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Before the

UNITED STATES POSTAL RATE COMMISSION

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

In the Matter of: POSTAL RATE AND FEE CHANGES

Docket No. R97-1

VOLUME 25

DATE: Tuesday, February 24, 1998

PLACE: Washington, D.C.

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BEFORE THE
POSTAL RATE COMMISSION

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In the Matter of: :
POSTAL RATE AND FEE CHANGES : Docket No. R97-1
- - - - - X

Third Floor Hearing Room
Postal Rate Commission
1333 H Street, N.W.
Washington, D.C. 20268

Volume 25
Tuesday, February 24, 1998

The above-entitled matter came on for hearing,
pursuant to notice, at 9:34 a.m.

BEFORE:

- HON. EDWARD J. GLEIMAN, CHAIRMAN
- HON. W. H. "TREY" LeBLANC, III, COMMISSIONER
- HON. GEORGE W. HALEY, COMMISSIONER
- HON. GEORGE A. OMAS, COMMISSIONER

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	C O N T E N T S				
	WITNESS	DIRECT	CROSS	REDIRECT	RECROSS
1					
2					
3	KENNETH C. ERICSON				
4	BY MR. SWENDIMAN	13148			
5	BY MR. HOLLIES		13232		
6	BY MR. SWENDIMAN			13258	
7	SHARON L. CHOWN				
8	BY MR. BAKER	13259			
9	BY MR. WIGGINS		13391		
10	BY MR. McLAUGHLIN		13402		
11	BY MR. OLSON		13412		
12	BY MR. BAKER			13437	
13	STEVE ZWIEG				
14	BY MR. MAY	13440			
15	BY MR. McKEEVER		13455/13468		
16	JOHN H. O'BANNON				
17	BY MS. DRIEFUSS	13470			
18	BY MR. KOETTING		13527		
19	J. STEPHEN HENDERSON				
20	BY MR. McKEEVER	13545			
21	BY MR. CALLENDER		13635		
22	BY MR. MAY		13644		
23	BY MR. COOPER		13668		
24	BY MR. MAY		13686		
25					

DOCUMENTS TRANSCRIBED INTO THE RECORD:	PAGE
1 Direct Testimony and Exhibits of Kenneth C.	
2 Erickson, GCA-T-1	13151
3 Designation of Written Cross-Examination of	
4 Kenneth C. Erickson, GCA-T-1	13215
5 Direct Testimony and Exhibits of Sharon L.	
6 Chown, NAA-T-1	13261
7 Designation of Written Cross-Examination of	
8 Sharon L. Chown, NAA-T-1	13294
9 Direct Testimony and Exhibits of Steve	
10 Zwieg, PSA-T-3	13442
11 Direct Testimony and Exhibits of John H.	
12 O'Bannon, OCA-T-200	13472
13 Designation of Written Cross-Examination of	
14 John H. O'Bannon, OCA-T-200	13509
15 Direct Testimony and Exhibits of J. Stephen	
16 Henderson, UPS-T-3	13547
17 Designation of Written Cross-Examination of	
18 J. Stephen Henderson, UPS-T-3	13588
19 Cross-Examination Exhibit USPS/UPS-T3-EX-1	13677
20	
21	

E X H I B I T S

EXHIBITS AND/OR TESTIMONY	IDENTIFIED	RECEIVED
23 Direct Testimony and Exhibits of		
24 Kenneth C. Erickson, GCA-T-1	13150	13150

E X H I B I T S [continued]			
	EXHIBITS AND/OR TESTIMONY	IDENTIFIED	RECEIVED
1			
2			
3	Designation of Written Cross-		
4	Examination of Kenneth C.		
5	Erickson, GCA-T-1	13214	13214
6	Direct Testimony and Exhibits of		
7	Sharon L. Chown, NAA-T-1	13260	13260
8	Designation of Written Cross-		
9	Examination of Sharon L.		
10	Chown, NAA-T-1	13293	13293
11	Direct Testimony and Exhibits of		
12	Steve Zwieg, PSA-T-3	13441	13441
13	Direct Testimony and Exhibits of		
14	John H. O'Bannon, OCA-T-200	13471	13471
15	Designation of Written Cross-		
16	Examination of John H.		
17	O'Bannon, OCA-T-200	13508	13508
18	Direct Testimony and Exhibits of		
19	J.Stephen Henderson, UPS-T-3	13546	13546
20	Designation of Written Cross-		
21	Examination of J. Stephen		
22	Henderson, UPS-T-3	13587	13587
23	Cross-Examination Exhibit		
24	USPS/UPS-T3-EX-1	13674	13676
25			

P R O C E E D I N G S

[9:34 a.m.]

CHAIRMAN GLEIMAN: Good morning.

Today we continue hearings on Docket R97-1 to receive direct cases of participants other than the Postal Service including their rebuttal to the Postal Service.

We're scheduled to receive the testimony of Greeting Card Association Witness Erickson, Newspaper Association of America Witness Chown, Office of the Consumer Advocate Witness O'Bannon, United Parcel Service Witness Henderson, and we'll conclude today's hearing with the testimony of Parcel Shipper Association Witness Zwieg, who was originally scheduled to appear yesterday but who couldn't get out of the airport in Milwaukee as I understand it because of weather problems.

This morning AMMA counsel contacted the Commission to confirm that Witness Schick will be available to testify on Thursday, February 26. He'll be scheduled as our last witness that day.

Does any participant have a procedural matter to raise this morning before we begin?

If not, then Mr. Swendiman, if you could identify your witness so that I could swear him in.

MR. SWENDIMAN: Yes. Good morning, ^{Mr. Chairman.} ~~Your Honor~~
Alan Swendiman, appearing on behalf of the Greeting Card

1 Association. I would call to the witness stand Dr. Ken C.
2 Erickson.
3 Whereupon,

4 KENNETH C. ERICKSON,
5 a witness, was called for examination by counsel for the
6 Greeting Card Association and, having been first duly sworn,
7 was examined and testified as follows:

8 DIRECT EXAMINATION

9 BY MR. SWENDIMAN:

10 Q For the record, Dr. Erickson, can you state your
11 full name and your position?

12 A Kenneth C. Erickson. I'm a research associate
13 professor of anthropology in the Department of Sociology at
14 the University of Missouri, Kansas City.

15 Q I'm going to show you two copies of a document
16 designated direct testimony of Ken C. Erickson on behalf of
17 the Greeting Card Association designated GCA-T-1, and I'd
18 ask you to identify it.

19 A Yes, that's correct.

20 Q Was this testimony prepared by you or under your
21 direction?

22 A Yes, it was.

23 Q Does this testimony reflect certain errata that
24 ~~was~~^{were} filed with the Commission on January 28, 1998?

25 A Yes, it does.

1 Q And specifically as to two of them, to clarify the
2 record, Dr. Erickson, on page 5, line 18, there are the
3 words -- there are two words "cultural." Can you please
4 indicate which one in fact was changed, the first or the
5 second, on that line?

6 A I believe it was the first one.

7 Q And second, there was as part of that errata ~~a~~
8 in GCA Exhibit 2 there was a page that was substituted?

9 A That's correct.

10 Q And that page was designated?

11 A Exhibit 2, page 2, and it's called "Ethnicity" in
12 the upper left-hand portion of the table. That's the
13 correct table.

14 Q That is the table.

15 A Correct.

16 Q If you prepared this testimony today, would your
17 testimony be the same?

18 A Yes, it would.

19 MR. SWENDIMAN: Mr. Chairman, I'm handing the
20 reporter two copies of a document designated Direct
21 Testimony of Ken C. Erickson on behalf of Greeting Card
22 Association, and I would move it into evidence and ~~it~~ be
23 transcribed into the record.

24 CHAIRMAN GLEIMAN: Are there any objections?

25 Hearing none, Dr. Erickson's testimony and

1 exhibits are received into evidence, and I direct that they
2 be transcribed into the record at this point.

3 [Direct Testimony and Exhibits of
4 Kenneth C. Erickson, GCA-T-1, was
5 received into evidence and
6 transcribed into the record.]

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GCA-T-1

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

POSTAL RATE AND FEE CHANGES, 1997

Docket No. R97-1

DIRECT TESTIMONY OF
KEN C. ERICKSON
ON BEHALF OF
GREETING CARD ASSOCIATION

Table of Contents

Executive Summary	v
Statement of Qualifications of Ken C. Erickson	1
I. Purpose and Scope of Testimony.....	3
II. Cultural Significance and Greeting Cards	4
A. Brief History	
GREETING CARDS HAVE LONG PLAYED A ROLE IN AMERICAN CULTURE AND ARE CLOSELY LINKED TO THE MAIL SYSTEM.....	4
B. The Concept of Culture in Anthropology	
CULTURE, MATERIAL CULTURE, AND NATIONAL CULTURE ARE TERMS THAT HELP MAKE SENSE OF THE IMPORTANCE OF GREETING CARDS.....	5
C. Culture	
MORE THAN "HIGH CULTURE," THE ANTHROPOLOGICAL VIEW OF CULTURE INCLUDES MATERIAL, BEHAVIORAL AND SYMBOLIC ELEMENTS.....	6
D. American Culture	
WHILE A MIXTURE, AMERICAN CULTURE CONTAINS SHARED PATTERNS	9
E. Cultural Value	
GREETING CARDS, LIKE OTHER ITEMS OF MATERIAL CULTURE INVOLVED IN GIFT EXCHANGE, POSSESS VALUE BEYOND THEIR ECONOMIC IMPORTANCE.....	10
III. Material Culture and Exchange	13

IV. Exploratory Research on Greeting Cards and American Culture	14
A. The Cultural Life of Greeting Cards	
THOUGH THEY ARE MATERIAL THINGS, GREETING CARDS ACT OUT CULTURAL ROLES IN AMERICAN RELATIONSHIPS.....	16
B. Greeting Cards and American Ritual	
GREETING CARDS ARE TIED TO THE AMERICAN RITUAL CALENDAR, WHICH HIGHLIGHTS THEIR CULTURAL SIGNIFICANCE.	20
C. Greeting Cards Communicate	
THE COMMUNICATIVE FUNCTION OF GREETING CARDS INCLUDES MARKING OR ACTIVATING RELATIONSHIPS; THEY COMMUNICATE WHEN THE SPOKEN WORD CANNOT.....	21
D. Other Cultural Significance	
IF CULTURES ARE FLUID BUT STRUCTURED SYSTEMS OF MEANING, THEN THE SIGNIFICANCE OF GREETING CARDS EXTENDS TO OTHER AREAS OF AMERICAN CULTURAL LIFE.	23
V. A National Survey on the Significance of Greeting Cards	24
A. The Survey	
A NEW TELEPHONE SURVEY TAPPED A WIDE SAMPLE OF AMERICANS	25
B. Demographic Profile	
THE SURVEY INCLUDED AFRICAN-AMERICANS, HISPANIC-AMERICANS, AND A RANGE OF INCOME GROUPS.....	28

C. The Survey	
QUESTIONS FOCUSED ON THE IMPORTANCE OF GREETING CARDS TO RECIPIENTS AND EXPECTATIONS ABOUT HOW CARDS WOULD BE DISPLAYED	28
D. The Survey Results	
THE SURVEY SHOWS THAT GREETING CARDS APPEAR TO BE ESPECIALLY SIGNIFICANT FOR SOME GROUPS AND THE CULTURAL SIGNIFICANCE OF GREETING CARDS IS SUPPORTED.....	30
VI. Summary and Conclusions.....	38
A. Potential Cultural Impact of Higher First-Class Rates	
A SMALLER VOLUME OF GREETING CARDS IN THE MAILSTREAM WOULD HAVE NEGATIVE CULTURAL CONSEQUENCES	39
B. Greeting Cards Bind the Nation Together	
AS PART OF THE MAILSTREAM, GREETING CARDS LINK FAMILY AND FRIENDS IN SHARED CULTURAL MEANINGS THAT REFLECT AND EVEN SHAPE AMERICAN CULTURE.....	40
C. The Cultural Value of Greeting Cards	
GREETING CARDS ARE INTIMATELY LINKED WITH AMERICAN EXPRESSIONS OF RELATIONSHIPS.....	41

List of Appendices

Exh. GCA-1 Ken Cleland Erickson's Curriculum Vitae

Exh. GCA-2 Age, Ethnicity, and Income; Text of the Survey

Executive Summary

1

2

3 My testimony is an analysis of the cultural significance of greeting cards
4 that are sent through the mail in the United States. As an anthropologist, I show
5 how greeting cards are a part of American culture. I present my prior
6 anthropological research among greeting card shoppers and provide an analysis
7 of new survey research about the cultural significance of greeting cards.

8 After presenting my qualifications, this testimony provides a short
9 historical introduction to greeting cards and their link to the mail system in section
10 II.A. Then, the anthropological concepts of culture, national culture, and cultural
11 value are introduced in sections II.B through II.D. The importance of the
12 "imagined community" to national culture is discussed—that is, how in
13 communities too large for face-to-face relationships printed matter such as
14 greeting cards help create a sense of shared national experience. In section II.E,
15 this cultural perspective is used to show how greeting cards possess cultural—
16 not just economic—value.

17 In section III, the concepts of material culture and exchange are presented
18 to underscore the ways in which material culture always carries cultural
19 significance—meaning—in exchanges between senders and receivers.

20 Sections IV.A through IV.D describe prior ethnographic research in which I
21 conducted participant observation and interviews with greeting card shoppers.
22 This research provided initial insights about the cultural importance of greeting
23 cards to American individuals and groups. It demonstrated the "cultural life" of
24 greeting cards in interpersonal relationships, in shared religious and secular
25 rituals, and in communication that transcends the limitations of the spoken word.

26 The insights gained from the prior research were employed in the
27 construction of a national telephone survey, described in sections V.A through

1 V.D. The survey was designed to tap the perspectives of greeting card recipients
2 on the cultural significance of greeting cards sent through the mail. Respondents
3 were asked to rank their level of agreement with thirteen statements about
4 greeting cards. The results point out the cultural importance of greeting cards
5 sent through the mail in times of illness and mourning and point to the role of
6 greeting cards in establishing and displaying shared meanings by "sharing a
7 good laugh." The survey verifies the extent to which Americans agree that
8 greeting cards help them celebrate holidays and special occasions—important
9 cultural features in any society. It shows that senders expect their cards to be
10 displayed for others to see. The survey also suggests important differences
11 across age, ethnic, and income groups.

12 The conclusions to this testimony, in sections VI. A through VI.D, state
13 that greeting cards sent through the mail bind the nation together by linking
14 families, friends and others. I end my testimony with some observations on the
15 ethnic and income differences that emerged from the survey data and how those
16 differences point to differential effects of postal rate changes that would make it
17 more costly to exchange greeting cards through the mail.

1 **Statement of Qualifications of Ken Cleland Erickson**

2 My name is Ken C. Erickson. I am a Research Associate Professor of
3 Anthropology in the Department of Sociology at the University of Missouri-
4 Kansas City. My curriculum vitae is attached as Exh. GCA-1.

5 I have conducted nearly all of my research and applied practice on
6 cultural issues in the United States. Presently, I work as an academic applied
7 anthropologist, but I worked for a number of years in Kansas state
8 government as an anthropological practitioner in refugee resettlement and in
9 education. My work with refugees in Southwest Kansas evolved into a
10 collaborative anthropological research project, funded by the Ford
11 Foundation, through which a team of researchers conducted a two year
12 ethnographic study in Garden City, Kansas. The study was part of a larger
13 study of accommodation and accord among new immigrants and established
14 U.S. residents in five U.S. cities. The project sought to understand the
15 process of "becoming an American" in a variety of U.S. contexts. This
16 experience is part of my background to understanding the cultural
17 significance of greeting cards in the United States.

18 I have worked as an archaeological researcher in Wyoming and Idaho,
19 and have produced published and unpublished papers on historical
20 archaeology, Wyoming mining communities, and cowboy culture. My
21 doctoral dissertation resulted from an ethnographic study of a High Plains
22 boxed-beef factory, a place where several immigrant cultures came into
23 contact with both shop-floor industrial and midwestern American cultures. As
24 an equity coordinator and bilingual education program consultant for the
25 Kansas State Department of Education, I worked with ethnic minority
26 students and parents, and the schools that served them. As a senior
27 research associate with LTG, Inc., of Takoma Park, Maryland and Turlock,

1 California, I conducted program evaluations of health programs in the West
2 and Midwest, and researched multilingual access to U.S. public health
3 services.

4 My most recent professional publications focus on Southeast Asian
5 refugee resettlement and adjustment to the United States, anthropology and
6 radio broadcasting, and changing industrial culture in meatpacking. I recently
7 have published a monograph on team ethnographic research. I have a
8 publication in preparation for Princeton University Press on a multicultural
9 meatpacking plant. I teach research methodology courses in sociology for
10 the University of Missouri-Kansas City. As a research professor, I am
11 charged with the task of developing new applied research in the Kansas City
12 region. My present work in the Kansas City region includes evaluating
13 housing programs for HIV+ persons and persons living with AIDS, directing a
14 research project on HIV and new immigrants to western Kansas, completing
15 an evaluation of public housing residents' needs, and providing technical
16 assistance on ethnographic research methods for Hallmark Cards, Inc.

17 I presently am the Treasurer of the National Association for the
18 Practice of Anthropology, the section of the American Anthropological
19 Association that represents applied researchers within and outside the
20 academy. I am a Fellow of the American Anthropological Association, a
21 member of the Society for Linguistic Anthropology and the Council on
22 Anthropology and Education, and an editorial board member of the Journal of
23 the High Plains Society for Applied Anthropology. I have been funded as a
24 co-principal investigator by the Ford Foundation and as a research associate
25 for program evaluation by the Robert Wood Johnson Foundation. I have
26 been a guest lecturer at the Shelby Cullom Davis Center for Historical
27 Studies at Princeton University, Duke University, San Jose State University,

1 and Kansas State University. I have served as a grant reader for the U.S.
2 Department of Education and as a keynote speaker on issues of U.S.
3 multiculturalism for professional organizations in the Midwest.

4 **I. Purpose and Scope of Testimony**

5 My testimony is given on behalf of the Greeting Card Association. In
6 my testimony, I discuss the significance of greeting cards in American culture
7 from the perspective of cultural anthropology. I will introduce some of the
8 definitions and theory of contemporary cultural anthropology. To begin the
9 discussion, I will explain what, as an anthropologist, I mean when I refer to
10 American culture. I will explain that culture has a material aspect and that
11 communication through the exchange of material cultural objects plays
12 important cultural roles. I will explain how greeting cards and their exchange
13 through the mails are a part of the American material culture fostering and
14 maintaining familial and other cultural relationships. Against this background,
15 I shall describe my anthropological research on greeting cards.

16 When a nation's mail system begins to be used for other than official or
17 governmental messages, mail can be among the resources used to reflect,
18 reproduce, and even change aspects of national culture. This is equally true
19 of the American postal system. In other words, messages moving through
20 the mail as greeting cards can have an identifiable cultural value far beyond
21 the institutional context of officialdom.

22

23

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25

1 **II. Cultural Significance and Greeting Cards**

2 **A. BRIEF HISTORY: GREETING CARDS HAVE LONG PLAYED A ROLE IN AMERICAN**
 3 **CULTURE AND ARE CLOSELY LINKED TO THE MAIL SYSTEM.**

4 Greeting cards have been around for a long time, perhaps even longer
 5 than mass-production printing.¹ Historians of popular art place the origins of
 6 the greeting card in Great Britain in the middle of the last century, though it
 7 seems likely that other industrializing countries included stationers and
 8 printers who also made and sold greeting cards at about the same time.²
 9 Greeting cards have had a close connection with certain aspects of national
 10 political and social structure. Their existence may be tied to the development
 11 of international postal agreements. The first global postal convention, signed
 12 in Austria in 1869, approved the use of the 123mm by 83mm open-faced
 13 postal card that we know today, but it was limited to 20 words of message
 14 text. This seems to have enhanced the use of the post beyond its official and
 15 governmental uses.³

¹ Kombolin, Yuri Pozdravitelnaia Otkrytka v Rossii: Konets XIX Veka-nachalo XX Veka. The Greeting Card in Russia: End of the 19th Century--Beginning of the 20th Century. [Russian and English]Kiesa Malen, trans. Skant-Petersburg: Trade House Konstantin (1994) Page 14; Ernest Dudley Chase, in The Romance of Greeting Cards Dedham, MA: Rust Craft Publishers (1956), identifies woodcut greeting cards from the mid-1400s in the Rhine Valley as among precursors of the present-day greeting card. [Reprinted by the National Association of Greeting Card Publishers in Sentimental Communication, no date]

² Buday, Gyorgy The History of the Christmas Card. London: Rockliff, (1954). Fink, Joanne Greeting Card Design. New York: Graphic Details (1994).

³ Kombolin, *ibid.*

1 Yuri Kombolin has noted the rapid and dramatic increase in the use of
2 postal cards intended as a form of interpersonal communication after the
3 admission of these cards to the mailstream of the past century. Even before
4 the postal agreement of 1869, greeting cards were mass-produced for
5 domestic use in England as early as 1843.⁴ In Britain, Gleeson White was
6 able to write in 1895 that "a complete set of all designs published in England
7 alone would include at least 200,000 examples."⁵ Greeting cards, it appears,
8 are and for many years have been a part of the English popular culture that is
9 so closely linked to our own. While a more detailed historical study of the role
10 of greeting cards would be interesting, my purpose here is to introduce some
11 of the definitions and the theory of contemporary cultural anthropology and
12 show how they apply in evaluating the here-and-now cultural role of greeting
13 cards.

14 **B. THE CONCEPT OF CULTURE IN ANTHROPOLOGY: CULTURE, MATERIAL**
15 **CULTURE, AND NATIONAL CULTURE ARE TERMS THAT HELP MAKE SENSE**
16 **OF THE IMPORTANCE OF GREETING CARDS**

17 Understanding the role of greeting cards in American culture calls for
18 an understanding of the ways in which anthropologists use concepts like
19 culture, material culture, and national culture. American culture is a kind of
20 national culture, and no member of a national culture directly interacts with
21 everyone or everything else in that culture. Despite distance and the lack of
22 face-to-face relationships among all members of a national culture, shared
23 national culture exists. Benedict Anderson has synthesized and expanded

⁴ Budday *ibid.*.Page 3.

⁵ White, Gleeson Christmas Cards and Their Chief Designers. London:
Offices of the Studio, (1895).

1 on this view of national culture. He points out that national cultures are
 2 "imagined communities," communities whose existence are dependent upon
 3 a technological means of distributing shared images of belonging.⁶ Large
 4 national communities, unlike smaller face-to-face communities, are imaginary
 5 things because they can not be experienced quite as directly. For Anderson,
 6 the invention and use of the printing press fostered a sense of national
 7 belonging. As part of the printed representations of cultural traditions,
 8 greeting cards hold considerable—and as yet untapped—potential as data for
 9 the study of how America's "imagined community" is portrayed, shared, and
 10 reshaped by people over time.

11 Greeting cards are printed examples of popular art and writing—art
 12 and writing designed for the marketplace. They appear in the marketplace in
 13 most, if not all, of the world's market economies. As they move from
 14 production to buyer to recipient, their importance and meaning shifts. Their
 15 economic value in the marketplace is transformed into cultural value, just as
 16 anthropologists have shown for other items of exchange in other cultures.⁷
 17 The ways in which terms like "culture" and "cultural value" are used by
 18 anthropologists is explored here to clarify this anthropological perspective on
 19 greeting cards in American culture

20 **C. CULTURE: MORE THAN "HIGH CULTURE," THE ANTHROPOLOGICAL VIEW OF**

21 **CULTURE INCLUDES MATERIAL, BEHAVIORAL AND SYMBOLIC ELEMENTS.**

22 In the nineteenth century, the Englishman E. B. Tylor popularized a
 23 term still used by anthropologists—"culture." According to Tylor, culture is

⁶ Anderson, Benedict R. Imagined Communities: Reflections on the Origin and Spread of Nationalism. London: Verso (1983).

⁷ Appadurai, Arjun. The Social Life of Things: Commodities in Cultural Perspective. New York: Cambridge University Press (1986).

1 "that complex whole which includes knowledge, belief, art, morals, law,
 2 custom, any other capabilities and habits acquired by man as a member of
 3 society."⁸ While other anthropologists have clarified and extended the idea,
 4 Tylor's definition still remains central to anthropology.⁹

5 Culture is an explanatory tool that distinguishes flesh-and-blood
 6 elements of human life from the non-biological stuff. It includes the
 7 meanings, learning, values, music, ritual, manners, taste, religion, art. . .the
 8 list is potentially endless because culture, in both material and expressive
 9 forms, is both created and creative. Yet, culture has historical depth,
 10 transcending individual human lives. Culture includes both the so-called
 11 rational economic choices people make, based on dollars and cents, and the
 12 too-often overlooked cultural choices that people make based on cultural
 13 values (which are not quite the same as economic value, as discussed
 14 below). Cultural regularities are patterns which are more or less shared by
 15 individuals within a culture.¹⁰

⁸ E. B. Tylor, Primitive Culture, New York: Harper (1874) Page 1.

⁹ An example of the extension of Tylor's views may be found in Alfred Louis Kroeber's "The Concept of Culture in Science" in The Nature of Culture. Chicago: University of Chicago Press (1952) Page 118 ff. See also George W. Stocking's After Tylor: British Social Anthropology, 1888-1951. Madison, University of Wisconsin Press (1951).

¹⁰ Clyde Kluckhohn's Culture and Behavior. Edited by Richard Kluckhohn, New York: Free Press of Glencoe (1962) provides an American account of the culture concept in both "traditional" and Western societies. Just what "counts" as legitimate cultural content at a particular time in a particular social group may be a subject of discussion or even conflict, conflict which is itself creative of new cultural forms. See for example Sherry Ortner, Culture/Power/History: A Reader in Contemporary Social Theory.

1 Anthropologists engage in continual discussion about the particular
2 nature and extent of cultural patterns. There also is continual scholarly
3 *debate about where in space, when in time, and to what extent individuals*
4 share patterns of culture. Despite these debates, there is agreement that
5 shared understandings of cultural elements are critical in human interaction.
6 Among members of what we generally refer to as particular cultures, there is
7 often disagreement about the contents and meaning of shared culture, but as
8 long as the material and social products of culture are circulating among a
9 group of people, cultural elements are shared among a culture's individual
10 members to some extent.

11 What individuals include and exclude varies according to the cultural
12 context that surrounds any set of behaviors. In other words, people can and
13 sometimes do rearrange the patterns of culture to fit new circumstances.
14 Anthropologists have written that humans are both the marks and the shills of
15 culture. People respond to the constraints and opportunities that culture
16 presents them and they also create new constraints and opportunities. Alfred
17 Louis Kroeber called this culture's "causal circularity."¹¹ Culture's influence
18 on people is not one way, but it is patterned. *With this in mind, it does not*
19 *make sense to talk about how American culture "causes" greeting card*
20 *exchange any more than it makes sense to say that greeting card exchange*
21 *causes American culture in the linear sense. But it does make sense to*
22 *explore how the availability and use of cards creates possibilities for existing*
23 *cultural connections and lays the foundation for new ones.*

Edited by S. Ortner, N. Dirks, and G. Eley. Princeton, NJ: Princeton
University Press (1994).

¹¹ Kroeber, *ibid.* Page 132.

1 **D. AMERICAN CULTURE: WHILE A MIXTURE, AMERICAN CULTURE CONTAINS**
 2 **SHARED PATTERNS**

3 When the term "American culture" is used here, it refers to the United
 4 States. American culture, like all others, is a mixture of many cultural
 5 influences. Ralph Linton's famous essay, "One Hundred Per Cent American,"
 6 made this point in the *American Mercury* in 1937.¹² Nevertheless, the
 7 American cultural mixture has a common core. The common cultural core of
 8 a complex society like the United States would have been said by pre-war
 9 anthropologists to represent its "ethos."¹³ Today, anthropological attention
 10 to national culture can be found in discussions of "cultural values" or
 11 "languaculture."¹⁴ The primacy of any of these anthropological concepts as
 12 explanatory tools is subject to debate, but the existence of common national
 13 cultural patterns that are widely shared is not a matter of dispute. These
 14 concepts—cultural values, world view, and languaculture—point to underlying
 15 cultural regularities in the ways in which culture is shared in complex societies
 16 like the U.S. There is diversity in that sharing to be sure, but there are
 17 patterns just as surely. In American culture, greeting cards and their
 18 exchange connect in patterned ways with cultural values, languaculture, and
 19 world view. Exploratory ethnographic research, supported by a national
 20 survey, demonstrates how they do.

¹² Linton, Ralph. "One Hundred Per-Cent American," *The American Mercury*, vol. 40 (1937). Pages 427-429.

¹³ For example, Benedict, Ruth. Patterns of Culture. New York: Houghton Mifflin (1934).

¹⁴ Gillin, John P. "Cultural Values in the United States" in Human Ways: Selected Essays in Anthropology. Pittsburgh, PA: University of Pittsburgh Press (1969); Agar, Michael Language Shock: Understanding the Culture of Communication. New York: William Morrow (1994).

1 **E. CULTURAL VALUE: GREETING CARDS, LIKE OTHER ITEMS OF MATERIAL**
 2 **CULTURE INVOLVED IN GIFT EXCHANGE, POSSESS VALUE BEYOND THEIR**
 3 **ECONOMIC IMPORTANCE**

4 One way of expressing the connectedness of greeting cards to other
 5 aspects of American culture is to refer to their cultural value. This notion of
 6 value does not replace the view of value in classical economics, the view that
 7 surrounds notions of *homo economicus*. That view assumes that human
 8 choices can best be measured and studied in terms of their financial costs
 9 and benefits. But anthropologists—and many institutional economists—
 10 argue that while costs and benefits are part of the picture, additional factors
 11 need to be considered.¹⁵ The factors that are missing from a classical
 12 economic analysis are the cultural factors. The cultural factors point to
 13 discussions about the question: "Where does value come from?" It does not
 14 assume that value comes only from scarcity. Not everything in a culture is
 15 bought or sold. Some things that are not bought or sold are valueless—
 16 others are so valuable that they are beyond price.

17 This anthropological view of value is used in this analysis of the
 18 cultural significance of greeting cards. It involves a definition of "value" that is
 19 different from the one commonly found in classical economics textbooks.
 20 The economic definition tends to make value depend, ultimately, on scarcity;

¹⁵ "The primary focus of institutional economics is on the evolution of institutional processes of providing the material means of life. Early twentieth-century founders of institutional thought include Thorstein B. Veblen and John R. Commons, followed by Wesley C. Mitchell and Walton H. Hamilton. These scholars laid initial groundwork for analytically relevant and empirically grounded inquiry in political economy." *Journal of Economic Issues Website* (<http://economics.csusb.edu/orgs/JEI/>) (1997).

1 the less there is of some economic good, the higher the value of each unit of
2 that good. In a market model like this, value is reflected in price.

3 The anthropological view does not depend in this way on scarcity. For
4 example, a religious or national symbol may have a very great value to a
5 society, yet be widely available, widely distributed, and even freely given. In
6 other words, some parts of culture need not be economic goods. The
7 anthropological approach holds that values—in the broad sense—are not
8 determined solely by scarcity (that is, by supply), but that the value of a card
9 is a function of the complex interaction of culturally imposed values within a
10 system that makes the card an element in economic transactions. These
11 culturally imposed values can include the relationship with the sender(s) or
12 recipient(s), the occasion for sending or receiving the card, and the pictorial
13 and textual content of the card—none of which are solely dependent upon
14 the number of cards available in the marketplace or the quantity of resources
15 used to transport and deliver them.

16 It is true that economic factors can affect the availability of a culturally
17 valuable object—whether an object that moves through a cultural system as a
18 gift or as a commodity—and in that sense cultural value may reflect or
19 respond to monetary costs and benefits. If something of cultural value—say,
20 cranberry sauce used during parts of the ritual cycle in American culture—
21 should come to cost more than anyone could ever afford, it may cease to be
22 part of the cultural repertoire surrounding a traditional event. In that case,
23 however, the loss of value would not be canceled out simply by showing that
24 the resources formerly spent on cranberry sauce are now being spent on
25 some other useful or “valuable” thing. What is at issue here, however, is not
26 whether some object has cultural value—a question that is independent of

1 the scarcity of the object—but whether society will be able to keep on
2 enjoying and using that culturally valuable object.

