

ADVO, INC. INTERROGATORIES TO VAL PAK WITNESS MITCHELL (VP-T-3)

ADVO/VP-T3-1. On page 20 (lines 4-10), you state:

“Quite aside from the Ramsey formulas, a notion of cross subsidy has evolved. The reasoning has been that if the presence of product D causes the price of product C to be higher than it would otherwise be, then product C is subsidizing product D. The test to determine whether such a cross subsidy exists is to estimate the incremental cost of product D, and if the revenue from product D is not covering this incremental cost, then the extent of cross subsidy is taken to be the revenue shortfall, based on these numbers.”

- (a) Please confirm that product D’s incremental cost is the total postal system cost saved if that product is eliminated, including any cost savings from other products in the system (such as C) that are generated when product D is eliminated. If you cannot, please explain fully why not.
- (b) Please confirm that if a product’s revenues cover its incremental postal system cost, then it is not being subsidized. If you cannot, please explain fully why not.
- (c) Please confirm that if product C’s revenues do not exceed the postal system costs to produce only product C (exclusive of any other postal products and services), then that product is not subsidizing any other. If you cannot, please explain fully why not.

ADVO/VP-T3-2. On page 10, you cite the Ramsey pricing formula as a situation case where cross-subsidies are permitted and are not considered “bad.” Please describe the circumstances where the Ramsey formula would permit cross-subsidies and explain precisely why “. . . the welfare of the nation is higher with this thing called a cross subsidy than without it. . . .”