professor Stigler used these two definitions to apply as you suggest in your testimony.

Response:

I am not familiar with any published work of Professor Stigler wherein he deals with issues of discrimination in reresetting. Within a page or so of the two definitions at issue, however, he **does** discuss the importance of markets having different elasticities if discrimination is **to** occur and he does discuss the importance of markets being relatively independent, which is an issue of cross elasticity. Applying these notions to postal pricing is, in my opinion, relatively straightforward. (1) Differences in elasticities among subclasses receive a great deal of attention, but there is little discussion about whether the elasticities of categories within subclasses are different. **If** resources are to be allocated efficiently, another issue Stigler discusses at great length, this leads to equal percentage markups between categories like letters and flats, or least **as** a default solution. (2) Large potential gains being available on the technical side from having billions of pieces of mail processed in a lower-cost way, issues of worksharing have also received attention, with attendant arguments **of** significant cross elasticities between workshared and non-workshared mail. Since welfare gains tend to be smaller than these technical gains, and since any bases for discriminating

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among workshare categories are not generally clear, attention has focused on equality of per-
piece contributions.

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USPS/VP-T1-7.

Please refer to pages 109, lines 16-17 of your testimony. Do you consider parcels to be a "variant" of flats (or vice-versa) in the same or similar way that automation letters might be considered a variant of machinable letters?

- (a) If your answer to the above question is in the affirmative, please explain why these two shapes should be considered variants of each other.
- (b) If your answer to the above question is in the affirmative, please explain why letters and flats should not be similarly considered variants of each other.

Response:

- (a-bf) The relation between automation letters and machinable letters is an intra-shape distinction and is generally considered to be one of worksharing, although I understand that several requirements are involved. The relation among letters, flats, and parcels, however, is more distant, for several reasons. (1) In worksharing, the gains can be very large, as in having substantial portions of mail processed in a lower-cost way. Geometrically speaking, such gains can be thought of as the areas of rectangles, potentially several cents high and billions of pieces wide. Gains of this magnitude, which lead to a focus on cost avoidances, are not at issue in regard to movements between such categories as letters, flats, and parcels. (2) With automation, the processing of letters, flats, and parcels has become increasingly well defined and separate, much as though they were separate products. (3) The cross elasticities between letters, flats, and parcels are generally thought of as rather low. It is easy to conceive of a mailer saying to a mail preparation agency: "You can put a barcode on that flat if you

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want to, but don't you dare convert it into a letter." The reality is that separate markets are involved, again consistent with the notion of separate products.

(4)If the resulting prices or market position of letters, flats, or parcels were found to raise questions, **it** would be easy to argue that separate subclasses should be considered, in which case questions **of** different markups would arise immediately, clearly a step beyond thinking in terms of a high passthrough of a cost difference between them. **An** argument for an automation subclass would be much more difficult to defend.

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USPS/VP-T1-8.

Please refer to page 115, line 3 of your testimony. Please supply the data or studies you relied on to determine that the differences in average weight between commercial Standard Mail Regular Basic nonautomation letters and Basic nonautomation flats will translate easily into “two or more truck-loads of flats for each truckload of letters.”

Response:

My only reference was the billing determinants for Standard mail, contained in USPS-LK-L-77, which show basic non-automation letters to have an average weight of 0.7951 ounces and corresponding flats to have an average weight of 1.9156 ounces, well over twice as much (both figures being on page 2 of section G-1, cells K12 and K19, respectively). Given that trucks loaded with printed matter such as Standard mail generally weigh out before they cube out, it seems intuitive that these differences could translate easily into “two or more truck loads of flats for each truckload of letters.”

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

USPS/VP-T1-9.

Please refer to page 126, lines 12-16 of your testimony.

- (a) If the Commission were to follow your recommendation and establish an unrestricted Automation Basic Letters category in ECR (with the same minimums that now exist for Automation Basic Letters), is it your view that no mail that is currently being entered and processed as Standard Mail Regular 5-digit Automation Letters would migrate to the new ECR category?
- (b) If your answer to the above question is not an unqualified no, please state whether you believe that carrier route sorting, sequencing and bundling of the newly migrated mail will have significant operational value to the Postal Service if the Postal Service continues to delivery point sequence these letters at plants.

Response:

- (a) No. See my response to USPS/VP-T1-3(d)
- (b) Not applicable.

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to Interrogatory of USPS**

USPS/VP-T1-10.

Please refer to page 148, line 8 of your testimony. Please explain the basis for describing the proposed NFM rate category as “temporary” as opposed to a permanent rate category to which certain parcels will have temporary rate access.

Response:

The basis for my description was Postal Service witness Kiefer’s use of the term “temporary,” USPS-T-36. page 11, line 6. If I misinterpreted his statement, I would be happy for the record to contain any clarification on this point that the Postal Service wishes to provide. Whether it be temporary or permanent, relative to the Postal Service proposal, I have not proposed any changes in how the rates for the NFM category are developed.

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USPS/VP-T1-11.

Please refer *to* page 156, lines 4-10 of your testimony. Is it your view that limiting the passthrough of cost differences in order to partially offset the rate change impacts of rate deaveraging is not a legitimate tool in ratemaking?

Response:

No, although I think a significant first step should be taken; otherwise, responses to the decision to deaverage can be minimal and it can take a long time to get to the preferred rate position. Part of the problem *here is* that other events can occur along the way, and interfere with the best laid of plans. **Also**, questions should be raised about limiting *established* discounts as part of such an arrangement, since the effects on mailers could be significant and it might be difficult to get those discounts back in place. In any case, the situation needs to be examined.

The categories at issue on page 156 are those of machinable flats. The basic level is proposed to be deaveraged into mixed ADC and ADC, and the 3/5-digit level into 3-digit and 5-digit. In doing this, there is **no** reason to reduce the passthrough between the **MxADC/ADC** aggregate and the 3-d/5-d aggregate, as this would disadvantage *both* 3-digit and 5-digit mailers. Under the Postal Service proposal, MxADC mailers see **an** increase of 18.73 percent while 3-digit mailers see **an** increase of 24.34 percent. **A** case could therefore be made for a temporary passthrough of greater than 100 percent between the ADC level and the 3-digit level.

Another problem **exists** in the rate difference between machinable flats and corresponding automation flats. Under the Postal Service proposal, this difference is larger at

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the 5-digit level than at the **MxADC** level (**4.3** cents at the former and **4.0** cents at the latter)

If anything, the difference at the 5-digit level should be *smaller* than at the **MxADC** level

This is because, at the 5-digit level, the Postal Service receives very little benefit from having a barcode applied by the mailer. Therefore, if an “offset” is going to be developed, a number of factors need to be taken into account.

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USPS/VP-T1-12.

Please refer to page 156, lines 11-13 of your testimony where you say, in part, “whenever deaveraging occurs...significant impacts on mailers should be expected, and accepted.”

- (a) Is it your view that the Postal Service and mailers whose rates are pushed up by rate deaveraging should “accept” those impacts, regardless of the size of the impact?
- (b) If your answer to part (a) is not **an** unqualified yes, please state at what level would deaveraging rare impacts become unacceptable and warrant rate change mitigation.

Response:

- (a-b) Page 156 is part of a section that discusses the deaveraging of basic flats and 3/5-digit flats (machinable, in Regular). It might be better to think of acceptance in terms of whether the bases for the increases are justified and understood. It is true that sonic mailers would realize effects, usually on a limited portion of their mail. though this would not apply to the Postal Service. In effect, an opportunity to be averaged with some lower-cost mailers is being withdrawn. **See** also my responses to USPS/VP-T1-19, **23, and 24.**

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USPS/VP-T1-13.

Please refer to pages 156-57, subsection 9 of your testimony. If the Commission were to agree with your assertion that the letter-flat cost differential should be more fully reflected in rates, would it be your view that mailers whose rates were pushed up “accept” those impacts, regardless of the size of the impact? Please explain your answer fully.

ResDonse:

In subsection 9, the word “accept” is not **used**, although it is used in the subsection referenced in USPS/VP-T1-12. Please see my response to that interrogatory.

One could hypothesize a linear relation between the size of a rate increase and the degree of unhappiness. It might **be** better to think of acceptance in terms of whether the bases for the increases are justified and understood. Consider the following example. Suppose that you (my reader) and I each have a life insurance policy with the same company and that the rates for some years have been **the** same for smokers and non-smokers. I am a smoker and you are not. With increased knowledge about the health effects of smoking, our company has decided to ~~deaverage~~ the rates and charge me more and you less. The explanation is that the costs have not been reflected in the rates. I could be given the opportunity to talk to the insurance company and explain why my rates should not increase, and I could attempt to make a case that the company is being unfair to me. **But** I do not get a vote. Unless I give the company a good reason, which I cannot, it **will** not reduce my rate. The company does, however, provide me with a rational explanation, which would seem a reasonable thing for it to **do**. The fact that rates have been out of alignment with costs in the past is not relevant,

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Also, to the extent to which you express yourself on the decision to deaverage, I would guess that you would support it and argue that it is fair to all parties

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USPS/VP-T1-14.

Please refer to page 171, lines 8-18 of your testimony.

- (a) If the Commission were to follow your proposal and recommend rates for the ECR Basic Letters category that were below the rate for Standard Mail Regular 5-digit Automation Letters, is it your view that no mail that is currently being entered and processed as Standard Mail Regular 5-digit Automation Letters would migrate to the ECR Basic Letters category?
- (b) If your answer to the above question is not **an** unqualified no, please state whether you believe that carrier route sorting, sequencing and bundling of the newly migrated mail will have significant operational value to the Postal Service if the Postal Service continues to delivery point sequence these letters at plants.

Response:

- (a) Please see my response to USPS/VP-T1-1
- (b) According to sheet 18 of the UDCModel worksheet of USPS-LR-L-67, about **82** percent of Standard letters are DPS'd. I have not found separate figures for 5-digit automation and basic ECK letters. However, my proposal develops rates using the costs that are available, which include a non-machinable component in basic ECK letters. My **strength** does not lie in describing the details of operations. It is important to note, however, that operations are only one part of any rate difference. The other part relates to the subclasses involved, which goes back in part to whether the market characteristics, on average, are different for ECR mail

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USPS/VP-T1-15.

Please refer to page 182, lines 16-18 of your testimony. Please state the basis for your opinion that the studies that show the effect of weight on cost of Standard Mail are not reliable. If you relied on your own or other analyses of these studies, please provide those analyses and state which studies were evaluated in each analysis.

Response:

The sentence beginning on line 16 says: "If one takes the position, as I do, that the studies done to date to estimate the effects of weight on the costs of Standard Mail are indicative but not terribly reliable, then no real basis exists for evaluating the pound charges." The phrase "not terribly reliable" is an expression meaning somewhat reliable, but not as reliable as one would wish. Also, the word "indicative" was meant to be positive.

However, I have reviewed studies of weight over a period of years, in a very general way. Although there is some consistency over time in the results, my recollection is that the graphs of the costs have been far from smooth and well behaved. Also, although I am not an expert on statistical confidence levels and standard errors, I have always been concerned that the estimates we have are very rough. I feel like my concerns were shared by Postal Service witness Daniel in Docket No. R2000-1, who, referring to her own work, said: "The results of the weight analysis presented in this testimony are intended to guide rate design by providing a general indication of the effect weight has on total volume variable costs. They are not necessarily intended to be an exact quantification of costs for every individual weight increment." USPS-T-28, p. 3, ll. 21-24, emphasis in original. Then, after reviewing some factors that made her study complex and difficult, she said: "Thus, while it is possible to

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analyze the data for guidance in rate design, it is difficult, if not impossible, to isolate precisely the impact of weight on costs or identify the exact unit cost of each ounce increment for three **of the major classes of mail.”** *Id.*, p. 4. ll. 4-7. I interpret these comments as a signal of significant reservations about the reliance that should be put on the results. No study of the effects of weight on costs is available in the instant docket.

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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 ^{notions} notions 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
- h. 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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to Interrogatory of USPS**

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." 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 *nor* 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 purposes, 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. ^{the} 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

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

USPS/VP-T1-21.

Please refer to Table USPSIVP-TI-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.

	Origin	DBMC	DSCF
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

Response of Valpak Witness Mitchell
to Interrogatory of USPS

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

Response of Valpak Witness Mitchell
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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			
Letters			
Mixed AADC	7.8%	5.3%	4.4%
5-digit Automation	9.0%	6.2%	5.2%
Flats			
Mixed ADC	56.3%	58.2%	58.5%
Automation			
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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to Interrogatory of USPS**

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.

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

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.

Resuonse:

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 ADV0/VP-T1-10, when it is filed.

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to Interrogatory of USPS**

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**

USPSIVP-TI-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

**Response of Valpak Witness Mitchell
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USPS/VP-T1-28.

Please refer page 97 of your testimony where you discuss your proposed cost coverages and rate increases for Standard Mail.

- (a) Please confirm that your proposed rate increase for Standard Mail Regular is 17.6 percent, approximately 6.8 percentage points higher than the Postal Service's proposed rate increase for Standard Mail Regular and your proposed rate decrease for ECR is 8.5 percent, approximately 16.3 percentage points lower than the Postal Service's proposed rate change for ECR.
- (b) Please confirm that your testimony proposes no changes to cost coverages or rates proposed by the Postal Service for mail subclasses outside of Standard Mail.
- (c) Please confirm that under your proposals Standard Mail Regular and Nonprofit Regular will generate \$18.6 billion in revenue in the test year, and Standard Mail ECR and Nonprofit ECR will generate **\$5.7** billion in revenue, for a total Standard Mail revenue of **\$24.2** billion, and that this total revenue is approximately 30 percent of the Postal Service's revenue requirement in the test year.
- (d) Please state whether you considered how your proposed Standard Mail pricing should affect the pricing of mail classes and subclasses outside of Standard Mail, giving particular attention to First-class Mail in your response.
- (e) If your response to part (d) is that there should be no impact on prices outside of Standard Mail, please explain your rationale fully.
- (f) If your response to part (d) is that there should be an impact, please explain why you did not propose alternate cost coverages and rate designs for other mail classes and subclasses, giving particular attention to First-class Mail in your response.

Response:

- (a) Confirmed
- (b) Confirmed.
- (c) Confirmed
- (d) I considered First-Class, to some degree, as discussed in the section beginning on page 94 of my testimony. It is not easy to summarize the evolution of the

**Response of Valpak Witness Mitchell
to Interrogatory of the United States Postal Service**

Commission's preference for a cost coverage on Standard mail that is somewhat below the coverage on First-class, and opinions might differ on how to do it. Remembering that Standard was thirdclass before Docket No. MC95-1, I believe it is fair to summarize it as follows: "It is understood that emphasis on economic efficiency would bring a coverage on third class that is considerably lower than the coverage on First-class, because of the high elasticity of third class. However, First-class is most strongly affected by the Private Express Statutes and by requirements that some materials *must* be sent First-class. For reasons of national policy, including recognition of the Private Express Statutes, the Commission believes it best to set the cost coverage on third class only a little lower than the coverage on First-class, not a lot lower." If this is a fair summary, it needs to be recognized that, since Docket No. R95-1, third class has been deaveraged and the elasticity of Standard Regular is just slightly below the elasticity of First-class as estimated by Postal Service witness Thress

- (e) My view is that the recommendation in Docket No. MC95-1 was to deaverage third class into Regular and ECR, to the point of creating two separate subclasses, and that an implication of deaveraging is that one coverage should increase and the other should decrease. In its simplest form, no other subclasses are necessarily involved. This general issue is discussed at some length in my testimony. See sections beginning on pages 26, 30, and 91, as well as the entire Introduction, beginning on page 6

Response **of Valpak** Witness Mitchell
to Interrogatory **of the United States Postal** Service

- (f) My testimony is based on two presumptions: (1) that it is possible and reasonable to present testimony that analyzes the cost coverage of **a** subclass or a pair **of** subclasses and comes to conclusions on their cost coverage, without reviewing every other subclass and providing an overall analysis of financial breakeven for the Postal Service; and (2) that the Commission is highly proficient at assessing such testimony, along with testimony on other subclasses, and dealing in detail with the question of overall breakeven. The number of witnesses who have done just this in the past is very large. **Also**, I have not analyzed other subclasses

**Response of Valpak Witness Mitchell
to Interrogatory of the United States Postal Service**

USPSIVP-TI-29.

Please confirm that your testimony and workpapers do not estimate the impacts of your pricing proposals on Standard Mail volumes or test year after rates revenues.

Response:

Confirmed. Note, however, that the difference between before-rates and after-rates cost coverage is usually very small.

Response of Valpak Witness Mitchell
to Interrogatory of the United States Postal Service

USPS/VP-T1-30.

Please refer page Charts 1 and 2 in your testimony where you show the percentage rate increases you are proposing for mailers of Standard Mail Regular and Nonprofit Regular flats.

- (a) Is it your view that at their current rates, Standard Mail Regular and Nonprofit Regular cover their volume variable costs? Please explain in detail any failure to confirm that these pieces cover their costs.
- (b) Please confirm that your proposals would require some commercial mailers of minimum-per-piece-rated flats to experience rate increases exceeding 50 percent?
- (c) Please confirm that your proposals would require some nonprofit mailers of minimum-per-piece-rated flats to experience rate increases exceeding 100 percent?
- (d) Please explain whether you examined the impacts that such large rate increases would have on mailers of lightweight flats and explain why you believe that these rate increases are appropriate regardless of their impact on mailers.

Response

- (a) As I read the Domestic Mail Classification Schedule, "Standard Mail Regular" and "Nonprofit Regular" are separate subclasses. However, since separate costs are not available for them, we have no way of estimating whether they cover their costs. If combined and viewed as one subclass, of course, they do cover their costs, which, given the 60-percent rule, assures that "Standard Mail Regular." at least, does cover its costs

One way to look further at this question is to examine some of the costs for specific categories. As shown on the 'Inputs' sheet of my workpapers, the cost of a non-automation flat at the mixed ADC level is estimated to be 35.497 cents in the test year, including only mail processing and delivery costs. The current

Response of Valpak Witness Mitchell
to Interrogatory of the United States Postal Service

Nonprofit rate for such a piece is 19.5 cents. A similar result exists for the category of automation flats. Even at the 5-digit level, a misalignment exists. The suggestion is that, at least for flats, the current Nonprofit rates are pretty far below costs.

- (b) See my response to USPS/VP-T1-23. The two percentages that are marginally over 50 percent are due in part to deaveraging, consistent with that proposed by the Postal Service. The extent to which some mailers may send all of their mail in one category is unknown, but it is likely rather low.
- (c) According to Chart 2 in my testimony, page 194, one category, automation flats at the mixed ADC level, would be over 100 percent, at 102.6 percent. I do not know if any mailers send all of their pieces in this category, but such would not generally be expected. These are pieces that are now being rated substantially below their costs. See my response to part (a) of this question.
- (d) I understand the size of the increases. Questions of appropriateness are discussed in the section beginning on page 110 of my testimony. Issues of fairness are discussed in the section beginning on page 71. As discussed several places in my testimony, these changes have been needed for some time.

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to Interrogatory of the United States Postal Service**

USPS/VP-T1-31.

- (a) Please confirm that under your rate proposals an origin-entered minimum-per-piece rated Standard Mail Regular automation 5-digit letter would pay a rate of 21.8 cents per piece and that the same letter, if it qualified as **an** ECR Basic letter would pay 18.5 cents, a difference of 3.3 cents. Explain any failure to confirm.
- (b) Please explain how your revenue, volume and contribution projections treat the impacts that are likely to arise from Regular automation 5-digit letters migrating to ECR in response to the 3.3 cent lower rates in ECR.

Response:

- (a) Confirmed
- (b) See my response to USPS/VP-T1-1(d-e)

Response of Valpak Witness Mitchell
to Interrogatory of the United States Postal Service

USPS/VP-T1-32.