3 In the case of greeting cards, cultural value may be more complex
4 than for most cultural commodities. Greeting cards are part of gift
5 exchanges: a favorite topic for anthropologists.¹⁶ They are a commodity that
6 is tied up with relationships and the expression—or display—of the nature of
7 those relationships. So unlike cranberry sauce, they hold their value as
8 individual and unique expressions long after their exchange on some ritual or
9 other occasion. This gives them a greater cultural importance than other
10 elements of material culture. Greeting cards have special cultural value.

11 To summarize then, the theory that surrounds culture includes the idea
12 that: (1) culture changes in patterned and understandable, if not always
13 predictable, ways; (2) culture may not be shared equally by individuals in a
14 society; and (3) cultural value must be considered along with economic value.
15 An additional point, discussed briefly below, is that research methods best
16 adapted to the study of culture are context-sensitive and designed to tap
17 cultural features in cultural context.

¹⁶ See, for example, the classic ethnography by Bronislaw Malinowski, Argonauts of the Western Pacific, London: Routledge & Sons (1922), for an account of a complex exchange system, the Kula ring, that operates among a set of islands west of New Guinea. The same system was explored more recently by Nancy D. Munn in The Fame of Gawa : A Symbolic Study of Value Transformation In A Massim (Papua New Guinea) Society, New York : Cambridge University Press, (1986). Both draw on early formulations of the cultural significance of gifts published by Marcel Mauss at the beginning of this century, in Essai Sur le Don, The Gift: Forms and Functions of Exchange in Archaic Societies, New York: Norton (1967).

1 Anthropologists generally consider ethnography, with its emphasis on
2 participant observation, to be a key element in the anthropological approach
3 and among the discipline's major contributions to the social sciences.¹⁷ Both
4 the ethnographic method and the concept of culture are important to
5 understand an anthropological view of the cultural significance of greeting
6 cards as cultural products that participate actively in the social system.
7 Ethnography is an eclectic blend of social science methods that always
8 includes some up-close participant observation. The goal of ethnography,
9 simply stated, is to obtain the "native point of view" so as to understand
10 culture from the inside. My own exploratory work on greeting cards in
11 American culture has been conducted within this theoretical and
12 methodological tradition, and in the specific context of anthropology's long-
13 standing fascination with gifts and exchange systems.

14 **III. Material Culture and Exchange**

15 Culture has material manifestations. It uses material objects, and it
16 may be shaped by them just as it is shaped through non-material events such
17 as spoken words or performances. Material things become cultural things
18 when they are used by people for cultural purposes. Anthropological studies
19 of cultures around the world suggest that practically any "thing" can become a
20 cultural thing, or what anthropologists call "material culture." Seeing the
21 cultural aspects of material things helps specify how cultural things have
22 meaning in particular cultures, and how the value of material culture changes
23 as it moves about in market systems or in gift exchanges.¹⁸

¹⁷ Agar, Michael The Professional Stranger (2nd Edition) (Orlando, FL: Academic Press. (1996) provides a key introductory text to ethnographic methods.

1 Material culture is symbolically dense—but the multiple and at times
2 puzzling meanings attached to material culture can be understood with
3 reference to a particular cultural context. While the meanings of material
4 things are potentially limitless, cultures do not take advantage of all such
5 meanings. In fact, this picking and choosing is present in many cultural
6 domains. In language, for example, the range of sounds a human can
7 produce approaches infinity, at least in theory, yet humans only make use of
8 a limited set of possible sounds.¹⁹ So it is with the meanings associated with
9 material culture. There are boundaries, regularities, and patterns in the
10 meanings that are attached to gifts and other material media of exchange. In
11 particular, there are patterns in the way greeting cards fit with aspects of
12 American culture. Specifying just what some of those are at this moment in
13 the American cultural trajectory is the task at hand.

14 **IV. Exploratory Research on Greeting Cards and American Culture**

15 I conducted ethnographic research among card shoppers in the
16 Midwest in 1997. With the help of a team that included a graduate student
17 from the University of Missouri-Kansas City and some researchers from
18 Hallmark Cards, Inc., we designed a participant observation and interview
19 study with shoppers in a greeting card store. We shopped along with
20 customers, asked them about the cards they examined and selected, and
21 interviewed them about their experience afterward. Our aims were among
22 the traditional ethnographic goals: to tap the "native" point of view about
23 some aspect of culture. In this case, the "natives" were Americans and the

¹⁸ Marcel Mauss, *ibid.*.

¹⁹ Jakobson, Roman. *On Language*. Edited by L. Waugh and Monique Monville-Burson. Cambridge, MA: Harvard University Press (1990).

1 topic of interest was greeting cards. About half of the shoppers were pre-
2 selected and about half of them were intercepted" when they came into the
3 store to buy a card. We found them all quite willing to talk with us while they
4 shopped. In two days, we shopped for and talked about sixty-four greeting
5 cards with nineteen people.²⁰

6 Our research provided us with a set of preliminary insights about the
7 ways greeting cards are used and how they relate to American culture.
8 Among the key findings were: (1) that greeting cards, in their selection and
9 use, have a cultural life of their own that is linked to American cultural
10 values;²¹ (2) that greeting cards play a role in the celebration of American
11 family rituals, and are therefore linked to American world view; and (3) that
12 cards are linked to American languaculture—they facilitate special kinds of
13 communication, often beyond the "me-to-you" communication that is
14 ordinarily thought to be the reason for card sending. All three are discussed
15 briefly below. These earlier findings, along with a general understanding of
16 the place of symbolically important material things in any culture, helped me
17 to generate a set of survey questions that were used to sample a broader,
18 more diverse group of Americans (see below) to clarify the cultural
19 significance of greeting cards in American culture. (Linking ethnographic

²⁰ The research sought general insights into the card-shopping process, but like much exploratory ethnography, we were forced to take notice of a still wider context: we came to learn about the complex roles played by cards in relationships. The research was not designed for this testimony, but the insights from the research are relevant here.

²¹ By the cultural life of greeting cards I mean the way cards play a role in social relationships.

1 research with more focused survey work is a common feature in
2 anthropological inquiry).²²

3 **A. THE CULTURAL LIFE OF GREETING CARDS: THOUGH THEY ARE MATERIAL**
4 **THINGS, GREETING CARDS ACT OUT CULTURAL ROLES IN AMERICAN**
5 **RELATIONSHIPS**

6 We found that greeting cards have a cultural life of their own. They act
7 on people when at the point of purchase, and they act on relationships when
8 they are exchanged. While shoppers are selecting greeting cards with a
9 friend—or a researcher—they talk about how the cards do or do not fit the
10 relationship in which the card will play a part. During this process, shoppers
11 talk freely about the relationship they have with the person (or persons) that
12 card is for.²³ Greeting cards in this way seem to act like formal projective
13 tests in psychological research. Shopping for them becomes an occasion for
14 talking about relationships. This is the first element of the cultural life of
15 greeting cards. Greeting cards provide a window into American
16 relationships—and relationships are a key part of what American (or any
17 other) culture is all about.

²² Bernard, H. Russel. Research Methods in Anthropology. Thousand
Oaks, CA: Sage (1994).

²³ Some greeting cards are designed and labeled to be given by
people to pets. Of particular interest here are the cards sent to
another person's pet, which reflect the value senders place on their
relationship with recipients, and their understanding of recipients'
relations with the significant beings, human and non-human, in their
circle. (Cards sent to Santa Claus are another example.) It appears
likely that cards sent to someone else's pet are likelier to go by
mail, and are also relevant for that reason. This underscores the
fact that the cultural importance of cards in American culture hinges
on human relationships in general.

1 This aspect of the cultural life of greeting cards had methodological
2 significance for our research. The ability of shoppers to talk about the
3 relationships they have with the people for whom the cards were intended
4 was a great help in establishing rapport while shopping. This is important
5 because ethnographic research depends on a genuine, honest, and overt
6 presence by a researcher who is herself or himself the primary data collection
7 tool. (In other kinds of research, data collection tools may be non-human—
8 i.e., survey instruments or metering devices.) This setting provided rich data
9 about greeting cards and the relationships in which they do their cultural
10 work. The flow of talk about relationships, in the context of card shopping,
11 highlighted an anthropological axiom: gifts are more than things.²⁴ Cards,
12 from the perspectives of their users, embody as well as mediate social
13 relationships. They communicate meanings and intentions about
14 relationships and, in so doing, they signal their cultural value. This is another
15 aspect of the cultural life of greeting cards. Greeting cards are a way to
16 signal (and sometimes reshape) the cultural value attached to relationships
17 over time.

18 For example, we found that some greeting cards are put out on display
19 after they are received. This makes their content available for view and
20 comment by other friends and family members. This possibility was taken
21 into account and talked about by people who bought cards. They sometimes
22 bought cards "more carefully," they said, because they knew that their cards
23 would not just be viewed and decoded by the recipient alone. They knew
24 that others would take part in interpreting (or misinterpreting) the meaning of
25 the card they sent. So choices about the card's "look" and the card's

²⁴ Marcel Mauss, *ibid.*

1 "content"—Would it be funny or serious? Would it have a rhyme or would it
2 have a simple greeting?—were made against complex social webs of
3 relationships.

4 Even when the cards were expected to be seen and appreciated by
5 only one person, that relationship also was more complex than that simply
6 marked by the momentary receipt of the card. The card had to match the
7 present state of the relationship with reference to past relationships,
8 relationships that are shaped by the presence (or absence) of other people.
9 *A card for a family member with whom you have had a warm and affectionate*
10 *relationship in the past but do not have such a close relationship now is*
11 *different from a card for someone with a different interpersonal connection*
12 *with you. Cards tap both the past and the present and may tap an imagined*
13 *or desired future state of a relationship.*

14 Relationships among family and friends in American culture are
15 different from similar kinds of relationships in other national cultures.
16 Greeting card content and appearance has to “match” complex and often
17 intimate relationships in culturally determined ways. For the present, it is
18 enough to state that there is a patterned relationship between cards and
19 American cultural patterns of friendship and family.²⁵

20 Greeting cards play out part of their cultural role as representatives of
21 relationships. While they are sometimes given in person, they are more often
22 received in the mail. They can act as bridges that cross time, physical space,

²⁵ On the culture of American families, see Schneider, David M. American Kinship: A Cultural Account. Chicago: University of Chicago Press [2nd Ed.] (1980) and Coontz, Stephanie. The Way We Never Were: American Families and the Nostalgia Trap. New York: Basic Books (1992).

1 and social space. Not being there in person for a special occasion—a
2 celebration, an illness, a death—can, of course, be the result of more than
3 physical distance. Modern transportation has made the globe physically
4 accessible, but our culture keeps us busy. Time and resources often limit our
5 ability to be there in person. And for many relationships, especially those
6 laden with ambivalence or some socially difficult dimension, being there in
7 person may not be the best idea. Cards can establish closeness and they
8 also can mark respectful distance. They are ready-made for doing their work
9 in relationships that are geographically dispersed, or challenged to find time
10 for face-to-face communication, or seeking respectful distance.

11 Greeting cards, then, have a public cultural life outside their physical
12 creation by greeting-card companies. The life course of greeting cards
13 includes people shopping for them and reflecting on how the cards "fit" the
14 cultural values surrounding the relationships in which the card participates.
15 The card's cultural trajectory—and the meaning it bears—shifts again when it
16 is exchanged. Cards stand for relationships and they are social actors—
17 mediators—in those relationships. We know this to be true because of the
18 ways shoppers talk about the decisions they make about cards. They
19 evaluate the artistic content of the card for its relationship to the shopper's
20 understanding of the taste, the likes, the dislikes, and the personality of the
21 recipient. The history of the relationship enters in, as cards are not only
22 bought to reflect the recipients favorite colors or artistic tastes, but to reflect
23 the experiences that the purchaser and recipient share. The same is true for
24 the words on the cards.

25 When a greeting card is received, it represents and acts on the
26 relationship, standing as we all do (and as the old hymn says), "between
27 memory and hope," marking the past and containing the potential for a future

1 relationship. American greeting card senders and recipients share
 2 relationships that are affected by the presence (or absence) of the card and
 3 by the recipient's and the sender's ability to invest it with deep cultural
 4 meaning.

5 **B. GREETING CARDS AND AMERICAN RITUAL: GREETING CARDS ARE TIED TO**
 6 **THE AMERICAN RITUAL CALENDAR, WHICH HIGHLIGHTS THEIR CULTURAL**
 7 **SIGNIFICANCE.**

8 *Greeting cards are part of American cultural rituals. Calendrical*
 9 *rituals—rituals that occur on a regular schedule through the year—appear in*
 10 *all human cultures. Everyone on the globe celebrates the passage of the*
 11 *seasons (though not everyone identifies four of them as American culture*
 12 *does). These changes are usually tied to cosmological or religious beliefs*
 13 *and as such are closely linked to officially sanctioned views about the nature*
 14 *of the world and humanity's place in it. For example, the Passover Seder is*
 15 *more than a family gathering, it is a religious observance. A Vietnamese-*
 16 *American Têt celebration is more than a new year's party. It is an occasion*
 17 *for reading aloud the year's troubles and future hopes which are then offered*
 18 *up as burnt offerings to the supernatural. In my own ethnographic work*
 19 *among Vietnamese immigrants, I have observed (and been a participant in)*
 20 *greeting card exchanges through the mail that mark graduation, marriage,*
 21 *Têt, and death.²⁶*

²⁶ See the film, *America Becoming*, produced by Dai Sil Kim-Gibson for the Ford Foundation's Changing Relations Project, which aired on PBS in 1993. The film contains a sequence about a death among Kansas Vietnamese friends, and documents the exchanges that took place before the funeral.

1 Greeting cards flow among American families and individuals at these
 2 ritual times. In fact, according to some art historians, the first greeting cards
 3 (in Great Britain at least) were Christmas cards.²⁷

4 American cultural traditions—both religious and secular—are marked
 5 by the receipt of greeting cards. As any introductory text in anthropology
 6 demonstrates, ritual and religion are closely tied to basic cultural assumptions
 7 about the nature of the world and the place of humans in it—in
 8 anthropological terms, a culture's world view. While not everyone participates
 9 in all of the possible religious or secular traditions in American rituals, card
 10 giving penetrates many dimensions of American culture.

11 **C. GREETING CARDS COMMUNICATE: THE COMMUNICATIVE FUNCTION OF**
 12 **GREETING CARDS INCLUDES MARKING OR ACTIVATING RELATIONSHIPS;**
 13 **THEY COMMUNICATE WHEN THE SPOKEN WORD CANNOT.**

14 Greeting cards communicate things that sometimes cannot be
 15 communicated face-to-face. When they flow through the mail, they bridge
 16 distance. Indeed, the Greeting Card Association estimates that between 60
 17 and 70 percent of all greeting cards—approximately 4.0 to 5 billion—are sent
 18 through the mail every year.²⁸ Greeting cards also facilitate communication
 19 in at least one other way: they help people do things with written words that
 20 spoken words alone can not accomplish. In this way, anthropologists say
 21 that greeting cards facilitate ritual speech. What counts as ritual speech is
 22 part of the blend of language and culture that Mike Agar calls

²⁷ White, Gleeson Christmas Cards and Their Chief Designers.
 London: Offices of the Studio (1895).

²⁸ McDermott, Marianne, personal communication October 28, 1997.
 Author's notes, University of Missouri-Kansas City. "Household
 Diary Study"

1 "languaculture."²⁹ Ritual speech can be supplemented, highlighted, or
 2 facilitated by the written form and by graphic images in any culture. This kind
 3 of ritual communication in speech and in graphics is well studied in
 4 anthropology.

5 In all cultures, some kinds of things are difficult to express with the
 6 spoken word. What those things or experiences are vary from culture to
 7 culture, yet all cultures have special language that "does things." Language
 8 sometimes does things that can not be done with ordinary speech or with
 9 speech alone.³⁰ Linguists call language that "does things," rather than
 10 merely stating propositions, speech acts.³¹ Cards combine graphics with
 11 words to enable them to "do things" in the social world.

12 For example, in a different cultural setting, the Walbiri people, among
 13 the original inhabitants of Australia, use graphic images—icons—to recount
 14 recent and mythical events.³² Walbiri graphic design, their "iconic
 15 repertoire," serve as memory aides and a means to instruct, entertain, or
 16 enlighten other Walbiri people. In our own national culture, anthropological
 17 linguists have pointed out that the American English lexicon is relatively

²⁹ Agar, *ibid.*

³⁰ See especially Malinowski (*ibid.*) and Malinowski's essay in Ogden and Richards *The Meaning of Meaning: A Study of the Influences of Language Upon Thought and of the Science of Symbolism.* New York: Harcourt, Brace & World (1946)

³¹ See Austin, John L. *How To Do Things With Words.* Cambridge: Harvard University Press (1962); also Hymes, Dell and J. Gumperz *Directions in Sociolinguistics: The Ethnography of Communication.* New York: Holt, Rinehart and Winston (1972)

³² Munn, Nancy. *Walbiri Iconography: Graphic Representation and Cultural Symbolism in a Central Australian Society.* Ithaca, NY: Cornell University Press (1973).

1 impoverished in its ability to express a compliment. Others have noted how
2 difficult it is for some members of American culture to apologize or express
3 grief.³³ So, instead of "just saying it," American people use the written form.
4 A glance at the bookshelf in any bookstore will reveal volumes that contain
5 prefabricated toasts, jokes, and quotes for ready use by Americans who are
6 challenged to come up with just the right words to say. Cards provide a
7 ready and culturally appropriate means to supplement and enhance ritual
8 messages—a kind of American iconic repertoire.

9 *The language on greeting cards, and the cards themselves, are like*
10 *prayers because when they are used, they exhibit special language. Special*
11 *images often accompany prayer. The "specialness" of the words and*
12 *images, and their context of use, give them social efficacy. Cards are a*
13 *special medium of communication that allow people in American culture to do*
14 *things with words and images that they cannot do in person or on the*
15 *telephone.*

16 **D. OTHER CULTURAL SIGNIFICANCE: IF CULTURES ARE FLUID BUT**
17 **STRUCTURED SYSTEMS OF MEANING, THEN THE SIGNIFICANCE OF**
18 **GREETING CARDS EXTENDS TO OTHER AREAS OF AMERICAN CULTURAL**
19 **LIFE.**

20 The ways in which we found that cards are important in American
21 culture do not exhaust the roles they play. Recent research by Karen
22 *Fingerman, professor of human development and family studies at*
23 *Pennsylvania State University, shows that greeting cards play a role in the*
24 *maintenance of networks of "peripheral" friends among elderly Americans*

³³ Tannen, Deborah *You Just Don't Understand: Women and Men in Conversation*. New York: William Morrow (1990).

1 who are otherwise thought to be involved in shrinking circles of friends and
2 family. Her research on the elderly, not funded by any greeting card
3 company, led her to explore greeting cards as a way of understanding the
4 non-peripheral nature of so-called peripheral friendships.³⁴ According to
5 summaries of her research, greeting cards have an affective role in individual
6 well-being: "Christmas, Hanukkah, and New Year's cards really do make
7 people feel good."³⁵

8 To learn about additional connections between greeting cards and
9 American culture, and to explore the extent to which other Americans outside
10 that small group of shoppers use cards, I devised some survey questions to
11 be used with a wider sample of Americans. I did so with the following
12 theoretical idea in mind: cultures are more or less integrated systems of
13 meaning. This means that any element of a culture can have discoverable
14 links to other arenas of a culture. Rather than just explore what we had
15 learned, we explored other arenas of cultural life and tried to come up with
16 questions about cards in those arenas.

17 **V. A National Survey on the Significance of Greeting Cards**

18 To develop a national survey on the cultural significance of greeting
19 cards, I began by selecting the survey's topics of inquiry that cover the
20 arenas of culture likely affected by greeting cards. To get at a more or less
21 "encyclopedic" description of a culture, anthropologists refer to lists of human
22 cultural traits like Notes and Queries in Anthropology (the original British

³⁴ Personal communication. Telephone call to Professor Fingerman, December 11, 1997. Author's notes: 12/11/97, University of Missouri-Kansas City.

1 encyclopedic list or the more recent Outline of Cultural Materials.³⁶ These
2 lists provide taxonomies of nearly all the dimensions of human culture—
3 material, technological, social, organizational, and so on—for use in collecting
4 and coding research data about cultures. By scanning these lists, I derived a
5 set of questions that direct attention to several aspects of culture. The list
6 was narrowed to include those dimensions of culture in which it seemed
7 reasonable to expect some role for greeting cards. In this way, the full range
8 of possible connections between greeting cards and American culture was
9 filtered by my own participation in American culture. Because the culture is
10 always moving and changing, neither this list nor any other could ever be
11 exhaustive. Americans, like members of any culture, are always assigning
12 new meanings to objects of material culture. But the questions we used in
13 the national survey tap highly significant dimensions of culture: dealing with
14 life changes such as death and sickness; with religious and secular ritual; and
15 with the ways in which people mark the progress of cultural—and "natural"—
16 seasons.

17 **A. THE SURVEY: A NEW TELEPHONE SURVEY TAPPED WIDER SAMPLE OF**
18 **AMERICANS.**

19 A telephone survey was used because that was the best way to obtain
20 information quickly from a clearly understood sample of Americans. The text
21 of the survey is included here as GCA-Exh. 2. In this case, I was interested
22 in tapping the range of views about the cultural significance of greeting cards.

³⁵ Anonymous. "Business Bulletin: "Seasons Greetings." Wall Street Journal, (December 11, 1997) Page 1.

³⁶ British Association for the Advancement of Science (1929);
Murdock, George P. Outline of Cultural Materials. New Haven, CT:
Human Relations Area Files, Inc. (1982).

1 In practical terms, I sought to discover the extent to which respondents would
2 agree or disagree with statements that reflected greeting cards' cultural
3 significance.³⁷ The survey is about what people say; it does not tap what
4 they do first hand, the way ethnographic methods do. But it does measure
5 people's expectations about how some categories of greeting cards will be
6 displayed and it uncovers the extent to which Americans agree or disagree
7 about the statements in the survey. The survey offers the possibility of
8 discovering some sub-cultural differences on the multicultural palette that
9 makes up American culture as a whole.

10 As an anthropologist, I am cautious about using the usual categories
11 which assign people to racial or ethnic groups. Designations such as
12 "Hispanic" or "Black" often hide more information than they reveal. Hispanic,
13 for example, might mean one thing in Miami where most (but not all) Spanish
14 speakers are Cubans and quite another thing in parts of New York City,
15 where most (but not all) Spanish speakers share some Puerto Rican cultural
16 history. Categories like "African-American" and "European-American" also
17 include wide ranging internal diversity. Therefore I employed a strategy
18 known as "theoretical sampling" to capture information about the attitudes of
19 more narrowly defined American minority group attitudes.

20 My theoretical sample had two parts: a random sampling of telephone
21 numbers drawn nationally (the "General Population" sample) and a purposive
22 sampling of Chicago ethnic neighborhoods (the ethnic sample), within which
23 telephone numbers were called at random. According to Dr. Terry Catlett at
24 Elrick and Lavidge, Inc. (a nationally known survey research firm contracted

³⁷ The survey was designed to obtain a sample at the .05 level of confidence, that is, a margin of error of plus or minus five percent with this size sample.

1 to conduct the survey), the national random dial component (the General
2 Population sample) would be expected to yield a somewhat lower percentage
3 of African-American and Hispanic individuals than are actually present in the
4 U.S. population.³⁸ I wanted the sample to include the views of Hispanic and
5 African-Americans in an equitable way. The Chicago sample would provide
6 information from neighborhoods that I had visited while I was part of the Ford
7 Foundation study. The Chicago Hispanic neighborhoods include first and
8 second generation people from a variety of different national cultures, and
9 African-Americans there represent a broad range of economic and cultural
10 variation among established-resident African-Americans. The survey thus
11 constructed allows the generation of trustworthy generalizations about ethnic
12 populations like those found in Chicago's north and west-side Hispanic and
13 African-American neighborhoods. It also allows trustworthy statements to be
14 made about the cultural significance of greeting cards among European-
15 Americans generally.³⁹

³⁸ In fact, the General Population sample, drawn from a random selection of residential telephone numbers in the continental United States, drew eleven percent of its total from African-Americans, six percent of its total from Hispanic-Americans, and three percent of its total from "Native Americans." The latter category is traditionally a source of considerable confusion, as any American born in the U.S. could consider herself or himself a "Native American," rather than an American Indian to which the term actually refers.

³⁹ There is considerable variation within all these groups, even in Chicago, but the present purpose is to explore the range of variation across what is for Americans a culturally significant dimension of difference: the difference between so-called mainstream and so-called minority-group Americans.

1 The telephone survey was conducted by Elrick and Lavadge by their
2 telephone researchers in Chicago. The survey did not record the telephone
3 number or location of respondents in order to respect the confidentiality of
4 their responses.

5

6 **B. DEMOGRAPHIC PROFILE: THE SURVEY INCLUDED AFRICAN-AMERICANS,
7 HISPANIC-AMERICANS, AND A RANGE OF INCOME GROUPS.**

8 The responses are shown in the data tables from the survey, included
9 here as GCA-Exh. 2. Age was fairly normally distributed in the sample (see
10 GCA-Exh. 2). Respondents were asked first for their age category; those
11 under 18 were thanked and they were not interviewed further. Income in the
12 sample reflected a range of income groups among each ethnic group, also
13 shown in the data in GCA-Exh. 2.

14 The sample does not exactly mirror the shape of the U.S. ethnic,
15 economic, or gender landscape. Indeed no survey could do this because
16 American demographics are a moving target. But this sample does
17 encompass significant ethnic and income diversity among American men and
18 women.

19 **C. THE SURVEY: QUESTIONS FOCUSED ON THE IMPORTANCE OF GREETING
20 CARDS TO RECIPIENTS AND EXPECTATIONS ABOUT HOW CARDS WOULD
21 BE DISPLAYED.**

22 The survey tapped the cultural significance of the following statements
23 which were read to respondents. The percentage of the entire sample in
24 strong agreement or in agreement (who responded with a "five" or a "four") is
25 listed in parenthesis after each question

- 1 1. Greeting cards that come in the mail help me celebrate holidays and
2 special occasions (72%).
- 3 2. Greeting cards that come in the mail help me hear things others might
4 be reluctant to say in person (48%).
- 5 3. Greeting cards that come in the mail help me know that others are
6 thinking of me in a time of illness (77%).
- 7 4. Greeting cards that come in the mail help me know that others are
8 thinking of me in a time of mourning (77%).
- 9 5. Greeting cards that come in the mail help me appreciate artwork and
10 photography (49%).
- 11 6. Greeting cards that come in the mail help me know that others are
12 praying for me (63%).
- 13 7. Greeting cards that come in the mail help me maintain family traditions
14 (60%).
- 15 8. Greeting cards that come in the mail help me share a good laugh with
16 others they show the card to (72%).
- 17 8. Greeting cards that come in the mail help me celebrate religious
18 holidays and traditions (57%).
- 19 9. Greeting cards that come in the mail help me participate in and know
20 the changing seasons of the year (37%).
- 21 10. People expect that when their mother is a recipient of a Mother's Day
22 card, she will put it on display for others to see (68%).
- 23 11. When I receive a Valentine's Day card in the mail, I put them on
24 display for others to see (57%).
- 25 11. When I receive a birthday card in the mail, I put them on display for
26 others to see (67%).

1 **D. THE SURVEY RESULTS: THE SURVEY SHOWS THAT GREETING CARDS**
2 **APPEAR TO BE ESPECIALLY SIGNIFICANT FOR SOME GROUPS AND THE**
3 **CULTURAL SIGNIFICANCE OF GREETING CARDS IS SUPPORTED.**

4 The survey results for each question are discussed below with regard
5 to results for the entire sample, for ethnic differences, age differences, and
6 economic differences. Taken together, they point to overall patterns in the
7 way Americans use greeting cards. They also suggest ethnic or sub-cultural
8 differences that will need to be explored further.

9 Holidays and Special Occasions. Seventy-two percent of the
10 combined General Population and Ethnic neighborhood sample placed their
11 level of agreement at a four or a five on the five point scale when read the
12 statement, "Greeting cards that come in the mail help me celebrate holidays
13 and special occasions." African-Americans in either sample were slightly
14 weaker in their overall agreement, but nearly equal numbers of African-
15 Americans and European-Americans strongly agreed with the statement.
16 Even the small sample of Hispanic-Americans showed a similar level of
17 agreement or strong agreement: sixty-eight percent.

18 Middle-aged Americans agreed with this statement more strongly than
19 did younger Americans by thirteen percentage points: a statistically significant
20 margin ($p < .05$). This suggests that busy, mobile heads of household who are
21 more likely members of this group, find greeting cards important during
22 holidays or special occasions. It may be that the pattern in the response
23 among older Americans, which showed the highest percentage of all groups
24 in strong disagreement with this statement (twelve percent versus eight
25 percent for younger and middle-aged Americans), consider other means of
26 celebration more salient.

1 Income presented a pattern that held true across nearly all the
2 questions: people in the upper third income group, those earning more than
3 \$40,000 per year, were not as ready to agree with the statements as were
4 respondents from lower income groups. Seventy-six percent of all middle-
5 income respondents (earning \$20,000 to \$40,000 per year), and seventy-four
6 percent of low-income respondents (earning under \$20,000 per year) agreed
7 with the statement about the importance of greeting cards in celebrating
8 holidays and special occasions. The difference between these latter two is
9 statistically insignificant when calculated within this response but it is part of a
10 repeated pattern among the wider pattern of responses.

11 Holidays and celebrations are part of what most people view as
12 American Culture: Halloween, Thanksgiving, Hanukkah, and Christmas often
13 include the exchange of greeting cards. Americans by and large agree that
14 greeting cards help them celebrate these occasions.

15 Hearing What Others are Unwilling to Say. Greeting cards are only
16 somewhat likely to be seen as helpful to let recipients know things that others
17 "might be reluctant to say to [them] in person." But a near majority of
18 Americans in the General Population and in the Ethnic Neighborhood
19 samples reported they agreed with the statement: "Greeting cards that come
20 in the mail help me to hear things that others might be reluctant to say to me
21 in person."

22 It may be that there is higher agreement than the question suggests.
23 For many Americans, and perhaps more often for African-Americans, the
24 phrase "I hear you" is a metaphor for "I understand you." The question was
25 intended to mean "help me know and understand what others may be
26 unwilling to say out loud." A more literal reading of the question might result
27 in respondents wondering how a card helps you "hear" something when you

1 read it.⁴⁰ Indeed, fifty-seven percent of African-Americans agreed or
 2 strongly agreed with this statement. European-Americans (forty-six percent
 3 agreement or strong agreement) and Hispanic-Americans (forty-four percent
 4 agreement or strong agreement) were less inclined to agree.

5 Income seemed to have only a slight influence on this question, but
 6 high-income respondents were slightly less likely to agree with the statement.

7 Knowing that Others Care in Time of Sickness. The response to this
 8 question suggested that even more cultural importance is placed on greeting
 9 cards that, when received in the mail, tell the recipient that they are being
 10 thought of when they are ill. There are statistically significant (<.05) ethnic
 11 differences here: African-Americans are more inclined to agree with this
 12 statement (88 percent) than are European-Americans (76 percent), Hispanic-
 13 Americans (64 percent), or others (68 percent).⁴¹ This time, older people
 14 were more likely to agree with this statement (80 percent); other groups less
 15 so (among those age 18-34, 73 percent; among those age 35-54, 77 percent).
 16 The significance of greeting cards increases with the age of the American.
 17 The income relationship suggested above holds true: lower-income people
 18 (86 percent) and middle-income people (83 percent) are more likely to agree
 19 with the statement than are higher-income people (68 percent). This pattern

⁴⁰ According to the sociolinguist Shirley Bryce Heath, more literal interpretations characterize many European-American speech communities while more metaphoric speech patterns tend to characterize many African American speech communities. See Heath, Shirley Ways With Words. New York: Cambridge University Press (1983).

⁴¹ Reasons for this difference are presently unclear; the results hint at a subcultural difference regarding higher involvement by family and friends in expressions of care during illness among African-Americans.

1 is statistically significant. The reasons for this pattern are not quite clear, but
2 the lower an American's income, the more often he or she agreed that get-
3 well cards helped them know others were thinking about them. Interpersonal
4 expressions of care and concern during illness may be more important to the
5 elderly and to lower-income groups.

