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

Rate Adjustment due to Extraordinary or)
Exceptional Circumstances) Docket No. R2010-4

VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
SUGGESTED QUESTIONS TO BE ASKED OF THE POSTAL SERVICE
WITNESS CORBETT DURING PUBLIC HEARING
(August 5, 2010)

Pursuant to Order No. 485 (July 8, 2010), Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. ("Valpak") submit the following suggested questions to be asked of Postal Service witness Joseph Corbett during the public hearing on August 10, 2010.

BACKGROUND

Witness Corbett's testimony provides the "financial context for the Postal Service's request for an exigent price increase." P. 2, ll. 10-11.

QUESTIONS

1. Your testimony discusses "the **business model** that sustained the Postal Service for almost four decades...." P. 3, ll. 1-2 (emphasis added).

   a. In your opinion, was that business model workable in FY 2004 and FY 2005, or was it already broken during those years? Please explain.

   b. For FY 2004 and FY 2005, would you agree that the Postal Service's free cash flow (after investments) was positive and, even after the Postal Service made substantial investments in plant and equipment, as it still had net cash flow over $1.5 billion?

i. In those two fiscal years, is it correct that volume had not begun a dramatic decline and those years were reasonably profitable for the Postal Service?

ii. Would you agree that PAEA's CPI cap on rate increases limited the Postal Service's ability to increase its free cash flow?

c. So, starting in FY 2006, if the next 10 years had unfolded along similar lines, would it have been reasonable to assume that — barring some major change requiring legislative approval, such as adoption of delivery 5 days a week — the Postal Service reasonably might have expected a net free cash flow of $15 to $20 billion?

d. Starting with FY 2006, if we add $15 billion of possible debt to a maximum expected net cash flow of $15 to $20 billion, would the best the Postal Service could have expected to have available over the ensuing 10 years about $30 to $35 billion?

e. When PAEA imposed on the Postal Service a 10-year obligation of about $56 billion to pre-fund retiree health care benefits, do you have any idea where Congress expected the Postal Service to generate an extra $20 to $30 billion?

3. You state "we must take a balanced approach which includes efforts to **elevate the role of demand factors in pricing**…." P. 9, ll. 8-10 (emphasis added). "Demand factors" generally includes elasticity information. If elevating the role of demand factors in pricing does not mean more emphasis on use of information about own-price elasticity of demand:

a. What you do mean?

b. What do you think is the appropriate role for elasticity information in pricing?

c. Would you please explain how a rate adjustment that is close to across-the-board for most products elevates the role of demand factors in pricing?

3. You state that the Postal Service took many steps consistent with "best practices of **honest, efficient and economical management**" to improve its position. P. 16, ll. 3-14 (emphasis added).

a. Do you consider pricing of individual products to achieve profitability to be consistent — or inconsistent — with "best practices of economical management?"

b. Is pricing that countenances continued losses on Market Dominant products consistent — or inconsistent — with "best practices of economical management?"

c. In FY 2009, the ACR/ACD indicated that the Postal Service had 14 products whose revenue did not cover their attributable costs, and the total loss from those 14 products amounted to $1.7 billion.

i. Was pricing prior to FY 2009 which countenanced losses on those 14 products, consistent with best practices of economical management to improve its position?

ii. Please discuss how the Postal Service used its pricing flexibility available to it under PAEA for underwater products to improve its financial position?

d. Going back to years prior to FY 2009 — *i.e.*, to FY 2007 and FY 2008 — in each of those prior years, was it not almost predictable that virtually all of those underwater products would continue to be underwater and not comply with PAEA by failing to cover their attributable costs and make any contribution to institutional costs under 39 U.S.C. section 101(d)?

e. i. Would you agree that Mr. Masse's Attachment 9 predicts that at least six products will have coverage less than 100 percent and not comply with PAEA during FY 2010 (*i.e.*, this year)?

ii. Would you agree that Mr. Masse's Attachment 11 predicts that at least five products will have coverage less than 100 percent and not comply with PAEA during FY 2011 (*i.e.*, next year)?

f. Having failed to use much, if any, of the pricing flexibility made available under PAEA to reduce its losses and improve its financial condition, why do you think it is now reasonable for the Postal Service to propose what comes close to an across-the-board increase?

4. Your testimony states that PAEA "[a]llowed greater **pricing flexibility** in Competitive mail classes." P. 7, ll. 3-5 (emphasis added).

a. Were you implying that, under the modern system of ratemaking established by PAEA, the Postal Service does not have true pricing flexibility with respect to Market Dominant products?

b. Does pricing flexibility in Competitive mail classes allow the Postal Service to knowingly price and sell Competitive products at a loss?

c. Does pricing flexibility in Market Dominant mail classes allow the Postal Service to knowingly price and sell Market Dominant products at a loss?

d. Would you agree that for several years now, the Postal Service has knowingly priced and sold a number of Market Dominant products at a loss?

e. Under PAEA, would you say that the pricing flexibility which the Postal Service has in Competitive mail classes is greater than — or less than — the pricing flexibility in Market Dominant classes and products?

f. For Non-Flat Machinables ("NFMs")/Parcels in Standard Mail, the Postal Service has proposed a 23.3 percent increase in the price.

   i. That price adjustment will markedly reduce the Postal Service's loss on that product, will it not?

   ii. Do you consider that a good illustration of how pricing flexibility under PAEA should be used?

g. In view of the fact that NFMs/Parcels are underwater, is your opinion that the 23.3 percent price increase is reasonable?

5. You state, "the Postal Service was concerned about the **volume loss** that occurs with price increases. In the end, though, a modest price increase, despite the accompanying volume loss, will improve the financial situation." P. 17, ll.13-16 (emphasis added).

   a. Is the Postal Service more concerned with loss of volume than it is with reduction of profitability? If so, please explain why volume loss is more important, in light of what you describe as its "dire" financial condition.

b. When aggressively implementing "best practices of honest, efficient and economical management" to improve its position, to what extent does the Postal Service distinguish between volume that is:

i. Unprofitable;

ii. A little profitable; and

iii. Highly profitable?

c. Is the Postal Service as concerned about loss of unprofitable volume as it is about loss of highly profitable volume?

i. In your view as CFO of the Postal Service under the present circumstances of threatened insolvency, are concerns about loss of unprofitable volume misplaced, or do you consider such concerns reasonable?

ii. In your view, with respect to Market Dominant products, does PAEA authorize the Postal Service to use that pricing flexibility aggressively to improve its financial condition?

6. You state that "only four domestic Market Dominant products would remain below 100 percent cost coverage after implementation of the proposed exigent price adjustments." P. 18, ll, 5-7. Mr. Masse's attachment 11 shows that in FY 2011 the expected results from implementation of proposed rates on January 2, 2011, is a **loss on products with coverage below 100 percent of $727 million**. Does pricing that enables and continues losses of such magnitude reflect aggressive pursuit of economical management?

Respectfully submitted,

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