Please consider the following pricing hypothetical. The Postal Service proposes to de-average a mail category with two rate tiers (Basic and 3/5) into one with four tiers (Mixed ADC, ADC, 3-digit and 5-digit). Suppose that, based on available cost information, the Commission finds that, with 100 percent passthrough of worksharing costs, the rate change (i.e. push-up) for the 3-digit mail is unacceptably high and warrants rate mitigation consideration. All of the other rates resulting from the application of 100 percent passthroughs are deemed acceptable.

- (a) Please confirm that, if the Commission decided **not** to decrease or increase the other rates (Mixed ADC, ADC and 5-digit), mitigating the 3-digit rate increase would lead to passing through more than 100 percent of the ADC to 3-digit worksharing cost savings and less than 100 percent of the 3-digit to 5-digit worksharing cost savings.
- (b) Please state whether it is your view that, if the Commission deemed that rate change mitigation was appropriate in the above case, deviating from 100 percent passthroughs of some worksharing cost savings is an acceptable approach. If this is not your view, please explain fully why this approach is not acceptable. **If** you accept this view conditionally, please clarify all conditions you would impose to accept this view.
- (c) Please state whether it is your view that it is better for the Commission to lower all the other rates in the category (Mixed ADC, ADC and 5-digit) to achieve rate change mitigation for 3-digit mail while preserving 100 percent passthroughs of all worksharing cost savings. If this is your view, please explain fully why this approach is preferable to allowing some worksharing passthroughs to deviate from 100 percent. If you accept this view conditionally, please clarify all conditions you would impose to accept this view.
- (d) Please state whether it is your view that the most desirable approach for the Commission to take in the above hypothetical situation would be not to change any of the rates that result from applying 100 percent passthroughs to worksharing cost savings, allowing the rates for 3-digit mail to rise to whatever levels the cost information dictate. If this is your view, please explain fully why this approach is preferable to either of the two approaches described in parts (b) and (c), respectively. If you accept this view conditionally, please clarify all conditions you would impose to accept this view.

**Response of Valpak Witness Mitchell
to Interrogatory of the United States Postal Service**

Resuonse:

- (a) Confirmed. However, keep in mind that (1) few mailers would be expected to have all of their mail in the 3-digit category, (2) if the 3-digit category in question has a workshare variant, such as an automation category, the (horizontal) discount for automation compatibility might be affected also and need adjustment, and (3) the rate increase experienced by 3-digit mailers is affected by more than just the passthrough associated with the 3-digit discount in question; *i.e.*, it is also affected by the letter-flat differential and the costs found for various associated categories
- (b) See my response to part a of this question. I agree that mitigation could be found appropriate and that it would probably involve deviating from passthroughs of 100 percent. However, please note that my testimony discusses at great length the setting of this case and the reasons why a significant step toward recognizing costs should be made.
- (c) Generally, I agree with the view you state. Taking this view, however, **should** not preclude full review of the situation surrounding the rates in question. Sometimes the particulars surrounding a resulting rate suggest factors that may not **align** with a rule or a principle
- (d) It is difficult to apply judgment to a hypothetical situation where some aspects are known and some are not. The situation you posit focuses

**Response of Valpak Witness Mitchell
to Interrogatory of the United States Postal Service**

narrowly on four categories and specifies the Commission's view.

Under these conditions, the approach you outline in part a could be warranted

**Response of Valpak Witness Mitchell
to Interrogatory of the United States Postal Service**

USPS/VP-T1-33.

Please refer to page 174 of your testimony where you describe how you “transferred to the saturation discount” 1.4 cents of the estimated 4.43 cent cost difference between Standard Mail ECR Basic and High Density flats. Please state whether this transferal represents your attempt to disaggregate or de-average the combined mail processing cost data for ECR High Density and Saturation flats. If this was not the case, please explain fully why these costs should move between High Density and Saturation flats.

Response:

Nothing has been disaggregated or deaveraged, and no costs have been moved. Based on the costs shown in the presort tree on page 169 of my testimony, as well as on the ‘Inputs’ sheet of my wrkpapers. it can be viewed quite simply as a process of selecting a lower passthrough for high-density and then setting the saturation rate relative to the basic rate. See also my response to NAA/VP-T1-37 and 38.

Response of Valpak Witness Mitchell
to Interrogatory of the United States Postal Service

USPS/VP-T1-34.

Please refer to your response to USPS/VP-T1-2, part (d), where you say “[w]hether the Postal Service would assume the migrating pieces have the average cost of their categories, as it has done in some NSAs, is open to question, but the costs available for ECR flats are much lower than the costs for 5-digit automation flats.”

Do you believe that the cost per piece for the Postal Service to handle ECR flats in 10-piece bundles is likely to be higher on average than the cost per piece of handling the same pieces in 20-piece, or larger, bundles, all other things being equal? If your answer is anything other than an unqualified yes, please explain fully.

Response:

Interrogatory USPSIVP-TI-2(d) asked about a matter that my response called *gaming* the system. Your question here is somewhat more general, but not entirely clear. Assume that by “handling” costs you mean bundle handling and sorting, bundle opening, and piece sorting. Assume also that the ECR bundles are formed by reconstituting a series of 5-digit bundles with at least 20 pieces in them. I agree that the cost of getting the ECR bundles to the carriers might be a little higher than the cost of getting the output of an incoming secondary sort to the carriers. I agree also that more bundles would have to be opened when ECR bundles are used. On the other hand, the justification for carrier-route presortation has always been primarily that the incoming secondary is avoided entirely, with attendant savings. My assumption would be that when expressed on a per-piece basis, these savings are larger than any additional costs of handling the bundles

With regard to ratemaking, however, your question is not aligned well with the classification scheme and how rates are set. Mailpieces pay rates that are developed in

**Response of Valpak Witness Mitchell
to Interrogatory of the United States Postal Service**

defensible ways within the classifications of which they are members. The rates for the categories in the classifications are set on *average* costs for the categories, not on costs at a margin like the 10-piece limit. Averaging always occurs within categories, but does not provide a basis for excluding mail from a category or a rate for which it qualifies.

Response of Valpak Witness Mitchell
to Interrogatory of the United States Postal Service

USPS/VP-T1-35.

Please refer to your response to USPS/VP-T1-2, part (e). In your view, is it appropriate ratemaking for the Postal Service and the Commission to develop rates designed to have, among other goals, the goal of keeping mail with similar cost characteristics together within a particular mail category? If your answer is other than an unqualified yes, please explain fully why taking this factor into consideration when ratemaking is not appropriate.

Response:

The steps inherent in your question are not altogether clear, and may be troublesome. I agree that it is reasonable to establish classifications, such as subclasses, and that similarity in cost and other factors should be considered when this is done. I also agree that it is reasonable to establish categories and rate elements within subclasses to recognize costs and other factors. Much of my testimony is about how rates for such categories and elements should be set. But once established, the rates for these subclasses and categories should be set on defensible bases that recognize costs and ratesetting principles, pursuant to the Act. It is not reasonable, when all is said and done, to return and argue that the rates thus established should be moved in one direction or another because some pieces have been identified that are arguably similar to some pieces in another subclass. Your question challenges existing classifications, nor my proposed rate design.

**Response of Valpak Witness Mitchell
to Interrogatory of the United States Postal Service**

USPS/VP-T1-36.

Please refer to your response to USPS/VP-T1-8. Please confirm that, when you say that "trucks loaded with printed matter such as Standard mail generally weigh out before they cube out" you are basing your assertion on your general knowledge and not on any study of **how** the Postal Service, in particular, containerizes, moves, loads and trucks mail, that may include Standard Mail, between its plants.

Response:

Confirmed. However, interrogatory USPS/VP-T1-8 cites a section of my testimony dealing with whether **the** cost of 1.9-ounce flats might be higher than the cost of 0.8-ounce letters, transportation being one cost component, and suggests that the flats might fill two trucks and the letters might fill one truck. I did not mean to suggest that mailers are constrained to submit mail in truck-load lots or that the Postal Service dedicates specific trucks to specific mailers, although the latter can occur under plant loading. To make it easy, assume one mailer submits **80,000** pounds of flats and another mailer submits 40,000 pounds of letters. The Postal Service's own analysis of its transportation systems, as presented in proceedings before the Commission, **finds** that a high proportion of long haul transportation costs are variable and distributes these **costs** on pound-miles. Thus, if the mail is going the same distance, carrying 80,000 pounds costs twice as much as carrying 40,000 pounds.

1 CHAIRMAN **OMAS**: This now brings **us** to oral
2 cross-examination. Four participants have requested
3 oral cross-examination: Advo, Inc.; Mail Order
4 Association of America; Newspaper Association **of**
5 America; and the United States Postal Service.

6 Mr. McLaughlin, would you introduce yourself
7 and begin.

8 MR. McLAUGHLIN: Thank you, Mr. Chairman.
9 Tom McLaughlin representing Advo.

10 CROSS-EXAMINATION

11 BY MR. McLAUGHLIN:

12 Q **Good** morning, Mr. Mitchell.

13 A Good morning, Mr. McLaughlin.

14 Q I would like to start off talking with you
15 about your concept of separate products. Could you
16 turn to page 178 of your testimony?

17 A 117?

18 Q 178. There, down on, I believe, around line
19 16, you take the position that UCR saturation letters
20 and flats are, for all practical purposes, separate
21 products. Do you see that?

22 A Yes, I **do**.

23 Q Does that view apply as well, and with equal
24 force, at the saturation level? In other words, is it
25 your view that saturation letters and saturation flats

1 are, for all practical purposes, separate products?

2 A Yes. I have not really discussed a
3 separation between saturation and high-density flats,
4 for example, so you're singling out saturation, and
5 I'm saying yes because it's part of a category of
6 flats.

7 Q Is it fair to say that you base that
8 conclusion, that they are separate products, on
9 differences in postal handling and physical
10 characteristics rather than differences in market
11 characteristics?

12 A I've discussed that a number of places in my
13 testimony, and I think a number of factors have been
14 discussed, and those factors that you list are some of
15 the factors. I think there is a range of differences,
16 and, altogether, I think they are very consistent with
17 almost any definition of separate products.

18 Q And because you believe that saturation
19 letters and flats are separate products, you take the
20 position that, ideally, as a default position, the
21 saturation letter-flat cost differential should be
22 marked up by the ECR cost coverage factor?

23 A Yes.

24 Q In determining whether two categories are
25 separate products, are differences in market

1 characteristics relevant?

2 A Yes. They are an input. They are part of
3 the situation that we're facing.

4 Q Now, Val-Pak is a saturation letter mailer.

5 A That's my understanding, yes.

6 Q Does Val-Pak compete with saturation flat
7 mailers?

8 A In some sense, there is a wide range of
9 competition that occurs in all advertising avenues,
10 and so, in a general sort of way, yes, but in other
11 contexts, you might be able to describe a context in
12 which they don't view themselves as direct
13 competitors.

14 so it's a little bit risky to define these
15 things as a general statement without knowing how they
16 are going to be used, but I think they do, in fact,
17 compete, to some extent.

18 Q Well, in a very broad sense, billboard
19 advertising competes with saturation mail, competes
20 with TV. Every kind of advertising at some broad,
21 broad level competes in some minute way, don't they?
22 Is that what you're referring to about --

23 A It might not be minute, but, basically, yes.

24 Q I'm talking now about a more specific form
25 of competition, and let's define it more precisely.

1 Are there Val-Pak customers that are approached by
2 salesmen for both Val-Pak and by salesmen for
3 saturation flat mailers for advertising business?

4 A Well, in terms of my own personal
5 experience, I can't speak as an expert on that because
6 I've never really functioned in that area, but it
7 certainly wouldn't surprise me if that were the case.

8 Q Can you give examples of saturation flat
9 mailers that compete with Val-Pak for advertising?

10 A Well, I can give examples of saturation flat
11 mailers. I can't specify in any particular sense the
12 way in which they, would compete with Val-Pak.

13 Q Do you know whether Advo competes with Val-
14 Pak for advertisers?

15 A I would guess that they do.

16 Q Do you know whether shopper publications
17 compete with Val-Pak for advertisers?

18 A Well, there are obviously some differences
19 in format. I think Val-Pak is largely coupons, and
20 some of these others have different formats and
21 different printing arrangements, and they put them
22 together in different sorts of ways.

23 So if one decided to point out difference
24 between these various ways of advertising, I think **one**
25 could point out differences, but I think there is also

1 a sense in which, as you suggest, they compete with
2 each other.

3 Q Does Val-Pak compete with ECR basic,
4 presort, letter mailers?

5 A My understanding is that there are certainly
6 cases where people consider solo mailings that are
7 saturation and that are less than saturation. There
8 are some high-density materials, for example, so I'm
9 sure there are cases where an advertiser considers
10 saturation letters of one kind or another and also
11 consider some nonsaturation options that would be high
12 density and tries to make a decision. So there is
13 some competition there.

14 Q Are there any mailers that Val-Pak competes
15 with who are basic, presort, letter mailers?

16 A I don't know that I can name any

17 Q I was having difficulty myself.

18 MR. OLSON: Mr. Chairman, I ask to move to
19 strike counsel's comment on the evidence since counsel
20 is not testifying.

21 CHAIRMAN OMAS: Without objection.

22 BY MR. McLAUGHLIN:

23 Q Do saturation shoppers and shared-mail
24 programs compete with ECR basic, presort, flat
25 mailers, such as catalogs?

1 A Well, I think, in line with some of my
2 previous answers, we would have to say that there are
3 degrees of competition, and there are situations where
4 they don't view themselves as direct competitors. But
5 I think that we've been going on for some time here as
6 though I were an expert that operated at the
7 operations level in some of these markets, and I don't
8 present myself as someone who has a great deal of
9 expertise in the everyday details of how these markets
10 play themselves out.

11 Q So, in other words, you don't know.

12 A I forget the question.

13 Q Do saturation shoppers and shared-mail
14 programs compete with ECR basic, presort, flat
15 mailers. such as catalogs?

16 A I can't describe the extent to which they
17 are competitors.

18 Q Would you agree that the degree of
19 competition among and between saturation mailers, and
20 I'm talking about letter mailers and flat mailers, is
21 far more direct and intense than any competition
22 between saturation mailers and basic, presort mailers?

23 A My guess would be that, in most highly
24 developed, urban markets -- I'm thinking, in part, of
25 what I get at home. In other words, I get Advo pieces

1 which are, in effect, a wrap, and I get other
2 saturation flats that some are run of press instead of
3 individual pieces put together. So there are
4 differences between those two, but I would think that
5 they compete with each other rather strongly.

6 Q So, in terms of marketplace characteristics,
7 would it be fair to say that this far stronger product
8 differentiation is not letters versus flats but
9 saturation versus basic presort density, in terms of
10 market differentiation?

11 A So you mean the two different kinds of
12 saturation flats are in the same market, one product,
13 and the letters are another?

14 Q No. Let me rephrase this. In terms of
15 marketplace characteristics, would you agree that the
16 far stronger product differentiation is not between
17 letters versus flats but is, instead, between
18 saturation versus basic presort density?

19 A I don't think I understand what that means.
20 You've got two categories that compete very strongly,
21 and it sounds like you want them to be different
22 markets -- they are very similar -- have them in the
23 same category.

24 Q You are talking about differences in
25 products, and I'm now talking about market

1 characteristics of those product differences. Isn't
2 it true, or would you agree, that in terms of
3 differences between products, the greater marketplace
4 differences between products are saturation versus
5 low-density, basic, presort mail rather than letters
6 versus flats?

7 A I guess I'm going to decline to agree on the
8 grounds that I don't quite understand how we're
9 putting all of these words together and what it means.
10 We've agreed that the two saturation flat mailers
11 compete very strongly with each other.

12 Q I'm talking now about a saturation letter
13 and a saturation flat. They compete as well, don't
14 they?

15 A In some degree, we have agreed that they do.

16 Q And that degree of competition, would you
17 agree, is greater than between saturation-level
18 mailers and basic, presort, low-density mailers?

19 A Well, it might be, but I'm not quite sure
20 where this leads. I'm sure, if you talked to Val-Pak,
21 who produce letter-sized pieces, and asked them about
22 changing to a flat or something, they would say, gee
23 whiz, that's a lot different market. That's a lot
24 different vehicle. That's a lot different product
25 that you're talking about, but they might still

1 compete for some of the same customers.

2 I don't want to sound disoriented, but I
3 think we're trying to draw strong distinctions here
4 and strong relations here when it's not quite that
5 simple.

6 Q well, is it quite as simple as saturation
7 letters and saturation flats being products, for all
8 practical purposes, as you stated?

9 A Well, I put in "for all practical purposes"
10 on purpose. We don't have to decide whether or not
11 two things are separate products. I mean, the whole
12 nation and the dictionaries might have definitions of
13 products. We don't have to use that definition or
14 make a definite decision. What we have to do is
15 operate in the postal arena and decide how we're going
16 to set rates

17 For our present purposes, I think we've
18 given all kinds of reasons. It's reasonable to view
19 letters as one category and flats as another, and one
20 aspect of it is competition. I think the cross-
21 elasticity between the two is generally rather small
22 instead of rather large. We've indicated some other
23 reasons as well.

24 Q In your response to Advo Interrogatories 7
25 and 8, we asked you, in number seven, whether all ECR

1 letters are one product and then, in eight, whether
2 all ECR flats are one product, and then we
3 specifically --

4 MR. OLSON: Can you wait until we get to
5 that, Mr. McLaughlin?

6 THE WITNESS: Okay. I have Advo 7, which
7 focuses on letters.

8 BY MR. McLAUGHLIN:

9 Q Right, and Advo 8 is flats.

10 A Yes.

11 Q And asked you about whether, in terms of
12 degree of density, saturation versus basic presort,
13 whether there were product differentiations there.
14 Didn't you agree that a case could be made for giving
15 separate rate recognition to saturation flats compared
16 to basic density flats and the same for saturation
17 letters compared to basic density letters?

18 A Right. I said that that case could be made
19 for both interrogatories.

20 Q Right. So, from that standpoint, saturation
21 letters versus basic letters and saturation flats
22 versus basic flats could also be considered separate
23 products in some sense.

24 A I think we could agree that they are, in
25 some sense, separate categories, and I have testified

1 that we should treat them in a certain way.

2 So, in view of all that you're saying about
3 the similarities and differences and the competition
4 and the markets, I think we're at the point today
5 where I have proposed that the rates be set in a
6 specific way. Now, if someone else wants to propose
7 something different, they are free to do that.

8 Q Turn to page 82 of your testimony.

9 A 82?

10 Q 82.

11 A Okay.

12 Q And, particularly, I think, starting on line
13 22, you're talking about private delivery there, and
14 you indicate that much of private delivery volume
15 weighs more than 3.3 ounces. Would you agree that the
16 level of saturation of postal rates for flats is an
17 important factor in the choice of whether to use mail
18 or private delivery?

19 A Would I agree that the rates for saturation
20 flats, including the pound rates?

21 Q Yes.

22 A I missed a little bit of it. If you could
23 try to enunciate just a little bit more clearly.

24 Q Would you agree that the postal rates for
25 saturation flats are an important factor in the choice

1 of private delivery versus mail distribution?

2 A Are an important factor in --

3 Q -- the choice of distribution between
4 private delivery and mail?

5 A This is a choice being made by an
6 advertiser?

7 Q Or by a shopper publication

8 A I would think that they would look at postal
9 rates, and that would be a very important factor, yes.

10 Q Now, your response to Advo 15.

11 A Okay.

12 Q In Tart 15(b), we asked you whether you are
13 aware of any ECR saturation letter mail programs that
14 are mailed in a market on a regularly weekly basis,
15 and your answer was no. Right?

16 A Yes.

17 Q In your response to Part A, down about
18 toward the bottom of the first page, you have a
19 sentence which says: "I believe most weekly mailings
20 that are saturation tend to be flats." Didn't you
21 just state that you're unaware of any that are
22 letters?

23 A Yes. ■ said that I was unaware of any.
24 That doesn't mean there aren't any.

25 Q Do you think there might be some regular,

1 weekly, saturation letter mail programs that are
2 mailed through the U.S. Postal Service?