6 Knowing Others Are Thinking of Me in a Time of Mourning. Mourning
7 and sickness are similar in many ways: one signals a potential loss, and one
8 participates in an actual loss. There is agreement on this issue and
9 interestingly it shows the same pattern of response as does the question
10 about illness. African-Americans are more in agreement with the statement
11 as are lower-income and older persons. The reasons for the pattern must be
12 connected. The fact that the pattern is repeated further suggests the
13 presence of a set of sub-cultural patterns that connect interpersonal
14 expressions of care and concern to the life course (aging), to economic status
15 (income), and to ethnic background.

16 Greeting Cards Help Me Appreciate Art and Photography. These
17 aspects of popular culture are wrapped up in greeting cards, and nearly half
18 of all respondents agreed with the statement. There was no statistically
19 significant difference in the response among ethnic or age groups. But there
20 was a significant relationship to income. Both lower and middle-income
21 groups were more likely to agree (53 and 55 percent, respectively). Their
22 level of agreement was significantly different ($<.05$) than the 39 percent
23 agreement among higher-income groups. Perhaps access to art and
24 photography are, for higher-income Americans, provided by material culture
25 other than greeting cards. Art and photography in greeting cards is
26 accessible to lower and middle-income respondents while "fine" art may not
27 be. This suggests a very familiar relationship between economic status and

1 cultural ideas of "good taste" that go along with upper-income groups in most
2 cultures.⁴²

3 Greeting Cards Help Me Know Others Pray For Me. Another
4 significant difference emerges here among American ethnic and age groups.
5 While only 63 percent of the general population agreed with the statement,
6 78 percent of African-Americans agreed. There was little statistically
7 significant variation among income groups (though the pattern of lower and
8 middle-income groups agreeing more was apparent), but both middle-aged
9 and older Americans were significantly different in their responses from
10 younger Americans: from youngest to oldest, those agreeing or strongly
11 agreeing in each group represented 53, 65 and 70 percent of the total in each
12 group. There may be a major cultural shift occurring, or there may be new
13 ways in which spirituality and prayer is expressed among younger Americans.
14 Conversely, these data may indicate a developmental difference: it seems
15 likely that as life runs its course, more Americans are engaged in spiritual
16 pursuits.⁴³

17 Greeting Cards Help Maintain Family Traditions. There is little
18 disagreement in the sample about this point. Only younger Americans are
19 significantly less likely to disagree with this statement. This is
20 understandable with reference to the life-course. Older Americans are the
21 active ones in recreating cultural traditions. The pattern from old to young is

⁴² The French sociologist Pierre Bourdieu has explored this issue in his book, Distinction: A Social Critique of Judgement. Richard Nice, trans. Cambridge, MA: Harvard University Press (1984).

⁴³ See Robert Bellah, Habits of the Heart: Individualism and Commitment in American Life, Berkeley: University of California Press

1 clear: the percentage in agreement declines with age from 67, to 62, to 49
2 percent. The difference between the youngest age group and the other
3 groups is statistically significant and the connection to cultural values and
4 world view should be clear.

5 Greeting Cards Help Me Share a Good Laugh. Laughter—what is
6 funny—is tightly bound with languaculture. Laughter at a joke comes when
7 two people share enough cultural context or background knowledge to
8 perceive an incongruity, an unexpected pattern, a rule breaking, or a
9 hyperbolic statement. All of these are highly culturally specific. Not getting
10 the joke is a signal of cultural incompetence. When someone does not laugh
11 at the joke because it is not perceived as politically compassionate, not
12 laughing signals non-membership in the community of persons who *do* laugh
13 at the joke. Humor is among the better markers of cultural in- or out-group
14 status. It is among the top three questions in this survey with which
15 Americans tend to agree.

16 Interestingly, there are no statistically significant differences among
17 groups of respondents to this question. Everyone agrees, more or less, that
18 greeting cards that come in the mail can help share a laugh with people to
19 whom the card is shown. This suggests how cards containing funny text or
20 pictures are part of the cultural give-and-take that reaffirms shared knowledge
21 about cultural norms within American culture and American sub-cultures.
22 There are patterns, however, among these data that suggest some age
23 differences.

24 Middle-aged Americans are somewhat more likely to agree than older
25 Americans, and both are more likely to agree than the youngest group.

(1985) for a discussion of the complexity of American spirituality
that supports this point.

1 (From oldest to youngest, 72, 76, and 68 percent agreed or strongly agreed
2 with the statement.) Youth often are on the cutting edge of shifts in meaning
3 that are the turning point of many jokes. It seems sensible that young people
4 would not agree as much with this statement. It seems quite likely that mass-
5 marketed greeting cards often will not be on the cutting edge of what is funny
6 "on the street" among young people who, in our culture as well as in others,
7 are adept at challenging cultural norms and reshaping cultural values.

8 Greeting Cards Help Celebrate Religious Holidays. Religious traditions
9 are associated with greeting cards for a majority of older and middle-aged
10 Americans (66 and 61 percent, respectively, agreed or strongly agreed).
11 While there are a range of views on this point in our survey, and while a
12 number responded with a "three" (not agreeing or disagreeing), few
13 disagreed or strongly disagreed.

14 Income made a difference in the responses to this statement. Those
15 in the higher income bracket were just about as likely to disagree or have no
16 feelings about how greeting cards help in the celebration of religious
17 traditions. Sixty-two and 61 percent of middle and lower-income Americans
18 in the sample agreed or strongly agreed that greeting cards that come in the
19 mail help them celebrate religious holidays and traditions.

20 Religion is connected with any cultural group's conception of its place
21 in the universe, with the nature of the universe generally, and with the
22 expression of cultural values about the supernatural in particular. Therefore,
23 this question reveals how greeting cards are a part of American religious
24 holidays and traditions for most Americans, though less so for higher-income
25 Americans.

26 Greeting Cards Help Me Participate in Changing Seasons. This
27 question was designed to tap the ways American culture marks the seasons

1 of the year. The changing seasons are linked to important rituals featured in
2 many cultures. Different parts of the U.S. have very different climatic
3 changes, but American culture puts a great deal of emphasis on colorful
4 autumns, white Christmases, and sunny summers, whether in Southern
5 California, Florida or New York State. Yet, only thirty-seven percent of the
6 entire sample agreed with the statement. Older Americans, for whom family
7 traditions are more important, were significantly more likely to agree (43
8 percent) than were younger Americans. While only 34 percent of European-
9 Americans agreed, 49 percent of African-Americans and 40 percent of
10 Hispanic-Americans agreed or strongly agreed with the statement.

11 I Expect Mother's Day Cards to be Displayed. Most Americans of all
12 groups expect that Mother's Day cards will be displayed. In a reversal of
13 other responses, older Americans, who are of course less likely to give
14 Mother's day cards to their own mothers, were less likely to agree. In fact,
15 this is one of the few statements that younger Americans agreed with more
16 often. Fully 75 percent of younger Americans agreed or strongly agreed with
17 the statement. There were no significant differences among ethnic or income
18 groups on this question.

19 The display of greeting cards offers strong support for their cultural
20 significance. The fact that younger Americans participate in this aspect of
21 greeting card exchange points to the enduring, trans-individual nature of
22 American culture generally and greeting cards in particular. It points to
23 shared elements of American culture across sub-cultural or ethnic groups:
24 Hispanic-Americans and African-Americans in the sample are as likely as
25 other Americans to expect their mothers to display the card they send them in
26 the mail.

1 **A. POTENTIAL CULTURAL IMPACT OF HIGHER FIRST-CLASS RATES: A**
2 **SMALLER VOLUME OF GREETING CARDS IN THE MAILSTREAM WOULD**
3 **HAVE NEGATIVE CULTURAL CONSEQUENCES**

4 While I cannot comment on the degree of change in greeting card use
5 that would arise as a result of increases in first-class postage, I can comment
6 on the cultural significance of a reduction in the number of greeting cards in
7 the mailstream. The survey demonstrates that for low-income persons,
8 greeting cards are a highly salient means of cultural expression. They are
9 especially important during some of the most important—and emotionally
10 taxing—moments in American life: illness, death, and growing older. Older
11 Americans have been shown by independent research to gain positive
12 emotional support from greeting cards.⁴⁴ In the national survey data, older
13 Americans feel that greeting cards are culturally significant along several
14 dimensions.

15 Both senders and receivers participate in core cultural beliefs and
16 values through the sending and receiving of greeting cards. Changing—or
17 enduring—relationships among families and friends are made visible in the
18 display of cards; the selection and receipt of cards is laden with emotional
19 and cultural baggage. Unlike gifts of a more general kind, greeting cards are
20 intended to carry and transmit highly specific meanings—meanings linked to
21 individual, family, and group experience, meanings represented in culturally
22 patterned ways of expressing ideas through graphic art and through text.
23 Any action that the Postal Service takes that reduces American ability to
24 engage in greeting card exchange will have a negative impact on individual
25 and group participation in the production, reproduction, and reshaping of
26 these cultural forms of interpersonal and intergroup expression. Fewer cards

⁴⁴ Fingerma, *ibid.*

1 to send or receive means fewer moments of participation in shared feelings,
2 felt togetherness, and felt belonging. Any such reduction in greeting card use
3 would measurably lessen the feeling of community that may be at the very
4 heart of our collective sense of national belonging.

5 **B. GREETING CARDS BIND THE NATION TOGETHER: AS PART OF THE**
6 **MAILSTREAM, GREETING CARDS LINK FAMILY AND FRIENDS IN SHARED**
7 **CULTURAL MEANINGS THAT REFLECT AND EVEN SHAPE AMERICAN**
8 **CULTURE.**

9 Historically, the national post has been viewed as a force to bind the
10 nation together: this is among the concerns that should arise in considering
11 postal rate increases. The importance of greeting cards for binding the nation
12 together can be seen in the survey research, in the ethnographic research
13 among card shoppers, and through well-established anthropological
14 understandings of the nature and meaning of interpersonal and intergroup
15 exchange. Humor is perhaps the most obvious example.

16 Humor is not comprehensible as humor without a shared
17 understanding of cultural context. The "point" of a joke is set in cultural
18 expectations about beliefs, behavior, and tradition. The survey has
19 demonstrated that greeting cards help people "share a good laugh." When
20 greeting cards act in relationships in a humorous way, they signal shared
21 expectations, shared values, and common perceptions about the trajectory of
22 American culture. The fact that Americans "get the joke" when a mass-
23 produced product reaches them demonstrates the shared experience in
24 which Americans participate as members of American linguistic and cultural
25 groups.

1 Humorous greeting cards—inscribed physically with an address on the
2 outside and a signature or note on the inside, and inscribed culturally with
3 shared understandings about the topic of the humorous card—bind the nation
4 together by reproducing the cultural patterns that underlie humor. Anyone
5 who has ever experienced an American workplace has shared the joke with a
6 card recipient in a neighboring work-space; anyone who has ever read the
7 funny papers (or heard them read as a child) has participated in the
8 recognition of shared cultural meanings through shared, audible laughter.

9 Aside from the core cultural meanings encoded in humor, greeting
10 cards bind the nation together in the public display of artistic and textual
11 messages about key life events: birth, death, illness, and seasonal
12 celebrations. We all see greeting cards in our friends' homes, on their
13 refrigerators, or even cut up into ornaments and displayed. The extent to
14 which these cultural practices are evident in American daily life reflects the
15 cultural importance of greeting cards. The continued presence of greeting
16 cards in American culture despite the availability of the telephone (and, to a
17 lesser extent, computer e-mail) indicates that their role extends far beyond
18 simple one-to-one communication. Greeting cards are American ritual
19 objects, connected as all such objects are to the culture in which they
20 continue to evolve. Any disconnect between Americans and greeting cards
21 would fray part of the fabric that binds the national community—our imagined
22 community—together.

23 **C. THE CULTURAL VALUE OF GREETING CARDS: GREETING CARDS ARE**

24 **INTIMATELY LINKED WITH AMERICAN EXPRESSIONS OF RELATIONSHIPS**

25 When Americans were asked in the survey about what greeting cards
26 do for them, they responded that greeting cards are especially important in

1 times of illness and mourning. The next highest level of agreement was
2 about "sharing a good laugh" through a greeting card that comes in the mail.
3 Laughter is part of languaculture; the findings about humor point to the
4 importance of greeting cards in the public display and reproduction of the
5 cultural patterns that engender humor—deep patterns that are linked to in-
6 group status and to American notions of well-being.

7 We discovered interesting ethnic and income differences in the survey
8 responses. African-Americans seem to attach more importance to most
9 greeting cards at all levels than do other groups. Greeting cards sent through
10 the mail are especially important to the low and middle-income groups in the
11 sample. These data point to potential differential effects of postal rates
12 regarding the importance of greeting cards. Greeting cards are more
13 culturally salient, more important in their connection to languaculture, cultural
14 values, and world view among lower and moderate-income persons. They
15 would be affected more by increases in postal rates than their position on the
16 economic scale suggests because they place greater cultural value on
17 greeting cards.

18 Greeting cards are significant elements in American material and
19 symbolic culture. Postal ratemaking policy making that aims to consider the
20 impact of first-class rate increases upon American culture should recognize
21 the ways in which greeting cards connect with cultural values, languaculture,
22 and world view. Such consideration also must take into account the ways in
23 which American ethnic groups and income groups show variation in the
24 cultural significance of greeting cards. Greeting cards, while deeply
25 embedded in expectations surrounding key life events and ceremonies for all
26 Americans, appear to be even more culturally salient for African-Americans
27 and for low and middle-income Americans. Changes in postal rates that

1 affect the mailing of greeting cards may therefore impact lower and middle-
2 income persons and African-Americans more than the population as a whole.

3 For several categories of cultural significance—illness, mourning,
4 sharing a good laugh, and celebrating Mother's Day—Americans of all kinds
5 share a high level of cultural involvement with greeting cards. Indeed, an
6 important material and symbolic means of displaying and reproducing
7 American cultural values, languaculture, and world view is potentially affected
8 by any Commission action that would impact sending greeting cards through
9 the mail.

Exh. GCA-1
Curriculum Vitae

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Education

Ph.D. Anthropology, University of Kansas, 1995.
 M.A. Anthropology, University of Wyoming, 1984.
 B.A. Anthropology, *cum laude*, Washington State University, 1976.

Professional Experience

Research Associate Professor, University of Missouri—Kansas City. 1996 to Present.
 Senior Research Associate, LTG Associates, Turlock, CA and Tacoma Park, MD. 1992 to present.
 Senior Research Associate, Research and Training Associates, Overland Park, KS. 1995.
 Program Coordinator, Kansas Department of Education. 1994 to 1995.
 Education Program Consultant, Kansas Department of Education. 1990 to 1994.
 Social Services Administrator, Kansas SRS. 1983 to 1990.
 Broadcaster; Program Director, Station Manager, WDLW, KBUF, KANZ. 1980 to 1983.
 Graduate Research Fellow, Anthropology. Brandeis University. 1980.

Selected Publications

1998 (in preparation) Talking About Meat: How Immigrant Meat Packers and Supervisors Communicate. Paper presented at the session on Changing Ecologies of Technical Work Practice and the Ethnographic Stance at The International Congress of Anthropological and Ethnological Sciences, College of William and Mary, Williamsburg, VA (July).

1998 (in preparation) Teamwork and Collaboration. Paper presented at the session on Doing Team Ethnography at the Annual Meeting of the Society for Applied Anthropology, San Juan, Puerto Rico (April).

1998 (in preparation) "I Just Put My Boyfriend In the Trunk": Performing Gender in High Plains Packinghouse Towns. Paper presented at the session on Garden City: Ten Year Retrospective at the Central States Anthropological Association Meetings, Kansas City, MO (April).

1998 (in preparation) Making Meat in Three Cultures: Industrial Slaughter on the US High Plains. In *Dead or Alive: Animal Captives of Human Cultures*. Bill Jordan, Editor. Princeton, NJ: Shelby Cullom Davis Center and Princeton University Press.

1997 (with Don Stull) *Doing Team Ethnography: Warnings and Advice*. Beverly Hills, CA: Sage.

1996 *Muscle and Meat: Rewriting a Story of Progress*. In *The Story of Progress*. Gösta Arvastson, Ed. Studia Upsalensis No. 17. Uppsala, Sweden: Acta Universitatis Upsalensis

1996 (with Don. Stull) *Management and Multiculturalism*. *Meat&Poultry*; 42(4):44-50.

1994 *Guys in White Hats: Short-Term Participant Observation Among Workers and Managers*. In *Newcomers in the Workplace: Immigration and the Restructuring of the US Economy*. L. Lamphere, Ed., Pp. 78-98. Philadelphia: Temple University Press.

1994 *The Anthropologist as Radio Producer*. In *Media Anthropology*. S. Allen, Ed., Pp. 145-160. New York: Avondale.

1993 (with D. Stull and M. Broadway) *The Price of a Good Steak*. In *Structuring Diversity: Ethnographic Perspectives on the New Immigration*. Louise Lamphere, Ed., Pp. 35-64. Chicago: University of Chicago Press.

1990 (with Stull, Donald D., J. Benson, M. Broadway, M. Grey and A. Campa) *Changing Relations: Newcomers and Established Residents in Garden City, KS*. Final report to the Ford Foundation. Lawrence, KS: Institute for Public Policy and Business Research. Report No. 172.

1990 New Immigrants and the Social Service Agency: Changing Relations at SRS. *Urban Anthropology* 19(4):387-407.

Selected Unpublished Papers And Presentations

Crossing Ritual Borders: Cultural Change in Celebrations and Gift Giving. Presentation for Hallmark continuing education program. 1997.

That Mom/Mother Thing: Invited lecture; Hallmark Creative Advisory Group. 1997.

Making Meat Among Mexican, Southeast Asians, and Anglos: Industrial Slaughter On the High Plains. Invited paper presented to the Shelby Cullom Davis Center for Historical Studies, Princeton University, Princeton, NJ. 1997

Culture Against Knowledge: Power at the Center Applied at the Margins. Paper presented at the annual meetings of the Society for Applied Anthropology, Baltimore, MD. 1995.

Literature Review: Bi/multilingual Service Delivery in Community and Migrant Health Clinics. Paper prepared for the US Department of Health and Human Services and LTG Associates. 1995.

Language, Culture, and Disability. Keynote address. Midwest Association for Behavior Disorders. Kansas City, MO. 1994.

Lao Classroom Discourse: Audio from Kansas, Video from Thailand. Paper presented at the Illinois Statewide Conference for Teachers of Linguistically and Culturally Diverse Students, Chicago, IL 1994.

What Social Workers Don't Know can be Fatal: Appropriate Cross-cultural Human Services Delivery to New Immigrants in Kansas. Invited Workshop. Governor's Conference on Human Services, Topeka, KS. 1993.

Native Language and Literacy: What is Reading? Southwest Regional Adult Educator's Conference, Dodge City, KS. 1992.

Language and Cultural Diversity. Topeka USD 500. Topeka, KS. 1992.

Language Proficiencies

- Spanish; fluent speaking, reading, and writing
- Vietnamese; good speaking, some reading and writing
- Swedish; some speaking, reading, and writing
- French; fair speaking and reading
- Lao; some speaking
- Wind River Shoshone, Tetela (West African Bantu); some linguistic ethnography.

Selected Recent Grants and Consulting

Uinta County Futures Assessment. Uinta County, Wyoming Planning Group. 1998.

Hallmark Business Research Mother's Day Project. Hallmark Cards, Inc. 1997.

Assessment of HIV Risk Among Mexican Immigrant Men in Southwest Kansas. Kansas Department of Health and Environment, Winter 1998.

Enhancing the Capacity of SAVE, Inc. [HIV+/PLWA Housing in Kansas City, MO] Spring and Summer, 1997.

Public Housing Resident's Council Project. Economic Development needs assessment and technical assistance. 1996-1997.

1996 Single Women's Strengths: Life Histories of Lincoln Garden's Residents. UMKC Faculty Research Grant. (With Professor Kristin Esterberg; Fall, 1996.

Anti-Gang Project Evaluation. (With Professors Max Skidmore and Doug Perez; Fall 1996 and Winter, 1997)

University Courses Taught

Undergraduate Sociological Research Methods.

Graduate Sociological Research: Qualitative Methods

Talk Like an American: Sociolinguistics and American Speech.

Cultural Issues in Schooling.

Introduction to Linguistics.

Second Language Acquisition for Teachers.

Professional Memberships

Fellow, American Anthropological Association.

Treasurer, National Association for the Practice of Anthropology.

Member, Society for Applied Anthropology

Member, Society for Linguistic Anthropology

Member, Council on Anthropology and Education

Exh. GCA-2
Text of National Survey

Age	Quota Group			Age			Gender		Income			Ethnicity			
	GENRL	AFRGN	HISPN	18-35	35-54	55+	MALE	FE	<\$20K	\$20K-\$40K	>\$40K	WHITE	AMER.	LATN	OTHER
	Total	POP/N	AMER.	LATIN											
	400	320	40	40	113	165	122	151	249	88	109	142	256	81	25
	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%
Under 18	---	---	---	---	---	---	---	---	---	---	---	---	---	---	---
18 to 24	41	31	5	5	41		22	19	16	11	11	23	6	8	4
	10%	10%	13%	13%	36%		15%	8%	18%	10%	8%	9%	7%	32%	11%
25 to 34	72	57	6	9	72		28	44	9	20	29	49	14	4	5
	18%	18%	15%	23%	64%		19%	18%	10%	18%	20%	19%	17%	16%	13%
35 to 44	97	75	9	13	97		33	64	17	20	47	58	21	9	9
	24%	23%	23%	33%	59%		22%	26%	19%	18%	33%	23%	26%	36%	24%
45 to 54	68	57	9	2	68		23	45	11	20	27	37	18	3	10
	17%	18%	23%	5%	41%		15%	18%	13%	18%	19%	14%	22%	12%	26%
55 to 64	48	39	6	3	48		21	27	13	14	13	33	11	1	3
	12%	12%	15%	8%	39%		14%	11%	15%	13%	9%	13%	14%	4%	8%
65 and Older	74	61	5	8	74		24	50	22	24	15	560	11		7
	19%	19%	13%	20%	61%		16%	20%	25%	22%	11%	219%	14%		18%
Refused	---	---	---	---	---		---	---	---	---	---	---	---	---	---

Ethnicity	Quota Group				Age			Gender			Income				Ethnicity			
	GENR	AFRCN	HISPN/	LATIN	18-35	35-54	55+	FE	MALE	<\$20K	\$20K- \$40K	>\$40K	WHITE	AFRCN	HISPN/	LATIN	OTHER	
Total	400	320	40	40	113	165	122	151	249	109	81	142	256	81	25	10	10	
	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	
Euro-American	256	233	1	22	72	95	89	100	156	54	65	99	256	81	25	10	10	
	64%	73%	3%	55%	64%	58%	73%	66%	63%	50%	80%	70%	100%	100%	100%	100%	100%	
African-American	81	36	36	9	20	39	22	28	53	23	28	22	81	25	10	10	10	
	20%	11%	90%	23%	18%	24%	18%	19%	21%	21%	35%	15%	100%	26%	21%	8	8	
Hispanic/Latino	25	19	1	5	12	12	1	11	14	6	8	10	25	10	10	10	10	
	6%	6%	3%	13%	11%	7%	1%	7%	6%	6%	10%	7%	100%	10	10	10	10	
Native American	10	10	10	2	4	4	4	6	4	2	1	3	10	10	10	10	10	
	3%	3%	0%	0%	2%	2%	2%	4%	2%	2%	1%	2%	26%	10	10	10	10	
Asian-American	8	7	1	1	6	6	1	2	6	2	1	4	8	10	10	10	10	
	2%	2%	3%	1%	4%	4%	1%	1%	2%	2%	1%	3%	21%	10	10	10	10	
Other	10	6	2	2	4	6	1	1	9	5	3	3	10	10	10	10	10	
	3%	2%	5%	5%	4%	4%	1%	1%	4%	6%	2%	3	10	10	10	10	10	
Refused	10	9	1	1	2	3	5	3	7	1	1	1	10	10	10	10	10	
	3%	3%	3%	3%	2%	2%	4%	2%	3%	1%	1%	1%	40%	10	10	10	10	

Household Income	Quota Group				Age				Gender				Income				Ethnicity			
	GENL	AFRCN	HISPNV	LATIN	18-35	35-54	55+	MALE	MALE	FE	<\$20K	\$20K-\$40K	>\$40K	WHITE	AMER.	LATN	HISPNV	OTHER		
Total	400	320	40	40	113	165	122	151	249	109	81	142	256	81	25	38	100%	100%		
Under \$20 Thousand	88	66	17	8	25	28	35	25	63	88			54	23	6	5	22%	13%		
Under \$30 Thousand	54	45	3	6	14	16	24	19	35	54			30	17	3	4	14%	11%		
Under \$40 Thousand	55	42	6	7	17	24	14	14	4	55			35	11	5	4	13%	11%		
Under \$50 Thousand	41	29	5	7	17	17	7	21	20	41			29	6	5	1	10%	3%		
Under \$60 Thousand	28	22	4	2	8	12	8	12	16	28			19	4	2	3	7%	8%		
Under \$70 Thousand	17	13	2	2	3	11	3	7	10	17			11	5	1		4%			
\$70,000 or More	56	49	3	4	12	34	10	29	274	56			40	7	2	7	14%	18%		
Refused	61	54	3	4	17	23	21	24	37				38	8	1	14	15%	37%		

Cultural Significance of Greeting Cards Survey October, 1997

National Sample (320)
Hispanic / Latino Areas (40)
African-American Areas (40)

Hello, this is _____ from Elrick & Lavidge, a national opinion firm. Today/tonight we are conducting a brief survey and we'd like to include the opinions of someone in your household. I assure you, we are not selling anything and are only interested in your opinions. Your input will be strictly confidential and very valuable in these efforts. The survey will take only five minutes.

1. In which of the following categories does your age fall? [READ]
 - 1 Under 18 [THANK AND TERMINATE]
 - 2 18 to 24
 - 3 25 to 34
 - 4 35 to 44
 - 5 45 to 54
 - 6 55 to 64
 - 7 65 and older
 - 8 [DO NOT READ] Refused [THANK AND TERMINATE]

2. I am going to read you some statements that can be used to describe your attitudes about greeting cards. Using a scale where 5 means "strongly agree" and 1 means "strongly disagree," please tell me how much you agree or disagree with each statement. You may use any number between 1 and 5. [ROTATE]

	Strongly Agree			Strongly Disagree		DK/R
Greeting cards that come in the mail help me celebrate holidays and special occasions.	5	4	3	2	1	0
Greeting cards that come in the mail help me to hear things that others might be reluctant to say to me in person.	5	4	3	2	1	0
Greeting cards that come in the mail help me know that others are thinking of me in a time of sickness.	5	4	3	2	1	0
Greeting cards that come in the mail help me know that others are thinking of me in a time of mourning.	5	4	3	2	1	0
Greeting cards that come in the mail help me appreciate artwork and photography.	5	4	3	2	1	0

	Strongly Agree			Strongly Disagree		DK/R
Greeting cards that come in the mail let me know that others are praying for me.	5	4	3	2	1	0
Greeting cards that come in the mail help me maintain family traditions.	5	4	3	2	1	0
Greeting cards that come in the mail help me share a good laugh with others I show the card to.	5	4	3	2	1	0
Greeting cards that come in the mail help me celebrate religious holidays and traditions.	5	4	3	2	1	0
Greeting cards that come in the mail help me participate in and know the changing of the seasons through the year.	5	4	3	2	1	0
When my mother receives a mother's day card in the mail, she puts it on display for others to see.	5	4	3	2	1	0
When I receive a Valentine's Day card in the mail, I put it on display for others to see.	5	4	3	2	1	0
When I receive a birthday card in the mail, I put it on display for others to see.	5	4	3	2	1	0

3. The last few questions are for classification purposes only. Please stop me when I read the category that contains your total household income before taxes.

[READ]

- 1 Under \$20 thousand
- 2 Under \$30 thousand
- 3 Under \$40 thousand
- 4 Under \$50 thousand
- 5 Under \$60 thousand
- 6 Under \$70 thousand
- 7 Or \$70 thousand or more
- 8 [DO NOT READ] Refused

4. Are you? [READ]

- 1 White or Caucasian
- 2 African-American
- 3 Asian-American
- 4 Hispanic or Latino
- 5 Native American
- 6 Or, Another Race
- 7 [DO NOT READ] Refused

5. [PLEASE RECORD GENDER OF RESPONDENT. DO NOT READ.]

- 1 Male
- 2 Female

Thank you for participating in our survey. Your opinions count.

1 CHAIRMAN GLEIMAN: Mr. Erickson, have you had an
2 opportunity to examine the packet of designated written
3 cross-examination that was made available to you earlier
4 today?

5 THE WITNESS: Yes, sir.

6 CHAIRMAN GLEIMAN: Those are the responses you
7 previously provided in writing.

8 THE WITNESS: Yes, I have.

9 CHAIRMAN GLEIMAN: And if those questions were
10 asked of you today, would your answers be the same as those
11 you previously provided?

12 THE WITNESS: They would be the same.

13 CHAIRMAN GLEIMAN: That being the case, I'm going
14 to provide two copies of the designated written
15 cross-examination of Witness Erickson to the reporter and
16 direct that it be accepted into evidence and transcribed
17 into the record at this point.

18 [Designation of Written
19 Cross-Examination of Kenneth C.
20 Erickson, GCA-T-1, was received
21 into evidence and transcribed into
22 the record.]

23
24
25

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 1997

Docket No. R97-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF GREETING CARD ASSOCIATION
WITNESS KEN C. ERICKSON
(GCA-T1)

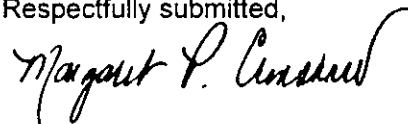
Party

United States Postal Service

Interrogatories

USPS/GCA-T1-1-3, 5, 7-14

Respectfully submitted,



Margaret P. Crenshaw
Secretary

**RESPONSE OF GREETING CARD ASSOCIATION
WITNESS KEN C. ERICKSON
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

USPS/GCA-T1-1 Please identify the portions of the Postal Reorganization Act pursuant to which the Commission can or should consider your testimony.

As a non-lawyer, I believe my testimony relates to Sec. 101(a) which directs the Commission to consider the importance of the mail to binding the nation together and language in Sec. 3622(b) that directs the Commission to consider the educational, cultural, and scientific importance of the mail. My testimony is particularly directed toward the cultural significance of greeting cards as a component of first-class mail. I also believe my testimony relates to Sec. 403 which directs the Postal Service to provide adequate and efficient postal services at fair and reasonable rates, and to provide types of mail service to meet the needs of different categories of mail and mail users.

**RESPONSE OF GREETING CARD ASSOCIATION
WITNESS KEN C. ERICKSON
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

USPS/GCA-T1-2 Starting at page v of your testimony, you discuss a national telephone survey. Is this survey subject to the foundational requirements in the Rules of Practice, e.g., Rule 31(k)?

- a. If not, why not?*
- b. If so, where is that foundational or other material? If it has not been filed, please provide it.*

The survey which supports portions of my testimony appears to me, as a non-lawyer, to be subject to the rules governing "other sample surveys." The requirements of Sec. 31 (k)(2)(ii) are listed below and I indicate either where the material may be found or provide clarification to address the section:

Sec. 31 (k)(2)(ii)(a): "A clear description of the survey design, including a definition of the universe under study, the sampling frame and units, and the validity and confidence limits that can be placed on major estimates."

A clear description of the survey design is found on pages 24 - 29.

The universe under study is Americans who receive greeting cards (see page 25).

The sampling frame is described beginning at section VA on page 25 through section VB on page 28.

The sampling units are individual households defined operationally by the presence of a telephone listing for the household.

**RESPONSE OF GREETING CARD ASSOCIATION
WITNESS KEN C. ERICKSON
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

Validity is a function of how questions are asked and depends upon the substantive significance posited for responses. These topics are discussed in the construction of the sample on page 26, line 10 through page 27, line 15. Validity is also discussed throughout section VD. The statistical confidence limits that can be placed on estimates are described in footnote 37 on page 26.

Sec. 31 (k)(2)(ii)(b): "An explanation of the method of selecting the sample and the characteristics measured or counted."

The method for selecting the sample is described in sections VA on page 25 through page 27 and in footnote 38 on page 27. The characteristics measured or counted are the respondent's agreement or disagreement with statements about the importance of greeting cards found on page 28 in section VC and listed on page 29. The entire text of the telephone survey is found in Exh. GCA-2, pages 4 - 6.

Sec 31(k)(2) requires "a comprehensive description of the assumptions made, the study plan utilized, and the procedures undertaken."

Section VA through VD contains the study plan and results, and also details the analytic procedures followed in making sense of the survey data.

The general assumptions made in the survey research were those generally made in sample survey research and shared by cultural anthropologists. These are foundational assumptions regarding human subjects' ability to understand the questions and answer honestly, and the likelihood that the survey research firm will faithfully execute the survey and tabulate the data. The assumption about question intelligibility was checked through careful review of the survey questions by me in consultation with Dr. Terrie Catlet of Elrick and

**RESPONSE OF GREETING CARD ASSOCIATION
WITNESS KEN C. ERICKSON
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

Lavidge. Dr. Catlet holds a doctorate in political science and is experienced in telephone survey research and statistical data analysis. The survey also assumed that there would not be significant biases from not surveying persons without telephones. That number of persons without phones is small enough to state that their exclusion did not materially effect the conclusions drawn from the survey.

**RESPONSE OF GREETING CARD ASSOCIATION
WITNESS KEN C. ERICKSON
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

USPS/GCA-T1-3 At page v, you indicate that the focus of the survey was limited to greeting cards sent through the mail.

- a. Why was this limitation imposed?*
- b. Of total greeting card volume, what portion goes through the mail?*
- c. Is there any reason to believe that cards sent through the mail have materially different cultural value from those exchanged by other means? Please comment on the respective cultural similarities and differences between the two groups of cards.*
- d. Are there any other means of exchanging messages that carry the cultural signals you identify with greeting cards? Please identify each and the extent to which each can serve as a substitute for greeting cards.*

(a) As the testimony is for a postal rate hearing, I felt it appropriate to limit the focus of the survey to greeting cards sent through the mail.

(b) According to information provided to me by Ms. Marianne McDermott of the Greeting Card Association, about two-thirds of all United States greeting cards are sent through the mail. An estimate of the number sent through the mail may be calculated from data that follows section IV, page 20, Vol. I of the 1996 USPS Household Diary Study.

(c) There is good reason to believe that cards sent through the mail have materially different cultural value from those exchanged by other means. Greeting cards that come in the mail are not generally accompanied by the person from whom they are sent. The sender is not present to interpret the card, to discuss the card with the recipient, or to evaluate the response of the recipient to the card. Greeting cards sent through the mail rely on their iconic content, along with any sender-written message, to convey meaning. Greeting cards

**RESPONSE OF GREETING CARD ASSOCIATION
WITNESS KEN C. ERICKSON
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

handed in person by the sender to the recipient do not have those limitations but hand delivery is limited by time and distance. Greeting cards sent through the mail are not limited by time and distance in the same way. They can go to a number of geographically dispersed recipients, and a large number can be sent simultaneously (unlike telephone calls).

(d). There are no other means of exchanging messages that carry the signals I identify with greeting cards.

Greeting cards signal their message both by their material features (art, words, paper) and by the cultural context (when and how) in which they are transmitted. The cultural context surrounding a greeting card that comes in the mail is not the same as the context surrounding a card that is delivered in person. Nor is the context surrounding other cultural performances or artifacts quite the same as the context surrounding greeting cards that come in the mail. The only item in the present-day mailstream that seems a potential candidate to take the place of greeting cards is the personal letter. It can embody past, present, and future states of a relationship. It may be set in a social context and displayed for others to see, enjoy, and comment on--and interpreted and reinterpreted according to the cultural and contextual background in which the letter is sent. Like a greeting card, it has a material existence apart from the performance that generates it and thus can transcend time.

On the other hand, a personal letter does not usually contain artwork. My mother-in-law, a former elementary school teacher of no small linguistic ability, pointed out recently that greeting cards are good "when you just don't have the right words." A greeting card can provide the "right words" when a letter writer cannot.

**RESPONSE OF GREETING CARD ASSOCIATION
WITNESS KEN C. ERICKSON
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

USPS/GCA-T1-5 On page 3 of your testimony, you introduce a paragraph with, "When a nation's mail system begins to be used for other than official or governmental messages. . ." Do you believe that domestic mail service in the United States was ever intended primarily or exclusively for use with official or governmental messages? If so, when did this change? If not, what is the significance of this statement?

I do not believe that domestic mail service in the United States was ever intended primarily or exclusively for use with official or governmental messages, but I believe that the development of institutionalized long-distance communication generally has its origins in governmentally-controlled, official communication rather than in communication among individuals and households. The imperial Inca's use of *quipu* and relay-runners are an early example of long-distance communication for government and official purposes. The significance of my statement was to suggest that interpersonal and inter-household communication is now a significant share of the mailstream where it seems not to have been so in early complex societies; the development and rapid growth in Christmas greeting cards in the British mail's penny post in the last century bears witness to this.

RESPONSE OF GREETING CARD ASSOCIATION
WITNESS KEN C. ERICKSON
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE

USPS/GCA-T1-7 Are you asserting in the discussion starting on page 10 that cultural value has no economic value? Why or why not? Please explain fully.

I am asserting that cultural and economic value may be distinguished. On page 10 at lines 5 - 7 I state that cultural value "does not replace the view of value in classical economics, the view that surrounds notions of *homo economicus*." *Not everything with cultural value has economic value. A Kansas sunset may have great cultural value but it may not, strictly speaking, be bought or sold.*

**RESPONSE OF GREETING CARD ASSOCIATION
WITNESS KEN C. ERICKSON
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

USPS/GCA-T1-8 Prior to the development of your testimony, had you done any work in your professional capacity that involved the greeting card industry? If so, please provide the dates and describe the substance of that work.

Prior to the development of this testimony, I conducted three projects involving the greeting card industry. These were the only projects I have ever undertaken for the greeting card industry. The first two projects are listed in my curriculum vita (Exh. GCA-1, page 3). They were both presentations at Hallmark Cards, Incorporated, in preparation for which I spent about three days compiling research and preparing a lecture. The first, "Crossing Ritual Borders," was presented in August of 1996. That presentation was about cultural identity and shifts in meaning of gifts across and within national cultures. The second, "That Mom/Mother Thing" was presented in November of 1996. That presentation dealt with sociolinguistic conventions surrounding terms of reference and address in American kinship.

The third project, reported in section IV of my testimony, was the ethnographic research among greeting card shoppers. It was conducted in April of 1997. The focus of the study was to explore the "fit" between card shopper needs and the card purchased by the shopper.

**RESPONSE OF GREETING CARD ASSOCIATION
WITNESS KEN C. ERICKSON
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

USPS/GCA-T1-9 Please identify the "researchers from Hallmark Cards, Inc." (page 14 lines 17-18) by position, and describe their qualifications and respective roles.

The two researchers were William Strickler, MBA, who is Business Research Manager for Emerging Opportunities. He has held that position at Hallmark Cards, Inc. since October 1, 1995. The other researcher was Lori Givan, MBA, who is a project leader for the Emerging Opportunities Team at Hallmark Cards, Inc.; she has held that position since November of 1995.

These two persons acted as collaborative researchers using the model documented in Donald D. Stull and Jean J. Schensule's *Collaborative Research* (Boulder, Colorado: Westview Press, 1987). Mr. Strickler and Ms. Givan were not the lead researchers, but their contacts in their field provided entry to a card shop for my research. In some instances, they worked with me as camera operators as I conducted my participant observation. They helped insure that the research process and analytic products were interpretable to their internal clients. Putting research clients to work as co-researchers is standard practice in applied anthropology, where the goal is to produce results that are both scientifically trustworthy and meaningful to the persons with whom the anthropologist is working (see *Doing Team Ethnography: Warnings and Advice* by Ken C. Erickson and Donald D. Stull, Sage Publications, 1997).

**RESPONSE OF GREETING CARD ASSOCIATION
WITNESS KEN C. ERICKSON
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

USPS/GCA-T1-10 Please provide copies of all documentation furnished by or on behalf of Hallmark Cards, Inc. that in any way informed your research.

A copy of the summary version of the USPS Household Diary study is provided. That was the only document furnished me by or on behalf of Hallmark Cards, Inc. that in any way informed my research or the preparation of my testimony.

**RESPONSE OF GREETING CARD ASSOCIATION
WITNESS KEN C. ERICKSON
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

USPS/GCA-T1-11 Are any constituents of the mail stream in addition to greeting cards "part of American cultural rituals" (page 20 line 8)? If so, what are they? If not, why not? Please explain fully.

In a sense, all the contents of the day's mail are part of the daily American cultural ritual involving the receipt of the mail.

Some elements within the days mail are more dense with cultural significance than are others. Some have significance for different cultural arenas. Bills and advertisements are about economic transactions. Personal letters and greeting cards may include messages about economic transactions, and they may, of course, be full of economic significance, but they always carry cultural significance. Personal letters are part of American cultural rituals, though perhaps to a lesser extent than greeting cards because they do not seem to appear in the mailstream as often as greeting cards do (see the Postal Service's Household Diary Study of 1996).

For example, the arrival of garden-seed catalogues in February signals the coming end of winter, but they arrive because of the possibility of an economic transaction, not because the seed companies want to ritually mark the coming of Spring. Personal letters and greeting cards may mark cultural rituals and/or individual sentiment; they facilitate the reproduction of cultural norms through shared meanings and icons, and they derive their meanings from sources that include a potentially limitless array of significance. Pieces of mail that solicit or respond to economic exchange can not shed their pecuniary significance. Greeting cards and letters, if they have pecuniary significance, can shed it. Catalogues, bills, advertisements, and even magazines are either seeking the recipient's money or arrive because the recipient has requested or paid for them—not so for greeting cards and letters.

**RESPONSE OF GREETING CARD ASSOCIATION
WITNESS KEN C. ERICKSON
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

USPS/GCA-T1-12 In connection with the introduction to your national survey (pages 24-25), you indicate that you selected survey topics of inquiry that were "likely" affected by greeting cards.

- a. Of those that were selected, were they all seen as equally likely, or were some posited as more or less likely to be affected?*
- b. What topics of inquiry were considered and rejected, and why?*

Not all were seen as equally likely. Some, topics, like the questions about appreciating art and photography (on page 29 lines 9-10) and knowing the changing of the seasons (page 29 lines 19-20), were considered less likely.

I considered all the topics included in the Outline of Cultural Materials (OCM) and in the Table of Contents of Notes and Queries in Anthropology (cited in my testimony on page 24, line 22 and page 25, line 1; see also the citation on page 25, footnote 35). Those rejected were determined not to be part of greeting cards' cultural significance based on my own cultural competence. All the topics in the OCM or in the Table of Contents in Notes and Queries that did not appear in the survey were rejected because I felt that they did not connect to the cultural significance of greeting cards.

**RESPONSE OF GREETING CARD ASSOCIATION
WITNESS KEN C. ERICKSON
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

USPS/GCA-T1-13 Please identify an authoritative citation for "theoretical sampling" (page 26, line 18) and briefly describe your understanding of its goals and methods.

B. Glaser and A. Strauss, the authors of The Discovery of Grounded Theory (Chicago: Aldine, 1976) are generally regarded as the developers of theoretical sampling. Theoretical sampling argues that sample development may follow theoretical rather than strict statistical criteria. The goal of theoretical sampling is to locate strategic data that can reinforce or refute research hypotheses. An adequate sample may, under theoretical sampling, be reached with a lower number of cases (a smaller *n*) depending on the topic of study than could be achieved in a statistically derived sample. Such a sample may be said to have substantive rather than statistical significance as long as the reasons for the sample can be clearly explicated.

**RESPONSE OF GREETING CARD ASSOCIATION
WITNESS KEN C. ERICKSON
TO INTERROGATORIES OF THE UNITED STATES POSTAL SERVICE**

USPS/GCA-T1-14 Why is an address on the outside of a greeting card (page 41, line 1) necessary to its cultural value?

An address is necessary for a greeting card to be sent through the mail and cards sent through the mail are the subject of my testimony. The return address also informs the recipient of the greeting card's source (as may the handwriting or typewriting on the address itself).

1 CHAIRMAN GLEIMAN: Does any participant have
2 additional written cross-examination for the witness?

3 If not, then we'll move on to oral
4 cross-examination. Only the Postal Service has requested
5 cross-examination of this witness. Does any other party
6 wish to cross-examination the witness?

7 If not, Mr. Hollies, you can proceed when you're
8 ready.

9 CROSS-EXAMINATION

10 BY MR. HOLLIES:

11 Q Good morning, Mr. Erickson.

12 A Good morning. Your name is Mr. --

13 Q Hollies.

14 A Hollies. Sorry, thank you.

15 Q I was about to get to that. I am Ken Hollies,
16 representing the Postal Service, and I have a few questions
17 for you. This will be relatively simple and quick.

18 Several of your interrogatory answers are prefaced
19 with the qualification "as a nonlawyer" or words to that
20 effect. I can appreciate that you wish to leave to lawyers
21 the job of legal analysis and argument. However, do you
22 have legal counsel in this proceeding?

23 A Yes, I do.

24 Q Is that person a lawyer?

25 A Yes.

1 Q So you do have access to a lawyer.

2 A Yes, I do.

3 Q And did you take advantage of that access when
4 preparing your answers to the interrogatories?

5 A Yes.

6 Q On page 9, line 8 of your testimony you use the
7 term "prewar." To what war does this pertain?

8 A I was thinking of World War II in that instance.

9 Q In footnote 14 of your testimony, found on page 9,
10 you cite two sources for the proposition that, quote, today
11 anthropological attention to national culture can be found
12 in discussions of cultural values of "languaculture," end
13 quote.

14 Do they each -- do the two sources each support
15 both of the assertions in that statement, or does one --
16 does each source represent just one-half of the proposition
17 that it's cited for?

18 A The quotation is discussions of cultural values or
19 languaculture, and you're referring to the footnote?

20 Q Yes.

21 A And you're asking if both of them deal with both
22 cultural values and languaculture?

23 Q Exactly.

24 A The second reference to Michael Agar refers to his
25 book, "Languaculture," and Michael Agar's the anthropologist

1 who's coined that term. The first book discusses cultural
2 values.

3 Q Thank you. At page 1 of your testimony and again
4 this morning you identify yourself as a research associate
5 professor. Is this a tenure-track position?

6 A No, it is not a tenure-track position.

7 Q If you would turn for a moment to page 13, lines
8 17 and 18.

9 There you state, quote, material things become
10 cultural things when they are used by people for cultural
11 purposes, unquote.

12 Can you give me any examples of things that are
13 not used or have yet to be used for cultural purposes?

14 A Yes, I suppose I can.

15 Q And that would be?

16 A Oh, there would be items that human beings have
17 not yet interacted with that would be things that have not
18 been used by people for cultural purposes.

19 Q Could you give me an example?

20 A Well, the moment I would do so of course I would
21 be referring to it and it would suddenly ^{come} ~~become~~ into use as
22 something that we are referring to as something that is of
23 cultural --

24 Q I believe that's my point. Isn't your statement
25 tautological?

1 A No, I don't believe the statement is tautological.

2 Q Yet can you give me an example -- a
3 counterexample?

4 A I believe that I can. I think it's rather like
5 asserting that air is everywhere or saying that, you know,
6 by defining that something is a cultural thing, one asserts
7 that there are things in the world with which human beings
8 interact, and that's essentially the meaning of the
9 statement I was making there.

10 Q Moving on to page 15, lines 6 through 14 of your
11 testimony --

12 A I'm sorry, page?

13 Q Fifteen, lines 6 to 14. You identify three
14 preliminary insights that greeting cards in their selection
15 and use have a cultural life of their own that is linked to
16 American cultural values. The second is that greeting cards
17 play a role in the celebration of American family rituals.
18 And the third is that cards are linked to American
19 languaculture by facilitating special kinds of
20 communication.

21 Is that accurately stated or sufficiently --
22 accurately paraphrased?

23 A Well, the sentence continues, often beyond the
24 me-to-you communication that is ordinarily thought to be the
25 reason for card-sending.

1 Q Fair enough. Were any of these three preliminary
2 insights in any way a surprise to you?

3 A I would say the extent to which the first insight
4 is true was a surprise to me.

5 Q However, given that you are a cultural
6 anthropologist and you were studying greeting cards, again,
7 isn't it fairly likely that they would have a cultural life
8 of their own, as you stated?

9 A It is likely that any item in material culture
10 would have an important role to play in human culture, but I
11 was surprised at the nature and extent of the role that
12 greeting cards played as I discovered in my ethnographic
13 research.

14 Q So these were -- your point then is that it was
15 the strength of the preliminary insights rather than their
16 identity that was new.

17 A I don't think that's exactly correct.

18 Q Well, would you say that any of the three is in
19 any way counterintuitive?

20 A Counterintuitive to me or --

21 Q Well, yes, to you.

22 A I would say that at first face I would not have
23 expected under item 3 that greeting cards played a role
24 beyond the from-me-to-you kind of communication that I had,
25 without thinking about it, thought that they did. So in that

1 sense I would say that there were some things in the
2 findings that were surprising, and had I thought about them
3 before, I would not have expected greeting cards to have
4 behaved in that way or that greeting cards to have played
5 those roles in society.

6 So in that sense before the research was conducted
7 I would say yes, there were some things in those -- there
8 might have been some things in those statements that would
9 have been counterintuitive to me, because I wasn't aware of
10 them at that time.

11 Q Can you give me an example?

12 A Well, for example, the extent to which greeting
13 cards mediate relationships between more than just two
14 people. I was surprised to discover the extent to which
15 greeting-card shoppers considered the relationships of
16 people outside of the from-me-to-you exchange. For
17 example --

18 Q Which one of the three does that fit within?

19 A Well, that would fit with the first one, in the
20 cultural life of greeting cards. I would also say that it
21 fits with No. 3, that that's a rather different kind of
22 communication than the one-on-one communication that I
23 previously might have expected greeting cards to do.

24 Q What if any basis would there be for asserting
25 that greeting cards would not be associated with these three

1 insights?

2 A Well, while I would indeed expect greeting cards
3 to be linked to American cultural values, I would not have
4 been able to specify the nature of those connections without
5 having first conducted some research and talked to people
6 and interacted with people who were in the process of
7 shopping for greeting cards, as I did in the ethnographic
8 research.

9 I think also the extent to which greeting cards
10 play roles in family rituals was not something I had a clear
11 handle on until I had conducted the research. I found
12 aspects of family use of greeting cards that I had not
13 expected and did not know about before.

14 And on the third point, as I mention, that
15 greeting cards, for example, play a role in more than just
16 dyadic communication but also mediate relationships beyond
17 dyadic relationships, that greeting cards can play a role as
18 groups of people or families communicate in ways that I had
19 not expected.

20 Q Well, those are details not linked in your -- not
21 specified when you identified the three preliminary
22 insights. I guess the point here that I'm trying to make is
23 that these are fairly obvious or intuitive conclusions. For
24 example, you state for the second that, quote, that greeting
25 cards play a role.

1 Well, your answer as embellished does shed further
2 light on it, but it seems to me that one could almost assume
3 or one should assume, especially with somebody of your
4 background, that greeting cards play a role in the
5 celebration of American family rituals.

6 A Indeed, one would assume that any material item
7 plays a role in human culture. My task was to specify what
8 some of those roles were and to discover through a research
9 process what some of those roles were and how they played
10 themselves out in human relationships.

11 Q Okay. Let's move on to a different point. Page
12 32, line 16, you state, quote, the significance of greeting
13 cards increases with the age of the American, unquote.

14 Now does your study or other data of which you are
15 aware shed light on the relative likelihoods of two
16 plausible explanations for this statement? The first of
17 those explanations is greeting cards become more important
18 to people as they age. And the second thesis would be those
19 for whom greeting cards are most valuable are getting older,
20 and when they've passed on, there will ultimately be less
21 value in greeting cards.

22 Does your study or other data of which you may be
23 aware shed any light on the relative likelihoods of these
24 two plausible explanations?

25 A I need to hear the second explanation to know

1 whether or not it's plausible. I didn't quite catch it.

2 Can you say it again?

3 Q The first is that people appreciate cards more as
4 they get older. And the second is that the people who like
5 cards are already old, and it's not that there are new
6 people coming to like cards, it's the older people will
7 eventually die off, and demand will therefore go down for
8 cards.

9 A Well, first of all, the question you're addressing
10 or the statement that you address in my testimony was
11 embedded in an answer about knowing that others care in time
12 of sickness, so I would ~~be~~ ^{be} not happy about trying to draw a
13 general conclusion about the nature of greeting cards or
14 their ~~the~~ ^{their} nature -- I would not want to draw a conclusion
15 about the nature of greeting cards from just one question.

16 The statement on line 16 is that the significance
17 of greeting cards increases with the age of the American.
18 In this instance I'm referring to the fact that the survey
19 data showed that older people were more likely to agree with
20 the statement that greeting cards help me know that others
21 care in times of sickness.

22 That question doesn't address the pattern of use
23 of cards over the life course by any means, and I wouldn't
24 want to draw that kind of conclusion. I'm drawing the
25 conclusion, however, that in times of -- that greeting ^{cards} --

1 let me state the question carefully -- in fact, I can look
2 at the question here and make sure that I'm saying it
3 carefully. If you'll bear with me, I'll find it.

4 On page 29, line 5. Greeting cards that come in
5 the mail help me know that others are thinking of me in a
6 time of sickness.

7 That was the question that people were asked. And
8 the people in the older age category in this survey
9 responded to that question at a higher ^{level of agreement} ~~rate~~ than others.

10 I have to return to the correct page where I said
11 that.

12 On line 14, at this time older people were more
13 likely to agree with this statement at 80 percent. Other
14 groups less so.

15 Q Okay. Well, you've certainly answered the part of
16 my question which goes to whether or not the study informs
17 the two possible -- informs one about the two possible
18 alternative explanations. What about your -- based on your
19 background and your general knowledge?

20 A The question is based on my general knowledge do I
21 think that one of those two plausible explanations is
22 correct?

23 Q That's correct.

24 A Well -- and what is it you're trying to explain
25 with these questions. I need some clarity. I'm not exactly

1 sure where we're --

2 Q I'm trying to explore your knowledge.

3 A About?

4 Q Whether your background permits you to draw any
5 kind of an inference as to the relative likelihoods of the
6 two alternative reasonable, plausible explanations.

7 A About the importance of greeting cards to older
8 Americans?

9 Q Yes.

10 A Well, first of all, I would be just addressing two
11 plausible explanations. I think anthropologists, generally,
12 like to look at things more holistically than that. So I
13 would say that there -- that I would need time to explore
14 and study that issue, which was not the issue that was under
15 study for this testimony.

16 Q Fair enough. In light of the discussion that
17 starts on page 39 of your testimony, where -- the section
18 titled, "Potential Cultural Impact of Higher First Class
19 Rates. A smaller volume of greeting cards in the mail
20 stream would have negative cultural consequences." begins.
21 Are you aware of any data indicating that the proposed rate
22 increases in this proceeding would have a significant impact
23 on the volume of greeting cards sent through the mail?

24 A Well, I am aware that this proceeding is about a
25 rate increase and my testimony is directed to understand the

1 potential value, or cultural value of greeting cards that
2 are received in the mail. So I didn't direct my testimony
3 to questions about, nor did I study, in fact, questions
4 about the cost of sending greeting cards through the mail or
5 the price of postage. Instead, I addressed the cultural
6 value of greeting cards to recipients.

7 It seems to me that one of the -- an
8 anthropological approach to looking at greeting cards that
9 move through the mail is to take a holistic stance, which
10 means that you not only are concerned with the purchase of
11 the stamp, but also the end of the gift transaction, for
12 greeting cards are indeed gifts, and the meaning, the
13 cultural meaning, the cultural value of those cards seems to
14 rest more clearly in the hands of the recipient, or
15 recipients. So that while there may indeed be econometric
16 information out there, or postal science of some kind that
17 could project the impact of, you know, an increase in postal
18 rates and its impact on sending various kinds of mail, that
19 certainly isn't the focus of my testimony, nor is it part of
20 the arena about which I have expertise.

21 Q That sounds to me like a very long version of the
22 answer no, is that correct?

23 A No, I don't -- I don't think that's correct. I
24 was here yesterday --

25 Q You are aware of data?

1 A I have heard testimony here yesterday that
2 appeared to be about taking a look at what happens when a
3 postal increase comes about. My testimony is about the
4 cultural value of greeting cards to recipients.

5 Q You have made that clear. Thank you.

6 Is it your testimony that if there is a decrease
7 in the volume of greetings cards sent through the mail
8 occasioned by a rate increase, that in some measure there
9 will be less overall culture, thereby imposing a net
10 decrease on society?

11 A One way to answer that would be to refer to line
12 23 on page 39, where my testimony states that any action
13 that the Postal Services takes to reduce American ability to
14 engage in greeting card exchange will have a negative impact
15 on individual and group participation in the production,
16 reproduction and reshaping of these cultural forms of
17 interpersonal and intergroup expression, by which I mean
18 greeting cards that are received in the mail.

19 Q Okay. That answer sounds very much like a yes.
20 If so, on what basis can you assume that there are no
21 substitute providers of cultural value that might make up
22 for such a loss?

23 MR. SWENDIMAN: Mr. Chairman, I would object.
24 Postal Service counsel is putting words into the witness'
25 mouth. He didn't say yes. He answered the question to the

1 best of his ability to Mr. Hollies' question.

2 CHAIRMAN GLEIMAN: Well, you know, he
3 characterized the answer. Unless it is, you know, a
4 precursor to another question where, you know, it then
5 becomes a matter of whether he is basing a question on an
6 improper hypothetical, I don't think it is going to matter a
7 whole lot because counsel's comment, his interpretation of,
8 you know, that answer as a yes is not evidence in the
9 strictest sense, so, you know, we will take that into
10 account when we review the record, Mr. Swendiman.

11 BY MR. HOLLIES:

12 Q Mr. Erickson, are you square on the question?

13 A Why don't you repeat it for me?

14 Q Okay. If so, on what basis can you assume that
15 there are no substitute providers of cultural value that
16 might make up such potential loss of cultural value?

17 A Can you back up a bit? There was a subject to the
18 predicate.

19 Q Okay. You started with sort of a net decrease in
20 culture.

21 A No, that is not correct.

22 Q Okay. Could you go back and explain that to me
23 then?

24 A I did not say that there would be a decrease in
25 culture. I said that there would be a decrease in the

1 cultural value of cards to recipients.

2 Q So there --

3 A If I do not receive a card on the occasion of my
4 grandfather's passing, for whatever reason, I do not
5 participate in the cultural exchange of sentiments about
6 bereavement in ^{that} the instance. A card that is not there for
7 me is not there for me. And in that sense, I do not
8 participate in the cultural value of that greeting card that
9 comes to me in the mail from a distant kin. ~~person.~~

10 So I am not saying that you lose culture when I
11 don't get card. In fact, culture becomes changed as a
12 result of my not getting that card. You don't lose it, but
13 it changes.

14 Q On page 40, line 3 you say that greeting card use
15 would, quote, "measurably" lessen the feeling of community.

16 How would it do so and by what measure?

17 A Well, I suppose one could draw on the example that
18 I just used. If I didn't receive a card about the passing
19 of a valued relative from a distant relative, one could I
20 suppose with the assistance of a psychologist or someone who
21 measures emotional responses or with the assistance of a
22 sociologist who measures how families respond to things,
23 indeed measure the feeling of community that has been
24 decreased as a result of not receiving that card.

25 Q And are cards the sole source of such community

1 feelings?

2 A I think it wouldn't be fair to state that any one
3 thing is the source in a causal way of senses of community.
4 I think that the social sciences in general have moved
5 beyond that kind of unitary attribution of causality.

6 Q On page 41, lines 15 through 18, you assert,
7 quote, "The continued presence of greeting cards in American
8 culture despite the availability of the telephone and to a
9 lesser extent computer e-mail indicates that" -- I'm
10 substituting words in, greeting cards' "role extends far
11 beyond simple one to one communication."

12 Are there other forms of one to one communication
13 whose role does not extend beyond such communications?

14 A You are asking are there other forms of
15 communication whose role extends beyond simple one-to-one
16 communication?

17 Q Actually I asked it in the negative form.

18 A Right.

19 Q Are there any that do not?

20 A I'd have to get my head around that, twisting it
21 around into the negative here.

22 Q Let me make it easy for you --

23 A Let me try --

24 MR. SWENDIMAN: Could I ask that the question be
25 restated?

1 MR. HOLLIES: Certainly.

2 MR. SWENDIMAN: That would help.

3 BY MR. HOLLIES:

4 Q Looking at the language you used that I read to
5 you a moment ago, you talk about the fact that the role of
6 greeting cards extends far beyond simple one-to-one
7 communication, right?

8 A Yes.

9 Q Okay. Pick some other form of one-to-one
10 communication and can you identify one to me whose role does
11 not extend beyond such communications?

12 A Well, I might imagine an instance in which a
13 personal letter contained personal information that the
14 recipient would not care to divulge and in that instance I
15 would suspect that that letter would have a role that
16 extended only up to one-to-one communication and went no
17 further than that.

18 Q Well, doesn't the notion of privacy have larger
19 cultural value than one-to-one communication -- than solely
20 in one-to-one communication?

21 A Well, I can't speak to the relative cultural value
22 of privacy or any other aspect of culture. That is not an
23 arena in which I have paid particular scholarly attention.

24 For this testimony I am concerned to note that
25 greeting cards play a role beyond one-to-one communication

1 in many instances.

2 Q Well, my point here is that all forms of
3 one-to-one communication share that attribute, do they not?

4 A I don't think it's the case that all forms of
5 one-to-one communication are more than one-to-one
6 communication --

7 Q But --

8 A They do not.

9 Q So they don't have any cultural value beyond
10 one-to-one communication?

11 A No, that's not at all what I said.

12 I said that there are many other -- there are many
13 things that are used for one-to-one communication and of
14 those things greeting cards play roles that extend in many
15 instances beyond one-to-one communication.

16 Q Can you give me an example of one to one
17 communication -- well, I guess you did in terms of that
18 private letter.

19 I'll let it go at that.

20 MR. HOLLIES: Thank you. I have no further
21 questions at this time.

22 CHAIRMAN GLEIMAN: Is there any follow-up?
23 Questions from the bench? Commissioner LeBlanc?

24 COMMISSIONER LeBLANC: Mr. Erickson, let me say I
25 found your testimony extremely interesting. I really

1 enjoyed it, frankly. It's kind of a good break for us
2 sometimes, but you talk a lot about the cultural exchange
3 and what the cards mean to the culture of the American
4 people and so forth, and I am not trying to put words in
5 your mouth but in your survey, in your study, in your
6 experience and your background, do you have a way of knowing
7 a good feel for, based on your experience as an expert in
8 your field, how does a greeting card relate to, as an
9 example, a hometown newspaper, in some cases advertising
10 mail, in some cases a package that is received from a loved
11 one?

12 Can you give me some insight into that?

13 THE WITNESS: Into how greeting cards are perhaps
14 different in some way than those other things that come in
15 the mail?

16 COMMISSIONER LeBLANC: Different, keeping in mind,
17 because I kind of really got into the cultural exchange part
18 that you were talking about and --

19 THE WITNESS: Right.

20 COMMISSIONER LeBLANC: -- and of course -- I'm
21 sorry, go ahead?

22 THE WITNESS: No, I just -- I thought of one way
23 to answer that question is that greeting cards come in the
24 mail without the sender asking you to send money back, that
25 other things that come in the mail, not everything but many

1 things that come in the mail are there because they are
2 inviting you to participate in an economic exchange or they
3 are there because you have already participated in one and
4 you are receiving the benefits of paying for your local
5 newspaper or for a magazine, or, as I do, ~~receive~~^{for} a
6 professional journal.

7 That kind of mail carries with it a cultural
8 content rather different than the cultural content
9 surrounding greeting cards and that content becomes manifest
10 when the card -- beginning when the card is of course
11 created and purchased, and it becomes especially active when
12 it is received by the person who opens the card that they
13 have received from a friend or a loved one and ~~that~~ that is
14 a different kind of moment, opening that card, than it is
15 perhaps opening an academic journal certainly.

16 COMMISSIONER LeBLANC: I would hope so.

17 One of the things that we have to look at in our
18 criteria that we're mandated by Congress and others to look
19 at is the value from the sender as well as the recipient.

20 From a cultural standpoint, from almost any
21 standpoint that you want to look at from your perspective,
22 how do you look at the sender as well as because you talked
23 about the recipient earlier?