3 A This probably sounds a little bit evasive,
4 but it's a big nation here. I really don't know. I
5 said a few minutes ago that I don't operate normally
6 at the operations level in various markets in the
7 country. I'm somewhat influenced by what I receive at
8 home which brought it to my attention.

9 Q There are a large number of flat mailings
10 that are mailed on a regular weekly basis.

11 A I believe there are.

12 Q In your view, and you may not have an
13 opinion or any knowledge about this, would it be
14 easier, in general, to set up a private delivery
15 operation that delivers a product only once a month or
16 even less frequently, or it delivers a program every
17 week, 52 times a year? Which would be easier to set
18 up, in your view?

19 A Well, from direct experience, I can't give
20 you an answer, but this issue has been discussed in
21 the past in rate proceedings, and I have discussed it
22 with other people, and some people tend to point out
23 that hiring a person who only works one or two days a
24 month is more difficult than hiring a person that
25 works one or two days a week. Regularity is kind of

1 important.

2 So if that's what you're concerned about,
3 whether or not regularity helps you hire employees,
4 you know, that's one issue, but monthly could be
5 easier, too, if you printed some of the things ahead
6 of time, in your down time on your equipment, and
7 tried to have it ready by a certain time to mail.
8 It's just not an area that I have direct experience
9 in.

10 Q Now, of the shopper publications that use
11 private delivery, do you know what their typical
12 frequency is?

13 A Well, as a practical matter, the ones that
14 I've talked to the most that use private delivery were
15 local community newspapers, and I think a lot of them
16 were weekly, but we've also had -- I was going to say
17 we've had testimony, but I can't remember anything
18 specific right now

19 Q Now, saturation letters today pay a lower
20 postal rate than saturation flats. Is that right?

21 A Well, we could check the actual schedule,
22 but I think that's right.

23 Q There is a letter-flat rate differential
24 today for saturation mail.

25 A I think there is.

1 Q Does that lower rate, by itself, make
2 saturation letters a less likely candidate for private
3 delivery than saturation flats?

4 A I was going to check the rates here on my
5 computer screen. It just went to the bottom instead
6 of the top.

7 But the rate difference is pretty small for
8 origin entered -- well, saturation origin entry
9 letters are 16, and flats are 16.9 under current
10 rates. So that's a pretty small difference, I think,
11 in the scheme of things to allow you to say, "Gee, one
12 is a lot more likely to be delivered privately because
13 of rate differences." But to the extent to which .9
14 cents is important, then, yes, it has an influence.

15 Q You don't believe .9, nine-tenths of a cent,
16 is important to a saturation flat mailer? Do you know
17 what that is when you multiply it by millions and
18 millions of pieces of mail?

19 A Yes, I do, and I'm probably on record as
20 saying that mailers respond mightily to rate
21 differences of a tenth of a cent or two, particularly
22 in the area of presort and in some of their mailing
23 decisions. When you talk about a tenth of a cent or
24 two-tenths of a cent between presort levels, that's
25 all inside the Postal Service, and your question goes

1 to postal versus nonpostal, which is a little bigger
2 decision. But I don't want to downplay at all the
3 significance of nine-tenths of a cent.

4 We're talking about two different formats as
5 well, so I agree that it's part of the -- we're
6 talking about 16 versus 16.9. If we were talking
7 about 1 versus 1.9, it would probably even be a bigger
8 influence.

9 Q Now, the 16 versus 16.9; that's the rate for
10 nondrop-shipped mail, isn't it?

11 A That's true.

12 Q Wouldn't the more appropriate comparison be
13 the rate for DDU drop-shipped mail, which almost all
14 saturation flat, shared mailers and shopper programs
15 use?

16 A We could look at DDU, and I'm trying to pull
17 up my DDU rates. I have a 13.6 for flats, and I think
18 my letter, I had 13.3. Maybe I left DDU blank because
19 of the current proposal.

20 But we have the same drop-shipped discounts
21 for letters and flats, as I understand it, so the
22 comparison doesn't change a whole lot when you talk
23 about DDU instead of origin entry.

24 Q Now, in addition to that nine-tenths-of-a-
25 cent rate differential between saturation letters and

1 saturation flats, if the flat weighs more than 3.3
2 ounces, it also pays a pound rate on top of that. Is
3 that correct?

4 A That's also true for letters between 3.3 and
5 3.5. I think there is a proposal to raise it up to
6 four. The Postal Service may have something to say
7 about that, but there is also something to be said for
8 it.

9 Q How many of Val-Pak's saturation letters
10 weigh more than 3.3 ounces? Didn't Val-Pak provide a
11 response to that? I think that's in an institutional
12 interrogatory.

13 A I don't have that. That was a corporate
14 response, and I don't have it with me.

15 Q It's quite a small percentage, isn't it?

16 A I'm told that they have some and that it's
17 not large.

18 Q Compared to saturation flats, such as
19 shoppers and shared-mail programs, would you agree
20 that saturation letter mail programs, in general, are
21 distributed on a much less frequent schedule, they are
22 substantially lighter weight, on average, and they pay
23 a lower postage rate?

24 A I can't testify as to whether they are
25 substantially lighter in weight. I think quite a

1 number of them -- I have seen figures in rate cases
2 before on the average weight for Advo, and my
3 recollection is that it's not impressibly (sic) high.
4 Some of the letter pieces are well into the three-
5 ounce range.

6 There is a format difference. If you're
7 taking a piece that's 11 inches' wide and 14 inches'
8 high, it's a lot easier to come up with weight than if
9 you're taking a piece that's, *you* know, four inches-
10 by-eight inches and also understand that people pay a
11 lot of attention to the weight of the paper that they
12 use in putting these pieces together.

13 I think your question went to whether or not
14 the flats tend to be a lot heavier than the letters
15 and use the pound rate a lot more. I'm not sure that
16 that's the case.

17 Q I was talking about on average. I think
18 that's the way I phrased it. On average, saturation
19 letter mail programs are distributed on a much less
20 frequent schedule, are substantially lighter weight,
21 on average, and pay a lower postage rate. Now, if you
22 want to take out the word "substantially" and just say
23 "lighter weight on average and pay a lower postage
24 rate," would that be acceptable with you?

25 A Well, it's clear that the postage rate is

1 somewhat smaller. I do object to the word
2 "substantial." I can't back that up at all. I
3 wouldn't be surprised if they are slightly heavier. I
4 don't know that to be the case.

5 In terms of the frequency, I think the
6 conventional wisdom is that more of the flats are
7 weekly than letter-sized pieces.

8 Q Now, if under your preferred approach for
9 pricing of what you call "separate products," if the
10 PRC were to apply a subclass markup to the letter-flat
11 cost differential, that alone would substantially
12 widen the rate gap between letters and flats, would it
13 not?

14 A We might have trouble with the word
15 "substantial" again, but it's certainly significant.

16 Q If you're applying an ECR cost-coverage
17 factor to the letter-flat cost difference, you don't
18 believe that would be a substantial increase.

19 A Well, the cost difference that we have right
20 now -- did my mouse stop working here? The cost
21 difference that we have is not impressively large
22 right now. We can see what it is. We do have 7.1 for
23 flats and 4.4 for letters, so those costs are coming
24 out now. There is a pretty reasonable difference, so
25 it's under three cents, and the coverage would put it

1 up to in the range of seven. So if there was a markup
2 of 70 percent on that difference, it would spread the
3 rates further.

4 What was the question? I was looking to see
5 how big it was.

6 Q Okay. We're talking now about the
7 saturation letter-flat cost differential. Let's just
8 start with that. What is the saturation letter-flat
9 cost differential?

10 A Well, the letters, under PRC costing, that I
11 show in my pressrt tree were 4.4 cents, and the flats
12 are 7.1 cents. So that's 2.7.

13 Q You're saying that there is a 2.7 cent
14 letter-flat cost differential.

15 A Yes, at the saturation level. That's the
16 level that you specified in your question.

17 Q And if you mark that up by the ECR cost
18 coverage, what would the increase be?

19 A We had 3.8 times -- I thought I had
20 everything working here, and my mouse isn't moving too
21 fast. But if we took 3.8 times -- and what is the
22 coverage that I recommended, 1.9?

23 Q You're asking me?

24 A Well, I can look it up. I can look it up
25 here, but if it's 1.8, then we would get 6.8 cents

1 Q And what would the increase in the letter-
2 flat rate differential be?

3 A From what?

4 Q From current.

5 MR. OLSON: Mr. Chairman, I believe that
6 counsel has now changed from cost to rates. I'm not
7 sure if he meant to do that.

8 MR. McLAUGHLIN: Well, we are going from
9 cost to rates because the witness, I believe, is
10 talking about marking up the cost differential to get
11 a rate differential. So we are talking about rates.

12 BY MR. MCLAUGHLIN:

13 Q What is the increase in the rate if you
14 applied your proposed cost coverage markup to the
15 letter-flat cost difference?

16 A Well, the current rate difference -- didn't
17 we just go through this? -- at origin entry, it was
18 16.0 and 16.9, so there's .9 cents now. In the
19 scenario that you created, you asked me to create --

20 Q No, no, no. I didn't ask you to create
21 this.

22 A I didn't propose that.

23 Q I understand you did not propose that rate,
24 but you proposed this concept, and if you applied the
25 concept --

1 A As a reference point, I think we used the
2 word "default."

3 Q Do you have the answer to the question about
4 what the increase would be?

5 A Well, it's now .9, and the figure that we
6 just came up with was 6.8.

7 Q So it goes from .9 to 6.8.

8 A Yes, under the conditions that you
9 specified.

10 Q And then, in addition to that, you would
11 apply a pound rate on top of that 6.8 cent-per-piece
12 increase

13 A Both minimum per-piece rates would extend
14 upward at the pound rate for pieces that weighed over
15 the break point.

16 Q How would you characterize a 6.8 cent rate
17 spread and increase for saturation flat mailers?
18 Would you call that huge, substantial? Do you have
19 any feeling for that?

20 A Well, in this particular case, I might buy
21 into your term "substantial." But I think, in the
22 scheme of things, you said, how would I characterize
23 it, if we looked at this in general, I think letters
24 are the cheapest thing around. I think the Postal
25 Service is very well positioned to do a terribly

1 effective job of handling letters, both in DPS'ing or
2 handling them as a third bundle.

3 So I think, in the scheme of things, it
4 should not be terribly surprising if letters had a
5 lower cost and a lower rate.

6 Q We're not opposing letters having a lower
7 rate.

8 Turn to page 116 of your testimony, please.

9 A 116. Okay.

10 Q Here, you're talking, again, about the
11 letter-flat cost difference and separate product
12 notion. I'm looking at the paragraph starting at line
13 5. If you look at the sentence starting on line 7,
14 you state, and I quote: "One of the most fundamental
15 prescriptions for regulation is to seek to emulate
16 outcomes that would be generated by a competitive
17 process, were such competition feasible."

18 Do you see that statement?

19 A Yes, I do.

20 Q In your view, applying your notion of
21 separate product and your notion of a cost coverage
22 applied to a rate difference would be substantially
23 increasing the rate for the category of saturation
24 mail that is most susceptible to private delivery be
25 an outcome that emulates the results generated by a

1 competitive process?

2 A The way to look at that is not the way you
3 just outlined. The way to look at that, we're talking
4 about a very general prescription here for regulation
5 and emulating a competitive outcome. My general
6 feeling is that competitive outcomes tend to have
7 markups on costs -- I don't mean that they would all
8 be the same, but they do, in fact, tend to have
9 markups.

10 So if the competitors in this competitive
11 solution had costs anything like the Postal Service
12 does, I think they would have markups on them

13 Q Those competitors are shopper publications
14 and private delivery companies and even companies like
15 Advo that today are operating private delivery, aren't
16 they?

17 A Yes.

18 Q And so, presumably, the rates that they are
19 currently charging and the costs that they currently
20 have reflect whatever markups there are in the
21 marketplace today. Right?

22 A Well, with the exception that persons
23 wanting to compete in the letter area can't use the
24 mail box, so they don't exist.

25 Q How are you defining "letter"? The letter,

1 for purposes of the mailbox rule, doesn't refer to the
2 Postal Service six-by-nine letter. It's the
3 definition of the private express statutes that
4 includes flats as well, isn't it?

5 I just wanted to clarify, when you said
6 "letter" in relation to the mailbox rule, the
7 definition of "letter," under the mailbox rule, is not
8 the Postal Service definition of letter versus flat;
9 it's the private express definition of "letter," which
10 includes flats. Is that right?

11 A Thai's right.

12 Q Now, I think I interrupted your answer.
13 Were you through with your answer?

14 A I think I was almost through. My concern
15 was, you were looking to actual experience in the
16 market to see whether or not there is a substantial
17 difference in the rates charged for the delivery of
18 flats and letters, and I was just saying that, for one
19 reason or another, I don't think very many letter-
20 sized pieces are being delivered privately.
21 Therefore, we can't learn a whole lot by looking right
22 now at the private markets.

23 Q Yes, and the reason there are not many, if
24 any, letters delivered privately has nothing to do
25 with the mailbox or with the private express statutes,

1 does it, because flats have the same rules applicable
2 to them as letters in private delivery and the
3 mailbox? Isn't that correct?

4 A I think that's right.

5 Q And in terms of the question about
6 competitors having markups, those competitors already
7 have their operations in place, and those operations
8 already include whatever markups they need to operate.
9 Is that correct?

10 A One would think.

11 Q And so if you were then going to
12 substantially increase the rate for saturation flats,
13 would that, in your view, be an outcome that would
14 emulate the results generated by a competitive
15 process?

16 MR. OLSON: Mr. Chairman, I wouldn't want
17 there to be any assumption that that's what this
18 witness is proposing, that there be an increase in the
19 rates for ECR saturation flats, since it's not what's
20 being proposed. Just to clarify, that's not what the
21 proposal is.

22 MR. McLAUGHLIN: Mr. Chairman, we're fully
23 aware that Val-Pak, as a part of its proposal, has
24 proposed a substantial reduction in ECR cost coverage,
25 which would, in fact, result in a rate reduction for

1 all ECR mail. However, our questions here relate to
2 the witness's proposal that flats and letters should
3 be treated and priced conceptually on this basis, and
4 since we have no assurance that the Commission will go
5 along with a reduction in cost coverage that Val-Pak
6 has proposed, the letter-flat rate differential does
7 become a significant issue.

8 CHAIRMAN OMAS: I think that's a fair
9 question. Continue, Mr. McLaughlin.

10 MR. McLAUGHLIN: Mr. Chairman, actually, I
11 think I'll just end it right there. Thank you very
12 much.

13 CHAIRMAN OMAS: Thank you.

14 Our next participant to cross-examine is Mr.
15 Todd.

16 MR. TODD: I may have follow-up cross-
17 examination.

18 CHAIRMAN OMAS: Mr. Todd, would you please
19 introduce yourself?

20 MR. TODD: I'm David Todd representing the
21 Mail Order Association.

22 CHAIRMAN OMAS: Thank you. That's for the
23 record.

24 Mr. Baker, the floor is yours.

25 MR. BAKER: Thank you, Mr. Chairman

1 William Baker appearing on behalf of the Newspaper
2 Association of America.

3 CROSS-EXAMINATION

4 BY MR. BAKER:

5 Q Good morning, Mr. Mitchell.

6 A Good morning, Mr. Baker.

7 Q I wanted to start by just following up on
8 one line of cross that Mr. McLaughlin asked. He asked
9 your understanding of products. Particularly, he was
10 talking about basic and saturation flats and whether
11 they are different products or not.

12 Do you have a view as to whether high-
13 density and saturation flats are different products or
14 not?

15 A Well, I haven't called them, in any sense,
16 different products anywhere. It's certainly true that
17 a high-density mailer can't convert himself easily
18 into a saturation mailer unless he is close to a
19 borderline.

20 You know. if I say they are separate
21 products, where does that lead? If I say they are not
22 separate products, where does that lead? I don't
23 think it changes the rates that we're proposing or how
24 I view them within the framework of the rate
25 structure

1 Q Well, if an advertiser wants to distribute a
2 preprint advertisement, and the advertiser looks at
3 Advo and considers whether to participate in that
4 shared-mail package or looks at a newspaper TMC
5 program that might mail using high-density rates to
6 its nonsubscribers, do you think the advertiser sees
7 any real difference in product?

8 A Sure.

9 Q Because of the characteristics of the
10 newspaper delivery, it's party newspaper and partly
11 mailed product, or do you think the advertisers
12 realize that both of them are routes to achieve the
13 same result?

14 A The advertiser -- are you talking about a
15 person that wants total market coverage and has one ad
16 in the newspaper and another one in high density, and
17 that's an alternative to using Val-Pak or using Advo
18 for the entire mailing?

19 Q Yes.

20 A I mean, those are alternatives, and there
21 are differences in the different avenues, certainly.

22 Q All right. I want to move to -- much of
23 your testimony, you use the terms "low rates" and
24 "high rates," and I want to focus on what you mean by
25 that.

1 Would you agree that a rate that covers is
2 equal to attributable costs and no more are not likely
3 to be regarded as too high?

4 A Would I agree that a rate that covers
5 attributable costs and then some more?

6 Q No, no more. Set equal to attributable
7 costs is not likely to be too high, is it?

8 A I don't know the definition of "too high,"
9 but that's certainly not, in any reasonable way, a
10 high markup.

11 Q Well, you use the terms "high" and "low"
12 when referring to rates, and I'm just trying to get a
13 sense of what that means.

14 A Do we have a sentence? You had a question
15 or two about high and low markups or high and low
16 distance from rate to cost.

17 Q When we're talking about high and low, then
18 you're really talking about the institutional costs
19 that a particular piece will charge by a particular
20 rate, are you not?

21 A Well, I think, in many cases, we did talk
22 about the contribution, but I think context is a
23 little important. I tried hard not to use those *terms*
24 in places where it couldn't be understood.

25 Q Well, under the Postal Service's proposed

1 rates for **ECR** mail, the unit contribution is, on
2 average, about 10 cents. Is that correct?

3 **A** It may be. That sounds in the ball park. I
4 don't know that I have a reference here that shows
5 that contribution.

6 **Q** And is it your testimony that that is too
7 large a unit contribution for **ECR** mail?

8 **A** Well, if the cost is seven or eight cents,
9 and we've got a 10 cent contribution, I would say
10 that's pretty substantial. Absolute contributions
11 are, at best, difficult things to look at. I think we
12 usually think in terms of proportions. There is
13 nobody alive, when you tell them an absolute
14 contribution, they don't say "relative to what," so
15 proportions are pretty much a part of our thinking.

16 **Q** Under the Postal Service's proposal in thin
17 case, the unit contribution for presorted first-class
18 mail is slightly above 23 cents. Are you aware of
19 that?

20 **A** I wouldn't be surprised if that's right.

21 **Q** Do you have an opinion whether that is too
22 high?

23 **MR. OLSON:** Mr. Chairman, I think we're
24 getting beyond the scope of the testimony, which is
25 limited to standard mail. Commenting on first-class

1 mail may be interesting, but it has nothing to do with
2 the testimony.

3 MR. RAKER: Well, Mr. Chairman, the witness
4 is using the terms "high" and "low" and "excessive
5 unit contributions" and "institutional costs," so I'm
6 trying to get a sense of how those terms apply when
7 used on a different subclass of mail.

8 MR. OLSON: But when counsel asked a
9 question about high and low rates, and the witness
10 asked him to provide a single reference as to where
11 those terms were used so they could be explained, he
12 didn't come up with a single reference.

13 BY MR. BAKER:

14 Q Mr. Mitchell, can you answer the question,
15 please?

16 A Well, when you start taking absolute
17 contributions and moving between subclasses and asking
18 me if they are high or low, I just said that I usually
19 view these things in a relative sense and that
20 absolute contributions are usually very difficult to
21 think about.

22 SO outside of a context, our job here is to
23 design rates that recognize a large number of things.
24 Somebody did that in first class, and I haven't
25 criticized that or even commented much on it. I have

1 said a few things, a few pages' worth of things, here
2 about standard.

3 Q So the bottom line is you really do not have
4 an opinion.

5 A I don't see how I can outline an opinion for
6 you on that.

7 Q All right. Let's turn to your testimony,
8 starting on page 73, when you talk about value of
9 service.

10 A Yes.

11 Q You devote a fair number of pages to this,
12 and I want to understand how you're using the term.
13 You mention, on page 74, the own price elasticity of
14 demand, and am I correct that you regard that as an
15 important measure of the value of service?

16 A Absolutely.

17 Q Is it the only measure of the value of
18 service?

19 A I don't know of another measure that goes to
20 relative value of service between one situation and
21 another.

22 Q A few pages later, on page 77, you address
23 notions of intrinsic value of service, and you state
24 there that you did not see that any notions of
25 intrinsic value of service are relevant to determining

1 costs coverages for, I think, any class of mail. Is
2 that correct?

3 A Yes, it is.

4 Q And Postal Service Interrogatory -- I
5 believe it was number 17 -- asked you some questions
6 about intrinsic value, and if you could turn to that,
7 I would appreciate it.

8 A I have number 17.

9 Q Okay. As you use the term here, is an
10 intrinsic value of a product something to do with its
11 physical characteristics or the costs of handling it?

12 A I don't know about cost of handling. The
13 phrase here was "intrinsic value of service."

14 Q How would you define "intrinsic value of
15 service"?

16 A Well, I don't have a way of defining it.
17 What I have done is I have watched, for a considerable
18 number of years, how that concept has been discussed
19 by various parties in rate proceedings, and the only
20 thing that I have seen or read is that some people
21 look at product characteristics, and I listed those
22 several places in my testimony.

23 They point out that one of its
24 characteristics is that it receives a high level of
25 service, or one of its characteristics is that it gets

1 free forwarding, or one of its characteristics is that
2 it has a red envelope. I don't mean to make fun of
3 the process here, but, you know, one of the
4 characteristics is that you can use a special service
5 with it.

6 These are all product characteristics, and
7 that's all that I have ever seen, and what I'm saying
8 is that whether or not a product has product
9 characteristics and whether or not you can list them
10 and whether they are impressive has nothing to do with
11 whether or not there is value that can be drawn on to
12 increase the rate.

13 Q So the fact that a class of mail may receive
14 free forwarding is irrelevant to its value of service,
15 in your testimony. Is that correct?

16 A What I have described in several places is
17 that once you define that product, which may have free
18 forwarding, as you suggest, and when we say "free
19 forwarding," we understand that the cost of that
20 forwarding is included in the base rate, so it's not
21 entirely free, but within a certain context, we call
22 it free.

23 Once you define this product, and it may
24 have free forwarding, and it may have a lot of other
25 things, then you have to put it out in the market and

1 give it a price, and once that price is set, some
2 number of pieces are going to be bought. There might
3 be a million bought, there might be a billion bought,
4 there might be 10 billion bought, but some number of
5 purchase. Now, all of those people that bought it are
6 perfectly happy, or they wouldn't have bought it.

7 So they made a decision to buy it, and there
8 is a lot of them being purchased, but now, if you want
9 to know something about the value of service that's
10 available to increase the rate, you have to ask
11 yourself the question, if we increase this rate, how
12 many of the people would go away? **And** if there is a
13 lot of excess value there; in other words, if it's
14 inelastic, then we know that not many of the people
15 will go away, and the volume will stay, and the value
16 will continue to be received.

17 So you can't say that the product
18 characteristics have nothing to do with value, but you
19 have to say that you specify the product
20 characteristics, you allow the market to decide how
21 much it will purchase, but then you have to proceed to
22 ask the value-of-service question, and that is, how
23 much value is out there that is available to be used
24 to increase the rate, and that's what elasticity
25 points to.

1 Q So is it an accurate summary of your
2 testimony that once you know the own price elasticity
3 of demand of a subclass of mail, the Commission need
4 not take the time to review the intrinsic
5 characteristics of that mail because they are all
6 subsumed in their own price elasticity?

7 A Basically, yes, but I don't wish to preclude
8 an exercise that looks backwards and says, "Gee, we
9 have found out that this has this level of elasticity.
10 Is that believable?"

11 At that point, it's kind of a
12 rationalization or kind of a learning process. At
13 that point, you might review the characteristics of
14 the product and talk to yourself about how people view
15 those characteristics, but that doesn't lead you to
16 the elasticity. It might explain the elasticity.

17 Q Are service standards relevant to the value
18 of service?

19 A They are part of the definition of the
20 product that people look at when they decide how much
21 to buy.

22 Q Service performance; is the Postal Service's
23 performance against the service standards relevant?

24 A Yes. I think we all now that every time you
25 go to a reception, that somebody tells you about the

1 performance that they have received recently on their
2 mail, so people think about this quite a bit.

3 Q Is that completely subsumed in the own price
4 elasticity of demand, or is that something that the
5 Commission should consider?

6 A It's completely subsumed.

7 Q Completely subsumed. Okay.

8 A It's part of the way people behave. It's
9 their perception of the product and how they behave.

10 Q Is the value of the mail to the recipient
11 relevant?

12 A I have had a little bit of trouble over the
13 years understanding what "value to the recipient"
14 means because, to a very large extent, someone else is
15 paying the postage and making the decision, but I
16 think there is a very substantial extent to which the
17 behavior and value to the recipient is reflected in
18 the decision of the mailer to send the mail.

19 In other words, if people don't respond,
20 you're not going to send ads, and if people do
21 respond, then they must view the mail favorably, and
22 you'll send advertising to them. A similar thing
23 could be said about banking.

24 Q We're not talking about banking.

25 So the value to the recipient; it's listed

1 in the statute as a consideration.

2 A Yes, it is.

3 Q Okay. And what I think you just told me was
4 that you can infer a value to the recipient from the
5 own price elasticity of demand.

6 A Yes. I think it's subsumed to a
7 considerable degree.

8 Q When you're using price elasticity of demand
9 in this context, the value of service, are you looking
10 at the price elasticity to the marginal user, or is it
11 sum or total factor?

12 A Am I looking --

13 Q Is it ~~the~~ marginal user you're looking at,
14 the marginal mailer, the mailer on the margin who is
15 deciding whether to mail the next incremental unit, or
16 are you using sum or total?

17 A Well, if the price is 10 cents, and you're
18 selling 100, and you raise it to 11 cents, a small
19 amount of the volume is going to go away. Those are
20 people who value it at over 10 cents but not over 11.
21 I mean, they are at a margin. There is a margin
22 there. People would use the margin to -- as long as
23 we're clear about what kind of a margin we're talking
24 about, I think the answer is yes.

25 Q Do you consider the volume at all when

1 you're evaluating value of service?

2 A Do I consider the volume?

3 Q The volume.

4 A There is always a volume, but I can't tell
5 anything about value of service by looking at the
6 level of the volume. I mean, I just explained, if the
7 rate is 10 cents, and people buy a billion of them,
8 obviously, there is a lot of value there, but that
9 doesn't mean that there is a lot of value that can be
10 used to raise the rate.

11 Q Are you familiar with Val-Pak's contracts
12 with its advertisers?

13 A No, I'm not. Did *you* say contracts, plural
14 or singular?

15 Q Contract or contracts. It has more than one
16 advertiser in a Val-Pak envelope, so I used plural.

17 A No.

18 Q Okay. Ultimately, *you* propose cost
19 coverages for standard ECR and for standard regular
20 mail. You use Witness Tress's estimated price
21 elasticities of demand in doing so, I think, and you
22 recommend a markup of ECR that's below the system-wide
23 average and lower than for commercial regular. *Am* I
24 correct so far?

25 A Yes.

1 Q Did you further recommend, the markup for
2 commercial regular should be somewhat above the
3 system-wide average or below? I think it's above,
4 isn't it, commercial regular, standard regular?

5 A At some point, I'm going to have to look at
6 what I actually said and what numbers I used. I'm
7 having a little trouble getting everything to register
8 here systematically.

9 Q All right. Under your recommendation to the
10 Commission, is the markup for commercial regular mail
11 higher or lower than the system-wide average?

12 A You know, right now, I would have to look
13 and see what the system-wide average is.

14 Q Okay. Take the time to do that, please.

15 A Well, let's see here. For regular, I have
16 proposed 180 percent, and for ECR, 177 percent. Now,
17 the system-wide average is a matter of record. For
18 some reason, I can't get my mind to come up with
19 exactly what it is, but I'm sure we can find it.

20 System-wide average is 178.4.

21 Q So you're recommending --

22 A So my ECR is very slightly below the system-
23 wide average, and my regular is slightly above the
24 system-wide average.

25 Q Do you have any recommendation at all as to

1 whether the markup for standard regular should have
2 any particular relationship to that of first-class
3 mail?

4 A I agree that that is an interesting
5 question, and I think I have pointed out that the
6 elasticities that we have now for regular are not
7 substantially different from the elasticities that we
8 have for first class, but I haven't gotten to the
9 point where I make a recommendation for first class;
10 neither have I gotten to the point where I'm willing
11 to say that first class is too high or too low.

12 Q And then I suppose, then, we ask you, in
13 **NAA-26**, if your recommendations would be affected if
14 Dr. Clifton's alternative calculations for first-class
15 mail, price elasticity were adopted instead of Mr.
16 Tress's, and your answer there was you really didn't
17 get into that. You stay away from first-class mail,
18 in your testimony. Is that right?

19 A I think that's right. I missed some of
20 that, and I think you were talking about **26**.

21 Q **NAA-26**. We asked you what the implications
22 on your proposal would be if it turns out Dr. Clifton
23 is correct and not Mr. Tress, and your answer is your
24 testimony stands independent of that issue.

25 A That's right.

1 Q Okay. Could you turn now to pages -- well,
2 the beginning of page 173 of your testimony?

3 Actually, I'm going to ask you first about Table 10
4 that's on page 174.

5 A I have 173.

6 Q All right. And this is where you are
7 designing rates for high-density flats in ECR mail.
8 Correct?

9 A Yes.

10 Q All right. Could you now turn to Table 10
11 on page 174?

12 A Okay.

13 Q In Table 10, under the column "USPS Proposed
14 Cost," and the docket numbers are 2006-1, and I see
15 the figure, 4.43 cents. Do you see that?

16 A 4.43?

17 Q Yes.

18 A Yes.

19 Q And can you tell me what that 4.43 cents
20 represents?

21 A It represents the cost of record as
22 developed by the Postal Service. It includes both
23 mail processing and delivery.

24 Q For city carriers and rural carriers and all
25 mail processing.

1 A Yes.

2 Q Is it a base year cost or a test year cost?

3 A It's test year.

4 Q Test year. And further down that page, you
5 rejected that 4.43 cents cost savings as excessive for
6 high-density flats. Is that correct?

7 A Basically.

8 Q And that is because you thought it's an
9 unrealistic number. Is that right?

10 A It's because what?

11 Q You believe it to be an unrealistic number.

12 A I pointed out some reasons for raising the
13 questions that I did.

14 Q And you have done no independent measure of
15 the costs of high-density flats beyond what the Postal
16 Service presented, have you?

17 A That would be quite an undertaking. No, I
18 don't have independent measures of costs.

19 Q And is it your understanding that some of
20 the high-density flats mailers may be members of my
21 client who compete with saturation mailers? Is that
22 your understanding of who might mail at those rates?

23 A Do I understand that your clients might use
24 high density to compete with saturation?

25 Q Yes.

1 A There is a relationship there, yes.

2 Q Is it a competitive relationship?

3 A Well, I think, if your clients are sending
4 out total market coverage, that the competition
5 includes more than just high density. It also
6 includes the associated newspaper and the ones that go
7 out that way as well. So it's a little more complex
8 relationship than you outlined.

9 Q Can you agree with me that the rate for
10 high-density flats has some competitive significance
11 in the market between newspapers and saturation
12 mailers?

13 A Certainly.

14 Q Okay. Finally, could you turn to your
15 response to NAA-37? It wasn't finally, but almost
16 finally.

17 A Yes.

18 Q There you state you know of no way to
19 project the portion of saturation flats that will use
20 DALs in the test year. Is that correct?

21 A Yes.

22 Q Have you thought of any way -- anything the
23 Commission could look at to get some estimate of the
24 number of flats that will use DALs in the test year?

25 A These things are very difficult issues, as

1 you probably know. The thing that jumps out in my
2 mind is the experience I had with the Postal Service
3 in Docket No. R-90, when we created the letter-flat
4 differential. I think we spent \$1.1 million on
5 quantitative marketing research in order to try to
6 estimate how the market would respond, and, even then,
7 our estimate probably wasn't highly accurate.

8 SO the only agency that's really capable of
9 putting together estimates like this is the Postal
10 Service, and I think this one is extremely difficult,
11 and I think, if you look at the next interrogatory,
12 which is 38 -- we've been looking at 37 -- I think, if
13 you look at the next interrogatory, which is 38, I lay
14 out a pretty plausible explanation of why what the
15 Postal Service is doing here makes a lot of sense.

16 Q Well, sure, but let me ask you another
17 approach. Should the Commission consider record
18 evidence in this proceeding **as** to what's found on
19 statements in the record by saturation mailers as to
20 what they are likely to do in response to the proposed
21 DAL surcharge?

22 A Well, you will never find me suggesting that
23 the Commission can't consider record evidence.

24 Q Okay. So that's something that the
25 Commission might well want to consider, if they are

1 projecting how many **DALs** will convert.

2 A Well, when I say the Commission considers
3 record evidence, it does so quite thoughtfully. Just
4 because somebody said something on the record doesn't
5 mean it gets an awful lot of weight, but the answer
6 is, yes, they will consider that very carefully.

7 Q Okay. My final, and truly my final,
8 question, is, you are proposing to reduce the cost
9 coverage of ECR mail and to increase it for standard
10 regular. Correct?

11 A Yes.

12 Q Have you calculated the changes to
13 institutional cost contributions on a subclass basis?

14 A Sure. It's shown in my workpapers.

15 Q Okay. When I looked at your workpapers, it
16 looked to me that essentially -- have I read it
17 correctly? -- the ECR contribution would be about a
18 billion dollars less than the Postal Service's
19 proposal?

20 A I'm sorry. I couldn't hear everything you
21 said.

22 Q Comparing the ECR institutional cost
23 contribution under your proposal to that of the Postal
24 Service, if I'm reading your workpapers correctly, is
25 the figure about one billion dollars less under your

1 proposal?

2 A Well, under "Proposed Rates," the
3 contribution of proposed rates of ECR is \$3.5 billion,
4 and under the rates that I propose, it's 2.4.

5 Q So a little bit more than one billion
6 dollars.

7 A Yes.

8 Q Okay. And the contribution for standard
9 regular increases under your proposal by -- is it
10 about the same amount?

11 A Approximately.

12 Q All right. So the net result of your
13 proposal is to take \$1 billion of institutional costs
14 off of standard ECR and have that paid instead by
15 standard regular mail. Correct?

16 A That can be said, yes.

17 MR. BAKER: No more questions, Mr. Chairman.

18 CHAIRMAN OMAS: Thank you, Mr. Baker.

19 Ms. McKenzie?

20 MS. MCKENZIE: Mr. Chairman, I'm probably
21 going to have more than a half-hour of questioning but
22 maybe not much more. I didn't know if you wanted to
23 take the mid-morning break at this time or to just see
24 where we are at eleven-thirty.

25 CHAIRMAN OMAS: Why don't we take a mid-

1 morning break right now? We'll come back at 10-after-
2 11. Okay?

3 MS. MCKENZIE: Thank you, Mr. Chairman.

4 (Whereupon, a short recess was taken.)

5 CHAIRMAN OMAS: Ms. McKenzie?

6 CROSS-EXAMINATION

7 BY MS. MCKENZIE:

8 Q Nan McKenzie for the Postal Service, Mr.
9 Mitchell. I would like you to turn to page 190, which
10 is your Schedule 4, "Val-Pak Recommended Rates,
11 Commercial ECR." I wanted to understand some of the
12 impacts of your rates a little bit better.

13 Now, if I'm reading this correctly, you have
14 a per-piece rate for auto-basic letters of 16.5 cents.
15 Correct?

16 A Let's see. We're in the ECR. Okay. I'm
17 getting myself reoriented here. Schedule 4. Go
18 ahead.

19 Q Okay. So auto-basic letters is 16.5 cents.
20 Correct?

21 A Yes.

22 Q And then the plain, basic letter rate would
23 be 18.5 cents.

24 A Yes.

25 Q And the per-piece rate for flat basic at

1 20.8 cents. Correct?

2 A Yes.

3 Q Now, are you aware that the Postal Service
4 requires high-density, letter-rated pieces to be
5 automation compatible?

6 A High-density letters are required to be
7 automation compatible, yes.

8 Q Right. That's true also for saturation
9 letter rate of pieces.

10 A Yes.

11 Q Now, for your auto-basic letter rate of 16.5
12 cents, will that be available everywhere or only at
13 limited post offices?

14 A Only at limited post offices, as now.

15 Q As now. So it would be the same.

16 A I have not proposed any change in that.

17 Q Okay. Now, will pieces that are eligible
18 for the basic letter rate of 18.5 cents need to be
19 automation compatible?

20 A I don't think that they need to be, no.

21 Q Okay.

22 A There is no change from the existing
23 situation.

24 Q From the existing requirements of the Postal
25 Service.

1 A Yes.

2 Q Okay. Then I wanted to look at some of the
3 possible effects on volumes that this might have.
4 Please take a look at Schedule 2 on page 163.

5 A Schedule 2, page 163; we have changed from
6 ECR back to regular.

7 Q Correct.

8 A Yes.

9 Q Okay. Now, under commercial regular, the
10 rate for five-digit auto is 21.8 cents. Correct?

11 A Yes.

12 Q So a letter mailer will have the option of
13 sending a five-digit auto for 21.8 cents, or a
14 nonauto, carrier-route, basic piece at 18.5 cents,
15 assuming they have 10 pieces per route.

16 A Yes.

17 Q So the five-digit, auto-mail volume would
18 likely migrate to the nonauto basic rate. Correct?

19 A Yes. I think there were some
20 interrogatories on that.

21 Q Okay. And under your scenario, they would
22 no longer have to be automation compatible.

23 A That's true. I have, in fact, suggested
24 that the structure of relationships that now exists in
25 ECR surrounding the basic rate is not all that maybe

1 it should be. It raises a lot of questions. It's a
2 rather cumbersome relationship, but, yes, I think, as
3 it exists right now, everything you said is right.

4 Q Okay. And you haven't recommended changes,
5 then, to the characteristics or the mail-preparation
6 requirements.

7 A No, I haven't. Now, I think that some of
8 those requirements are fully under the control of the
9 Postal Service and are not in the DMCS. So if the
10 Postal Service found that some changes would be
11 helpful, I think they can be made, and that's not
12 something which is out of the realm of possibility.

13 Q Would you please turn to page 63 of your
14 testimony?

15 A 63. Okay.

16 Q You got there before I did. Now, the title
17 of the section, Section I, is that the markup on ECR
18 is too high. Correct? This begins a new section.

19 A Yes.

20 Q Then you proceed, in this section, to
21 discuss the noncost factors of Section 3622. Is that
22 correct?

23 A Yes.

24 Q Would it be a fair characterization of this
25 part of your testimony, Section I, that this supports

1 your argument as shown, the heading that ECR coverage
2 is too high?

3 A Yes.

4 Q And in Section I, and I'm focusing just on
5 Section I, you're not really arguing that standard
6 regular coverage is too low, are you?

7 A I had a lawyer explain to me once the role
8 that headings of sections should play in testimony,
9 and I think they are not the same level of evidence as
10 the content of the section. That may be immaterial to
11 my answer.