24 THE WITNESS: Well, so far I haven't -- at least
25 in the telephone survey I was focusing on the recipient, so

1 I look at the sender and the sender's intentions as they are
2 interpreted by the person who receives the cards, so to
3 really look at greeting cards in the mail I think it is
4 important to do so holistically, to look both at the sender
5 and the recipient, to look at their intentions and the kinds
6 of meanings that they are trying to transmit by sending
7 greeting cards through the mail. ^{So} ~~so~~ I would want to look at
8 understanding how you do or don't get the joke on the card,
9 for example, ^{that} ~~that~~ would be an interesting arena for me to look
10 at.

11 I am not sure if that is helpful to you though.

12 COMMISSIONER LeBLANC: Well, it is but let me kind
13 of follow it up with another part of the question.

14 As an example -- well, to use your example about
15 receiving a card on the passing away of a loved one or a
16 very sentimental moment of some kind, does the sender get
17 that cultural value as much as the recipient does in that
18 particular case?

19 THE WITNESS: I would say so. I would say
20 definitely so, that while the sender has to purchase the
21 card, the sender also invests that ^{card} ~~care~~ with cultural
22 significance and cultural meaning, drawing on the repertoire
23 of symbols that everyone carries around with them in their
24 heads and that are reinforced by the things around us in the
25 world, that the senders of greeting cards also participate

1 in the exchange in a non-economic and cultural way that is
2 very important, and often, it seems, not considered when we
3 are thinking about the value of the mail.

4 COMMISSIONER LeBLANC: Now you may not know this
5 next answer just simply because it might be a little bit
6 afar from your actual testimony and if it is please feel
7 free to tell me so, but from the standpoint of comparing it
8 to a privacy letter in a First Class situation which Mr.
9 Hollies was talking to you about, receiving your daily
10 newspaper, receiving some advertising mail, or that package,
11 where would you say that it would fit as far as importance,
12 if you will, to an individual?

13 THE WITNESS: I think I would want to look at the
14 context.

15 I can imagine individuals for ^{whom} the receipt -- I use
16 the example of a seed catalog in the ^{interrogatories} ~~rebuttal~~ -- is a big
17 event and over the course of several months it may be that
18 the greeting cards that come perhaps aren't as important
19 sometimes, but on the whole I guess what I can speak to is
20 that a greeting card ^{carries} ~~carried~~ with it something that is not
21 embedded in those other kinds of things.

22 COMMISSIONER LeBLANC: Well, let me stay with this
23 theme, if you will, and Mr. Hollies talked to you about the
24 older group versus the younger group and the e-mails and so
25 forth.

1 My son, who is 13, and my daughter, who is 23,
2 will probably forget more about a computer than I will know,
3 but from that perspective on a cultural exchange or a
4 cultural acceptance, if you will, can you see the value of
5 one versus another going up or down?

6 THE WITNESS: You mean over time, as people use
7 different kinds of technologies, is that --

8 COMMISSIONER LeBLANC: Yes, sir. I guess that is
9 one way of putting it.

10 THE WITNESS: Well --

11 COMMISSIONER LeBLANC: And excuse me for
12 interrupting you but the reason I am asking that is because
13 it seems to me if what you are saying is the case here where
14 the sender as well as that recipient has a big -- it is a
15 big value to them to either send it and/or receive it, and
16 when you were responding to Mr. Hollies about the one on one
17 communication, that was purpose that got me thinking about
18 this, so it is therefore possibly -- does one have a value
19 higher or lower than the other, I guess is the way to say it
20 then?

21 THE WITNESS: Does the -- in other words, can you
22 say that this has a greater cultural -- that a greeting card
23 may have greater cultural value sometimes than other things?
24 I would say yes, and very often I think that that is the
25 case.

1 COMMISSIONER LeBLANC: Then on page 39 of your
2 testimony you talked about on line 23 with Mr. Hollies about
3 "any action that the Postal Service takes that reduces the
4 American ability to engage in greeting card exchange" and so
5 forth "will have a negative impact."

6 Now if you can, let's bear with me a moment, and
7 let's -- the attorneys like to give you a hypothetical so
8 let's change it, and it's not a hypothetical, but let's look
9 at any action by the Postal Service that reduces the
10 American ability to engage in any type of exchange will have
11 a negative impact on individual and group participation.

12 Now if you say that, would that change your answer
13 in what you were talking about with Mr. Hollies?

14 THE WITNESS: Let's see. I am trying to remember
15 what was the answer --

16 COMMISSIONER LeBLANC: I am just saying if the
17 Postal Service, any action that it takes to reduce the
18 Americans' ability to engage in communication.

19 THE WITNESS: In other words, if you broadened
20 that statement --

21 COMMISSIONER LeBLANC: Exactly.

22 THE WITNESS: -- to communication rather than
23 greeting card exchange. Well, it would -- I would --

24 COMMISSIONER LeBLANC: You may not know that and
25 that's fine --

1 THE WITNESS: I would say that I don't know, but
2 the sentence goes on to talk really about the specific kinds
3 of icons that greeting cards are, so really that is what the
4 sentence addresses, so I don't know if I could move beyond
5 that.

6 COMMISSIONER LeBLANC: So -- what got me was
7 "reshaping of the American cultural forms of interpersonal
8 and intergroup expression" --

9 THE WITNESS: Right.

10 COMMISSIONER LeBLANC: So given that scenario, if
11 you take out, as an example, just the greeting card
12 exchange, would one be more or less higher, greeting card
13 versus the other classes of mail, or some other
14 participation?

15 THE WITNESS: I would say that -- I would say
16 based on my research that the greeting cards in fact carry
17 with them more symbolic load of greater interpersonal
18 importance than other kinds of mail with which I am
19 familiar, the possible exception being the letter that you
20 write personally.

21 Perhaps often you may include that with the
22 greeting card and ^{fold it} ~~folded~~ in.

23 COMMISSIONER LeBLANC: One last question then.
24 Yesterday you said you were in here. One of the things that
25 we deal with here is called elasticity. Are you familiar

1 with that term?

2 THE WITNESS: I am familiar with the term. I am
3 not sure that I am clear exactly ^{on} ~~in~~ the ways in which
4 economists use it.

5 COMMISSIONER LeBLANC: Okay. Well, let's just
6 assume for talking purposes since in the back -- in one of
7 the USPS interrogatories they were talking about the -- I
8 believe I remember it in the back -- where they were talking
9 about -- not the true form of elasticity but what happens on
10 price increases and so forth.

11 THE WITNESS: Right.

12 COMMISSIONER LeBLANC: If the price goes up
13 substantially, have you done any survey or study or whatever
14 it might be to see how this would affect the cultural
15 exchange in America?

16 THE WITNESS: No, I have not, no.

17 COMMISSIONER LeBLANC: Thank you very much.

18 Thank you, Mr. Chairman.

19 CHAIRMAN GLEIMAN: Other questions? Is there any
20 follow-up as a consequence of questions from the bench?

21 [No response.]

22 CHAIRMAN GLEIMAN: If not, that brings us to
23 redirect.

24 Would you like some time with your witness?

25 MR. SWENDIMAN: Just about two minutes?

1 CHAIRMAN GLEIMAN: Certainly.

2 [Discussion off the record.]

3 CHAIRMAN GLEIMAN: Mr. Swendiman?

4 MR. SWENDIMAN: Yes, Mr. Chairman. Just one
5 question.

6 REDIRECT EXAMINATION

7 BY MR. SWENDIMAN:

8 Q Dr. Erickson, is an ordinary telephone call a
9 one-to-one communication that does not go beyond one to one?

10 A If there is no one else in the room at the
11 receiving end and the sending end, one would hope so.

12 MR. SWENDIMAN: I have no further questions.

13 CHAIRMAN GLEIMAN: In Washington these days, it
14 can be more than one to one even if there's nobody else in
15 the room, we've come to find out. Depends, I guess, on
16 whether you're in a no-party or one-party or a two-party
17 state as to whether it's really a personal conversation.

18 Did redirect generate any further recross?

19 [No response.]

20 CHAIRMAN GLEIMAN: If not, then Dr. Erickson, I
21 want to thank you. We appreciate your appearance here today
22 and your contributions to our record.

23 THE WITNESS: Thank you.

24 CHAIRMAN GLEIMAN: And if there is nothing
25 further, you're excused.

1 THE WITNESS: Thank you for letting me present
2 today, Commissioners.

3 [Witness excused.]

4 CHAIRMAN GLEIMAN: Mr. Baker, if you could
5 identify your witness.

6 MR. BAKER: Mr. Chairman, on behalf of the
7 Newspaper Association, we call Sharon Chown to the stand.

8 CHAIRMAN GLEIMAN: Ms. Chown, before you get
9 settled in there, if I could ask you to please raise your
10 right hand.

11 Whereupon,

12 SHARON L. CHOWN,

13 a witness, was called for examination by counsel for the
14 Newspaper Association of America and, having been first duly
15 sworn, was examined and testified as follows:

16 CHAIRMAN GLEIMAN: Thank you. Please be seated.

17 Counsel, whenever you get settled in there, you
18 can proceed.

19 DIRECT EXAMINATION

20 BY MR. BAKER:

21 Q Ms. Chown, I am handing you two copies of a
22 document labelled NAA-T-1 and entitled Direct Testimony of
23 Sharon L. Chown on Behalf of the Newspaper Association of
24 America. Was this testimony and document prepared by you or
25 under your supervision?

1 A Yes, it was.

2 Q And if you would testify today, would this be your
3 testimony?

4 A Yes, it would.

5 MR. BAKER: Mr. Chairman, I move acceptance of the
6 testimony in the record as evidence.

7 CHAIRMAN GLEIMAN: Are there any objections?

8 [No response.]

9 CHAIRMAN GLEIMAN: Hearing none, Ms. Chown's
10 testimony and exhibits are received into evidence, and I
11 direct that they be transcribed into the record at this
12 point.

13 [Direct Testimony and Exhibits of
14 Sharon L. Chown, NAA-T-1, was
15 received into evidence and
16 transcribed into the record.]

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DUPLICATE

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NAA-T-1

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U.S. DEPARTMENT OF JUSTICE

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

POSTAL RATE AND FEE CHANGES, 1997

Docket No. R97-1

DIRECT TESTIMONY OF

SHARON L. CHOWN

ON BEHALF OF

THE NEWSPAPER ASSOCIATION OF AMERICA

Dated: December 30, 1997

1 I. QUALIFICATIONS

2 My name is Sharon L. Chown. I am a Principal and co-founder of Industrial
3 Economics, Incorporated (IEc). My office is located at 2067 Massachusetts Avenue,
4 Cambridge, Massachusetts 02140. I am a regulatory economist, specializing in utility
5 cost allocation, rate design and restructuring. Since co-founding IEc in September
6 1981, I have been engaged in numerous studies pertaining to these issues and have
7 testified before Federal, provincial and state commissions.

8 I have testified before the Postal Rate Commission in Dockets No. R84-1, C87-2,
9 R87-1, R90-1 and MC95-1. I have also testified on several occasions before regulatory
10 boards in Canada (Alberta, Manitoba, Ontario, Quebec, Nova Scotia and New
11 Brunswick) on cost allocation, rate design and industry restructuring in the natural gas
12 and electric utility industries.

13 I was previously employed as a Consultant at Putnam, Hayes & Bartlett, Inc.
14 (PHB) and at Data Resources, Inc. (DRI). At PHB I performed studies of electric and
15 gas utilities, including the various aspects of cost allocation and rate design. At DRI I
16 participated in telecommunication rate cases before several state public utility
17 commissions.

18 I received a Bachelor of Science degree in Mathematics, with an emphasis in
19 Statistics, for the University of California, Davis and a Masters of Science in Industrial
20 Administration from Carnegie-Mellon University.

1 II. INTRODUCTION AND SUMMARY

2 On behalf of the Newspaper Association of America, I was asked to review the
3 direct testimony of the Postal Service witnesses in Docket No. R97-1. As a result of
4 this review, I recommend an alternative metric—*total weighted attributable costs*—that
5 will allow the Commission to better gauge the appropriate level of the institutional costs
6 to be borne by each subclass of mail. As explained in this evidence, this metric
7 explicitly accounts for both differences in the mix of postal functions (i.e., mail
8 processing, window service, transportation and delivery) used by each subclass of mail
9 and differences in the level of institutional costs associated with providing each of the
10 different functions of the Postal Service.¹ This proposal is a refinement of the proposal I
11 put forward in Docket No. R90-1.

12 My testimony begins with a review of the problems associated with the
13 Commission's current metric for assessing the appropriate level of institutional costs to
14 be borne by each subclass. I then briefly review the unbundled institutional cost
15 assignment I proposed in Docket No. R90-1. Finally, my testimony presents my
16 alternative metric for gauging the appropriateness of the institutional cost burdens of
17 each subclass.

18 III. CURRENT INSTITUTIONAL COST ASSIGNMENT

19 To determine the institutional costs to be borne by each subclass of mail, the
20 Postal Service computes the total attributable costs for each subclass and applies a

¹ By definition, institutional costs are costs that are not causally related to any particular subclass. However, institutional costs can be related to the provision of a particular function of the Postal Service. The institutional costs incurred to provide a particular function should be paid by the subclasses of mail that use that function.

1 “markup” or “cost coverage” to these costs. These markups are based upon a
2 subjective assessment of the factors in Section 3622(b) of the Postal Reorganization
3 Act.

4 The total attributable costs for each subclass represent the sum of the
5 attributable costs for each of the functions provided by the Postal Service. The Postal
6 Service provides four basic functions—mail processing, window services, delivery and
7 transportation.² In the past, mailers purchased these four functions as a single
8 package. In recent years, however, it is increasingly possible for mailers to purchase
9 different mixes of these basic functions by relying on alternative suppliers for mail
10 processing and transportation; and availing themselves of the worksharing discounts
11 now offered by the Postal Service. As these worksharing discounts have increased in
12 both number and the amount, the mixes of the functions used by the different
13 subclasses of mail have changed.

14 One outcome of the introduction of discounts into the rate structures is the high
15 “implicit” markups for certain categories of presorted and dropshipped mail. Because
16 institutional cost markups are determined for subclasses of mail and not for individual
17 categories of mail, the Commission has historically given little or no direct weight to the
18 high “implicit” markups of these categories of presorted mail. (See, for example, Postal
19 Rate Commission, *Opinion and Recommended Decision*, Docket No. MC95-1, ¶ 3069-
20 3073.)

21 In Docket No. MC95-1, Standard A Enhanced Carrier Route (ECR) mail was
22 determined to meet the criteria for a separate subclass. Identification of this mail as a
23 subclass means that the Commission now needs to separately assess the appropriate
24 institutional cost contribution for this mail. As such, it is important that the Commission

² In Docket No. R90-1, I identified three basic functions as I did not include window service as a separate function. Given the disproportionate use of window services by First-Class mailers, it is useful to separately identify these costs.

1 have an explicit method of accounting for the fact that ECR mail has very low
2 attributable costs for some of the postal functions due to the heavily presorted and
3 dropshipped nature of this mail; and that the attributable costs of ECR mail are
4 predominately delivery costs -- a function that accounts for a large share of the
5 institutional costs of the Postal Service.

6 Problems with Current Method of Assigning Institutional Costs

7 As I pointed out in Docket No. R90-1, applying the markup or cost coverage to a
8 single pool of total attributable costs for each subclass ignores the relative mix of the
9 different postal functions used by each subclass and the contribution of each of these
10 functions to the total institutional costs of the Postal Service. This markup method can
11 result in a low institutional cost assignment for a subclass of mail that primarily uses
12 mail functions for which few of the costs are attributed, even if the provision of these
13 functions causes the Postal Service to incur substantial institutional costs. Conversely,
14 a subclass that makes greater use of the postal functions with high attributable costs
15 will be assigned a greater share of the institutional costs of the Postal Service when
16 using the current method for assigning institutional costs.

17 Applying a markup to total attributable costs is appropriate only if (1) all mailers
18 buy approximately the same mix of the four basic functions or (2) the ratio of
19 institutional costs to attributable costs is relatively constant across all four functions. As
20 demonstrated below, neither of these conditions is true in today's postal environment.

1 1. Mix of Attributable Costs by Subclass

2 Exhibits NAA-1A and NAA-1B present the Postal Service's total attributable
3 costs for each of the four functions.³ These functions are defined as follows:

- 4 • Mail Processing Cost Segments 3.1 and 4
5 • Window Service Cost Segment 3.2
6 • Transportation Cost Segment 14
7 • Delivery Cost Segment 6, 7, 8, 9 and 10

8 A summary of the total attributable costs by function is provided below.⁴

³ For purposes of illustration only, I have used the Postal Service's volume variable costs as my measure of attributable costs in my testimony. My proposal is equally applicable to alternative measures of attributable costs.

⁴ In Exhibit NAA-1A, the appropriate piggyback factors and the contingency fee are applied to the direct labor costs in each cost segment to derive the total costs associated with the different functions of the Postal Service. The piggyback factors can be found in Library Reference H-77.

The remaining cost segments include the costs of the support functions such as supervisory time, benefits, and space and utilities which are captured in the piggyback factors and the costs of corporate-wide functions such as postmasters and headquarters personnel.

Table 1		
Distribution of Total USPS Attributable Costs by Function		
Function	Attributable Costs	Percent of Total Attributable Costs
Mail Processing	\$17,184,862	50.08%
Window Service	1,400,548	4.08%
Transportation	3,808,826	11.10%
Delivery	9,938,214	28.96%
Other Costs & Adjustments	1,983,222	5.78%
Total Attributable Cost	\$34,315,672	100.00%

1 As shown above, mail processing costs comprise 50 percent of the total
2 attributable costs, while delivery costs account for 29 percent of the total attributable
3 costs of the Postal Service. The remaining two functions—window service and
4 transportation—account for 4 percent and 11 percent of the total attributable costs,
5 respectively.

6 Exhibit NAA-1B also shows the mix of functions used by each subclass.⁵ As can
7 be seen in this exhibit, the mix of functions differs substantially among the various
8 subclasses of mail.

9 For example, the table below compares the percentage of attributable costs by
10 function for First-Class letter mail and Standard A Commercial ECR mail.

⁵ Page 1 of Exhibit NAA-1B summarizes the total attributable cost by function for each subclass of mail. Page 2 of Exhibit NAA-1B provides the percentage mix of the different functions used by each subclass of mail.

Function	First-Class Letter Mail	Standard A Commercial ECR Mail
Mail Processing	57.94%	22.69%
Window Service	4.68%	0.45%
Transportation	5.36%	3.25%
Delivery	26.05%	71.66%
Other Costs & Adjustments	5.96%	1.95%
Total Attributable Cost	100.00%	100.00%

1 As shown above, mail processing costs comprise almost 58% of the attributable
2 costs of First-Class letter mail; whereas, delivery costs account for approximately 26%
3 of the attributable costs of this mail. In contrast, Standard A Commercial ECR mail is
4 presorted to the carrier route and much of this mail is also dropshipped to the
5 destination offices. As a result of these worksharing efforts, a large portion of mail
6 processing and transportation costs are avoided. Hence, mail processing costs
7 account for less than 23% of the attributable costs of Standard A Commercial ECR
8 mail; while over 70 percent of the attributable costs of this mail are the costs associated
9 with the delivery function.

10 A review of the other subclasses in Exhibit NAA-1B, page 2 reveals significant
11 differences in the mix of the functions used by other subclasses, as well. For example,
12 over 35 percent of the attributable costs of priority mail are transportation costs.
13 Similarly, 43 percent of the attributable costs of parcel post are transportation costs.
14 Also, while only 23% of the attributable costs of Standard A Commercial ECR mail are
15 mail processing costs, almost 58 percent of the attributable costs of Standard A
16 Commercial Regular mail are mail processing costs. Thus, it is clear that each subclass
17 of mail does not use the same mix of the basic functions provided by the Postal
18 Service.

1 2. Distribution of Institutional Costs

2 As discussed above, the appropriateness of applying a markup to a single pool
3 of attributable costs can rest upon the implicit assumption that the ratio of institutional
4 costs to the attributable costs for each function is constant across the four functions. A
5 constant ratio of institutional costs to attributable costs would result in an equivalent
6 distribution of institutional costs and attributable costs across the functions. However,
7 as the Commission is well aware, the distribution of institutional costs across the
8 functions is very different from the distribution of attributable costs due to differences in
9 the portion of costs attributed in each of the cost segments.

10 Exhibit NAA-1A shows the institutional costs associated with providing each
11 function. I determined the institutional costs associated with each function by
12 identifying the institutional costs corresponding to the same cost segments listed above,
13 and then applying an appropriate piggyback factor to these costs.⁶ After identifying the
14 institutional costs specifically associated with each function (hereafter, I refer to these
15 institutional costs as "identifiable" institutional costs), there is still a large pool of
16 institutional costs that cannot be specifically associated with any particular function. I
17 will refer to these institutional costs as "system-wide" institutional costs. These system-
18 wide institutional costs include costs such as postmasters, other supervisors and
19 technicians, headquarters personnel, communications expenses and other
20 miscellaneous supplies and services. These costs are incurred to run the Postal
21 Service and cannot be clearly identified with any particular function.

22 The distribution of identifiable institutional costs is shown below. The distribution
23 of attributable costs from Table 1 is provided for comparison purposes.

⁶ The derivation of the piggyback factors is described and illustrated in Exhibit NAA-1F. As explained in this exhibit, the piggyback factors for institutional costs equal the equivalent factor for total attributable costs less an adjustment for the imputed rental costs and related building depreciation and interest costs.

Function	Identifiable Institutional Costs	Percent of Total Identifiable Institutional Costs	Percent of Total Attributable Costs
Mail Processing	\$ 5,132,943	28.11%	50.08%
Window Service	1,464,467	8.02%	4.08%
Transportation	556,090	3.05%	11.10%
Delivery	11,107,739	60.83%	28.96%
Other Costs & Adjustments	0	0.00%	5.78%
Total Identifiable Institutional Costs	\$18,261,239 .00	100.00%	100.00%

1 As shown above, although mail processing costs represent over half of the total
2 attributable costs of the Postal Service, this function accounts for only 28 percent of the
3 identifiable institutional costs.⁷ In contrast, the delivery function, which accounts for
4 only 29 percent of the total attributable costs of the system, accounts for over 60
5 percent of the identifiable institutional costs. Transportation costs represent 11 percent
6 of total attributable costs, but only 3 percent of identifiable institutional costs. And,
7 window service costs represent 4 percent of attributable costs and 8 percent of
8 institutional costs.

9 3. Illustration of Problems with Current Method of Assigning Institutional Costs

10 The discrepancies between the different mix of functions used by the various
11 subclasses of mail and the distribution of attributable costs and identifiable institutional
12 costs present a problem when assigning institutional costs by marking up total
13 attributable costs. Mailers that reduce the total attributable costs of a particular
14 subclass by avoiding mail processing and transportation costs through presorting and

⁷ The percentage of institutional costs associated with mail processing will be less if the Postal Rate Commission does not accept the Postal Service's proposed attribution methods for these costs, but instead relies on the previously approved methods of attributing these costs.

1 dropshipping receive a reduced assignment of *all* institutional costs, not just the
 2 institutional costs associated with mail processing and transportation. Thus, mailers
 3 can reduce their contribution to the institutional costs associated with delivery by
 4 reducing their mail processing and transportation attributable costs.

5 An example demonstrates the problem. Assume there are three classes of
 6 mail—A, B and C—using two postal functions -- 1 and 2. Assume also that Class A
 7 uses a mix of both functions, while Class B uses only Function 1 and Class C uses only
 8 Function 2.

9 Assume further that, in this example, the attributable costs are \$150 for Function
 10 1 and \$100 for Function 2 for a total of \$250; and that the institutional costs associated
 11 with Function 1 are \$30 and the institutional costs associated with providing Function 2
 12 are \$120 for a total of \$150. Finally, for purposes of illustration, assume that the
 13 Commission decides that there is no reason to differentiate among the classes with
 14 respect to the factors in Section 3622(b) and therefore, that each subclass should be
 15 assigned institutional costs on an "equal" basis. The current method of assigning
 16 institutional costs would result in the following institutional costs contributions.

17

	Attributable Costs			Institutional Costs	
	Function 1	Function 2	Total	Markup	Contribution
Class A	\$75	\$50	\$125	60%	\$75
Class B	\$75	0	\$75	60%	\$45
Class C	0	\$50	\$50	60%	\$30
Total	\$150	\$100	\$250	60%	\$150

18 As shown in the above table, the current method of assigning institutional costs
 19 results in marking up the total attributable costs of each class of mail by 60 percent
 20 (total institutional costs of \$150 divided by total attributable costs of \$250). Class B,

1 which uses only Function 1, is assigned \$45 of institutional costs even though the
2 institutional costs for Function 1 total only \$30. Thus, in this example, Class B is
3 assigned a share of the institutional costs of Function 2 although the class makes no
4 use of this function. Class C which makes use of only Function 2 is assigned less
5 institutional cost than Class B, even though the bulk of the institutional costs are related
6 to the provision of Function 2. Thus, this "equal" assignment of the institutional cost
7 burden overburdens Class B, while Class C escapes paying a reasonable share of the
8 institutional costs associated with Function 2.

9 The Commission recognized this problem in Docket No. R90-1.

10 *"...the root of the problem is that when a subclass uses categories of*
11 *attributable costs in an uncommon way -- either by using mostly a function*
12 *whose costs are only very incompletely attributed, or by using mostly a*
13 *function whose costs are completely attributed -- it is not fully (or fairly)*
14 *comparable with other classes." (Ibid., ¶4051)*

15 The Commission can compensate for the problems inherent in the current
16 method of assigning institutional costs by altering the markups to reflect the mix of
17 functions used by the various classes of mail and the proportion of institutional costs
18 incurred to provide each function. To enable the Commission to do so, I have devised
19 a metric that directly gives weight to these factors when assigning institutional costs.

20 IV. UNBUNDLED METHOD PROPOSED IN DOCKET NO. R90-1

21 In Docket No. R90-1, I proposed an alternative method for assigning institutional
22 costs on an unbundled basis. At that time, I proposed that the institutional costs
23 associated with each function be assigned by marking up the attributable costs for that
24 function only. This method explicitly recognized the mix of functions used by each
25 subclass of mail and the portion of institutional costs incurred to provide each of the
26 functions offered by the Postal Service. In its decision, the Commission stated:

1 *"We are certainly always interested in ways which can help us to improve*
 2 *the fairness of institutional cost allocations. In particular, we think witness*
 3 *Chown has done us a service by focusing directly on the impact of*
 4 *unbundling costs, and how worksharing discounts can affect the*
 5 *apportionment of institutional costs to categories of mailers." (Postal Rate*
 6 *Commission, Opinion and Recommended Decision, Docket No. R90-1,*
 7 *January 4, 1991, ¶ 4043.)*

8 The Commission agreed that "...total attributable costs are not a completely
 9 accurate measure of how much various subclasses benefit from institutional effort."
 10 (Ibid., ¶ 4049) While the Commission agreed that there is a problem, the Commission
 11 chose not to apply my proposed method at that time.

12 The method proposed in Docket No. R90-1 involved the application of the
 13 statutory factors separately to each of the functions offered by the Postal Service to
 14 determine the appropriate markup for each function for each subclass. Using the
 15 example discussed above, the markup for each function would be determined and
 16 applied to the attributable costs for that function, as shown in the following table.
 17 Again, in this example, I assume that the Commission has determined that "equal"
 18 markups for each of the subclasses are appropriate.

	Function 1			Function 2			Total
	Attributable	Markup	Institutional	Attributable	Markup	Institutional	Contribution
Class A	\$75	20%	\$15	\$50	120%	\$60	\$75
Class B	\$75	20%	\$15	0	120%	0	\$15
Class C	0	20%	0	\$50	120%	\$60	\$60
Total	\$150	20%	\$30	\$100	120%	\$120	\$150

19 In the above example, Function 1 bears a markup of 20% (\$30 of institutional
 20 costs divided by \$150 of attributable costs). Since Function 1 is used in equal
 21 proportions by Class A and Class B, the institutional costs are divided equally between

1 these two classes of mail. Function 2 bears a markup of 120% (\$120 of institutional
2 costs divided by \$100 of attributable costs). And, again the two classes using this
3 function bear the institutional costs of the function.

4 As shown in this table, the "unbundling" of the institutional cost assignment
5 results in a lower contribution for Class B since this class does not use any of Function
6 2 and since Function 2 accounts for 80 percent of the institutional costs. In contrast,
7 the contribution of Class C rises since this class uses only Function 2.

8 As noted in Docket No. R90-1, the "unbundling" of the institutional cost
9 assignment would have allowed the Commission to explicitly account for the different
10 mix of functions used by each subclass and the different amounts of institutional costs
11 incurred to provide the various functions. In this proceeding, I have focused on deriving
12 a better measure of total attributable costs for assigning institutional costs which
13 explicitly accounts for the different mix of functions used by each subclass of mail and
14 the different amounts of institutional costs incurred to provide these functions. In this
15 way, the Commission could apply their judgment to a single cost figure for each
16 subclass. As described below, a better metric for institutional cost assignment can be
17 derived by weighting the attributable costs associated with each function.

18 V. A BETTER METRIC -- WEIGHTED ATTRIBUTABLE COSTS

19 Using the traditional measure of total attributable costs, \$1 of mail processing
20 costs receives the same weight as \$1 of delivery costs when assigning institutional
21 costs. However, as shown above mail processing costs account for 50 percent of the
22 attributable costs and only 28 percent of the institutional costs. In contrast, delivery
23 costs account for 29 percent of the attributable costs and 61 percent of the institutional
24 costs. Therefore, using total attributable costs as the metric for assigning institutional
25 costs can result in a large share of the institutional costs of delivery being assigned to

1 subclasses with large amounts of mail processing costs. In contrast, subclasses which
2 use mostly the delivery function can receive a lower institutional cost assignment, even
3 though a large share of institutional costs are incurred to provide the delivery function.

4 When assigning institutional costs to subclasses, I propose that the attributable
5 costs of each function be weighted by a factor equal to the percentage of total
6 institutional costs divided by the percentage of attributable costs for that function. In
7 this way, the attributable costs for those functions that have a large portion of
8 institutional costs relative to attributable costs will be given greater weight when
9 assigning institutional costs. The attributable costs for those functions with a large
10 percentage of attributable costs but few institutional costs will be given far less weight
11 when assigning institutional costs.

12 Let us return to our example. In this example, Function 1 accounted for 60
13 percent of total attributable costs and Function 2 accounted for the remaining 40
14 percent of total attributable costs. However, Function 1 accounted for only 20 percent
15 of the institutional costs; while Function 2 accounted for the remaining 80 percent of the
16 institutional costs. Thus, the weights for these two functions are derived, as follows:

Table 6			
Example: Derivation of Weights			
	Function 1	Function 2	Total
Attributable Costs	\$150	\$100	\$250
Percentage of Attributable Costs	60%	40%	100%
Institutional Costs	\$30	\$120	\$150
Percentage of Institutional Costs	20%	80%	100%
Weighting Factor	0.333	2.000	

- 1 Applying these weighting factors to the attributable costs of each function for
2 each subclass results in the following "weighted attributable costs."

Table 7						
Example: Derivation of Weighted Attributable Costs						
	Function 1		Function 2		Total Attributable Costs	
	Unweighted	Weighted	Unweighted	Weighted	Unweighted	Weighted
Class A	\$75	\$25	\$50	\$100	\$125	\$125
Class B	\$75	\$25	0	0	\$75	\$25
Class C	0	0	\$50	\$100	\$50	\$100
Total	\$150	\$50	\$100	\$200	\$250	\$250

- 3 In this example, the attributable costs of Function 1 are multiplied by the
4 weighting factor of 0.333 (20% institutional costs divided by 60% attributable costs) and
5 the attributable costs of Function 2 are multiplied by the weighting factor of 2.000 (80%
6 institutional costs divided by 40% attributable costs). By so doing, greater weight is
7 given to the attributable costs of the function that causes the bulk of the institutional
8 costs to be incurred. Thus, the attributable costs of Function 2 are given greater weight
9 since this function accounts for the majority of the institutional costs. Less weight is
10 given to the attributable costs of Function 1 which has low institutional costs and a high
11 percentage of attributable costs.

1 Note that, as a result, the weighted attributable costs of Class C are greater than
 2 the unweighted costs for this class of mail. This weighting recognizes that Class C
 3 uses Function 2 only -- the function that accounts for the majority of the institutional
 4 costs -- and therefore, should bear a greater share of the institutional costs when
 5 compared to Class B which uses Function 1 only.