12 Without re-reading this, I can't tell you
13 how much in that section I talk about regular as
14 opposed to ECR, but I think it's that the heading is
15 there because "ECR" stands out as the principal
16 problem. But I think that because it was a de-
17 averaging process, that regular is associated with it.

18 Q And, frankly, that's the way I was reading
19 the first about 100 pages of your testimony. Your
20 focus really is on ECR being too high, and when you
21 discuss the noncost factors, that's really what your
22 focus was. Your focus wasn't so much as standard
23 regular is too low, although that does seem to come up
24 as part of your de-averaging argument.

25 I was looking at the two of them sort of

1 separately in terms of if you're justifying the rates
2 you proposed, you're really justifying that the markup
3 on ECR is too high, is how I was reading it, and I was
a wondering if that was accurate.

5 A Well, I think my testimony is oriented
6 extensively toward the de-averaging that, in effect,
7 occurred in MC95-1, but if you look at the adjustments
8 that I made, for regular, the Postal Service proposed
9 176.5 percent, and I proposed 180. So it's four
10 percentage points higher, but the reduction for ECR is
11 quite a bit more.

12 So just in terms of the sizes involved, the
13 ECR discussion plays a bigger role. I can see
14 basically what you're saying, but I don't want to read
15 too much into it.

16 Q Okay. If you could please turn to NAA's --
17 your Answer No. 7, NAA-Val-Pak-T-1-7.

18 A NAA-7, yes.

19 Q Now. in that question, NAA asked: "Please
20 state whether you believe the rates for standard ECR
21 mail recommended by the Postal Rate Commission in the
22 following cases 'were lawful," and they listed R97,
23 R2000, R2001, R2005. And the answer you gave is, "I
24 have not taken a position on whether any of the rates
25 recommended by the Commission are lawful, nor are you

1 qualified to do so."

2 I wanted to move out of the realm of the
3 lawyer and more more into the realm of the pricing
4 witness. What would your answer be if the question
5 had been asked, were the rates in those cases
6 consistent with the policies of the act?

7 A Well, the issue becomes a little more
8 complex than that because the Commission makes a
9 decision on the record, and the record is influenced
10 by what the Postal Service proposed. It's influenced
11 by what the Intervenor has put on the record and the
12 analysis that's available. A couple of those cases
13 had special characteristics in terms of settlements.

14 So I haven't gotten to the point where I
15 really criticize in any sense what the Commission did
16 in those cases. I mean, when I say the Commission
17 makes a decision on the record, I emphasize the
18 importance of the record, but I don't mean to preclude
19 the Commission having thoughts of its own. You know,
20 they, as POIRs, they have a lot of insight.

21 But the question becomes much more difficult
22 when you ask whether or not I agree with everything
23 that happened in previous cases, and whether or not it
24 should have been different, or whether or not I think,
25 at this point, it should have been different.

1 So, really, I think the emphasis of my
2 testimony is what we should do at this point and not
3 whether or not I want to take positions on all of
4 these things that happened in the past.

5 Q Well, my question wasn't whether you agreed
6 or disagreed. My question was, were those decisions
7 consistent with the policies of the act?

8 A Well, that's a legal question again.
9 Consistency. ■keep getting told by attorneys that a
10 lot of rates are consistent with the act, and I keep
11 responding by saying that the rate commission has a
12 responsibility to do what it thinks is best under the
13 act and not just define something that's consistent.

14 So the whole thing gets a little messy, but
15 you asked consistent with the act, and I haven't
16 argued that any of these are inconsistent with the
17 act.

18 Q So can I take from that answer that you
19 agree they were consistent with the act?

20 A You know. to reach a judgment and say, "My
21 opinion is these were consistent with the act," seems
22 to me to be a little bit of a strong statement for a
23 technical witness. It still seems to have a lot of
24 legal content.

25 All I have said is that I have not found

1 reason to believe that it's inconsistent, and I think
2 that's probably as far as I really want to go.

3 Q Okay. I'll take the double negative.

4 A Some people have pointed out that I love
5 negatives, including double ones, but I think they are
6 useful at times.

7 Q Could you turn to page 96 of your testimony?

8 A 96. Okay.

9 Q Okay. Page 96 is in a section of your
10 testimony entitled "Recommendations," but the title
11 isn't relevant here. On page 96, at line 10, you are
12 discussing a dilemma, and you had just been discussing
13 cost coverages and that you believe that cost
14 coverages were out of alignment.

15 You then say that "while the dilemma is
16 presented, under number of circumstances, five or 10
17 percentage points of movement could be made in one
18 case and another five or 10 in another." But then you
19 state, "The first problem with this approach is that
20 the mailers chose against a gradual change by settling
21 two consecutive omnibus rate cases," and that's the
22 part that I wanted to focus on.

23 Now, if I understand your position, then
24 because mailers signed the agreement, they have, in
25 effect, given up their opportunity for gradual

1 changes. Is that a fair characterization of your
2 testimony?

3 A That they have given up their opportunity?

4 Q To argue for gradual changes.

5 A Well, basically, I think mailers should be
6 allowed to argue whatever they wish, but the situation
7 clearly is that they did not argue for any change at
8 all in the previous case, even though it was apparent
9 that there were some misalignments and that testimony
10 could be presented on a number of these issues.

11 Q I wanted to focus a little bit more on
12 R2001-1, start **with** that one, because you mentioned
13 that, in the last two cases, they have been settled.

14 A Okay.

15 Q I'm interpreting your gradual changes to
16 mean basically that mailers really shouldn't be able
17 to claim rate shock. Is that an inappropriate
18 characterization?

19 A Basically, yes.

20 Q And **that** would be for mailers who are facing
21 price increases. Correct? I'm sure everybody would
22 be delighted if the Postal Service could cut 8 percent
23 of all of its rates. They might be shocked, but
24 that's not the kind of shock we're talking about.

25 A I prefer the word "effect" to the word

1 "shock," but maybe that's because I worked on auto
2 crashes for a while, on energy-absorption
3 characteristics, where there was a real event that
4 justified the word "shock." But I think the answer is
5 yes.

6 Your introduction had something to do with
7 R2001.

8 Q Right.

9 A And then we fizzled toward the end, and I
10 don't know what the point was on R2001.

11 Q well, I was quoting in your testimony saying
12 that there have been two consecutive omnibus rate
13 cases that have been settled, and, therefore, you're
14 saying that mailers, by settling, have chosen against
15 gradual changes, and you mentioned --

16 A Well, I think that the risk was not as
17 spelled out in R2001, and certainly the Commission
18 didn't say as much about that issue in **R2001**, but the
19 Postal Service made a full proposal in R2001. The
20 Postal Service didn't know that it was going to be
21 settled or that any of the events of that year would
22 occur. But mailers did not proceed to develop
23 testimony and present it, for the most part, so the
24 record was limited in that case.

25 Q So let me see if I understand you. With

1 respect to your discussion of rate effect or rate
2 shock, that's really limited more to **R2005-1**, just in
3 terms of the fact that, by settling, the mailers, in
4 effect, gave up their opportunity to argue for gradual
5 changes.

6 A Well, it's apparent that they gave up that
7 opportunity in **2001**, but I think the issue was a lot
8 clearer in **R2005**, and, in fact, the Commission
9 commented on it. to a considerable extent, in **R2005**,
10 and that didn't occur in **R2001**.

11 Q I thought I heard you testify just shortly
12 ago that in **R2001** it wasn't apparent.

13 A At the time it was filed, it was not
14 apparent that it would be settled, but at the time
15 that mailers signed a settlement agreement, they were
16 certainly aware that they had given up their
17 opportunity to argue for change. The difference
18 between the two cases was that I think there was a lot
19 more recognition in **R2005** that adjustments were not
20 being made.

21 Certainly, in **R2001**, we had the adjustments
22 that the Postal Service thought should be made, so
23 there was some limited input for change, but I don't
24 think the adjustments were very significant.

25 What have I left out? I hope I've dealt

1 with it.

2 Q I thought I heard you making a distinction
3 between the two cases, and I wanted make sure I
4 understood that. So the need for adjustment in R2001-
5 1 wasn't as great as the need in R2005-1.

6 A Well, there were some time period
7 differences as well. R2001 wasn't very long after
8 R2000. One could argue that it was approximately a
9 year between them. But R2005 was several years later,
10 so I think that, you know, if you presume, and I think
11 it's a safe presumption, if you presume that the
12 Postal Service is making changes all along -- there
13 were some mechanization changes, operations changes,
14 changes in the DMM that the Postal Service works
15 regularly with mailers -- we could go on and on.

16 If you presume that, over the period of at
17 least four years between R2001 and R2005, that more
18 and more changes occurred, then the need for
19 adjustment itself was probably more pronounced in
20 R2005 than it was in R2001.

21 Q So, summing up, at least what I'm taking
22 away from your discussion was that, at least on the
23 rate shock issue, that in R-2005-1 mailers were more
24 aware basically of the potential of changes that might
25 be more significant in the next rate case than they

1 would have been in R2001-1.

2 A I think there was more awareness because of
3 the nature of the process and also because of
4 observations the Commission made during the case, as
5 well as arguments that Val-Pak made during R2005
6 because, as I recall, Val-Pak pointed out some of
7 these issues during the case, so there was a very
8 great deal of awareness.

9 Q Now, in your proposal, and I think we had a
10 discussion a little bit earlier today, I believe,
11 perhaps when Mr. Baker was cross-examining you, would
12 Advo benefit under your proposal, just in general,
13 with respect to what happens with the rates under your
14 proposal?

15 A Advo, as I understand it, would certainly
16 benefit from the lower coverage for ECR. They would
17 not be overjoyed at the letter-flat differential
18 problem, but, you know, I don't have a percentage
19 increase right here at my fingertips for Advo mail,
20 but I think it's clear that they like parts of the
21 proposal, and some parts, they probably aren't too
22 happy about.

23 Q And would it be a fair statement that other
24 ECR mailers would benefit from your proposal, such as
25 those that are members of the Saturation Mailer

1 Council?

2 A Well, I think it follows pretty directly
3 that if you lower the cost coverage, unless there is
4 some offset, it would tend to benefit the entire
5 subclass.

6 Q Now, in looking at R2001-1, both Advo and
7 Saturation Mailer Coalition signed the stipulation
8 agreement. Do you accept that, subject to check?

9 A Yes.

10 Q Yet you're making an argument that I haven't
11 heard you totally back away from, that even the R2001
12 settlement, in effect, was a mailer choice against
13 gradual rate changes. Do you agree with that
14 statement?

15 A It was certainly a mailer choice, and I
16 think that it's clear that if you don't make any small
17 changes, there won't be any gradual rate adjustments.
18 I'm not sure of exactly the importance of your
19 question. I don't know the distinction you're trying
20 to make.

21 Q Well, it just struck me that they are going
22 to reap some tremendous benefits because they signed
23 the agreement. It's almost as if you're trying to use
24 the status of the settlement agreement as a shield
25 against an argument for rate shock or consideration of

1 the rate shock factor.

2 A It turns out, I think, and this is very
3 general reaction, but I think, in general, that the
4 proposal that the Postal Service filed in R2001 was a
5 rather passive proposal in the sense that it did not
6 suggest very many significant adjustments.

7 So, given that, I think it added to the
8 comfort that mailers found in signing onto the
9 agreement at that time.

10 It's also true, as I recall, and I think the
11 Commission pointed this out in its opinion, I think
12 it's also true that -- let me back away from the way I
13 wanted to finish that sentence. I'm not sure. I
14 might be mixing **up** two cases.

15 But there were also some timing issues
16 involved in R2001. You know, mailers felt like they
17 were agreeing to put something in place a little
18 earlier that was really needed. I'm not an expert on
19 all of the thoughts that mailers had. That was
20 obviously a very difficult time for all of us, and
21 it's been some years ago, and I think, at the time, I
22 was on the Commission staff, so my perspective on the
23 whole process was limited by what was presented to the
24 Commission. I wasn't a member of the outside world,
25 so there were limitations.

1 I think I've come to an end here, unless you
2 want to remind me. I don't mean to ramble, but you're
3 asking very complex questions about history here.

4 Q Okay. But with respect to, at least, **R2005**,
5 by mailers signing on to that settlement, if I
6 understand your position, they have chosen against
7 gradual changes. Correct?

8 A Yes.

9 Q Okay. And I'm interpreting that, at least,
10 with respect to 2005, that basically your
11 recommendation is that the Commission not consider the
12 factor of rate shock.

13 A Not consider it when? I lost --

14 Q Well, it just has to do with sort of the
15 status of settlement. I'm interpreting it as you're
16 using the settlement, and let's just do the **R2005-1**
17 settlement, as a shield against the argument of rate
18 shock, that your rates should be supported, and you
19 talk at length about it. You do discuss Factor 4, but
20 you say, you know, mailers signed onto it, basically,
21 the fact that there would be rate shock. So you're
22 using the settlement as a shield against rate shock,
23 is the way I'm interpreting it. Is that correct or
24 incorrect?

25 A I'm not sure how you get to the settlement

1 being a shield against rate shock. I think what we
2 have said is that. when mailers signed the settlement,
3 they understood that there could be a truing up
4 process later that would involve some effects. That's
5 all.

6 Q Okay. I want to move on to another topic.

7 In your testimony, you argue that ECP,
8 efficient component pricing, does not apply to shape-
9 based cost differences. Is that correct?

10 A Yes.

11 Q And the implication of your position is that
12 the unit contribution for letters and flats does not
13 necessarily have to be the same. Is that correct?

14 A Yes.

15 Q So, in your view, then, should the unit
16 contribution be the same between flats and parcels?

17 A No, I don't think so. I think the same
18 argument that applies between letters and flats would
19 apply between flats and parcels. I realize we're not
20 as far along there because there are some new
21 proposals in the Postal Service's case, and we need to
22 improve the costing a little bit in the future to get
23 a handle on this.

24 So we're dealing here with a first step, and
25 I haven't raised any questions about that step. It

1 appears to me to be a step that needs to be made, but
2 I haven't provided any specific evaluation of the
3 advocacy of that step or whether or not it should be
4 different. I don't think you can argue that there is
5 any specific reason in efficient component pricing
6 that the contribution per piece on parcels should be
7 the same as for flats.

8 Q Well, if the unit contribution differed
9 between flats and parcels, would that be de facto
10 evidence of price discrimination?

11 A No, it wouldn't. There is a cost
12 difference.

13 Q Okay. Can you turn to page 110, please, of
14 your testimony?

15 A Okay.

16 Q This is where you're discussing your rates
17 for the nonprofit categories of standard regular mail.
18 Now, at line 3, you're talking about the 60-percent
19 rule, and that's for nonprofit, the pricing of
20 nonprofit categories, and you say, "But this rule only
21 goes so far. It specifies average revenue per piece
22 but doesn't specify any of the rate relationships
23 between and among the various rate cells and does not
24 specify the relationship between these rates and their
25 corresponding costs."

1 Now, if you go down on the same page,
2 starting at line 14, the sentence starting there, it
3 states: "The potential exists now to bring nonprofit
4 categories into alignment with commercial categories."
5 I was wondering what you meant by that statement

6 A What I meant was, very simply, that they
7 should have the same discounts and the same cost
8 recognition for their categories as regular. In fact,
9 I think that my workpapers show very clearly that I
10 have the same presort tree for nonprofit that I do for
11 regular and that I found it very difficult to argue
12 that it should be different.

13 Q Okay. So is the alignment, then, having to
14 do with cost and cost issues, in that line of your
15 testimony?

16 A Yes. It has to do with how costs are
17 recognized in the rate differences, and the signal is
18 sent, therefore, in the rates. I think it centers
19 very much on the Ness argument, where I pointed out
20 the kinds of things that the court said in that case,
21 and those things seem very applicable, to me, to
22 nonprofit today.

23 Q Okay. Could you go to your answer to Val-
24 Pak 22, please?

25 A Val-Pak-22.

1 Q Yes.

2 A We didn't ask ourselves interrogatories.

3 Q Excuse me. You wouldn't have that, would
4 you? Okay. How about our 22 to Val-Pak, USPS, yes,
5 Postal Service.

6 A USPS-22?

7 Q Yes.

8 A Okay.

9 Q Specifically, the question asked about
10 nonprofit regular rates, as shown in Table USPS/VP-T-
11 1-A, and that table is immediately preceding. I
12 direct your attention to your response to Subparts (b)
13 and (c).

14 A To (b) and (c).

15 Q Yes.

16 A Okay.

17 Q You did a combined answer there, and you're
18 discussing whether the rate impacts are fair. Now, I
19 wanted to actually direct your attention to the second
20 paragraph of that combined response for (b) and (c).

21 A Yes.

22 Q And there you state that your table, being
23 the Postal Service's table, shows an increase of
24 letters of 1.4 percent and for flats of 102.6 percent.
25 Correct?

1 A Yes.

2 Q What are your conclusions about the costs of
3 nonprofit regular and flats and nonprofit regular
4 letters in your answer there?

5 A Well, I think that that answer, as you
6 suggest, goes on to talk a little bit about the costs,
7 and these include simply the mail-processing and
8 delivery costs, which are 90-some percent of the
9 costs, and it says: "According to the costs shown on
10 my workpapers. cost of letters is 9.703 cents --" I
11 apologize for the accuracy, but I just follow through
12 for consistency purposes. But 9.703 is the only cost
13 of record for letters, and there is not really a
14 weight problem here because letters can't be 12
15 ounces. They wouldn't be paying the letter rate.

16 So we got a cost for these of 9.703, and, as
17 proposed by the Postal Service, the rate for letters
18 is 16.2. So, for nonprofit, under the 60-percent
19 rule, you know, if you have a cost coverage for
20 regular in the neighborhood of 160 to 170 percent or
21 so, and you give a 40-percent discount, your rates
22 inherently are going to be somewhere close to costs,
23 and we've got a situation here were the cost is 9.7,
24 and the rate is 16.2.

25 I think that this kind of jumps off the page

1 and causes you to ask some rather serious questions,
2 and I think I went on here to talk about some implied
3 contribution figures, based on the costs that we have,
4 and also talked about flats.

5 Q Right. I think what your conclusion there
6 was, for flats, you calculate a negative contribution
7 of 9.573. Correct?

8 A Yes.

9 Q And then your letters make a positive
10 contribution of 6.497 under your calculations.

11 A Yes.

12 Q Now, the Postal Service doesn't provide
13 separate costs for commercial regular and nonprofit
14 regular. Correct?

15 A That's right. It doesn't.

16 Q Okay. And you allow for this, though, or,
17 at least, I was interpreting that you're allowing for
18 this, when you say, even if the cost of flat is
19 somewhat lower than this due to the effects of weight,
20 something is badly out of kilter. Correct?

21 A Yes.

22 Q Then you go on: "On the other hand, under
23 the rates I propose, these contributions are in the
24 same order, positive 5.430 and positive 5.297.
25 Correct?"

1 A Yes.

2 Q So are you saying that your proposal brings
3 the contribution of nonprofit back into kilter?

4 A Yes. Are you thinking that one is letters
5 and one is flats, and I proposed that there should be
6 markup on the difference? That's an issue that we can
7 talk about, but: you didn't quite go that far, so I
8 agreed with what you said.

9 MS. MCKENZIE: That's all I have, Mr.
10 Chairman.

11 CHAIRMAN OMAS: Thank you, Ms. McKenzie.
12 Is there anyone else who wishes to cross-
13 examine? Mr. Todd?

14 MR. TODD: **Just** a follow-up.

15 CHAIRMAN OMAS: Yes, sir.

16 CROSS-EXAMINATION

17 BY MR. TODD:

18 Q Mr. Mitchell, if I may quickly summarize
19 what (mike off) as well as your testimony, it is that
20 because mailers signed off on settlements in a couple
21 of cases or, at least, the last one, in R2005, with
22 the knowledge that the rate relationships were out of
23 kilter, it should reduce, if not entirely eliminate,
24 and argument in this case where you're proposing a
25 major realignment between standard mail, regular, and

1 ECR rates, that they should not be heard to complain
2 about rate shocks; that is, the regular mailer facing
3 very large rate increases. Is that a correct summary
4 of your testimony?

5 A I think that's basically correct, but there
6 is another dimension or two to the situation; in other
7 words, the prospective future, as far as the
8 legislation, was also a matter that I brought into the
9 equation.

10 I even went so far as to say that if it's
11 clear to the Commission, at the end of this case, that
12 further steps are going to be able to be made -- in
13 other words, I pointed out that price caps pretty much
14 prevent you from doing good things in rates. So if
15 it's clear that that constraint is gone, I suggested a
16 slightly different coverage as a first step in this
17 case.

18 Q Well, I'm glad you said that because that's
19 exactly where I was going. You've been around this
20 game a long time. You don't care to share your
21 prognostication as to what the Congress is going to do
22 with the Commission, do you? Are they going to
23 approve postal reform legislation or not?

24 A I generally do my best to stay away from
25 that.

1 Q That's probably very wise, but then, to go
2 on, let me say that we're at briefing time. Congress
3 has adjourned, and they are on their way home. They
4 are home. Would it be unfair of me, if I were
5 briefing this on behalf of the Mail Order Association
6 of America, to state in my brief that Mr. Mitchell's
7 testimony does not support the rates which have been
8 proposed in his tables but, rather, a much more
9 gradual change in the rates of standard mail, regular
10 and standard mail ECR? Would that be a fair thing for
11 me to brief and argue on brief?

12 A I have learned never to put constraints on
13 what someone can argue in their brief.

14 Q Then let me change the question. Would that
15 be a fair characterization of your testimony?

16 A You did ask me if I thought that would be
17 fair, and I think that's a reasonably fair
18 characterization. In fact, I have given you a
19 spreadsheet where you can go in, and you can change
20 the number in two cells, which anybody in the third
21 grade should be able to do, and the new rates will
22 come out. That's it. Two cells, and you'll have a
23 complete set of rates with increases, and I see no
24 reason why those wouldn't be defensible.

25 Q And you had recommended, in fact, that that

1 be done.

2 A Well, whether or not that is my specific
3 recommendation, I have certainly said that I would
4 understand if that were done, and if that position
5 were taken. But I think my recommendation, more
6 directly, is that the situation that I address has
7 been in place for a number of years, and it's time to
8 fix it. I think a pretty meaningful step in that
9 direction ought to be taken.

10 Q Let me go back to, again, your testimony
11 concerning the foregoing-of-the-rate-shock argument,
12 if I may express it that way. Suppose that I'm a
13 participant in the R2005 proceeding. I look around.
14 I said, "You know, ECR rates, standard mail ECR rates,
15 are too high, and it's too bad that we're going to go
16 along with these, but, for a lot of reasons, we've
17 decided to go along with the settlement, and even when
18 we realize there may have to be a future rate
19 realignment." But I conclude that that's fine. I'm a
20 standard mail regular mailer.

21 My conclusion here is not that standard mail
22 regular rates should be increased drastically in order
23 to provide lower standard mail *ECR* rates but that, in
24 fact, first-class mail rates ought to be increased
25 drastically in order to provide for lower standard

1 mail ECR rates. Would that have been a reasonable
2 conclusion by a mailer, and, in fact, is that perhaps
3 a conclusion that some mailers made?

4 A I can see why you would consider bringing up
5 that issue and you could develop testimony on that.
6 My conclusion at this point was that the implications
7 of the deaveraging decision in R-1995 did not at this
8 point need to involve first-class. First-class is a
9 difficult subclass with a lot of issues of its own and
10 I haven't gottec so far as to make any recommendations
11 on that. You could raise that question.

12 Q Well, and mailers may well have in fact made
13 that conclusion that they didn't face because of a
14 failure to realign rates in one of those earlier
15 proceedings, they weren't in any way concluding that
16 well, if I don't do it now I'm never going to be able
17 to raise rate shock because they never thought they
18 would face rate shock because they thought the
19 realignment was going to come between standard mail
20 and first-class mail.

21 That's certainly a conclusion that mailers
22 may well have reached, isn't it?

23 A They may have reached that conclusion. I am
24 not an expert on what conclusions mailers may have
25 reached.

1 MR. TODD: Thank you, Mr. Mitchell. No
2 further questions.

3 Thank you, Mr. Chairman.

4 CHAIRMAN OMAS: Mr. Todd, would you please
5 introduce yourself for the record?

6 MR. TODD: I'm sorry. I'm David Todd
7 representing the Mail Order Association of America.

8 CHAIRMAN OMAS: Thank you very much.

9 Mr. McKeever?

10 MR. MCKEEVER: Thank you, Mr. Chairman.
11 John McKeever for United Parcel Service.

12 CROSS-EXAMINATION

13 BY MR. MCKEEVER:

14 Q Good morning, Mr. Mitchell.

15 A Good morning.

16 Q Mr. Baker asked you a series of questions
17 about the relationship between value of service in
18 products or a class of mail's elasticity. Do you
19 remember that?

20 A Yes.

21 Q I believe you said in response to one of his
22 questions that all aspects of value of service are
23 completely subsumed in the elasticity for a class of
24 mail. Is that correct?

25 A I think we essentially reached that

1 conclusion at least in the sense that I don't know of
2 any other concepts that hold water that are relevant.

3 Q Are there factors other than value of
4 service that affect the elasticity of a class of mail?

5 A The reason I'm pausing is that it may not be
6 a nonsequitur, but it's very close to troublesome
7 because elasticity is an indicator of value of service
8 and you wanted to know if there were any aspects of
9 value of service that weren't included in elasticity?
10 Would you say it again?

11 Q No. No, no. I apologize. Are there
12 factors other than value of service that affect the
13 elasticity for a class of mail?

14 A I don't know that value of service is --
15 okay. When you said value of service affects
16 elasticity I guess it probably does. It's a
17 determinant. It's a characteristic of the situation
18 and elasticity is a measure of how people respond in
19 that situation, so we point out that the area under
20 the demand curve is measured in dollars and we point
21 to that as value.

22 We don't point to it as anything else, so I
23 think by implication I'm pretty close to agreeing with
24 your statement, but it's just a little bit awkward.

25 Q Well, I wasn't making a statement, I was

1 asking a question because I'm not sure you and I agree
2 on this, but what I'm trying to find out from you is
3 if -- let me ask it this way. Is value of service the
4 only determinant of the elasticity for a class of
5 mail?

6 A I haven't heard it said that way, but it
7 might very well be the case because I'm trying to
8 think of what other things people would think of when
9 they decide how much more or less to buy than the
10 value they're receiving from the product, so there's
11 certainly a very close relationship there. In fact
12 there was one pretty long interrogatory where somebody
13 asked me about utility and at some point we have to
14 agree that there's producer surplus involved here,
15 too, and it's not entirely utility of consumers.

16 The markets, some of the buyers are firm, so
17 it might make it a little bit different, but what else
18 would somebody look at when they decide how much of
19 something to buy than the value that they're receiving
20 and the price that's being charged? It might be
21 locked into a contract, but it seems to me like that's
22 about all you would consider.

23 Q So your answer is yes?

24 A I think so. If I understand it, yes.

25 Q Okay. Do you know whether it is the view of

1 the Commission that all aspects of value of service
2 are completely subsumed in a product's elasticity as
3 expressed in its decisions?

4 A Well, it's always difficult when you begin a
5 question by asking me whether or not I know if it's
6 the view of the Commission which is a collective body.

7 I know that the Commission has struggled
8 with this over the years, and I know that in some
9 cases it has pointed, and I point this out in my
10 testimony, to the fact that intrinsic notions often
11 lead you in a completely different direction from the
12 elasticity and they have proceeded I think in that
13 case to recognize the elasticity, so I'd like to
14 believe that the record on that is a little better in
15 this case than it has been in the past, but I don't
16 want to characterize the Commission's view at this
17 point.

18 MR. MCKEEVER: That's all I have. Thank
19 you.

20 CHAIRMAN OMAS: Thank you, Mr. McKeever.
21 Mr. McLaughlin?

22 MR. MCLAUGHLIN: Just Some brief follow-ups
23 on Mr. Baker's cross-examination, Mr. Chairman.

24 //

25 //

1 FURTHER CROSS-EXAMINATION

2 BY MR. MCLAUGHLIN:

3 Q Mr. Raker asked you some questions about
4 conversion from DALs for saturation flats asking about
5 the percentage of conversion that you expected. Is it
6 your understanding that the extra costs of DALs are
7 included in the Postal Service's base year costs for
8 saturation flats?

9 A Yes.

10 Q Would it also be fair to say that the
11 greater the conversion away from DALs in the test year
12 the lower the average cost will be for saturation
13 flats?

14 A Well, the revenue would go down, too, but I
15 would think that the costs would go down. I don't
16 know how much. I discussed some of that in one
17 interrogatory response. I don't remember which one,
18 but --

19 Q Well, the short answer is that whatever the
20 savings are from eliminating DALs the more DALs that
21 are eliminated the greater the reduction in the
22 average costs for saturation flats?

23 A As well as revenue. Yes.

24 CHAIRMAN OMAS: Mr. McLaughlin, your
25 microphone, please.

1 MR. MCLAUGHLIN: Sorry.

2 BY MR. MCLAUGHLIN:

3 Q Mr. Baker asked you some questions about
4 newspaper TMC programs that use high-density mail and
5 that compete with saturation mailers. Do you recall
6 that?

7 A Yes.

8 Q Are *you* aware that saturation mailers have
9 also entered into arrangements where they use and have
10 converted their saturation mailings to TMC mailings
11 with newspaper partners?

12 A Not to the point where I can testify about
13 it, but I have heard in general some indication that
14 Advo and the newspapers were working together on some
15 things, but I can't specify exactly what they are.

16 Q Do you recall whether that information was
17 provided in R-2005 in Advo discovery responses?

18 A No, I don't.

19 Q If it's there in the record it would be
20 there in the record, right?

21 A I think that's a safe statement.

22 Q Now, let's assume that when a mailer like
23 Advo that has a saturation mail program decides that
24 it wants to enter into a partnership with a newspaper
25 in a market and convert that saturation program into a

1 TMC program taking the portion that goes to newspaper
2 subscribers and having that delivered through the
3 newspaper let's assume that one of the reasons for
4 doing that is that the cost of distributing the
5 subscriber portion through the newspaper is lower than
6 the postage cost. Can you take that as an assumption?

7 A I understand that because I had a paper
8 route for five years and every time they put an insert
9 in they didn't pay me any more.

10 Q So that sounds reasonable to you that the
11 mailer would save costs when it converts from a
12 saturation program to a TMC program?

13 A I think that's possible. I'm assuming that
14 these would have to be addressed pieces for you to
15 discriminate between the recipients.

16 Q Yes. On piece addressed pieces.

17 A Okay. I just want to make sure I
18 understood.

19 Q Right. So the mailer might be better off in
20 terms of reducing its postage costs and its overall
21 distribution costs. Is the Postal Service better off
22 when the mailer converts from saturation to a TMC
23 program originally going from 100 percent of the
24 residents to only 50 percent? Does the Postal Service
25 benefit when that happens?

1 A It might be possible for an analyst to put
2 together some figures and say when this change occurs
3 it has the following affects, but I'm not sure that
4 the Postal Service should be in the business of saying
5 gee, that made us better off or that made us worse
6 off. They should rather be in the business of saying
7 we set the rates fairly, and mailers use them to their
8 best advantage and we hope they're all extremely
9 happy.

10 Q To the extent that they've lost half of
11 their saturatiun mail volume they may have lost
12 revenue. Is that right?

13 A As well as costs. I mean, if you want to
14 know if the Postal Service lost half of its volume and
15 its economies of scale were lower might be that
16 everybody's rate would be higher. That doesn't mean
17 it was wrong to lose the volume.

18 Q Let me just ask you a final question. If
19 you either raise the saturation rate or reduce the
20 high-density rate to narrow the difference between
21 those two would that increase a mailer's incentive to
22 convert from saturation to high-density through a
23 newspaper program?

24 A Well, it might, but I don't believe that's a
25 goal in --

1 Q I wasn't asking where that was a goal. Your
2 answer is that it might?

3 A Yeah.

4 MR. MCLAUGHLIN: Okay. I'll take that
5 answer.

6 CHAIRMAN OMAS: Thank you, Mr. McLaughlin.

7 Is there any other participant who wishes to
8 cross-examine Witness Mitchell?

9 (No response.)

10 CHAIRMAN OMAS: Are there any questions from
11 the bench?

12 (No response.)

13 CHAIRMAN OMAS: There being none, Mr. Olson,
14 would you like some time with your witness to
15 determine if you need to redirect?

16 MR. OLSON: Please. I th nk 10 minutes
17 would be fine.

18 CHAIRMAN OMAS: Very good We'll come back
19 at 12:20.

20 (Whereupon, a short recess was taken.)

21 CHAIRMAN OMAS: Mr. Olson?

22 MR. OLSON: Thank you, Mr. Chairman. We do
23 have a few questions.

24 //

25 //

1 REDIRECT EXAMINATION

2 BY MR. OLSON:

3 Q Mr. McLaughlin -- I'm sorry. Before I get
4 to him let me -- no. Mr. McLaughlin did raise this
5 one. He discussed with you some numbers as to the
6 cost difference between ECR saturation letters and
7 flats and a number was cited that I want to see if you
8 can confirm if it was right or wrong. The numbers
9 that I had written down was that the cost of flats of
10 7.1 and the cost of letters was 4.4 for a difference
11 of 2.7. Do you recall that?

12 A Yes

13 Q Then applying ECR coverage to that cost
14 differential I believe the record will reflect the
15 number that was discussed between you and Mr.
16 McLaughlin somehow became 6.8 cents, according to my
17 notes anyway. Is that the correct number?

18 A I have looked back at these numbers. We did
19 a very quick calculation while I was talking with Mr.
20 McLaughlin. The 7.13 cent figure that I had for
21 saturation flats was the cost of record at the
22 Commission costing and the 4.4 was for saturation
23 letters. The difference between those was 2.69 cents.
24 We may have subtracted wrong the last time we did it.

25 If we put a pass-through of 177 percent what

1 we get is a rate difference of 4.76 cents which is a
2 little lower than the 6.8 that I think we came up with
3 before. I would like to point out in addition that
4 the rates weren't set directly by focusing on this
5 kind of a pass-through.

6 The rates were set within a little larger
7 context which had to do with a presort tree, and the
8 overall treatment of letters and flats and the various
9 differences involved, so you don't get a complete
10 picture of the rate design process by focusing on this
11 one difference, but at the very least we should
12 recognize that it was 4.7 instead of 6.8.

13 Q Focusing on what rates you actually are
14 recommending in this case what rates are you
15 recommending for DDU entered saturation letters and
16 saturation flats?

17 A Well, of course the saturation flats get the
18 benefit of DDU entry at this point which wouldn't
19 occur for the letters which would have to go to the
20 DSCF, but if you look at page 190 in my testimony,
21 Schedule 4, I show 10.0 cents for saturation letters
22 at a DSCF and I show 11.4 for saturation flats at a
23 DDU, so at least in terms of this particular case the
24 order of magnitude of rate difference that we're
25 talking about is 1.4 cents which is not anywhere near

1 as high as some of these other figures that we were
2 throwing around.

3 Q Just to confirm is it your understanding of
4 the Postal Service's proposal that although there
5 would not be a discount for entering saturation
6 letters at a DDU that mailers could enter it there as
7 long as they paid the DSCF rate?

8 A Well, I think there was a statement in the
9 Postal Service's case to that effect. I'm trying to
10 think of the right word to describe it. I don't think
11 it's a viable or an attractive option for mailers. In
12 fact if there's back haul involved it seems to me like
13 you'd want to discourage it.

14 Q Clearly the question presumed that the
15 Postal Service was discouraging it by not providing an
16 incentive, but is it your understanding that they will
17 still accept the mail at the DDU for churches and such
18 that have saturation mailings so that they don't get
19 inconvenienced by bringing it to an SCF as long as
20 they pay the DSCF rate?

21 A Yeah. I think as long as the facility is
22 set up to accept bulk mailings, an adequate acceptance
23 process, that they would do it.

24 Q Let me turn to two questions that Ms.
25 McKenzie from the Postal Service asked you. One had

1 to do with Section I of your testimony beginning at
2 page 63. This is the section that's entitled the mark
3 up on ECR is too high. The thrust of the questioning
4 that Ms. McKenzie posited to you was that this was a
5 discussion pretty much about how ECR is too high, not
6 that regular is too low and I believe you said that
7 you didn't know to what extent regular was discussed
8 in here

9 Have you now had a chance to identify
10 references to regular mail in this section?

11 A Well, because of the question that was
12 raised we did a visual scan. I can't claim that I
13 used my computer for this, but we did a visual scan of
14 Section I which begins on page 63 and we found that
15 the word regular was used in there 20 times, so I just
16 want to avoid a situation where a heading or some
17 other reason is used to limit what I considered.

18 I think if you look at the first of my
19 testimony clear back toward page 1 and then the few
20 pages after that I emphasize very clearly the nature
21 of the deaveraging process that occurred and I
22 emphasized that I don't know any other way to look at
23 that process. So at least in my own mind I don't
24 think that I forgot that regular was part of the
25 situation we were dealing with.

1 Q My last question also the issue was begun I
2 think by Ms. McKenzie having to do with whether
3 mailers would be persuasive in making arguments about
4 rate shock after having settled R-2001-1 and R-2005-1
5 and you mentioned that the Commission had addressed
6 this in its opinion, recommended decision, in R-2005-
7 1. What did the Commission say at that time?

8 A Well., I think I did emphasize that the
9 Commission had pointed some of these things out. In
10 fact the Commission pointed them out rather strongly.
11 If you look at page 7 of my testimony I have three
12 quotations there, actually four quotations there -- it
13 goes on to page 8 -- from the Commission that pertain
14 to that.

15 In one of them the Commission says that this
16 will probably result in unusual disproportionate
17 increases and decreases in different rates in the next
18 case, and then the Commission observed that the Postal
19 Service and mailers seem prepared for that possibility
20 as they, too, recognize that proper cost based rates
21 should be something that we pursue.

22 Not all of that was word for word, but most
23 of those words are directly from the quote on page 7.
24 So my conclusion is that the Commission made some
25 pretty important observations on that point.

1 MR. OLSON: Okay. That's all I have. Thank
2 you, Mr. Chairman.

3 CHAIRMAN OMAS: Is there anyone who wishes
4 to re-cross Witness Mitchell?

5 (No response.)

6 CHAIRMAN OMAS: There being none, Mr.
7 Mitchell, that completes your appearance here today.
8 We thank you for your testimony and your contribution
9 to our record. You are now excused.

10 THE WITNESS: Thank you.

11 (Witness excused.)

12 CHAIRMAN OMAS: I think we'll take our lunch
13 break now before we begin with our next witness. Why
14 don't we come back around 1:30, okay? Thank you very
15 much.

16 (Whereupon, at 12:30 p.m., the hearing was
17 recessed, to reconvene at 1:30 p.m. this same day,
18 Tuesday, October 31, 2006.)

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1 Q Would your testimony be the same if it were
2 to have been delivered today before this Commission?

3 A Yes, it would.

4 MR. TODD: Mr. Chairman, I'm going to
5 provide two copies of the afore identified testimony
6 to the reporter and ask that it be admitted into
7 evidence at this time.

8 CHAIRMAN OMAS: Is there objection?

9 (No response.)

10 CHAIRMAN OMAS: Hearing none, Mr. Todd,
11 would you please provide to the reporter two copies of
12 the corrected direct testimony of Roger C. Prescott?
13 That testimony ~~is~~ received into evidence. However, as
14 is our practice it will not be transcribed.

15 (The document referred to,
16 previously identified as
17 Exhibit No. MOAI-T-1, was
18 received in evidence.)