6 If these weighted attributable costs are used to assign institutional costs to
 7 subclasses, the following institutional cost assignments will result. (Assuming once
 8 again that the Commission has determined that equal markups are appropriate for
 9 these classes of mail.)⁸

	Weighted Attributable Costs	Markup	Institutional Cost Contribution
Class A	\$125	60%	\$75
Class B	\$25	60%	\$15
Class C	\$100	60%	\$60
Total	\$250	60%	\$150

10 In the above table, the institutional cost contribution is reduced for Class B and
 11 increased for Class C relative to the assignments that result using unweighted
 12 attributable costs (Table 4). The use of the weighted attributable costs to assign
 13 institutional costs explicitly accounts for the fact that Class C is using a function with a
 14 large portion of institutional costs, while Class B is using a function with much lower
 15 institutional costs. The assignment of institutional costs to Class A is unchanged in this
 16 example.

⁸ The method applies equally well where markups are not uniform. For example, see my discussion in Section VI where I apply the method using the Postal Service's proposed institutional cost contributions.

1 When computing the revenues to be recovered from each class of mail, each
 2 class of mail would be assigned its actual attributable costs (unweighted) as required
 3 under the Act and the institutional costs as derived above. The total revenue to be
 4 recovered from each class of mail is shown below.

Table 9			
Example: Total Revenues by Class			
	Attributable Costs	Institutional Costs	Total Revenues
Class A	\$125	\$75	\$200
Class B	\$75	\$15	\$90
Class C	\$50	\$60	\$110
Total	\$250	\$150	\$400

5 This method provides a metric -- weighted attributable costs -- to which the
 6 Commission can apply markups based upon its assessment of the factors under
 7 Section 3622(b) of the Postal Reorganization Act. Thus, this method of assigning
 8 institutional costs does not replace the essential role of judgment with any mechanistic
 9 method. Instead, this method provides a better cost figure to which the Commission
 10 can apply its judgment.

11 In this testimony, I am not proposing a specific assignment of the institutional
 12 costs of the Postal Service. Instead, I am simply trying to provide a metric with which
 13 the Postal Rate Commission can gauge the reasonableness of any proposed
 14 institutional cost contributions. This section has provided an example of an assignment
 15 of institutional costs based upon my proposed metric. In the next section of my
 16 testimony, I derive the weighting factors for the four main functions provided by the
 17 Postal Service and compute the weighted attributable costs for each of the subclasses.
 18 I then illustrate the implied "weighted attributable cost" markups that result from the
 19 Postal Service's proposed institutional cost contributions.

1 VI. THE POSTAL SERVICE'S WEIGHTED ATTRIBUTABLE COSTS

2 In this section of my testimony, I apply my proposed method to the Postal
3 Service's cost data for the different functions provided. As discussed above, Exhibit
4 NAA-1A and Exhibit NAA-1B present the attributable costs for the four main functions
5 provided by the Postal Service -- mail processing, window service, transportation and
6 delivery -- for each subclass. Exhibit NAA-1C derives the weighting factors as
7 described in Section V above. These weighting factors are the percentage of
8 identifiable institutional costs divided by the percentage of attributable costs associated
9 with providing each function.

10 As shown Exhibit NAA-1C, mail processing costs receive a weight of 0.5613.
11 This factor reflects the fact that the institutional costs associated with mail processing
12 are a much smaller percentage than the attributable costs associated with providing this
13 function. In contrast, the delivery function receives a weighting factor of 2.1003. This
14 higher weight recognizes the fact that over half of the costs of providing the delivery
15 function are institutional costs. Window service and transportation receive weights of
16 1.9649 and 0.2744, respectively.

17 Applying these weights to the Postal Service's attributable costs in Exhibit NAA-
18 1B results in the weighted attributable costs shown in Exhibit NAA-1D. Exhibit NAA-1E
19 compares the Postal Service's institutional cost contributions at proposed rates to the
20 weighted attributable costs to derive the weighted markups in the Postal Service's
21 proposal. As this exhibit shows, the system-wide markup is 78.67%. The weighted
22 markup for First-Class letter mail is 102.15%. Standard A Commercial ECR mail has a
23 *weighted markup of 77.75%, a markup approximately equal to the system-wide markup.*

24 In my view, markups based upon the weighted attributable costs give a more
25 accurate and appropriate indication of the actual institutional cost burden imposed upon
26 each subclass. The Postal Service's measure of markup based upon unweighted

1 attributable costs results in a markup of 128.30% for Standard A ECR mail. However,
2 this markup is misleading in that it fails to account for the relative mix of the postal
3 functions used by ECR mail. In particular, the Postal Service's markup does not reflect
4 the fact that Standard A ECR mailers depend primarily on the delivery function -- a
5 function which accounts for the majority of the institutional costs of the Postal Service.

6 VII. CONCLUSION

7 In this testimony, I am proposing an alternative to the use of total attributable
8 costs for the assignment of institutional costs. In its Docket No. R90-1 decision, the
9 Commission noted that "total attributable costs are not a completely accurate measure
10 of how much various subclasses benefit from institutional effort." (¶14049) I am
11 proposing that the Commission use a new metric for assigning institutional costs to
12 subclasses of mail -- weighted attributable costs. By weighting the attributable costs of
13 each of the functions offered by the Postal Service, this measure of attributable costs
14 more accurately reflects how each subclass benefits from institutional effort. My
15 proposal is simply to substitute this measure of weighted attributable costs for total
16 attributable costs when assigning institutional costs. The Commission could then apply
17 its judgmental assessment of the factors under Section 3622(b) of the Act to derive the
18 appropriate markup for each subclass of mail.

19 In this direct testimony, my analysis is aimed simply at providing a better "ruler"
20 for measuring the appropriate assignment of institutional costs. I make no judgments
21 regarding the relative level of the institutional costs contribution to be recovered from
22 each of the subclasses.

Exhibit NAA-1A
ATTRIBUTABLE COSTS BY FUNCTION
 After Rates, Totals Include Contingency Fee

Line No.	Description	Mail Processing Costs CS 3.1	CS 4	Piggyback Factor	Mail Processing Total
First-Class Mail					
1	Single-Piece Letters	4,899,112	2,645	1.56702	7,757,963
2	Worksharing Letters	1,221,871	631	1.60350	1,979,885
3	Total Letters	6,120,983	3,276		9,737,848
4	Single-Piece Cards	137,636	77	1.53045	212,870
5	Worksharing Postcards	49,979	26	1.53597	77,574
6	Total Cards	187,615	103		290,445
7	Total First-Class Mail	6,308,598	3,379		10,028,292
8	Priority Mail	534,646	137	1.55900	842,064
9	Express Mail	96,575	0	1.55108	151,294
10	Mailgrams	95	0	1.28619	123
Periodicals					
11	In-County	15,977	3	1.47714	23,841
12	Outside County				0
13	Nonprofit	82,589	16	1.52572	127,292
14	Classroom	4,765	1	1.52048	7,319
15	Regular Rate	493,023	97	1.51853	756,306
16	Total Periodicals	596,354	117		914,758
Standard A Mail					
17	Single Piece	87,560	23	1.58271	0
18	Commercial Regular	1,900,197	495	1.56284	3,000,182
19	Commercial ECR	270,838	66	1.56331	427,742
20	Total Commercial	2,258,595	584		3,427,924
21	Nonprofit	404,828	107	1.55015	633,987
22	Nonprofit ECR	26,167	6	1.58836	41,988
23	Total Nonprofit	430,995	113		675,975
24	Total Standard A Mail	2,689,590	697		4,103,899
Standard B Mail					
25	Parcel Post	157,448		1.73911	276,558
26	Bound Printed Matter	80,829		1.69684	138,525
27	Special Rate	72,355		1.75785	128,461
28	Library Rate	15,581		1.70038	26,759
29	Total Standard B Mail	326,213			570,303
30	USPS Penalty Mail	80,180		1.49609	0
31	Free-for-the-Blind, etc.	12,075		1.62782	19,852
32	International Mail	212,491		1.55626	333,998
33	TOTAL ALL MAIL	10,856,817	4,330		16,964,584
34	Special Services	119,150	98	1.82894	220,278
35	TOTAL ATTRIBUTABLE COSTS	10,975,967	4,428	1.56505	17,184,862
36	INSTITUTIONAL COSTS	3,319,599	5,651	1.52834	5,132,943

1.0% Contingency Fee included in
 totals for each service.

Exhibit NAA-1A

ATTRIBUTABLE COSTS BY FUNCTION

After Rates, Totals Include Contingency Fee

Line No.	Description	Window Service CS 3.2	Piggyback Factor	Window Service Total	Transportation Costs CS 14
First-Class Mail					
1	Single-Piece Letters	525,379	1.41856	752,734	625,377
2	Worksharing Letters	24,113	1.41858	34,548	274,740
3	Total Letters	549,492		787,283	900,117
4	Single-Piece Cards	33,661	1.41856	48,228	9,292
5	Worksharing Postcards	1,016	1.41920	1,456	3,070
6	Total Cards	34,677		49,684	12,362
7	Total First-Class Mail	584,169		836,967	912,479
8	Priority Mail	51,186	1.41856	73,337	801,977
9	Express Mail	27,063	1.41856	38,774	68,466
10	Mailgrams	0	1.41854	0	0
Periodicals					
11	In-County	502	1.42406	722	66
12	Outside County				
13	Nonprofit	245	1.41129	349	64,043
14	Classroom	0	0.00000	0	1,993
15	Regular Rate	2,389	1.41784	3,421	279,349
16	Total Periodicals	3,136		4,492	345,450
Standard A Mail					
17	Single Piece	2,828	1.41902	0	0
18	Commercial Regular	29,333	1.41860	42,028	317,864
19	Commercial ECR	5,956	1.41834	8,532	61,321
20	Total Commercial	38,117		50,560	379,185
21	Nonprofit	9,685	1.41852	13,876	60,529
22	Nonprofit ECR	878	1.42001	1,259	7,160
23	Total Nonprofit	10,563		15,135	67,689
24	Total Standard A Mail	48,680		65,695	446,875
Standard B Mail					
25	Parcel Post	6,623	1.44380	9,658	327,576
26	Bound Printed Matter	720	1.42112	1,033	64,762
27	Special Rate	3,592	1.41863	5,147	60,023
28	Library Rate	101	1.38679	141	13,062
29	Total Standard B Mail	11,036		15,979	465,424
30	USPS Penalty Mail	12,599	1.41851	0	0
31	Free-for-the-Blind, etc.	216	1.41935	310	4,242
32	International Mail	24,292	1.41854	34,804	763,912
33	TOTAL ALL MAIL	762,377		1,070,358	3,808,826
34	Special Services	230,461	1.41855	330,190	0
35	TOTAL ATTRIBUTABLE COSTS	992,838		1,400,548	3,808,826
36	INSTITUTIONAL COSTS	1,058,584	1.36972	1,464,467	556,090

1.0% Contingency Fee included in totals for each service.

Exhibit NAA-1A
ATTRIBUTABLE COSTS BY FUNCTION
 After Rates, Totals Include Contingency Fee

Line No.	Description	City Delivery CS 6&7	Delivery Costs Piggyback Factor	Vehical Service Drivers CS 8	VS Drivers Piggyback Factor
First-Class Mail					
1	Single-Piece Letters	1,795,578	1.31157	30,419	1.57417
2	Worksharing Letters	898,440	1.32005	20,191	1.56117
3	Total Letters	2,694,018		50,610	
4	Single-Piece Cards	83,050	1.31694	242	1.55307
5	Worksharing Postcards	39,830	1.31804	241	1.50568
6	Total Cards	122,880		483	
7	Total First-Class Mail	2,816,898		51,093	
8	Priority Mail	130,873	1.37890	24,852	1.53564
9	Express Mail	24,571	1.41823	1,718	1.55041
10	Mailgrams	194	1.41733	1	1.00000
Periodicals					
11	In-County	25,037	1.30917	2,484	1.56783
12	Outside County				
13	Nonprofit	60,610	1.30919	6,167	1.57706
14	Classroom	1,554	1.30626	245	1.60828
15	Regular Rate	238,117	1.30669	32,339	1.56908
16	Total Periodicals	325,318		41,235	
Standard A Mail					
17	Single Piece	30,102	1.32621	498	1.54661
18	Commercial Regular	987,764	1.30701	49,525	1.54612
19	Commercial ECR	735,413	1.30485	39,615	1.55147
20	Total Commercial	1,753,279		89,638	
21	Nonprofit	207,195	1.30679	7,568	1.55569
22	Nonprofit ECR	43,267	1.30368	1,800	1.55785
23	Total Nonprofit	250,462		9,368	
24	Total Standard A Mail	2,003,741		99,006	
Standard B Mail					
25	Parcel Post	49,296	1.36570	29,452	1.54678
26	Bound Printed Matter	58,315	1.40517	15,584	1.55389
27	Special Rate	30,730	1.37620	5,520	1.56238
28	Library Rate	4,593	1.38838	625	1.57491
29	Total Standard B Mail	142,934		51,181	
30	USPS Penalty Mail	11,697	1.30397	994	1.62076
31	Free-for-the-Blind, etc.	3,837	1.29955	620	1.54646
32	International Mail	23,119	1.35378	5,606	1.58193
33	TOTAL ALL MAIL	5,483,182		276,306	
34	Special Services	126,759	1.29571	0	
35	TOTAL ATTRIBUTABLE COSTS	5,609,941		276,306	
36	INSTITUTIONAL COSTS	6,350,591	1.29616	172,666	1.54511

1.0% Contingency Fee included in totals for each service.

Exhibit NAA-1A
ATTRIBUTABLE COSTS BY FUNCTION
 After Rates, Totals Include Contingency Fee

Line No.	Description	Special Delivery CS 9	Spec. Del. Piggyback Factor	Rural Carriers CS 10	Rural Carrier Piggyback Factor	Total Delivery Costs
First-Class Mail						
1	Single-Piece Letters	729	1.49657	308,636	1.19701	2,801,177
2	Worksharing Letters	346	1.48285	286,874	1.19693	1,577,002
3	Total Letters	1,075		595,510		4,378,179
4	Single-Piece Cards	39	1.45000	19,991	1.19702	135,071
5	Worksharing Postcards	22	1.31818	14,421	1.19661	70,847
6	Total Cards	61		34,412		205,918
7	Total First-Class Mail	1,136		629,922		4,584,097
8	Priority Mail	1,164	1.49376	15,607	1.19650	241,427
9	Express Mail	50,446	1.49538	5,397	1.19693	120,601
10	Mailgrams	53	1.43396	13	1.07692	370
Periodicals						
11	In-County	3	1.00000	14,487	1.19696	54,556
12	Outside County					0
13	Nonprofit	5	1.20000	34,714	1.19697	131,940
14	Classroom	0	0.00000	763	1.19805	3,371
15	Regular Rate	23	1.39130	114,811	1.19696	504,337
16	Total Periodicals	31		164,775		694,204
Standard A Mail						
17	Single Piece	8	1.50000	1,320	1.19660	0
18	Commercial Regular	8	1.28571	393,561	1.19684	1,857,015
19	Commercial ECR	5	1.20000	264,433	1.19686	1,350,936
20	Total Commercial	21		659,314		3,207,951
21	Nonprofit	3	1.00000	82,285	1.19691	384,835
22	Nonprofit ECR	3	1.00000	12,670	1.19672	75,120
23	Total Nonprofit	6		94,955		459,954
24	Total Standard A Mail	27		754,269		3,667,906
Standard B Mail						
25	Parcel Post	44	1.38297	11,068	1.19684	127,449
26	Bound Printed Matter	3	1.00000	11,706	1.19687	121,374
27	Special Rate	3	1.00000	5,691	1.19676	58,306
28	Library Rate	3	1.00000	1,228	1.19783	8,923
29	Total Standard B Mail	53		29,693		316,052
30	USPS Penalty Mail	1	1.00000	1,317	1.19741	0
31	Free-for-the-Blind, etc.	0	0.00000	786	1.19592	6,954
32	International Mail	8,071	1.49531	2,560	1.19639	55,851
33	TOTAL ALL MAIL	60,982		1,604,339		9,687,461
34	Special Services	60	1.44615	70,136	1.19682	250,753
35	TOTAL ATTRIBUTABLE COSTS	61,042		1,674,475		9,938,214
36	INSTITUTIONAL COSTS	53,072	1.47535	2,047,129	1.18276	11,107,739

1.0% Contingency Fee included in totals for each service.

Exhibit NAA-1A
ATTRIBUTABLE COSTS BY FUNCTION
 After Rates, Totals Include Contingency Fee

Line No.	Description	Other Costs & Adjustments	Total Attributable
First-Class Mail			
1	Single-Piece Letters	821,413	12,758,664
2	Worksharing Letters	180,908	4,047,084
3	Total Letters	1,002,322	16,805,748
4	Single-Piece Cards	26,800	432,261
5	Worksharing Postcards	7,175	160,123
6	Total Cards	33,974	592,384
7	Total First-Class Mail	1,036,296	17,398,132
8	Priority Mail	307,412	2,266,217
9	Express Mail	31,429	410,564
10	Mailgrams	15	508
Periodicals			
11	In-County	2,176	81,360
12	Outside County	0	
13	Nonprofit	7,847	331,471
14	Classroom	72	12,755
15	Regular Rate	34,476	1,577,889
16	Total Periodicals	44,570	2,003,475
Standard A Mail			
17	Single Piece	-298	-298
18	Commercial Regular	-25,415	5,191,674
19	Commercial ECR	36,717	1,885,248
20	Total Commercial	11,003	7,076,624
21	Nonprofit	13,878	1,107,105
22	Nonprofit ECR	-406	125,121
23	Total Nonprofit	13,472	1,232,226
24	Total Standard A Mail	24,476	8,308,850
Standard B Mail			
25	Parcel Post	12,087	753,327
26	Bound Printed Matter	20,318	346,013
27	Special Rate	4,923	256,860
28	Library Rate	199	49,085
29	Total Standard B Mail	37,527	1,405,285
30	USPS Penalty Mail	0	0
31	Free-for-the-Blind, etc.	399	31,757
32	International Mail	17,465	1,206,030
33	TOTAL ALL MAIL	1,499,589	33,030,818
34	Special Services	483,633	1,284,854
35	TOTAL ATTRIBUTABLE COSTS	1,983,222	34,315,672
36	INSTITUTIONAL COSTS	0	26,997,063

1.0% Contingency Fee included in totals for each service.

Exhibit NAA-1B
 ATTRIBUTABLE COSTS BY FUNCTION AND SUBCLASS
 (Test Year After Rates)

Page 1 of 2

Line No.	Description	Mail Processing	Window Service	Transportation Costs	Delivery Costs	Other Costs Adjustment	Total Attributable Costs
First-Class Mail							
1	Single-Piece Letters	7,757,963	752,734	625,377	2,801,177	821,413	12,758,664
2	Worksharing Letters	1,979,885	34,548	274,740	1,577,002	180,908	4,047,084
3	Total Letters	9,737,848	787,283	900,117	4,378,179	1,002,322	16,805,748
4	Single-Piece Cards	212,870	48,228	9,292	135,071	26,800	432,261
5	Worksharing Postcards	77,574	1,456	3,070	70,847	7,175	160,123
6	Total Cards	290,445	49,684	12,362	205,918	33,974	592,384
7	Total First-Class Mail	10,028,292	836,967	912,479	4,584,097	1,036,296	17,398,132
8	Priority Mail	842,064	73,337	801,977	241,427	307,412	2,266,217
9	Express Mail	151,294	38,774	68,466	120,601	31,429	410,564
10	Mailgrams	123	0	0	370	15	508
Periodicals							
11	In-County	23,841	722	66	54,556	2,176	81,360
12	Outside County	0			0	0	0
13	Nonprofit	127,292	349	64,043	131,940	7,847	331,471
14	Classroom	7,319	0	1,993	3,371	72	12,755
15	Regular Rate	756,306	3,421	279,349	504,337	34,476	1,577,889
16	Total Periodicals	914,758	4,492	345,450	694,204	44,570	2,003,475
Standard A Mail							
17	Single Piece	0	0	0	0	-298	-298
18	Commercial Regular	3,000,182	42,028	317,864	1,857,015	-25,415	5,191,674
19	Commercial ECR	427,742	8,532	61,321	1,350,936	36,717	1,885,248
20	Total Commercial	3,427,924	50,560	379,185	3,207,951	11,003	7,076,624
21	Nonprofit	633,987	13,876	60,529	384,835	13,878	1,107,105
22	Nonprofit ECR	41,988	1,259	7,160	75,120	-406	125,121
23	Total Nonprofit	675,975	15,135	67,689	459,954	13,472	1,232,226
24	Total Standard A Mail	4,103,899	65,695	446,875	3,667,906	24,476	8,308,850
Standard B Mail							
25	Parcel Post	276,558	9,658	327,576	127,449	12,087	753,327
26	Bound Printed Matter	138,525	1,033	64,762	121,374	20,318	346,013
27	Special Rate	128,461	5,147	60,023	58,306	4,923	256,860
28	Library Rate	26,759	141	13,062	8,923	199	49,085
29	Total Standard B Mail	570,303	15,979	465,424	316,052	37,527	1,405,285
30	Free-for-the-Blind, etc.	19,852	310	4,242	6,954	399	31,757
31	International Mail	333,998	34,804	763,912	55,851	17,465	1,206,030
32	TOTAL ALL MAIL	16,964,584	1,070,358	3,808,826	9,687,461	1,499,589	33,030,818
33	Special Services	220,278	330,190	0	250,753	483,633	1,284,854
34	TOTAL ATTRIBUTABLE COSTS	17,184,862	1,400,548	3,808,826	9,938,214	1,983,222	34,315,672

Exhibit NAA-1B
 ATTRIBUTABLE COSTS BY FUNCTION AND SUBCLASS
 (Test Year After Rates)

Page 2 of 2

Line No.	Description	Mail Processing	Window Service	Transportation Costs	Delivery Costs	Other Costs Adjustment	Total Attributable Costs
First-Class Mail							
1	Single-Piece Letters	60.81%	5.90%	4.90%	21.96%	6.44%	100.00%
2	Worksharing Letters	48.92%	0.85%	6.79%	38.97%	4.47%	100.00%
3	Total Letters	57.94%	4.68%	5.36%	26.05%	5.96%	100.00%
4	Single-Piece Cards	49.25%	11.16%	2.15%	31.25%	6.20%	100.00%
5	Worksharing Postcards	48.45%	0.91%	1.92%	44.25%	4.48%	100.00%
6	Total Cards	49.03%	8.39%	2.09%	34.76%	5.74%	100.00%
7	Total First-Class Mail	57.64%	4.81%	5.24%	26.35%	5.96%	100.00%
8	Priority Mail	37.16%	3.24%	35.39%	10.65%	13.56%	100.00%
9	Express Mail	36.85%	9.44%	16.68%	29.37%	7.66%	100.00%
10	Mailgrams	24.29%	0.00%	0.00%	72.76%	2.95%	100.00%
Periodicals							
11	In-County	29.30%	0.89%	0.08%	67.05%	2.67%	100.00%
12	Outside County						
13	Nonprofit	38.40%	0.11%	19.32%	39.80%	2.37%	100.00%
14	Classroom	57.38%	0.00%	15.62%	26.43%	0.56%	100.00%
15	Regular Rate	47.93%	0.22%	17.70%	31.96%	2.18%	100.00%
16	Total Periodicals	45.66%	0.22%	17.24%	34.65%	2.22%	100.00%
Standard A Mail							
17	Single Piece	0.00%	0.00%	0.00%	0.00%	100.00%	100.00%
18	Commercial Regular	57.79%	0.81%	6.12%	35.77%	-0.49%	100.00%
19	Commercial ECR	22.69%	0.45%	3.25%	71.66%	1.95%	100.00%
20	Total Commercial	48.44%	0.71%	5.36%	45.33%	0.16%	100.00%
21	Nonprofit	57.27%	1.25%	5.47%	34.76%	1.25%	100.00%
22	Nonprofit ECR	33.56%	1.01%	5.72%	60.04%	-0.32%	100.00%
23	Total Nonprofit	54.86%	1.23%	5.49%	37.33%	1.09%	100.00%
24	Total Standard A Mail	49.39%	0.79%	5.38%	44.14%	0.29%	100.00%
Standard B Mail							
25	Parcel Post	36.71%	1.28%	43.48%	16.92%	1.60%	100.00%
26	Bound Printed Matter	40.03%	0.30%	18.72%	35.08%	5.87%	100.00%
27	Special Rate	50.01%	2.00%	23.37%	22.70%	1.92%	100.00%
28	Library Rate	54.51%	0.29%	26.61%	18.18%	0.41%	100.00%
29	Total Standard B Mail	40.58%	1.14%	33.12%	22.49%	2.67%	100.00%
30	Free-for-the-Blind, etc.	62.51%	0.98%	13.36%	21.90%	1.26%	100.00%
31	International Mail	27.69%	2.89%	63.34%	4.63%	1.45%	100.00%
32	TOTAL ALL MAIL	51.36%	3.24%	11.53%	29.33%	4.54%	100.00%
33	Special Services	17.14%	25.70%	0.00%	19.52%	37.64%	100.00%
34	TOTAL ATTRIBUTABLE COSTS	50.08%	4.08%	11.10%	28.96%	5.78%	100.00%

**Exhibit NAA-1C
DERIVATION OF WEIGHTING FACTORS**

Line No.		Mall Processing	Window Service	Transportation	Delivery	Other	Total
1	Total Attributable Costs	17,184,862	1,400,548	3,808,826	9,938,214	1,983,222	34,315,672
2	Percent of Total Attributable	50.08%	4.08%	11.10%	28.96%	5.78%	100.00%
3	Total Institutional Costs	5,132,943	1,464,467	556,090	11,107,739	0	18,261,239
4	Percent of Total Institutional	28.11%	8.02%	3.05%	60.83%	0.00%	100.00%
5	% Institutional/% Attributable	56.13%	196.49%	27.44%	210.03%	0.00%	

Line 1: Exhibit NAA-1B, page 1, line 34.

Line 2: Attributable Costs for each function in Line 1 divided by Total Attributable Cost.

Line 3: Exhibit NAA-1A, line 36.

Line 4: Institutional Costs for each function in Line 3 divided by Total Institutional Costs for these four function.

Line 5: Line 4 divided by Line 2.

Exhibit NAA-1D
 WEIGHTED ATTRIBUTABLE COSTS BY FUNCTION AND SUBCLASS
 (Test Year After Rates)

Line No.	Description	Mail Processing	Window Service	Transportation Costs	Delivery Costs	Other Costs	Total Attributable Costs
1	First-Class Mail						
2	Single-Piece Letters	4,354,420	1,479,060	171,577	5,883,288	0	11,888,345
3	Worksharing Letters	1,111,278	67,884	75,377	3,312,165	0	4,566,704
4	Total Letters	5,465,698	1,546,945	246,953	9,195,453	0	16,455,049
5	Single-Piece Cards	119,481	94,763	2,549	283,689	0	500,482
6	Worksharing Postcards	43,541	2,862	842	148,800	0	196,045
7	Total Cards	163,022	97,625	3,392	432,489	0	696,527
8	Total First-Class Mail	5,628,720	1,644,570	250,345	9,627,941	0	17,151,576
9	Priority Mail	472,637	144,100	220,028	507,068	0	1,343,833
10	Express Mail	84,919	76,188	18,784	253,297	0	433,188
11	Mailgrams	69	0	0	776	0	846
12	Periodicals						
13	In-County	13,381	1,419	18	114,583	0	129,401
14	Outside County						
15	Nonprofit	71,447	686	17,571	277,112	0	366,816
16	Classroom	4,108	0	547	7,081	0	11,736
17	Regular Rate	424,502	6,722	76,641	1,059,255	0	1,567,121
18	Total Periodicals	513,439	8,827	94,777	1,458,031	0	2,075,074
19	Standard A Mail						
20	Single Piece	0	0	0	0	0	0
21	Commercial Regular	1,683,954	82,581	87,208	3,900,273	0	5,754,017
22	Commercial ECR	240,085	16,765	16,824	2,837,360	0	3,111,033
23	Total Commercial	1,924,039	99,346	104,032	6,737,633	0	8,865,050
24	Nonprofit	355,847	27,265	16,607	808,265	0	1,207,983
25	Nonprofit ECR	23,567	2,474	1,964	157,773	0	185,779
26	Total Nonprofit	379,414	29,739	18,571	966,038	0	1,393,762
27	Total Standard A Mail	2,303,453	129,085	122,603	7,703,671	0	10,258,813
28	Standard B Mail						
29	Parcel Post	155,227	18,977	89,873	267,679	0	531,757
30	Bound Printed Matter	77,752	2,031	17,768	254,920	0	352,471
31	Special Rate	72,103	10,113	16,468	122,460	0	221,143
32	Library Rate	15,019	278	3,584	18,742	0	37,623
33	Total Standard B Mail	320,102	31,398	127,692	663,801	0	1,142,993
34	Free-for-the-Blind, etc.	11,143	608	1,164	14,605	0	27,521
35	International Mail	187,468	68,386	209,585	117,303	0	582,742
36	TOTAL ALL MAIL	9,521,949	2,103,164	1,044,978	20,346,494	0	33,016,585
37	Special Services	123,639	648,795	0	526,653	0	1,299,087
38	TOTAL ATTRIBUTABLE COSTS	9,645,588	2,751,959	1,044,978	20,873,147	0	34,315,672
39	WEIGHTING FACTORS	56.13%	196.49%	27.44%	210.03%	0.00%	

Exhibit NAA-1E
 USPS MARKUPS BASED UPON WEIGHTED ATTRIBUTABLE COSTS
 (Test Year After Rates)

<u>Line No.</u>	<u>Description</u>	<u>USPS Contribution at Proposed Rates</u>	<u>Weighted Attributable Costs</u>	<u>Weighted Markup</u>
	First-Class Mail			
1	Single-Piece Letters	9,390,095	11,888,345	78.99%
2	Worksharing Letters	7,418,926	4,566,704	162.46%
3	Total Letters	16,809,021	16,455,049	102.15%
4	Single-Piece Cards	228,751	500,482	45.71%
5	Worksharing Postcards	267,843	196,045	136.62%
6	Total Cards	496,594	696,527	71.30%
7	Total First-Class Mail	17,305,615	17,151,576	100.90%
8	Priority Mail	2,086,476	1,343,833	155.26%
9	Express Mail	430,652	433,188	99.41%
10	Mailgrams	4,168	846	492.92%
	Periodicals			
11	In-County	2,305	129,401	1.78%
12	Outside County			
13	Nonprofit	11,160	366,816	3.04%
14	Classroom	-2,215	11,736	-18.87%
15	Regular Rate	111,057	1,567,121	7.09%
16	Total Periodicals	122,307	2,075,074	5.89%
	Standard A Mail			
17	Single Piece	298	0	
18	Commercial Regular	2,830,371	5,754,017	49.19%
19	Commercial ECR	2,418,756	3,111,033	77.75%
20	Total Commercial	5,249,425	8,865,050	59.21%
21	Nonprofit	244,328	1,207,983	20.23%
22	Nonprofit ECR	76,287	185,779	41.06%
23	Total Nonprofit	320,615	1,393,762	23.00%
24	Total Standard A Mail	5,570,040	10,258,813	54.30%
	Standard B Mail			
25	Parcel Post	29,589	531,757	5.56%
26	Bound Printed Matter	178,595	352,471	50.67%
27	Special Rate	95,470	221,143	43.17%
28	Library Rate	3,342	37,623	8.88%
29	Total Standard B Mail	306,996	1,142,993	26.86%
30	Free-for-the-Blind, etc.	-31,757	27,521	-115.39%
31	International Mail	437,814	582,742	75.13%
32	TOTAL ALL MAIL	26,232,311	33,016,585	79.45%
33	Special Services	764,752	1,299,087	58.87%
34	TOTAL	26,997,063	34,315,672	78.67%

**Exhibit NAA-1F
DERIVATION OF PIGGYBACK FACTORS FOR
INSTITUTIONAL COSTS BY COST COMPONENT***

Line No.		Mail Processing	Window Service	City Delivery Carriers	Vehicle Service Drivers	Special Delivery Messengers	Rural Carriers
1	Direct Labor	10,910,433	1,008,886	5,639,362	280,125	62,011	1,683,448
2	Total Estimated Attr. Costs	17,169,421	1,431,357	7,414,004	435,876	92,719	2,014,932
3	Piggyback Factor	1.57367	1.41875	1.31469	1.55601	1.49520	1.19691
4	Total Estimated Attr. Costs	17,169,421	1,431,357	7,414,004	435,876	92,719	2,014,932
5	Less: Imputed Rents	246,796	24,683	52,130	1,524	614	11,885
6	Bldg. Depreciation	208,505	20,854	44,043	1,287	519	10,042
7	Bldg. Interest	39,239	3,925	8,289	242	98	1,890
8	Adjusted Attributable Costs	16,674,881	1,381,895	7,309,542	432,823	91,488	1,991,115
9	Piggyback Factor for Institutional Costs	1.52834	1.36972	1.29616	1.54511	1.47535	1.18276

Source: Direct Labor and all Attributable Cost figures on Lines 1, 2, 4-7 from Library Reference H-77.