19 CHAIRMAN OMAS: Mr. Prescott, have you had
20 an opportunity to review the packet of information
21 handed to you today?

22 THE WITNESS: My disk interrogatories?

23 CHAIRMAN OMAS: Yes. Your cross-
24 examination.

25 THE WITNESS: Yes, I have.

1 CHAIRMAN OMAS: **If** those questions contained
2 in that packet were posed to you orally today would
3 they be the same as those answers you provided
4 previously in writing to the Commission?

5 THE WITNESS: Yes, they would.

6 CHAIRMAN OMAS: Are there any corrections or
7 additions you would like to make to those answers?

8 THE WITNESS: No, sir.

9 CHAIRMAN **OMAS**: Counsel, would you please
10 provide two copies **of** the corrected designated written
11 cross-examination of Witness Prescott? That material
12 is received into evidence and is to be transcribed
13 into the record.

14 MR. TODD: Yes. Mr. Chairman, **I** would also
15 like to note for the record that this morning the
16 Postal Service has designated a few additional
17 interrogatories and the responses thereto.
18 Specifically they have designated in addition to the
19 designations made by other parties as shown on the
20 notice distributed this morning USPS Nos. 6 through 8
21 and USPS **Nos.** 10 through 13.

22 Those interrogatories and responses are also
23 in the packet which **I** will hand to the reporter.

24 //

25 //

1 (The document referred to was
2 marked for identification as
3 Exhibit No. MOAA-T-1 and was
4 received in evidence.)

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 2006

Docket No. R2006-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF MAIL ORDER ASSOCIATION OF AMERICA
WITNESS ROGER C. PRESCOTT
(MOAA-T-1)

Party

Interrogatories

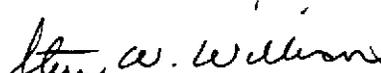
Newspaper Association of America

NAA/MOAA-T1-2-5
USPS/MOAA-TI-1-5, 9, 14, 16-18

United Parcel Service

NAA/MOAA-T1-3

Respectfully submitted,


Steven W. Williams
Secretary

INTERROGATORY RESPONSES OF
MAIL ORDER ASSOCIATION OF AMERICA
WITNESS ROGER C. PRESCOTT (T-1)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory

Designating Parties

NAAIMOAA-TI-2

NAA

NAA/MOAA-T1-3

NAA, UPS

NAA/MOAA-T1-4

NAA

NAAIMOAA-TI-5

NAA

USPS/MOAA-T1-1

NAA

USPSIMOAA-TI-2

NAA

USPSIMOAA-TI-3

NAA

USPS/MOAA-T1-4

NAA

USPSIMOAA-TI-5

NAA

USPS/MOAA-T1-9

NAA

USPS/MOAA-T1-14

NAA

USPSIMOAA-TI-16

NAA

USPSIMOAA-TI-17

NAA

USPS/MOAA-T1-18

NAA

RESPONSE **OF** MQAA WITNESS ROGER C. PRESCOTT **TO**
INTERROGATORIES **OF** NEWSPAPER ASSOCIATION **OF** AMERICA

Q: NAA/MOAA-T1-2: Please refer to page 12, lines 9 to 12 of your testimony. Is it your testimony that "contribution per piece" has **no** relevance to postal ratemaking? **If** you believe that "contribution per piece" has relevance to postal ratemaking, please describe what you believe that relevance is.

Response:

Contribution per piece **will** naturally result from the volumes, revenues generated and the costs associated **with** a particular subclass **of** mail. However, I do **not** believe that rates for a particular subclass should be established based on the goal of a particular level of contribution per piece. In other words, I do **not** believe that setting the rates **should** start with the objective of determining the contribution per piece for the subclass.

**RESPONSE OF MOAA WITNESS ROGER C. PRESCOTT TO
INTERROGATORIES OF NEWSPAPER ASSOCIATION OF AMERICA**

Q: NAA/MOAA-T1-3: Please refer to page 13, line 10, of your testimony where you state: "Historically, the PRC has not relied on unit contribution per piece to validate rates." Please confirm that in its Opinion and Recommended Decision in Docket No. R97-1, the Commission stated (at paragraph 4084):

In past cases, the Commission has commented that allocating institutional costs on the basis of markup alone could fail to give adequate recognition to the benefit that subclasses **with** low attributable cost derive from the existence of a national integrated postal system. The Commission has reviewed the unit contribution of such subclasses and adjusted markups, where appropriate, to assure that the factors of the Act are fairly and equitably reflected.

Response:

Confirmed.

**RESPONSE OF MOAA WITNESS ROGER C. PRESCOTT TO
INTERROGATORIES OF NEWSPAPER ASSOCIATION OF AMERICA**

Q: NAA/MOAA-T1-4: Please refer to page 14, lines 7 through 10 of your testimony. In this passage, are you making an implicit assumption that the average unit contribution of all mail to institutional costs to attributable costs has remained constant since 1997? If so, please explain the basis for that assumption. If not, please explain what implicit assumptions, if any, you have made regarding the average unit contribution **of all** mail since 1997.

Response:

The phrase “the average unit contribution **of all** mail to institutional costs **to** attributable costs” in the question is unclear to me. If the question intends to ask if I believe that the unit contribution for **all** mail has been constant since 1997, the answer is no. As explained in my testimony, the contribution of 8.6 cents per piece reflects the **simple** average of the annual contribution per piece for ECR mail for the 1997 through 2005 time period. The basis for my calculation is shown in Witness O’Hara’s response to NAA/USPS-T31-9 (Tr. 17/5125).

**RESPONSE OF MOAA WITNESS ROGER C. PRESCOTT TO
INTERROGATORIES OF NEWSPAPER ASSOCIATION OF AMERICA**

Q: NAA/MOAA-T1-5: Please refer to pages 19-20 of your testimony. Do you believe that Standard ECR mail volumes were affected by any changes in the general condition of the U.S. economy during the period from 1998 to 2006? If ~~so~~, please state your understanding of the effect of economic conditions on ECR mail volumes. If not, why not?

Response:

I believe all parties recognize that changes in ECR volumes result from a host of factors, including changes in the general condition of the U. S. economy. 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.

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 ("WOOS-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 MOOS-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 E00S-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).
- h. **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).

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

- c. Confirmed.
- d. Confirmed.

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

- 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 **Afcr** 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

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

- 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.
- h. 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.

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

- 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-T3 1-9, which he sources to the USPS's CRA.

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

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.

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

- 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.

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

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.

ResDonse:

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.

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

- 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

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

- 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.

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

- 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.

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

- 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 **h a 4** 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 FCR mail and then increasing Standard Regular mail to the level of FCR.

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

- 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. P94-1 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 of 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.

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

- 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-TI-1, the table shown on TR. 17 5123 does not present markup indexes.

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

- 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

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

- 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.

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

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.

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

- 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.

1 CHAIRMAN OMAS: Thank you. Is there anyone
2 else who wishes to cross-examine Witness Prescott?

3 (No response.)

4 CHAIRMAN OMAS: That then brings us to oral
5 cross-examination. Two participants have requested
6 oral cross-examination, the Newspaper Association of
7 America and the United Parcel Service.

8 Mr. Baker, would you please begin?

9 MR. BAKER: Thank you, Mr. Chairman. For
10 the record William Baker appearing on behalf of the
11 Newspaper Association of America.

12 CROSS-EXAMINATION

13 BY MR. BAKER:

14 Q Good afternoon, Mr. Prescott.

15 A Good afternoon.

16 Q Mr. Prescott, could you turn to your
17 response to Postal Service Interrogatory No. 9 to you?

18 A I have it.

19 Q In this question the Postal Service asked
20 you about language appearing on page 11 of your
21 prepared testimony where you stated that the increased
22 price elasticity of ECR as measured by the Postal
23 Service, "should caution the PRC to avoid an increase
24 in rates for ECR mail". That was their quotation of
25 your testimony.

1 They went on to ask in Part B of that, is it
2 your testimony that the PRC should not raise ECR rates
3 at all? Your answer appears there in *B* and I wanted
4 to focus on your answer to *B*. Your first sentence
5 says my testimony is not that the PRC should not
6 approve rates that increase the overall prices to ECR
7 mail, so that sounds like kind of a no answer to the
8 question they ask in Part B, but you elaborate in the
9 second sentence. Is that fairly accurate so far?

10 A Yes

11 Q Okay. Then you say the point of the
12 sentence was to suggest that the PRC should exercise
13 caution in improving increases and rates for the ECR
14 subclass for the reasons you state here. I want to
15 focus on what you would really recommend the
16 Commission do, so maybe let me put it to you this way.

17 If the Commission were to write an opinion
18 to say we acknowledge your observations presented in
19 your testimony, Mr. Prescott, but after thinking about
20 it thoroughly and carefully we have decided to approve
21 the Postal Service's proposals in this case, would
22 that be a use of caution on their part if they've done
23 it thoughtfully and with consideration, but
24 nonetheless proceed to recommend the rates requested
25 by the Postal Service?

1 A Well, no, I would not say that would be
2 exercising caution.

3 Q Okay.

4 A The problem is that this is a subclass
5 that's highly competitive, has been losing volume and
6 thus a rate increase is going to further drive volume
7 away.

8 Q Okay. So your testimony then is the
9 Commission should not adopt the proposed rates of the
10 Postal Service for ECR mail. Is that correct? They
11 should not approve the Postal Service's request for
12 ECR rates. Is that correct?

13 A I believe that the rates proposed by the
14 Postal Service would be damaging to the subclass.
15 From the perspective that something damaging to the
16 subclass shouldn't be done then, yes, I would be
17 recommending that they not approve these rates.

18 Q Do you have a specific recommendation for
19 what the Commission should do with respect to ECR
20 prices?

21 A I've not made a specific recommendation as
22 to specific rate levels. No.

23 Q Are you recommending that the Commission not
24 change ECR rates at all?

25 A I think that is one alternative that they

1 could consider.

2 Q Okay. So if the Commission were to
3 recommend a change in ECR rates less than the Postal
4 Service has requested as your testimony seems to
5 encourage them to do is it your understanding that the
6 institutional cost contributions from ECR would be
7 less than under the Postal Service's proposal?

8 A It would depend on what the ultimate
9 determination of the costs were.

10 Q Assume with me that the institutional cost
11 contributions from ECR would be less than under the
12 Postal Service's proposal because of those factors do
13 you have a recommendation as to what classes of mail
14 should make up the difference?

15 A I don't think that because one subclass is
16 overpriced should prevent increasing another subclass
17 that's perhaps underpriced or due to elasticities can
18 stand a higher price.

19 Q Do you have a recommendation for this
20 Commission as to what subclasses may be underpriced or
21 have such an elasticity that could absorb it?

22 A I've not made a specific recommendation to
23 that.

24 Q That's your testimony? You're not going to
25 make one now, are you?

1 A No.

2 MR. BAKER: Okay. Mr. Chairman, I have no
3 more questions.

4 CHAIRMAN **OMAS**: Thank you, Mr. Baker.
5 Mr. McKeever?

6 MR. MCKEEVER: Thank you, Mr. Chairman.
7 John McKeever for United Parcel Service.

8 CROSS-EXAMINATION

9 BY MR. MCKEEVER:

10 Q Mr. Prescott, as I think you've indicated in
11 response to Mr. Baker you take issue with the Postal
12 Service's proposed rates for ECR because they do not
13 preserve or increase volumes. Is that correct?

14 A That's one of the issues that I raise. Yes

15 Q A product's own price elasticity measures
16 how much its volume changes in response to a rate
17 change. Is that correct?

18 A Yes. In simple terms.

19 Q Well, do you have any qualifications or
20 concerns about that statement?

21 A It measures the change in demand for a
22 product related to the change in price of that
23 product.

24 Q Right, and therefore it measures the extent
25 to which demand or volume will change as a result of

1 the rate change. Is that correct?

2 A The way it's applied here, yes.

3 Q Okay. The lower the elasticity the more
4 volume the Postal Service keeps. Is that correct?

5 A No.

6 Q It's not?

7 A No.

8 Q The lower the elasticity the more volume the
9 Postal Service loses? Is that your testimony?

10 A With a price increase, yes.

11 Q Well, it loses volume with any price
12 increase. Is that right?

13 A Well, it depends on the elasticity. If it's
14 practically inelastic you don't lose any volume with
15 price increase,

16 Q It is true that as the elasticity moves
17 lower then the Postal Service will not lose as much
18 volume. Is that correct?

19 A No. It will lose more.

20 Q If the elasticity moves lower the Postal
21 Service --

22 A Perhaps we're miscommunicating on what
23 diversion or what lower means. In this case the
24 elasticity presented by the Postal Service for ECR
25 mail is negative 1.08. In prior cases the elasticity

1 was roughly negative .5. I consider 1.08 to be lower
2 than .5 --

3 Q Okay. We are miscommunicating. Let's just
4 focus on the absolute. The elasticity is normally a
5 negative number. Is that correct?

6 A That's true.

7 Q As price goes up volume goes down?

8 A That's correct.

9 Q All right. Let's focus on the absolute
10 value and assume negative elasticities, but just look
11 at the absolute value of the number, okay, so we can
12 communicate. Then will you agree that the lower the
13 number as you testified then the less the volume
14 impact. Is that correct? Go ahead.

15 A Yes.

16 Q Okay. Thank you. In your view if a
17 product's elasticity or the elasticity of a class of
18 mail is lower in that absolute sense then the cost
19 coverage that users pay should be higher. Is that
20 right?

21 A Well, I think that's one consideration.
22 That's a general concept. If you look at the concept
23 of differential pricing it says that products that are
24 more elastic should be responsible for less of the
25 fixed or institutional costs.

1 Q That's probably how we should say it, so let
2 me go back one question just so we're clear on the
3 record here. The less elastic a service is the less
4 volume the Postal Service loses and the more it keeps.
5 Is that correct?

6 A Yes.

7 Q Okay. In your view if a class of mail is
8 less elastic then the cost coverage its users pay
9 should go up. Is that right? As it becomes less
10 elastic the cost coverage should move up?

11 A All other things being equal. Yes.

12 Q Correct. Okay. The elasticity for a class
13 of mail with all other things being equal would be
14 less if there are no or fewer competitive alternatives
15 to the class. Is that correct?

16 A Generally speaking, yes.

17 Q Okay. Conversely the more elastic a class
18 of mail becomes then it should in your view have lower
19 cost coverages. That's the essence of your testimony.
20 Is that right?

21 A All other things being equal, yes, that's
22 correct.

23 Q Yes. A class of mail will be more elastic
24 if there are more competitive alternatives to it. Is
25 that correct?

1 A Generally speaking, It depends on the
2 degree of the competition and the effectiveness of the
3 competition, but as a basic concept I would agree.

4 Q Okay. Now, that principle that the more
5 elastic a class is the lower the cost coverage should
6 be and the less elastic a class is the higher the cost
7 coverage should be, that general principle, that's a
8 classic statement of the Ramsey pricing principles,
9 isn't it?

10 A Well, it's a statement of the concept of
11 differential pricing. Ramsey pricing is a theory
12 based on a paper that relates to differential pricing
13 but I think it's broader than just Ramsey pricing.

14 Q Well, but isn't it the case that the Ramsey
15 pricing principle states that the more elastic
16 services should have lower cost coverages and the less
17 elastic services should have higher cost coverages?

18 A Well, I don't know that Ramsey deals with
19 cost coverages. It really deals with the allocation
20 of the fixed or institutional costs.

21 Q Isn't that what cost coverages deal with?
22 How to allocate the fixed or institutional costs?

23 A That's what you get out of it once you have
24 allocated the fixed costs. Yes.

25 Q Okay. So with that understanding let me try

1 once more to see if we're on the same wavelength.
2 Under Ramsey pricing the more elastic the demand for a
3 class of service is then the lower proportion of the
4 fixed or institutional costs it should bear and
5 conversely the less elastic the demand for a class is
6 the higher portion of fixed costs it should bear. Is
7 that correct?

8 A As a general rule, yes.

9 Q Do you know whether the Commission has
10 explicitly rejected calls to use Ramsey pricing?

11 A Yes, I do.

12 Q What has it said?

13 A They've rejected it as a criteria for
14 determining the rates, but I don't believe that
15 they've rejected differential pricing as a concept.

16 Q No. I think we can agree on that, that the
17 Commission has to price the classes of mail
18 differently. The question is how you do that. Is
19 that correct? What principles you use?

20 A That's correct.

21 MR. MCKEEVER: Okay. That's all I have, Mr.
22 Chairman. Thank you.

23 CHAIRMAN OMAS: Thank you, Mr. McKeever.

24 Is there anyone else who wishes to cross-
25 examine Witness Prescott?

1 (No response.)

2 CHAIRMAN OMAS: Mr. Todd, would you like
3 some time with your witness?

4 MR. TODD: Yes, but I think it will *only*
5 take a short time if we can just do this in place.

6 CHAIRMAN OMAS: Okay. Fine.

7 MR. TODD: Mr. Chairman, I have no further
8 questions.

9 CHAIRMAN OMAS: Thank you, Mr. Todd.
10 However, I would like one thing. I was caught off
11 guard and did not ask the bench if there were any
12 questions. I think Commissioner Goldway has one or
13 was anticipating one.

14 COMMISSIONER GOLDWAY: Well, thank you,
15 Chairman. I just wanted to ask the witness in your
16 testimony you indicate that the Postal Service when it
17 established the ECR class did that as a way to counter
18 competition and establish rates that would increase
19 volume.

20 THE WITNESS: Yes.

21 COMMISSIONER GOLDWAY: I believe that's what
22 you said. So what would your general approach be for
23 the Postal Service to develop rates that increased
24 volume at this point?

25 THE WITNESS: Well, I think you have to look

1 at the overall impact of the pricing since MC-95 when
2 the subclass was established and you have to look at
3 the competitive alternatives for the subclass and the
4 fact that there is a market out there that seems to be
5 sapping the volume away, that there is a lot of
6 competition in the subclass and that a great deal of
7 caution needs to be exercised before you increase
8 rates over the level that they are at.

9 COMMISSIONER GOLDWAY: So other than slowing
10 the rate of increase or not increasing the rate you
11 don't have any other proposals that might adjust the
12 relationships that would increase volume?

13 THE WITNESS: I did not make specific rate
14 proposals in terms of what base rates should be.

15 COMMISSIONER GOLDWAY: Other than a cheaper
16 rate is there anything else that might work to
17 increase volume?

18 THE WITNESS: From the perspective of what
19 we have in this proceeding, no. I would say that the
20 way to protect volumes in the subclass is through the
21 rate.

22 COMMISSIONER GOLDWAY: Thank you.

23 CHAIRMAN OMAS: Thank you, Commissioner
24 Goldway, and thank you, Mr. Prescott.

25 MR. MCKEEVER: Mr. Chairman?

1 CHAIRMAN OMAS: Yes?

2 MR. MCKEEVER: May I briefly follow-up on
3 Commissioner Goldway's questions?

4 CHAIRMAN OMAS: Certainly. I'm sorry.

5 FURTHER CROSS-EXAMINATION

6 BY MR. MCKEEVER:

7 Q Mr. Prescott, if the Postal Service were to
8 improve service might that increase volumes?

9 A It might. I have not done the analysis to
10 be able to definitively say yes or no on that.

11 Q As a general principle though as the service
12 of a product gets better the more likely it is that
13 its volume is going to increase. Is that correct?

14 A Well, it creates more value for the consumer
15 theoretically and that makes the product more
16 appealing. I'm not sure whether that does more to
17 keep volume or to draw new volume.

18 Q Well, at the very least it might help stave
19 off a volume loss. Is that correct?

20 A Yes.

21 MR. MCKEEVER: Okay. Thank you. That's
22 all.

23 CHAIRMAN OMAS: Thank you, Mr. McKeever.
24 Mr. Todd?

25 MR. TODD: Sorry, Mr. Chairman.

1 REDIRECT EXAMINATION

2 BY MR. TODD:

3 Q Mr. Prescott, in preparing your testimony
4 did you do any examination of the quality of service
5 that is offered to ECR measured by either speed, or
6 reliability of delivery, or any other examination of
7 how good the service might or might not be for
8 standard mail ECR?