Line 3 = Line 2 divided by Line 1

Line 8 = Line 4 less Lines 5-7

Line 9 = Line 8 divided by Line 1

* The piggyback factor for institutional costs in each cost segment equals the corresponding piggyback factor for the total attributable costs in the cost segment, except for the imputed rental costs and related building depreciation and interest. Since rental costs, building depreciation and building interest are 100 percent attributable based upon market values, there are no corresponding institutional costs for these cost components. Therefore, these costs are removed and the piggyback factors are recomputed to derive the appropriate piggyback factors for institutional costs.

EXHIBIT NAA-1G
SOURCES OF DATA FOR EXHIBITS

Exhibit NAA-1A

Cost data for each cost segment from USPS-15H, Cost Segments and Components,
Test Year 1998, Proposed Rates, with Workyear Mix Adjustment.

Cost data for Cost Segment 14 are adjusted per UPS/USPS-T33-36.

Piggyback factors from Library Reference H-77.

Other Costs & Adjustments are derived by subtracting the attributable costs of mail processing,
transportation, window service and delivery service from the total attributable costs for each subclass

Total Attributable Costs from USPS-30F, Column (1), revised 9/19/97.

Exhibit NAA-1B

Page 1: All cost data from Exhibit NAA-1A.

Page 2: Percentages derived by dividing attributable costs for each subclass by total
attributable costs for that function.

Exhibit NAA-1C

Sources given on exhibit.

Exhibit NAA-1D

Weighted attributable costs derived by multiplying the cost data in Exhibit NAA-1B, page 1
by the weighting factors on line 39.

Weighting factors from Exhibit NAA-1C, line 5.

Exhibit NAA-1E

USPS Contribution at Proposed Rates from USPS-30F, Column (4), revised 9/19/97.

Weighted attributable costs from Exhibit NAA-1D.

Exhibit NAA-1F

Sources given on exhibit.

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 1997

Docket No. R97-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF NEWSPAPER ASSOCIATION OF AMERICA
WITNESS SHARON L. CHOWN
(NAA-T1)

<u>Party</u>	<u>Interrogatories</u>
Advo, Inc.	ADVO/NAA-T1-1-10
Direct Marketing Association, Inc.	ADVO/NAA-T1-1, 4-7, 9 AMMA/NAA-T1-1, 4-5 DMA/NAA-T1-1-5 UPS/NAA-T1-3 USPS/NAA-T1-1 VP-CW/NAA-T1-4, 11
Mail Order Association of America	ADVO/NAA-T1-1, 3-7 AMMA/NAA-T1-1-8 DMA/NAA-T1-1 NNA/NAA-T1-1 UPS/NAA-T1-1-3 USPS/NAA-T1-1-5 VP-CW/NAA-T1-1-11
National Newspaper Association	NNA/NAA-T1-1-6
Office of the Consumer Advocate	ADVO/NAA-T1-1-10 AMMA/NAA-T1-1-8 DMA/NAA-T1-1-6 NNA/NAA-T1-1-6 UPS/NAA-T1-1-3 USPS/NAA-T1-1-5
United Parcel Service	UPS/NAA-T1-3
United States Postal Service	ADVO/NAA-T1-1-10 AMMA/NAA-T1-1, 3-8 DMA/NAA-T1-1-6

Party

Interrogatories

USPS/NAA-T1-1-5

Val-Pak Direct Marketing Services,
Val-Pak Dealers Association, and Carol
Wright

VP-CW/NAA-T1-1-11

Respectfully submitted,



Margaret P. Crenshaw
Secretary

INTERROGATORY RESPONSES OF
 NEWSPAPER ASSOCIATION OF AMERICA
 WITNESS SHARON L. CHOWN (T1)
 DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory:

ADVO/NAA-T1-1
 ADVO/NAA-T1-2
 ADVO/NAA-T1-3
 ADVO/NAA-T1-4
 ADVO/NAA-T1-5
 ADVO/NAA-T1-6
 ADVO/NAA-T1-7
 ADVO/NAA-T1-8
 ADVO/NAA-T1-9
 ADVO/NAA-T1-10
 AMMA/NAA-T1-1
 AMMA/NAA-T1-2
 AMMA/NAA-T1-3
 AMMA/NAA-T1-4
 AMMA/NAA-T1-5
 AMMA/NAA-T1-6
 AMMA/NAA-T1-7
 AMMA/NAA-T1-8
 DMA/NAA-T1-1
 DMA/NAA-T1-2
 DMA/NAA-T1-3
 DMA/NAA-T1-4
 DMA/NAA-T1-5
 DMA/NAA-T1-6
 NNA/NAA-T1-1
 NNA/NAA-T1-2

Designating Parties:

ADVO, DMA, MOAA, OCA, USPS
 ADVO, OCA, USPS
 ADVO, MOAA, OCA, USPS
 ADVO, DMA, MOAA, OCA, USPS
 ADVO, DMA, MOAA, OCA, USPS
 ADVO, DMA, MOAA, OCA, USPS
 ADVO, DMA, MOAA, OCA, USPS
 ADVO, OCA, USPS
 ADVO, DMA, OCA, USPS
 ADVO, OCA, USPS
 DMA, MOAA, OCA, USPS
 MOAA, OCA
 MOAA, OCA, USPS
 DMA, MOAA, OCA, USPS
 DMA, MOAA, OCA, USPS
 MOAA, OCA, USPS
 MOAA, OCA, USPS
 MOAA, OCA, USPS
 DMA, MOAA, OCA, USPS
 DMA, OCA, USPS
 DMA, OCA, USPS
 DMA, OCA, USPS
 DMA, OCA, USPS
 OCA, USPS
 MOAA, NNA, OCA
 NNA, OCA

NEWSPAPER ASSOCIATION OF AMERICA
WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)

ADVO/NAA-T1-1. Please confirm that, of all rate classes and categories listed in Exhibits NAA-1B and 1E, the two that have the highest ratio of "weighted attributable costs" to actual attributable costs are In-County Periodicals and Standard A Commercial ECR.

Answer:

Not confirmed. Mailgrams actually have the highest ratio of "weighted attributable costs" to actual attributable costs. Standard A Commercial ECR and In-County Periodicals have the second and third highest ratios, respectively.

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ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)

ADVO/NAA-T1-2. At page 19, you state that "Standard A ECR mailers depend primarily on the delivery function."

- (a) Is the same true of In-County Periodicals mailers?
- (b) Please confirm that, according to your Exhibit NAA-1B, delivery costs account for approximately 67 percent of the total attributable costs of In-County Periodicals.
- (c) Please confirm that In-County Periodicals mailers consist predominantly of daily and weekly newspapers. If you cannot confirm because you do not know, please state whether you have any basis to disagree that In-County mail consists predominantly of daily and weekly newspapers, and identify the basis for your disagreement.

Answer:

- (a) Yes.
- (b) Confirmed.
- (c) Confirmed.

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WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)

ADVO/NAA-T1-3. Please confirm the following with respect to In-County Periodicals and Standard A ECR mail:

- (a) The "weighted attributable costs" you calculate for In-County Periodicals, \$129.401 million, is \$48.041 million (or 59 percent) greater than In-County attributable costs.
- (b) The \$129.401 million "weighted attributable costs" you calculate for In-County Periodicals is almost \$46 million greater than the total revenues from In-County mail at the USPS proposed rates.
- (c) The \$3,111.033 million "weighted attributable costs" you calculate for Standard A ECR is \$1,190 million less than the total revenues from ECR mail at the USPS proposed rates.
- (d) At the USPS proposed rates, please confirm that ECR mail would generate revenues substantially greater than your calculated "weighted attributable costs" whereas In-County Periodicals would generate revenues substantially less than your "weighted attributable costs."

Answer:

- (a) Confirmed.
- (b) Confirmed.
- (c) Confirmed.
- (d) Weighted attributable costs are not a substitute for the actual attributable costs to be recovered from a subclass of mail, as required by the Act. I propose that the Commission use weighted attributable costs only in assigning institutional costs. As long as revenues exceed actual (unweighted) attributable costs, the subclass is making a positive contribution to the institutional costs of the Postal Service.

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WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)

With the understanding that the comparison that you are making is not useful, I confirm that the revenues at USPS proposed rates from ECR mail are greater than the weighted attributable costs, and that the revenues from in-county mail are less than weighted attributable costs. As you've not defined the word "substantial," I cannot state whether these differences are substantial or not. See also my answers to ADVO/NAA-T1-6 (a) & (b) and AMMA/NAA-T1-6(b).

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WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)

13302

ADVO/NAA-T1-4. To facilitate a comparison of your Docket No. R90-1 proposed approach with your current approach, please provide the following:

- (a) An itemization of all the differences between your Docket No. R90-1 proposed approach and your current proposed approach.
- (b) Using your example in Table 5 and Tables 6/7/8, a demonstration of how the institutional cost contributions for the three classes would be calculated under both (R97-1 and R90-1) approaches if there is not equal markup but rather Class C receives a markup approximately twice as large as that for the other two.

Answer:

- (a) First, both my Docket No. R90-1 method and my current proposed approach identify the attributable and institutional costs associated with the basic functions provided by the Postal Service. In Docket No. R90-1, I identified three basic functions – mail processing, transportation and delivery. In this proceeding, I identify four basic functions. I have added "window service" as a separate function.

Second, in Docket No. R90-1, I separately analyzed each cost component of the Postal Service to identify the costs associated with each of the three basic functions. In this proceeding, I identify the direct costs associated with each function and employ the Postal Service's piggyback factors to identify the remaining costs associated with that function. In so doing, more of the total attributable costs of the Postal Service are

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WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)

identified with the four functions in my direct testimony in this proceeding, leaving fewer costs in the "administrative" or "other" cost category.

Third, in Docket No. R90-1, I proposed that the institutional costs associated with each function be assigned to subclasses of mail based upon the attributable costs of that function only. The remaining system-wide institutional costs were assigned based upon the total attributable costs. In this proceeding, my method does not assign the institutional costs associated with each function based upon the attributable costs of that function only. Instead, I am proposing that the total institutional cost pool be assigned to subclasses using the "weighted attributable costs" of each subclass. The weights reflect the percentage of the costs of the function that are institutional in nature, relative to the attributable costs of the function. Thus, my method in this proceeding requires a single judgmental assignment of total institutional costs based upon the weighted attributable costs, rather than the four-step assignment of institutional costs I proposed in Docket No. R90-1.

- (b) Assuming Class C receives a markup approximately twice as large as the other two classes across all functions, the following institutional cost contributions would result using my Docket No. R90-1 methodology:

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 WITNESS SHARON CHOWN
 ANSWERS TO INTERROGATORIES OF
 ADVO, INC. (ADVO/NAA-T1-1-10)

Table 1 (based upon Table 5 in Direct Testimony)
Example: Unbundled Method of Assigning Institutional Costs

	Function 1			Function 2			Total
	Attributable	Markup	Institutional	Attributable	Markup	Institutional	Contribution
Class A	\$75	20%	\$15	\$50	80%	\$40	\$55
Class B	\$75	20%	\$15	0	80%	0	\$15
Class C	0	40%	0	\$50	160%	\$80	\$80
Total	\$150	20%	\$30	\$100	120%	\$120	\$150

Again assuming that Class C receives a total markup twice as large as the other two classes, my current proposal would result in the following institutional cost contributions:

Table 2 (based upon Table 8 in Direct Testimony)
Example: Institutional Cost Assignment using Weighted Attributable Costs

	Weighted Attributable Costs	Markup	Institutional Cost Contribution
Class A	\$125	42.86%	\$53.6
Class B	\$25	42.86%	\$10.7
Class C	\$100	85.72%	\$85.7
Total	\$250	60%	\$150.0

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 WITNESS SHARON CHOWN
 ANSWERS TO INTERROGATORIES OF
 ADVO, INC. (ADVO/NAA-T1-1-10)

ADVO/NAA-T1-5. On page 17, you state:

"...this method of assigning institutional costs does not replace the essential role of judgment with any mechanistic method. Instead, this method provides a better cost figure to which the Commission can apply its judgment."

Please confirm the following. If you cannot confirm, please explain why not.

- (a) Your current proposal weights the attributable costs from each of four cost pools on the basis of the ratio of that cost pool's institutional costs to system-wide institutional costs.
- (b) Your current proposal, assuming equal mark-up of the "weighted attributable costs," generates the same results as your R90-1 proposal, assuming equal mark-up of attributable costs within each cost pool.
- (c) Under your proposal, the Commission would develop mark-up percentages that would be applied to subclass "weighted attributable costs" in order to develop the subclass contribution.
- (d) Under your proposal, once the Commission developed mark-up percentages and subclass contributions on the basis of "weighted attributable costs," it would then have to add the subclass contribution amount to the subclass unweighted attributable cost in order to develop subclass revenue requirement.
- (e) Under your proposal, if the Commission wanted to determine how alternative mark-ups would affect subclass rates, it would have to apply those mark-ups to the "weighted attributable costs," derive the contributions, and then add the contributions to the unweighted attributable costs.

Answer:

- (a) Not confirmed. As explained at page 18, lines 7-8, the weighting factors for each of the attributable cost pools equal the percentage of identifiable

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WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)

institutional costs divided by the percentage of attributable costs associated with providing each function.

- (b) Confirmed. The same results will be generated using my Docket No. R90-1 approach and my current proposed approach to institutional cost assignment *if you assume equal markups for all subclasses*. I use equal markups for illustrative purposes only. Historically, the Commission has never selected equal markups for all subclasses.
- (c) Confirmed.
- (d) Confirmed.
- (e) Confirmed.

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WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)

ADVO/NAA-T1-6. With respect to your proposal,

- (a) Please explain the underlying economic significance of your "weighted attributable costs."
- (b) Please explain the underlying economic significance of the "weighted attributable costs" plus contribution amount.
- (c) In considering application of the statutory factors for institutional cost assignment, should the Commission view your "weighted attributable costs" any differently than the unweighted attributable costs? If so, please explain why and how the Commission should view these figures differently. If not, please explain why not.
- (d) With regard to your proposed approach, would it [be] appropriate to apply the same relative percentage mark-ups or indices that the USPS or Commission would use with unweighted attributable costs to your proposed "weighted attributable costs"? If so, please explain why. If not, please explain why not.

Answer:

- (a) As this metric is used to assign institutional costs only, "weighted attributable costs" have no underlying economic significance beyond the fact that they are a better measure of how each subclass of mail benefits from institutional effort.

The current reliance on unweighted attributable costs for assigning institutional costs assumes that each dollar of attributable costs should be given equal weight when assigning institutional costs. Thus, a dollar of attributable mail processing costs is given the same weight as a dollar of attributable delivery costs, even though the provision of the delivery

NEWSPAPER ASSOCIATION OF AMERICA
WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)

function accounts for a far greater share of the institutional costs of the Postal Service. Using unweighted attributable costs as the basis for the markups implicitly assumes that institutional costs are incurred to provide the different functions of the Postal Service in proportion to the attributable costs of these functions. As explained in my direct testimony, this assumption is not valid. As shown at page 9 (see, in particular, Table 3 at page 9), the distribution of institutional costs across the various functions are very different from the distribution of attributable costs. Therefore, in my view, it is inappropriate to give equal weight to each dollar of attributable cost. Weighting the attributable costs of the various functions in the manner I propose provides a better measure of how the different subclasses of mail benefit from institutional effort.

- (b) Unweighted attributable costs plus the contribution amount will equal the revenues to be recovered from each subclass of mail. The sum of the "weighted attributable costs" and the contribution amount has no underlying economic significance, and this sum is not used in my method.
- (c) I cannot answer this question as I am not privy to how the Commission currently views unweighted attributable costs when applying the statutory factors for institutional cost assignment.

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WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)

If, in the past, the Commission viewed unweighted attributable costs as a reliable measure of how much the various subclasses of mail benefited from institutional effort, then I believe the Commission should view weighted attributable costs no differently when applying the statutory factors for institutional cost assignment. If, however, the Commission viewed unweighted attributable costs as an inaccurate measure of how much the various subclasses of mail benefited from institutional effort, then I think the Commission should view weighted attributable costs differently, as the weighted attributable costs are a more accurate measure of how each subclass of mail benefits from institutional effort.

- (d) Again, I cannot answer this question as I am not privy to the Commission's or the Postal Service's thoughts when selecting markups for assigning institutional costs based on unweighted attributable costs. See (c) above.

NEWSPAPER ASSOCIATION OF AMERICA
WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)

ADVO/NAA-T1-7. For Standard A ECR mail, please confirm that your Exhibit NAA-1B shows total TYAR attributable costs of \$1,885.248 million, whereas your Exhibit NAA-1D shows "weighted attributable costs" of \$3,111.033 million, an amount that is \$1,225.785 million (or 65 percent) greater than ECR attributable costs. If you cannot confirm, please explain why not, provide the figures that you believe to be correct, and show how they are derived from your exhibits.

- (a) Please confirm that this extra \$1,225.785 million amount allocated to ECR is not part of the attributable costs of ECR mail. If you cannot confirm, explain why not, including a full explanation of why this extra amount should be treated as "attributable" to ECR mail.
- (b) Does this extra \$1,225.785 million amount allocated to ECR constitute a portion of USPS institutional costs that are reallocated by your method to ECR mail?
- (c) Does this extra \$1,225.785 million amount allocated to ECR constitute a portion of the attributable costs of other classes or subclasses of mail, such as First Class Mail, that are reallocated by your method to ECR mail?
- (d) If you claim in Answer to (a) - (c) above that this extra \$1,225.785 million amount is neither an attributable cost of ECR, nor a portion of institutional costs reallocated to ECR, nor a portion of attributable costs of other mail subclasses reallocated to ECR, please explain what kind of "costs" this amount represents.

Answer:

Confirmed.

- (a) I confirm that the "extra \$1,225.785 million amount" should not be included in attributable costs for any purpose other than assigning institutional costs.

My method does not "allocate" an extra \$1,225.785 million in costs to Standard A ECR mail. My method gives greater weight to the actual

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WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)

attributable costs of Standard A ECR mail *for the purposes of assigning institutional costs* because the subclass heavily relies upon functions which account for a large share of the institutional costs of the Postal Service.

- (b) No.
- (c) No.
- (d) The extra "costs" are not costs of any type. As explained in my Answer to ADVO/NAA-T1-6(a), each dollar of attributable costs does not result in the same institutional cost effort. Hence, my metric weights the attributable costs of each subclass in order to make the figures more comparable to the attributable costs of other subclasses *for institutional cost assignment purposes only*.

My method does not change the dollar amount of costs attributed to a subclass. Instead, my method simply recognizes that each dollar of attributable costs should not be given the same weight when assigning institutional costs as explained in my Answer to ADVO/NAA-T1-6(a).

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WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)

ADVO/NAA-T1-8. Please refer to Exhibit NAA-1E, where you calculate a "weighted markup" of 77.75 percent for Standard A ECR mail at the USPS proposed rates.

- (a) Please confirm that you derived this "weighted markup" by dividing the ECR contribution to institutional costs at USPS proposed rates by your calculated \$3,111.033 million "weighted attributable costs" for ECR.
- (b) Please confirm that your divisor is 65 percent greater than the attributable costs of ECR mail as shown in your Exhibit NAA-1B.
- (c) Please confirm that your resulting "weighted markup" represents ECR total contribution to institutional costs divided by a number that includes both (i) total ECR attributable costs plus (ii) a portion of either the institutional costs or attributable costs of other subclasses that have been reallocated by you to ECR mail.

If you cannot confirm any of the above, explain why not.

Answer:

- (a) Confirmed.
- (b) Confirmed.
- (c) Not confirmed. Please see my Answer to ADVO/NAA-T1-7(a) and (d).

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WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)

ADVO/NAA-T1-9. For First Class Letters, please confirm that your Exhibit NAA-1B shows total TYAR attributable costs of \$16,805.748 million, whereas your Exhibit NAA-1D shows "weighted attributable costs of \$16,455.049 million, an amount that is \$350.699 million (or 2.1 percent) less than First Class Letters attributable costs. If you cannot confirm, please explain why not, provide the figures that you believe to be correct, and show how they are derived from your exhibits.

- (a) Please confirm that this \$350.699 million amount that is deducted from First Class Letter mail under your method is a part of the attributable costs of First Class Letter mail. If you cannot confirm, explain why not, including a full explanation of why this amount should be considered as part of the attributable costs of First Class Letter mail.
- (b) Please confirm that this \$350.699 million of attributable First Class Letters that is deducted from First Class Letters is, under your method, reallocated to other classes or subclasses of mail, such as ECR mail. If you cannot confirm, please explain the nature of this \$350.699 million amount (i.e., attributable costs of First Class Letters, attributable costs of other specific subclasses, or institutional costs), and explain what happens to these costs under your method (i.e., reclassified as institutional costs, reallocated to other subclasses, vanishing costs).

Answer:

Confirmed.

- (a) No costs have been "deducted" from First Class Letter mail attributable costs. The attributable costs have been weighted to reflect the mix of the functions used by First Class Mail and the institutional costs associated with those functions. The fact that the weighted attributable costs for First Class Letter mail are slightly less than the actual attributable costs of the

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WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)

subclass reflects the fact that the mix of functions used by First Class Letter mailers requires less institutional effort than the average. As explained in my Answer to ADVO/NAA-T1-7(d), these weighted attributable costs should be used for institutional costs assignment purposes only. My method does not change the dollar amount of the attributable costs to be recovered from each subclass of mail.

- (b) Not confirmed. See my Answer to ADVO/NAA-T1-7.

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WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)

ADVO/NAA-T1-10. With respect to Priority Mail and Parcel Post, please confirm the following:

- (a) For Priority Mail, please confirm that your Exhibit NAA-1B shows total TYAR attributable costs of \$2,266.217 million, whereas your Exhibit NAA-1D shows "weighted attributable costs" of \$1,343.833 million, an amount that is \$922.384 million (or nearly 47 percent) less than Priority Mail attributable costs.
- (b) For Parcel Post, please confirm that your Exhibit NAA-1B shows total TYAR attributable costs of \$753.327 million, whereas your Exhibit NAA-1D shows "weighted attributable costs" of \$531.757 million, an amount that is \$221.570 million (or 29 percent) less than Parcel Post attributable costs.

If you cannot confirm, please explain why not, provide the figures that you believe to be correct, and show how they are derived from your exhibits.

Answer:

- (a) I can confirm your cost figures, but the "weighted attributable costs" are nearly 41 percent (rather than 47 percent) less than the Priority Mail attributable costs.
- (b) Confirmed.

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

AMMA/NAA-T1-1. In Line 6 of page 6 of your testimony you state that "Exhibit NAA-1B also shows the mix of functions used by each subclass."^{5/} Footnote 5 reads:

"Page 1 of Exhibit NAA-1B summarizes the total attributable cost by function for each subclass of mail. Page 2 of Exhibit NAA-1B provides the percentage mix of the different functions used by each subclass of mail."

- a. Is it an accurate reformulation of these portions of your testimony to say that Exhibit NAA-1B also shows the mix of attributable costs of functions used by each subclass?
- b. If that statement is not correct, please explain why not.

Response:

- a. Yes. Exhibit NAA-1B shows the amount and the percentage of the attributable costs that are incurred to provide each of the functions used by each subclass.
- b. Not applicable.

- 3 -

AMMA/NAA-T1-2. Please confirm that your "metric" for assigning institutional costs to subclasses described in Part 5 of your testimony (page 13, line 18 to page 17, line 19) assumes that each subclass of mail "consumes" institutional costs associated with any function in proportion to its attributable costs for that function multiplied by the weighting factors set out on line 39 of your Exhibit NAA-1D.

- a. If you cannot confirm, please explain why.
- b. If you did confirm, does this imply that the consumption of attributable costs by a subclass of mail in any function causes that subclass of mail to consume institutional costs? Please explain any negative answer.
- c. If you responded to sub-part b in the affirmative, what evidence do you have of this relationship?

Response:

a. Not confirmed. First, I do not understand how a subclass of mail can "consume" institutional costs. Institutional costs are incurred by the Postal Service to provide service to mailers; these costs are not "consumed" by mailers. Second, my method does not assign the institutional costs associated with each function to subclasses in proportion to the attributable costs of that function. Rather, by weighting the attributable costs to reflect the relative mix of services used by each subclass, my method will provide the Commission with a better basis for evaluating the assignment of institutional costs.

- b. Not applicable.
- c. Not applicable.

- 3 -

- 4 -

AMMA/NAA-T1-3. In its Opinion in Docket No. R90-1 (at paragraph 4051 (pages IV-16-17)) the Commission said this about your proposal concerning institutional cost assignment in that proceeding:

"The difficulty Chown sees is a real one, but it is not solved by fragmenting the institutional costs and continuing to apply, in mechanical fashion, an essentially comparative technique to institutional cost assignment. This is so because the root of the problem is that when a subclass uses categories of attributable costs in an uncommon way -- either by using mostly a function whose costs are only very incompletely attributed, or by using mostly a function whose costs are completely attributed -- it is not fully (or fairly) comparable with other classes. Chown has tried to attack this problem with a more elaborate formula, but we think it calls not for more complex mechanical solutions but for the focused exercise of rational judgment."

- a. Do you believe that your proposal concerning the distribution of institutional costs in this docket is responsive to the Commission's criticism of your R90-1 proposal?
- b. If your answer is in the affirmative, please explain the basis for that belief.
- c. If your answer is in the negative, do you believe that the Commission was wrong in its earlier criticism and, if so, how?

Response:

Although the Commission may have understood my unbundled institutional cost proposal in Docket No. R90-1 to be a mechanical approach, that proposal need not and should not have been implemented in a mechanical fashion. Therefore, I believe that the Commission's criticism of my method in that proceeding may have been based on a misunderstanding. This misunderstanding could have stemmed from an example that I provided in my testimony in that proceeding in an attempt to illustrate my method. My example involved a mechanical application of the Postal Service's relative cost coverages to the attributable costs for each function to derive institutional cost

- 4 -

- 5 -

assignments. With respect to the example contained in my testimony in that proceeding, the Commission's criticism was indeed valid.

- a. & b. Yes. I do not mechanically apply any coverage factors in my recommended method. My proposal simply recommends an alternative metric to which the Commission can apply its rational judgment. By weighting the attributable costs to reflect the relative mix of services used, my method will provide the Commission with a better basis for evaluating the assignment of institutional costs and applying its rational judgment. Therefore, the weighting of the attributable costs in my metric addresses the Commission's concerns that the attributable costs for some subclasses of mail are "not fully (or fairly) comparable with other classes."
- c. Not applicable.

- 5 -

NEWSPAPER ASSOCIATION OF AMERICA WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVERTISING MAIL MARKETING ASSOCIATION (AMMA/NAA-T1-4-8)

AMMA/NAA-T1-4.

The following is a general statement of the system of cost functions, classes (or products), volume variable costs, and institutional costs discussed in NAA-T-1:

I_j	=	Institutional costs that are "identifiable" with cost function j
$I = \sum_{j=1}^m I_j$	=	The total of all "identifiable" institutional costs
V_{ij}	=	The total volume variable costs in cost function j that have been shown to vary with a change in volume of subclass i
$V_{.j} = \sum_{i=1}^n V_{ij}$	=	The total of all volume variable costs for all classes served by cost function j
$V_{..} = \sum_{j=1}^m V_{.j}$	=	Total volume variable cost in the system
j	=	Name (index) of the cost function ($j = 1, 2, \dots, m$)
m	=	The total number of cost functions
i	=	Name (index) of the subclass ($i = 1, 2, \dots, n$)
n	=	The total number of subclasses

- a. Please confirm that your R90-1 Method with equal markup for the recovery of "identifiable" institutional costs at the cost function level distribute a markup of the volume variable cost of the i th subclass and the j th cost function equal to:

$$I_j * \frac{V_{ij}}{V_{.j}} \quad \text{(equation a)}$$

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 ANSWERS TO INTERROGATORIES OF
 ADVERTISING MAIL MARKETING ASSOCIATION (AMMA/NAA-T1-4-8)

If you cannot confirm, please explain and provide the correct expression for equation a.

- b. Please confirm that the total of these distributed "identifiable" institutional costs for all cost functions used by the i th subclass is equal to:

$$\sum_{j=1}^m [I_j * V_{ij} / V_{.j}] \quad (\text{equation b})$$

If you cannot confirm, please explain and provide the correct expression for equation b.

- c. Please confirm the weighting factor proposed in R97-1 for the j th cost function is equal to:

$$\frac{I_j}{V_{.j}} * \frac{V_{.j}}{I} \quad (\text{equation c})$$

If you cannot confirm, please explain and provide the correct expression for equation c.

- d. Please confirm that the R97-1 weighting factor that you propose for the j th cost function, when used to weight the volume variable cost of the i th subclass, is equal to:

$$\frac{I_j * V_{ij}}{V_{.j}} * \frac{V_{.j}}{I} \quad (\text{equation d})$$

If you cannot confirm, please explain and provide the correct expression for equation d.

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 ANSWERS TO INTERROGATORIES OF
 ADVERTISING MAIL MARKETING ASSOCIATION (AMMA/NAA-T1-4-8)

- e. Please confirm that the total of the R97-1 weighted volume variable costs for the i th class is equal to:

$$\left(\frac{V_{..}}{I}\right) * \sum_{j=1}^m [I_j * V_{ij}/V_{.j}] \quad (\text{equation e})$$

If you cannot confirm, please explain and provide the correct expression for equation e.

Answer:

- (a) Confirmed, assuming equal markups across all subclasses.
- (b) Confirmed.
- (c) Confirmed.
- (d) Confirmed.
- (e) Confirmed.

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ANSWERS TO INTERROGATORIES OF
ADVERTISING MAIL MARKETING ASSOCIATION (AMMA/NAA-T1-4-8)

AMMA/NAA-T1-5. In responses to our interrogatory AMMA/NAA-T1-2 you state, in part, "First, I do not understand how a subclass of mail can "consume" institutional costs."

- a. Do you believe that a subclass of mail can cause the Postal Service to incur institutional costs?
- b. If your answer to part (a) is affirmative, do you contend that the "metric" advocated in your testimony reflects this cost-causative phenomenon and, if so, how?
- c. How do you define the terms "cause" and "cost-causation" as you have interpreted them in framing your answers to parts (a) and (b) above?

Answer:

- a. No. A *single* subclass of mail cannot *cause* the Postal Service to incur institutional costs. Costs caused by a single subclass of mail are attributable costs. Institutional costs are those costs for which a reliable causal connection has not been found.
- b. Not applicable.
- c. Costs are "caused" by a subclass of mail if the elimination of that subclass would result in the elimination of the cost.

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ANSWERS TO INTERROGATORIES OF
ADVERTISING MAIL MARKETING ASSOCIATION (AMMA/NAA-T1-4-8)

AMMA/NAA-T1-6. Professor Panzer (sic), in his testimony for the Postal Service, states:

Applying mark-ups to average incremental costs instead of to marginal (unit volume variable) costs reduces economic efficiency unnecessarily. This is because, as explained above, the efficient pursuit of any objective subject to a break-even constraint requires that one trade-off costs and benefits at the margin. Marginal costs provide relevant information for conducting this trade-off, while average incremental costs do not.

Direct Testimony of John C. Panzer (sic) on behalf of the United States Postal Service, Docket No. R97-1, USPS-T-11 at 28 ll. 14-19.

- a. Do you agree with this statement?
- b. If you do agree with the statement, how do you justify using weighted attributable costs instead of volume variable costs to determine contribution to institutional costs?
- c. If your answer to part (a) is negative, please provide arguments from economic literature and/or regulatory proceedings to support your reason(s) for disagreement, including specific citations to published materials.

Answer:

a. As explained below, I agree with Dr. Panzar's statement in part and I disagree in part.