9 A No, I have not.

10 MR. TODD: That's all the questions I have.

11 CHAIRMAN OMAS: Thank you, Mr. Todd.

12 MS. MCKENZIE: Mr. Chairman?

13 CHAIRMAN OMAS: Excuse me.

14 MS. MCKENZIE: Can we chime in?

15 CHAIRMAN OMAS: I'm really not trying to
16 force this. I looked around, but now everybody --
17 that's fine. We've all had lunch. Ms. McKenzie?

18 RE-CROSS-EXAMINATION

19 BY MS. MCKENZIE:

20 Q Mr. Prescott, if the Postal Service were to
21 increase service, but by doing so would increase costs
22 and the increased costs would lead to higher rates
23 what impact on volume would that be?

24 A That would probably lead to decreased
25 volumes.

1 MS. MCKENZIE: Okay. Thank you.

2 MR. MCKEEVER: Mr. Chairman?

3 CHAIRMAN OMAS: Is there anyone else? This
4 is great

5 Mr. McKeever?

6 RE-CROSS-EXAMINATION

7 BY MR. MCKEEVER:

8 Q Doesn't that really depend on how much the
9 service improves and how much the costs go up?

10 A Yes.

11 Q Sometimes it might be better for a service
12 if its service level went up even at the expense of
13 somewhat higher costs. Is that correct?

14 A Well, now you get into what the consumer
15 prefers. I mean, does the consumer prefer speed or
16 rate level? I haven't studied as to how that would
17 impact the ECR subclass.

18 Q As a general principle if a consumer has two
19 services available to him, one with a high service
20 level and one with a low service level, wouldn't you
21 expect that the consumer would be willing to pay more
22 for the class of service with the high service level?

23 A It depends. It depends on how they value
24 the product. For example I rarely use overnight mail.
25 Because of the cost I would use something else instead

1 of --

2 Q Because you don't particularly care if it
3 gets there overnight when you send something. Is that
4 right?

5 A Well, if I am overly concerned with the
6 speed I might consider a competitive alternative like
7 scanning a document and sending it electronically. I
8 mean, there's a multitude of considerations that would
9 go into the choice of price versus service.

10 Q Well, I understand that, but I was just
11 trying to get you to agree with what I thought was,
12 and I guess it's not a self-evident, proposition and
13 that is if you have two services one that has a higher
14 service level and another that is otherwise identical
15 but has a lower service level, that a consumer who at
16 least cares about service would be willing to pay more
17 for the service with the higher service level.

18 A You get into a demand curve and how much
19 they value that versus the cost. I don't think
20 there's a 100 percent rule on that.

21 Q I agree, but that's where we started. It
22 depends on how much the service improves compared to
23 how much the cost increases and the only way to find
24 out I guess is to really do it. Is that right? Is to
25 really try it?

1 A That would be one way. Yes.

2 MR. MCKEEVER: Okay. Thank you.

3 COMMISSIONER GOLDWAY: Mr. Chairman?

4 I'm very glad that you brought up the issue
5 of service. To yet again follow-up in the ECR class
6 isn't it true that if not speed accuracy of time of
7 delivery is very important with regard to advertising
8 information that goes out and that's a highly valuable
9 aspect of the product?

10 THE WITNESS: Yes, yes. Having the product
11 delivered on time.

12 COMMISSIONER GOLDWAY: SO a service that
13 ensures really high accuracy of delivery at a
14 particular time may be quite valuable to a customer?

15 THE WITNESS: It might be. Yes.

16 COMMISSIONER GOLDWAY: One could agree
17 that's a valuable part of the ECR product?

18 THE WITNESS: Yes. I think for all
19 advertising mail that is a consideration. Yes.

20 COMMISSIONER GOLDWAY: Okay. Thank you. I
21 just wanted to clarify the discussion.

22 CHAIRMAN OMAS: Mr. Baker? Anyone else?
23 Going once.

24 MR. BAKER: I do have one more.

25 //

1 FURTHER RE-CROSS-EXAMINATION

2 BY MR. BAKER:

3 Q Is it true as a general principle that when
4 mail is drop shipped into the destination delivery
5 unit the reliability or accuracy of delivery will
6 probably improve?

7 A I don't know.

8 MR. BAKER: Okay. Thank you.

9 CHAIRMAN OMAS: Going once. Mr. Todd?

10 MR. TODD: Just proving that lawyers can do
11 almost anything to prolong things.

12 FURTHER REDIRECT EXAMINATION

13 BY MR. TODD:

14 Q Assume, Mr. Prescott, that the level of
15 service for standard mail ECR is such that customers
16 really don't worry about it. That is to say they are
17 perfectly satisfied with the speed and the reliability
18 of the delivery whether through drop shipping or
19 whatever they may be doing. At that point is it not
20 clear that the only thing that will influence the
21 demand for the service is the price?

22 A Yes. I believe so.

23 MR. TODD: Thank you.

24 CHAIRMAN OMAS: Again, is there anyone else?
25 Going once. Going twice.

1 (No response.)

2 CHAIRMAN OMAS: Mr. Prescott, we thank you
3 for your contribution to our record here today and for
4 your testimony. We appreciate it, and thank you very
5 much. I think you're now excused.

6 THE WITNESS: Thank you.

7 CHAIRMAN OMAS: Thank you.

8 (Witness excused.)

9 CHAIRMAN OMAS: Our next witness today has
10 already been sworn in under oath. I ask Mr.
11 Richardson, would you please introduce our next
12 witness?

13 MR. RICHARDSON: Thank you, Mr. Chairman.
14 I'm Ken Richardson, the Office of the Consumer
15 Advocate. OCA calls our next witness, J. Edward
16 Smith.

17 Whereupon,

18 J. EDWARD SMITH

19 having been previously duly sworn, was
20 recalled as a witness herein and was examined and
21 testified further **as** follows:

22 (The document referred to was
23 marked for identification as
24 Exhibit No. OCA-T-2.)

25 //

1 DIRECT EXAMINATION

2 BY MR. RICHARDSON:

3 Q Dr. Smith, do you have before you two copies
4 of your direct testimony filed in this proceeding
5 styled direct testimony of J. Edward Smith on behalf
6 of the Office of the Consumer Advocate revised
7 October 30, 2006, and designated Exhibit No. OCA-T-2?

8 A I do have it. Yes.

9 Q Was that prepared by you or under your
10 direction?

11 A Yes, it was.

12 Q Do you have any changes to this particular
13 document as revised?

14 A No, I don't.

15 MR. RICHARDSON: Mr. Chairman, I would move
16 the testimony of J. Edward Smith into the record at
17 this time.

18 CHAIRMAN OMAS: Is there any objection?

19 (No response.)

20 CHAIRMAN OMAS: Hearing none I will direct
21 counsel to provide the reporter with two copies of the
22 corrected direct testimony of J. Edward Smith. That
23 testimony is received into evidence. However, as is
24 our practice it will not be transcribed.

25 //

1 (The document referred to,
2 previously identified as
3 Exhibit No. OCA-T-2, was
4 received in evidence.)

5 CHAIRMAN OMAS: Mr. Smith, have you had an
6 opportunity to examine the packet of designated
7 written cross-examination that was provided to you
8 today?

9 THE WITNESS: I have.

10 CHAIRMAN OMAS: If those questions were
11 posed to you orally today would your answers be the
12 same as those you provided previously in writing?

13 THE WITNESS: They would be.

14 CHAIRMAN OMAS: Are there any additions or
15 corrections you would like to make?

16 THE WITNESS: No.

17 CHAIRMAN OMAS: Therefore, counsel, would
18 you please provide two copies of the corrected
19 designated written cross-examination of Witness Smith
20 to the reporter. That material is received into
21 evidence and is to be transcribed into the record.

22 (The document referred to was
23 marked for identification as
24 Exhibit No. OCA-T-2 and was
25 received in evidence.)

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 2006

Docket No. R2006-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF OFFICE OF THE CONSUMER ADVOCATE
WITNESS J. EDWARD SMITH
(OCA-T-2)

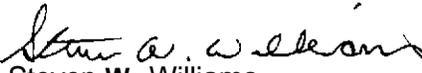
Party

Interrosatories

United States Postal Service

USPS/OCA-T2-1-8

Respectfully submitted,


Steven W. Williams
Secretary

INTERROGATORY RESPONSES OF
OFFICE OF THE CONSUMER ADVOCATE
WITNESS J. EDWARD SMITH (T-2)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory

Designatina Parties

USPS/OCA-T2-1

USPS

USPS/OCA-T2-2

USPS

USPS/OCA-T2-3

USPS

USPS/OCA-T2-4

USPS

USPS/OCA-T2-5

USPS

USPS/OCA-T2-6

USPS

USPS/OCA-T2-7

USPS

USPS/OCA-T2-8

USPS

RESPONSE OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES USPS/OCA-T2-1-8

USPSIOCA-T2-1

Please refer to your testimony at page 1, entitled "Statement of Qualifications":

- (a) Have you written any articles in the area of econometric analysis which have been published? If yes, please provide citations for all articles.
- (b) Have you submitted any articles concerning econometric analysis for publication? If yes, please provide copies of all such articles.
- (c) Please provide copies of, or citations to, every piece of testimony concerning econometric studies which you have sponsored in front of any court, administrative agency, or regulatory agency.

RESPONSE TO USPSIOCA-T2 1

(a) No

(b) No

(c) The following reports summarized corporate modeling efforts, including the application of econometric analyses developed by me or under my direction

Before the District of Columbia Public Service Commission

- F C No. 834. Phase II. Integrated Least Cost Plan, Fifteen Volumes, 1990.
- F.C.No. 834. Phase III. Integrated Least Cost Plan, Twelve Volumes, 1992
- F.C. No. 921, Integrated Least Cost Plan, Seven Volumes, 1994. Review of programs. modeling efforts. and plans.
- F.C.No. 921. Integrated Least Cost Plan, 1996. Two Volumes

Before the Maryland Public Service Commission

- Washington Gas, Maryland Division. Conservation Status Report, 1994
- Washington Gas, Maryland Division, Conservation Status Report, 1995.

Before the Virginia State Corporation Commission

- Washington Gas, Virginia Division, Status Report of Washington Gas CLM Activities, 1995.

RESPONSE OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES USPS/OCA-T2-1-8

- Washington Gas, Virginia Division, Status Report of Washington Gas CLM Activities, 1996.

Before the Postal Rate Commission

- Docket No. R97-1. Direct Testimony of J. Edward Smith, Jr. (OCA-T-600) on Behalf of the Office of the Consumer Advocate, December 30, 1997.
- Docket No. 97-1. Rebuttal Testimony of J. Edward Smith, Jr. (OCA-RT-1000) on Behalf of the Office of the Consumer Advocate, March 9, 1998.
- Docket No. R2000-1. Direct Testimony of J. Edward Smith (OCA-T-4) on Behalf of the Office of the Consumer Advocate, May 22, 2000.
- Docket No. MC2002-2. Direct Testimony of J. Edward Smith (OCA-T-1) on Behalf of the Office of Consumer Advocate, December 20, 2002.
- Docket No. R2006-1. Direct Testimony of J. Edward Smith (OCA~~T~~- 2) on Behalf of the Office of the Consumer Advocate. September 6, 2006.
- Docket No. R2006-1. Direct Testimony of J. Edward Smith (OCA~~T~~- 3) on Behalf of the Office of the Consumer Advocate, September 6, 2006.

RESPONSE OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES USPS/OCA-T2-1-8

USPSIOCA-T2-2

- (a) Please explain how the row entitled "Total Sales" in Table 1 was derived.
- (b) Please provide your analysis, workpapers, and citations supporting the entirety of Table 2, the column entitled "Total Time Observed Hours" in Table 3, and the entirety of Table 4. If any of the supporting data is in spreadsheet form, please provide electronic versions.

RESPONSE TO USPS/OCA-T2-2

- (a) "Total Sales" is the product of revenue per site multiplied by number of sites.

Please see *Table1WindowService.xls* in the associated Library Reference being filed concurrently with this response (OCA-LR-L-9).

- (b) *Table2WindowService.xls* is in the associated Library Reference being filed concurrently with this response (OCA-LR-L-9). *Table2WindowService.xls* is of a simulation nature, providing several "What if..." Scenarios.

Table3WindowService.xls is in the associated Library Reference. The column "Total Time Observed Hour," was incorrect and has been corrected; however, no conclusions were dependent on the value. and the testimony is unchanged from this clerical error. *Table 4WindowService.xls* is in the associated Library Reference.

RESPONSE OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIESUSPS/OCA-T2-1-8

USPS/OCA-T2-3

Please refer to page 12 of your testimony.

- (a) Is it your view that total walk-time is proportional to the total transaction time, or that total walk-time is proportional to the total number of customers?
- (b) Is it your view that total transaction time should be directly proportional to the total number of customers?

RESPONSE TO USPS/OCA-T2-3

- [a] Total walk-time would be proportional to total transactions where the time is measured. However, the table from which data were obtained in the construction of Table 3 (Table3WindowService.xls) did not contain total transactions but, rather contained transaction time, the variable used.

- (b) No

RESPONSE OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES USPS/OCA-T2-1-8

USPSIOCA-T2-4

This interrogatory attempts to accurately reproduce the results that you report in OCA-LR-3. Please consider the following table:

	Replication of Bradley Recommended Model	Bradley Recommended Model with Walk	Difference
First Class	15.50142	15.4987	0.00272
Stamps Bulk	3.51428	3.49426	0.02002
Stamps Non-	0.57943	0.58171	-0.00228
Priority Mail	28.27652	28.28101	-0.00449
Money Order	36.17514	36.23265	-0.05751
Parcel Post	41.33933	41.18931	0.15002
Other Weigh & Rate	25.90035	25.91913	-0.01878
Express Mail	78.88407	78.77349	0.11058

- (a) Please confirm that first column of the table accurately represents the estimated coefficients for the listed variables from your replication of witness Bradley's recommended model. If you do not confirm, please provide the correct coefficients.
- (b) Please confirm that second column of the table accurately represents the estimated coefficients for the listed variables from your estimation of witness Bradley's recommended model including walk time. If you do not confirm, please provide the correct coefficients.
- (c) Please confirm that the third column of the table accurately represents the difference in the estimated coefficients for the listed variables from the two versions of the estimate equation discussed in parts a. and b. above. If you do not confirm, please provide the correct differences.
- (d) Please provide a valid test of whether these differences are statistically different from zero.

RESPONSE OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES USPS/OCA-T2-1-8

RESPONSE TO USPS/OCA-T2-4

- (a) Confirmed.
- (b) Confirmed.
- (c) Confirmed
- (d) In the table below, the HC standard error is reported for each coefficient. A simple visual inspection shows that for each case the two coefficients are well within one standard error. There is no statistical difference between the two coefficients.

	Bradley Recommended Model	HC Standard Error	Consistent Covariance Estimates	Recommended Model with Walk
First Class	15.50142	1221191	1491307	15.4987
Stamps Bulk	3.51423	0807587	06521965	3.49426
Stams non-Bulk	0.57943	0 13556	0 0183766	0.58171
Priority Mail	28.27652	1 705945	2 9102484	28.28101
Money Order	36.17514	3976126	15809582	36.23265
Parcel Post	41.33933	8 191589	67 102125	41.1893 1
Other Weigh & Rate	25.90035	5659228	32026862	25.91913
Express Mail	78.88407	4412701	19471934	78.77349

RESPONSE OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES USPS/OCA-T2-1-8

USPS/OCA-T2-5

In your testimony at page 21 you state:

Witness Bradley's response to Question 7 of POIR No. 7 provided a list of studentized residuals with an absolute value above 2. He concluded that observations with a studentized residual above absolute value 3 are likely outliers, and that those with a studentized residual above 2 in absolute value bear investigation.

- (a) Please confirm that neither your testimony nor your library references contain an investigation of the 250 observations with residuals above 2 in absolute value.
- (b) If you do not confirm, please provide a citation to where in your testimony there is a discussion of the nature and results of the investigation of the 250 observations.
- (c) If you do not confirm, please provide a citation to where in your library references the procedure to be followed in the investigation are presented and where the computer programs accomplishing the investigation are located

RESPONSE TO USPS/OCA-T2-5

- (a) Confirmed
- (b) Not applicable
- (c) Not applicable

RESPONSE OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES USPS/OCA-T2-1-8

USPS/OCA-T2-6

Please confirm that program entitled Studentized³ Model in OCA-LR-3 is a replication of the econometric model presented by witness Bradley in his response to question 7 of POIR #7.

RESPONSE TO USPS/OCA-T2-6

Confirmed,

RESPONSE OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES USPS/OCA-T2-1-8

USPSIOCA-T-2-7

Please refer to the program listing entitled "Studentized3 Output" in OCA-LR-3.

- (a) Please confirm that the regression is estimated on a data set containing 7,798 observations.
- (b) Please confirm that one of those observations has a value for Stamps Non-Bulk of 1,440. If you do not confirm please explain why the value of "Maximum" in the Proc Means output for the variable is listed as 1,440.
- (c) Please confirm that this means that 1,440 individual stamps were sold in this transaction. If you do not confirm, please provide your interpretation of this number.
- (d) Please confirm that the average value for Stamps Non-Bulk is listed in the same output as 1.933. If you do not confirm, please provide the average value for Stamps Non-Bulk listed in that program.

RESPONSE TO USPS/OCA-T2-7

- (a) Confirmed
- (b) Confirmed
- (c) Confirmed.
- (d) Confirmed

RESPONSE OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES USPS/OCA-T2-1-8

USPSIOCA-T2-8

Please refer to the program listing entitled "Studentized2 Output" in OCA-LR-3.

- (a) Please confirm that the regression is estimated on a data set containing 7.665 observations.
- (b) Please confirm that one of those observations has a value for Stamps Non-Bulk of 800. If you do not confirm please explain why the value of "Maximum" in the Proc Means output for the variable is listed as 800.
- (c) Please confirm that this means that 800 individual stamps were sold in this transaction. If you do not confirm, please provide your interpretation of this number.
- (d) Please confirm that the average value for Stamps Non-Bulk is listed in the same output as 1.713. If you do not confirm, please provide the average value for Stamps Non-Bulk listed in that program.

RESPONSE TO USPS/OCA-T2-8

- (a) Confirmed
- (b) Confirmed
- (c) Confirmed
- (d) Confirmed

1 CHAIRMAN OMAS: There are no requests for
2 oral cross-examination of Witness Smith.

3 Does any participant have any questions they
4 would like to pose to Witness Smith at this point?

5 Ms. Portonovo?

6 MS. PORTONOVO: The Postal Service has no
7 questions.

8 CHAIRMAN OMAS: I'm just giving you a rough
9 time today.

10 Mr. Smith, therefore that completes your
11 appearance here today. We appreciate your testimony
12 and your contribution to our record. Again, thank
13 you, and you are excused.

14 THE WITNESS: Thank you.

15 (Witness excused.)

16 CHAIRMAN OMAS: This concludes today's
17 hearings. We will reconvene tomorrow morning at 9:30
18 when we will receive testimony from Witnesses Geddes,
19 Panzar and Sidak. Thank you, and have a nice
20 afternoon.

21 (Whereupon, at 2:06 p.m., the hearing in the
22 above-entitled matter was adjourned, to reconvene on
23 Wednesday, November 1, 2006, at 9:30 a.m.)

24 //

25 //

REPORTER'S CERTIFICATE

9102

DOCKET NO. : R2006-1

CASE TITLE: Postal Rate and Fee Changes

HEARING DATE: 10/31/06

LOCATION: Washington, D.C.

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the Postal Rate Commission.

Date: 10/31/06

L. Conway

Official Reporter
Heritage Reporting Corporation
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