First, Dr. Panzar states that:

"Applying mark-ups to average incremental costs instead of to marginal (unit volume variable) costs reduces economic efficiency unnecessarily."

I disagree with the term "unnecessarily." It is necessary to deviate from rates that would achieve economic efficiency in order to meet other objectives of the Postal

NEWSPAPER ASSOCIATION OF AMERICA WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVERTISING MAIL MARKETING ASSOCIATION (AMMA/NAA-T1-4-8)

Reorganization Act. As Dr. Panzar himself confirms, economic efficiency is not the sole objective for setting rates under the Act. (See NAA/USPS-T11-1, Tr. 9/4630)

Second, I agree that economic efficiency requires a trade-off between costs and benefits at the margin and that marginal costs provide relevant information for making this tradeoff. However, it is also necessary to have relevant information on incremental costs. As Dr. Panzar points out:

"If the monopolist's prices are set below per unit incremental costs, firms with superior productive techniques would be inefficiently deterred from entering the market." (USPS-T-11, page 10, lines 24-5 and page 11, line 1)

Therefore, it is necessary to have information on both marginal costs and incremental costs when setting rate levels and determining the rate structures.

Third, it is important to note that the Postal Service is not proposing that rates be set *equal* to marginal costs. In order to achieve the break-even constraint, it is necessary to set rates above marginal costs and thus "[p]rices necessarily lose some of this efficiency role in markets served by a multiproduct monopoly firm operating under conditions of economies of scale." (USPS-T-11, page 10, lines 17-19)

Since rates are not set equal to marginal costs, mailers are not comparing marginal costs and benefits when making the tradeoff at the margin. Instead, mailers are comparing the actual rate (which exceeds marginal cost) and the benefit. (See NAA/USPS-T20-13, Tr. 2/193) Rates *based upon but not equal to* marginal costs are not, by definition, economically efficient.

NEWSPAPER ASSOCIATION OF AMERICA WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVERTISING MAIL MARKETING ASSOCIATION (AMMA/NAA-T1-4-8)

Finally, economic efficiency requires that tradeoffs between marginal costs and benefits be made for individual products, not for a mix of products. As noted below in my response to part (b), the overall rate level for each subclass is currently determined jointly for all functions provided by the Postal Service. Rate levels are not determined separately for each function provided by the Postal Service. As explained in more detail in part (b) below, it is precisely the fact that a single aggregate measure of the attributable costs is used when determining institutional cost contribution that necessitates, in my view, a better metric for assigning institutional costs.

b. Historically when the Postal Rate Commission established the institutional cost contribution for each subclass, it relied upon a single aggregate measure of attributable costs and hence it considered all the functions provided by the Postal Service simultaneously. By so doing, a dollar of mail processing attributable costs was given the same weight as a dollar of delivery costs when assigning institutional costs, even though the provision of the delivery function accounts for a far greater share of the institutional costs of the Postal Service. Using the unweighted attributable costs as a markup base makes an implicit assumption that institutional costs are incurred to provide the different functions of the Postal Service in proportion to the attributable costs of these functions. As demonstrated in my testimony, this is clearly untrue. By weighting attributable costs for markup purposes, I do not make this faulty assumption and provide a better measure of how the subclasses of mail benefit from institutional effort.

NEWSPAPER ASSOCIATION OF AMERICA WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVERTISING MAIL MARKETING ASSOCIATION (AMMA/NAA-T1-4-8)

If rate levels were established for each function separately, then there would be no need to weight the attributable costs of the functions and marking up the actual attributable costs would be appropriate. However, since rate levels are not established in this manner, it is necessary to correct for the erroneous assumption that each function gives rise to institutional costs in proportion to the function's attributable costs.

c. See (a).

NEWSPAPER ASSOCIATION OF AMERICA WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVERTISING MAIL MARKETING ASSOCIATION (AMMA/NAA-T1-4-8)

AMMA/NAA-T1-7, You say that "weighting the attributable costs to reflect the relative mix of services used by each subclass...will provide the Commission with a better basis for evaluating the assignment of the institutional costs." Response to AMMA/NAA-T1-2.

- a. Does the word "weighting" in this recitation refer to anything other than the factors set out on line 39 of your Exhibit NAA-1D and, if so, what?
- b. If your answer to part (a) is in the affirmative, why does the percentage of institutional costs divided by the percentage attributable costs for what you define as USPS functions (Exhibit NAA-1C line 5) improve the Commission's power to apply the statutory cost assignment criteria correctly?
- c. Would an index created by dividing the percentage of attributable costs of each function by the percentage of institutional costs of that function equally serve the Commission's interest and, if not, why not?

Answer:

- a. No.
- b. First, I would change the word "correctly" to "better" as there is no single correct way to assign institutional costs.

As discussed in my response to AMMA/NAA-T1-6(b), the current metric for assigning institutional costs -- total attributable costs -- rests upon the assumption that each dollar of attributable costs should be given equal weight when assigning institutional costs. Yet, as I have explained in my direct testimony, the different functions of the Postal Service give rise to very different proportions of institutional costs relative to attributable costs. By weighting the attributable costs by the weighting factors I propose, the attributable costs of the functions that give rise to large shares of

NEWSPAPER ASSOCIATION OF AMERICA WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVERTISING MAIL MARKETING ASSOCIATION (AMMA/NAA-T1-4-8)

the institutional costs of the Postal Service are given greater weight when assigning these institutional costs.

c. No. Your suggested weighting factors would not provide a better metric of how the various subclasses of mail benefit from institutional effort. If attributable costs were weighted by a factor equal to the percentage of attributable costs divided by institutional costs, then (contrary to common sense) those functions that give rise to a large portion of attributable costs and few institutional costs would be given greater weight when assigning institutional costs. In contrast, the attributable costs of those functions which account for a large share of institutional costs would receive little weight when assigning institutional costs.

To understand how your suggested weighting factors defy common sense, consider a function whose costs are almost entirely attributed, with few remaining institutional costs. Assume 95 percent of the costs are attributed for a given function. Using your suggested weighting factors, the attributable costs of this function would be weighted by a very large factor. (For example, 95% divided by 5% or a factor of 19.0.) As a result, the majority of the institutional costs of the Postal Service would be assigned to the subclasses of mail based, in large part, upon their relative use of this function, even though the Postal Service incurs few institutional costs in providing the function. Other functions that give rise to large portions of institutional costs relative to attributable costs would be given little weight when assigning institutional costs. Yet, it is these very functions that generate a large portion of the institutional costs.

NEWSPAPER ASSOCIATION OF AMERICA WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVERTISING MAIL MARKETING ASSOCIATION (AMMA/NAA-T1-4-8)

Therefore, your suggested weighting factors would provide a very poor measure of how the subclasses of mail benefit from institutional effort.

NEWSPAPER ASSOCIATION OF AMERICA WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVERTISING MAIL MARKETING ASSOCIATION (AMMA/NAA-T1-4-8)

AMMA/NAA-T1-8. If your "Better Metric" is adopted, will sortation and destination entry discounts be impacted? If your answer is affirmative, please provide a detailed explanation of the impacts and give separate examples of impacts on sortation discounts and destination entry discounts.

Answer:

No. I propose that my "better metric" be used only to determine the institutional cost contribution of each subclass of mail.

NEWSPAPER ASSOCIATION OF AMERICA WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF THE DIRECT MARKETING ASSOCIATION

DMA/NAA-T1-1. Please refer to Page 17, Lines 1 through 3 where you state, "When computing the revenues to be recovered from each class of mail, each class of mail would be assigned its actual attributable costs (unweighted) as required under the Act and the institutional costs as derived above."

- a. Please confirm that the following process accurately reflects your method for computing the revenues to be recovered from each class of mail. If not confirmed, please correct.
 - 1) Determine attributable costs and institutional costs for five functions: delivery, mail processing, transportation, window service, and other.
 - 2) Divide the attributable costs for each function by total attributable costs for all functions to determine the "attributable ratio."
 - 3) Divide the institutional costs for each function by the total institutional costs for all functions to determine the "institutional ratio."
 - 4) Divide the institutional ratio for each function by the attributable ratio for the function to determine the weighting factor for that function.
 - 5) Separately for each function and subclass, multiply the subclass' attributable costs for the function by the function's weighting factor to obtain weighted attributable cost for the function.
 - 6) Sum weighted attributable costs by subclass across all functions.
 - 7) Determine markup for each subclass based upon pricing factors.
 - 8) Determine the institutional costs borne by each subclass by applying the subclass' markup to its weighted attributable cost.
 - 9) Determine revenue to be recovered from each subclass of mail by adding the institutional costs from Step 8 to actual attributable cost.
- b. Please confirm that under your proposed approach the revenue produced by a subclass would be equal to its actual attributable costs plus the institutional costs borne by the subclass, and not weighted attributable costs plus institutional costs.

NEWSPAPER ASSOCIATION OF AMERICA WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF THE DIRECT MARKETING ASSOCIATION

Answer:

- a. Confirmed.
- b. Confirmed.

NEWSPAPER ASSOCIATION OF AMERICA WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF THE DIRECT MARKETING ASSOCIATION

DMA/NAA-T1-2. Please confirm that, in general, the Postal Service's costing approach for this case defines volume variable costs as attributable costs. If not confirmed, please explain fully.

Answer:

Confirmed.

NEWSPAPER ASSOCIATION OF AMERICA WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF THE DIRECT MARKETING ASSOCIATION

DMA/NAA-T1-3. Refer to Page 21-23 of USPS-T-11.

- a. Please confirm that in theory volume variable costs are all costs that will vary with marginal changes in mail volume. If not confirmed, please explain fully.
- b. Please confirm that all costs other than volume variable costs are costs that do not vary with marginal changes in mail volume.

Answer:

- a. Confirmed, in theory.
- b. Confirmed, in theory.

NEWSPAPER ASSOCIATION OF AMERICA WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF THE DIRECT MARKETING ASSOCIATION

DMA/NAA-T1-4. Do you agree that all rates should be free from cross-subsidy? If not, please explain fully.

Answer:

Yes.

NEWSPAPER ASSOCIATION OF AMERICA WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF THE DIRECT MARKETING ASSOCIATION

DMA/NAA-T1-5. Refer to USPS-T-11, page 8, lines 9-15. Do you agree that the incremental cost test is the appropriate test to ensure that the rate schedule is free from cross-subsidy? If not, please explain fully.

Answer:

In general, yes. Rates should recover revenues in excess of the average incremental costs or the marginal costs of the service, *whichever is greater*. Where economies of scale are present, incremental costs are higher than marginal costs and the incremental cost test is the appropriate test to ensure that the average rate for the service is free from cross-subsidy.

NEWSPAPER ASSOCIATION OF AMERICA WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF THE DIRECT MARKETING ASSOCIATION

DMA/NAA-T1-6. Refer to section 3626 of the Revenue Forgone Reform Act where it describes the required relationship between the markup on preferred rate subclasses and the markup on the most closely corresponding regular rate subclass. Please confirm that the constraint that for FY 1998 the markup on attributable costs for preferred rate subclasses be equal to five-twelfths of the markup for regular rate subclasses is applicable even if one uses your method for assigning institutional costs. If not confirmed, please explain fully.

Answer:

Confirmed, based upon my understanding of the Act. However, I am not a lawyer and therefore, cannot render a legal opinion as to what the Act requires.

NEWSPAPER ASSOCIATION OF AMERICA
WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
THE NATIONAL NEWSPAPER ASSOCIATION (NNA/NAA-T1-1-6)

NNA/NAA-T1-1. Please examine Footnote 1 on page 2 of your testimony where it is stated..."[I]nstitutional costs incurred to provide a particular function should be paid by the subclasses of mail that use that function." Do you consider these "institutional costs" to be service-related costs? If not, please explain the difference between your metric and service-related costs.

Answer:

No. My proposal has nothing to do with "service-related costs."

The term "service-related costs" has been used in past proceedings to refer to "the fixed delivery costs that could be saved in the absence of published delivery standards for the preferential classes." (*Opinion and Recommended Decision*, Docket No. R84-1, ¶ 3057) In Dockets No. R77-1 and R80-1, the Commission "attributed" these service-related costs to the preferential classes of mail that were thought to cause these costs.

Unlike service-related cost proposals, I am not proposing to attribute any institutional costs to particular subclasses of mail.

NEWSPAPER ASSOCIATION OF AMERICA
WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
THE NATIONAL NEWSPAPER ASSOCIATION (NNA/NAA-T1-1-6)

NNA/NAA-T1-2. Please state whether you consider weighted attributable costs to be a part of the "direct or indirect postal costs attributable" to a mail class that the Commission is required to consider under 39 U.S.C. § 3622 (b)(3). Please explain your answer fully.

Answer:

My weighted attributable costs are not a substitute for the actual attributable costs to be recovered from a subclass of mail, as required by 39 U.S.C. § 3622 (b)(3). I propose weighted attributable costs as a metric for assigning institutional costs only, not as a new attribution methodology. The institutional cost contribution determined by the Commission using this approach would then be added to the actual (unweighted) attributable costs to arrive at the revenues for a subclass. Please see my answers to UPS/NAA-T1-1, ADVO/NAA-T1-6(a), and ADVO/NAA-T1-7(d).

NEWSPAPER ASSOCIATION OF AMERICA
WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
THE NATIONAL NEWSPAPER ASSOCIATION (NNA/NAA-T1-1-6)

NNA/NAA-T1-3. If your answer to Interrogatory No. 2 is yes, please state whether you believe a failure to consider weighted attributable costs as the basis for a markup could lead the Commission to approving below-cost rates for a subclass with a small markup.

Answer:

Not applicable. As explained in my response to NNA/NAA-T1-2, I recommend that the Commission use weighted attributable costs for the assignment of institutional costs *only*. As long as the revenues for a subclass exceed its actual (unweighted) attributable costs, the subclass will make a positive contribution to the institutional costs of the Postal Service.

NEWSPAPER ASSOCIATION OF AMERICA
WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
THE NATIONAL NEWSPAPER ASSOCIATION (NNA/NAA-T1-1-6)

NNA/NAA-T1-4. If your answer to Interrogatory No. 3 is yes, please state whether you are recommending that weighted attributable costs as you define them should be considered incremental costs by the Commission.

Answer:

Not applicable. Please see my response to NNA/NAA-T1-2.

NEWSPAPER ASSOCIATION OF AMERICA
WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
THE NATIONAL NEWSPAPER ASSOCIATION (NNA/NAA-T1-1-6)

NNA/NAA-T1-5. Please examine the chart attached to this interrogatory and labeled "Table 1. Comparison of Attributable Cost and Weighted Attributable Cost." Please confirm that the markup proposed in your testimony would result in an increase in institutional costs for within-county mail from \$2.385 million to \$3.666 million. If you do not confirm, please explain why and provide the percentage increase in markup that you are proposing for within-county and regular rate periodicals.

Answer:

Not confirmed. I do not propose any specific markups in my direct testimony. Nor do I propose a specific dollar amount of institutional cost contribution for any subclass of mail. I simply provide a better metric to which the Commission can apply its judgment to determine the appropriate institutional cost contributions.

The increase in institutional costs for within-county mail shown in your chart results from applying the *Postal Service's* proposed markups to my weighted attributable costs. This is not my recommendation.

Table 1. Comparison of Attributable Cost and Weighted Attributable Cost
(Dollars in Thousands)

Class & Subclass	USPS Markups Based Upon Attributable Costs			Chown Method			Institutional Cost Based Upon USPS Markup		
	Attributable Cost ¹	Institutional Cost ²	Markup	USPS Markups Based Upon Weighted Costs			Institutional Cost Based Upon USPS Markup		
				Weighted Attributable Cost ³	Institutional Cost ²	Markup	Weighted Attributable Cost ³	Institutional Cost	Markup
First-Class Mail									
Single Letters	\$12,768,894	\$9,380,065	73.6%	\$11,888,345	\$9,380,065	79.0%	\$11,888,345	\$8,749,559	73.6%
Worksharing Letters	4,847,894	7,418,926	183.3%	4,868,704	7,418,926	162.5%	4,868,704	8,371,489	183.3%
Total Letters	18,805,748	16,809,021	100.0%	16,455,049	16,809,021	102.2%	16,455,049	16,458,254	100.0%
Single Postcards	432,281	228,751	52.9%	500,482	228,751	45.7%	500,482	264,853	52.9%
Worksharing Postcards	188,123	287,843	167.3%	188,045	287,843	136.8%	188,045	327,931	167.3%
Total Cards	620,404	486,594	83.8%	688,527	486,594	71.3%	688,527	583,897	83.8%
Total	17,388,132	17,306,615	99.5%	17,151,576	17,306,615	100.9%	17,151,576	17,060,370	99.5%
Priority Mail	2,288,217	2,088,478	82.1%	1,343,833	2,088,478	155.3%	1,343,833	1,237,249	92.1%
Express Mail	418,884	430,862	104.9%	433,188	430,862	99.4%	433,188	454,383	104.9%
Mailgrams	808	4,188	820.5%	848	4,188	482.7%	848	6,941	820.5%
Periodicals									
In County	81,380	2,306	2.8%	129,401	2,306	1.8%	129,401	3,666	2.8%
Nonprofit	331,471	11,180	3.4%	368,818	11,180	3.0%	368,818	12,350	3.4%
Classroom	12,788	-2,215	-17.4%	11,738	-2,215	-18.8%	11,738	-2,038	-17.4%
Regular-Rate	1,877,888	111,057	7.0%	1,887,121	111,057	7.1%	1,887,121	110,298	7.0%
Total	2,003,475	122,307	6.1%	2,075,074	122,307	5.9%	2,075,074	126,878	6.1%
Standard Mail A									
Single Piece	-298	298	-100.0%	0	298	N A	0	0	-100.0%
Commercial Regular	8,191,874	2,830,371	64.5%	5,764,017	2,830,371	49.2%	5,754,017	3,136,946	54.5%
Commercial ECR	1,886,248	2,418,758	128.3%	3,111,033	2,418,758	77.7%	3,111,033	3,991,427	128.3%
Total Commercial	7,078,624	5,249,425	74.2%	8,865,050	5,249,425	58.2%	8,865,050	6,578,076	74.2%
Nonprofit	1,107,105	244,328	22.1%	1,207,983	244,328	20.2%	1,207,983	266,918	22.1%
Nonprofit ECR	125,121	78,287	61.0%	185,779	78,287	41.1%	185,779	113,198	60.9%
Total Nonprofit	1,232,226	320,615	26.0%	1,393,762	320,615	23.0%	1,393,762	382,645	26.0%
Total Standard Mail A	8,308,850	5,570,040	67.0%	10,258,813	5,570,040	54.3%	10,258,813	6,877,245	67.0%
Standard Mail B									
Parcel Post	753,327	29,589	3.9%	531,757	29,589	5.6%	531,757	20,886	3.9%
Bound Printed Matter	348,013	178,595	51.8%	352,471	178,595	50.7%	352,471	181,828	51.6%
Special Rate	298,880	95,470	37.2%	221,143	95,470	43.2%	221,143	82,185	37.2%
Library Rate	49,085	3,342	6.8%	37,623	3,342	8.9%	37,623	2,582	6.8%
Total	1,408,285	306,996	21.8%	1,142,993	306,996	26.9%	1,142,993	249,696	21.8%
Free-for-the-Blind, etc.	31,757	-31,757	-100.0%	27,521	-31,757	-115.4%	27,521	-27,521	-100.0%
International Mail	1,208,030	437,814	36.3%	582,742	437,814	75.1%	582,742	211,547	36.3%
Special Services	1,284,854	784,752	59.5%	1,299,087	784,752	58.9%	1,299,087	773,224	59.5%
Total Cost	34,316,672	28,987,863	78.7%	34,316,672	28,987,863	78.7%	34,316,672	28,988,813	78.6%

¹NAA-1A at 5

²NAA-1E

³NAA-1D

NEWSPAPER ASSOCIATION OF AMERICA
WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
THE NATIONAL NEWSPAPER ASSOCIATION (NNA/NAA-T1-1-6)

NNA/NAA-T1-6. For the purpose of this interrogatory, please assume: (1) a law requires that the markup on Class B be equal to one half of the markup on Class A; (2) Class A's markup, stated as a percentage of attributable costs, is 10 percent; and, (3) Class A's markup, stated as a percentage of weighted attributable costs, is 6 percent. What should be the markup on Class B? Please state the markup as a percentage of attributable cost or as a percentage of weighted attributable cost and explain your answer.

Answer:

In your question, if the law defines markup as the percentage of institutional cost contribution relative to actual (unweighted) attributable costs, then Class B's markup should be 5 percent of its actual (unweighted) attributable costs. See also my answers to DMA/NAA-T1-6 and VP-CW/NAA-T1-10.

RESPONSES OF NAA WITNESS CHOWN TO INTERROGATORIES
OF UNITED PARCEL SERVICE

UPS/NAA-T1-1. Please refer to page 18, line 24, where you refer to "markups based upon the weighted attributable costs."

- a. Please confirm that you are not recommending that these markups be applied directly to unweighted attributable costs to determine rates. Please explain any answer other than an unqualified confirmation.
- b. Please confirm that to determine the actual rates, the Commission must convert the weighted markups to another set of numbers -- call them unweighted markups -- which are then applied to unweighted attributable costs. Please explain any answer other than an unqualified confirmation.
- c. Is it correct that your testimony does not indicate how to determine specific rates from the weighted markup system you propose? If the answer is "no," please provide the reference to your proposed method.
- d. Do you agree that one way for arriving at actual rates could be summarized as follows: First, compute weighted attributable costs according to the method set forth in your testimony; second, determine markups based on the criteria set forth in Section 3622(b), using weighted attributable costs as the cost base; third, compute the contribution to institutional costs that would result from those markups; fourth, to determine actual rates, calculate another set of markups by dividing the sum of "true" attributable cost plus the contribution determined in steps one through three by the sum of the true attributable costs? Please explain any answer other than an unqualified confirmation.
- e. Aside from what is discussed in (d) above, are there any other ways to go from your weighted attributable cost calculations to actual rates?
- f. Please confirm that the markups computed in step four of part (d) would be applied to attributable costs in the same way that markups determined using the Commission's current methods are applied to attributable costs. If you do not confirm, please explain.

Response:

- a. Confirmed. See (b) below.
- b. Not confirmed. The Commission need not convert the "weighted markups" to a set of "unweighted markups" which are then applied to

RESPONSES OF NAA WITNESS CHOWN TO INTERROGATORIES
OF UNITED PARCEL SERVICE

unweighted attributable costs to determine the revenues to be recovered from each subclass of mail. As explained at page 17, lines 1-4 and as shown in the example at page 17, Table 9 of my direct testimony, the Commission need only take the institutional cost contribution in dollars that it determines judgmentally is appropriate using the weighted attributable costs and add the actual attributable costs to determine revenues to be recovered from each subclass.

- c. My testimony does not recommend specific rates or markups for each subclass.

However, I do indicate how the Commission can calculate the revenues to be recovered from each subclass of mail when assigning institutional costs using weighted attributable costs. See page 17, lines 1-4 of my direct testimony and the response to (b) above.

- d. I agree that your description is one way to arrive at the actual revenues to be recovered from each subclass of mail, with the exception that the "markups" you refer to in step four are actually "cost coverages" rather than "markups."
- e. Yes. See my response to part (b) above. The more direct method of computing the revenues to be recovered from each subclass of mail is to take the institutional costs derived in step three and simply add the actual attributable costs for the subclass. The Commission need not derive

RESPONSES OF NAA WITNESS CHOWN TO INTERROGATORIES
OF UNITED PARCEL SERVICE

another set of markups or cost coverages to apply to the actual
attributable costs.

- f. Confirmed, with the exception that the "markups" to which you refer are
actually "cost coverages."

RESPONSES OF NAA WITNESS CHOWN TO INTERROGATORIES
OF UNITED PARCEL SERVICE

UPS/NAA-T1-2. Please refer to NAA-1A, page 5, which refers to \$1,983,222,000 of "Other Costs & Adjustments." Please provide a list of the cost segments and components that make up "Other Costs," and please list or provide a reference for the "Adjustments."

Response:

As explained in Exhibit NAA-1G of my testimony, the "Other Costs & Adjustments" are derived by subtracting the attributable costs of mail processing, transportation, window service and delivery service from the total attributable costs for each subclass. As noted in my testimony, I have used the Postal Service's estimates of test year attributable and total costs for purposes of illustration.

"Other Costs" include those cost segments and components that are not directly related to providing the four basic functions – mail processing, window service, transportation and delivery. These other costs include the attributable costs associated with cost segments such as Cost Segment 1 (Postmasters) plus related benefits, Cost Segment 16.1 (Supplies), Cost Segment 16.3.4 (Other Miscellaneous Service), and portions of Cost Segment 18 (Administrative and Regional Operations).

"Adjustments" include the adjustments made to the total attributable costs by the Postal Service's pricing witnesses and Postal Service Witness O'Hara, as summarized on Exhibit USPS-30F, revised 9/19/97.

RESPONSES OF NAA WITNESS CHOWN TO INTERROGATORIES
OF UNITED PARCEL SERVICE

UPS/NAA-T1-3.

- (a) Please refer to Exhibit NAA-1C. Please confirm that you identify \$18,261,293,000 of institutional cost for the four functions.
- (b) Please refer to Exhibit NAA-1A, page 5. Please confirm that the Postal Service proposal shows total institutional costs of \$26,997,063,000.
- (c) Please confirm that \$8,735,824,000 of institutional cost is not identified in Exhibit NAA-1C. Please explain any answer other than an unqualified confirmation.
- (d) Is it a correct interpretation of your testimony that none of the \$8,735,824,000 of unidentifiable cost is associated with the \$1,983,222,000 of "Other Costs & Adjustments"? Please explain any answer other than an unqualified "yes."

Response:

- (a) Confirmed.
- (b) Confirmed.
- (c) Confirmed. As I discuss at page 8, lines 13-17, there is a pool of institutional costs that cannot be specifically associated with any particular function. I refer to these institutional costs as "system-wide" institutional costs. Because they cannot be associated with any particular function, they are not used in deriving the attributable cost weighting factors (as illustrated in Exhibit 1C). However, these costs should be included in the total institutional costs to be assigned to the subclasses of mail.
- (d) I have not associated any of these "system-wide" institutional costs with "Other Costs & Adjustments," as the other functions whose costs are included in the other costs do not appear to directly cause these "system-wide" institutional costs to be incurred.

NAA WITNESS CHOWN ANSWERS TO INTERROGATORIES
OF THE UNITED STATES POSTAL SERVICE

USPS/NAA-T1-1. Please refer to your testimony at page 5.

- (a) Please confirm that sorting mail to delivery point sequence (DPS) can take place either in the "mail processing" function (automated Function 1 or Function 4 DPS, Cost Segment 3.1) or the "delivery" function (manual DPS by city carriers, Cost Segment 6). If you do not confirm, please explain fully why not, providing your understanding of Postal Service sorting operations.
- (b) How would it have affected your testimony if you had classified Cost Segment 6 as a separate "unbundled element"? Please provide revised Tables 1-3, treating Cost Segment 6 as a separate "unbundled element."
- (c) How would it have affected your testimony if you had classified Cost Segment 6 as a part of the "mail processing" function? Please provide revised Tables 1-3, treating Cost Segment 6 as part of the "mail processing" function.

Answer:

- (a) Confirmed.
- (b) & (c) See attached tables.

To respond to these questions, separate piggyback factors are needed for each subclass for Cost Segment 6 and Cost Segment 7. While Library Reference H-77 provides separate piggyback factors for the total costs of these two cost segments (page 80A), it does not provide separate piggyback factors for each subclass for each of the two cost segments. Therefore, I estimated separate piggyback factors for the two cost segments for each subclass by taking the subclass piggyback factors on page 87 and multiplying these factors by the ratio of the total piggyback factor for each cost segment (page 80A, line 34, columns (A) and (B)) to the piggyback factor for the total of the two cost segments (page 80A, line 34, Column (C)).

NAA WITNESS CHOWN ANSWERS TO INTERROGATORIES
OF THE UNITED STATES POSTAL SERVICE

Hence, the piggyback factors for Cost Segment 6 for each subclass are equal to the piggyback factors on page 87 multiplied by 1.28620 divided by 1.31469 or 0.97833 and the piggyback factors for Cost Segment 7 for each subclass are equal to the piggyback factors on page 87 multiplied by 1.35093 divided by 1.31469 or 1.02757. This approximation should provide a reasonable estimate of the separate piggyback factors for Cost Segments 6 and 7 for each subclass.

Exhibit NAA-1A
ATTRIBUTABLE COSTS BY FUNCTION
After Rates, Totals Include Contingency Fee

Line No.	Description	Mail Processing Costs		Piggyback Factor	Mail
		CS 3.1	CS 4		Processing Total
First-Class Mail					
1	Single-Piece Letters	4,899,112	2,645	1.56702	7,757,963
2	Worksharing Letters	1,221,871	631	1.60350	1,979,885
3	Total Letters	6,120,983	3,276		9,737,848
4	Single-Piece Cards	137,636	77	1.53045	212,870
5	Worksharing Postcards	49,979	26	1.53597	77,574
6	Total Cards	187,615	103		290,445
7	Total First-Class Mail	6,308,598	3,379		10,028,292
8	Priority Mail	534,646	137	1.55900	842,064
9	Express Mail	96,575	0	1.55108	151,294
10	Mailgrams	95	0	1.28619	123
Periodicals					
11	In-County	15,977	3	1.47714	23,841
12	Outside County				
13	Nonprofit	82,589	16	1.52572	127,292
14	Classroom	4,765	1	1.52048	7,319
15	Regular Rate	493,023	97	1.51853	756,306
16	Total Periodicals	596,354	117		914,758
Standard A Mail					
17	Single Piece	87,560	23	1.58271	0
18	Commercial Regular	1,900,197	495	1.56284	3,000,182
19	Commercial ECR	270,838	66	1.56331	427,742
20	Total Commercial	2,258,595	584		3,427,924
21	Nonprofit	404,828	107	1.55015	633,987
22	Nonprofit ECR	26,167	6	1.58836	41,988
23	Total Nonprofit	430,995	113		675,975
24	Total Standard A Mail	2,689,590	697		4,103,899
Standard B Mail					
25	Parcel Post	157,448		1.73911	276,558
26	Bound Printed Matter	80,829		1.69684	138,525
27	Special Rate	72,355		1.75785	128,461
28	Library Rate	15,581		1.70038	26,759
29	Total Standard B Mail	326,213			570,303
30	USPS Penalty Mail	80,180		1.49609	0
31	Free-for-the-Blind, etc.	12,075		1.62782	19,852
32	International Mail	212,491		1.55626	333,998
33	TOTAL ALL MAIL	10,856,817	4,330		16,964,584
34	Special Services	119,150	98	1.82894	220,278
35	TOTAL ATTRIBUTABLE COSTS	10,975,967	4,428	0.36887	17,184,862
36	INSTITUTIONAL COSTS	3,319,599	5,651	1.52834	5,132,943

1.0% Contingency Fee included in totals for each service.

Piggyback Adjustment Factor

Exhibit NAA-1A
ATTRIBUTABLE COSTS BY FUNCTION
 After Rates, Totals Include Contingency Fee

Attachment to
 USPS/NAA-T1-1(b)
 Page 2 of 5

Line No.	Description	In-Office City Delivery CS 6	Piggyback Factor	In-Office City Delivery Total	Window Service CS 3.2	Piggyback Factor	Window Service Total
First-Class Mail							
1	Single-Piece Letters	1,205,922	1.28315	1,562,850	525,379	1.41856	752,73
2	Worksharing Letters	487,489	1.29144	635,860	24,113	1.41858	34,54
3	Total Letters	1,693,411		2,198,710	549,492		787,28
4	Single-Piece Cards	47,972	1.28840	62,425	33,661	1.41856	48,22
5	Worksharing Postcards	19,282	1.28948	25,112	1,016	1.41920	1,45
6	Total Cards	67,254		87,538	34,677		49,68
7	Total First-Class Mail	1,760,665		2,286,248	584,169		836,96
8	Priority Mail	39,203	1.34902	53,414	51,186	1.41856	73,33
9	Express Mail	3,516	1.38750	4,927	27,063	1.41856	38,77
10	Mailgrams	0	1.38662	0	0	1.41854	
Periodicals							
11	In-County	13,016	1.28080	16,838	502	1.42406	72
12	Outside County						
13	Nonprofit	31,721	1.28082	41,035	245	1.41129	34
14	Classroom	891	1.27795	1,150	0	0.00000	
15	Regular Rate	137,797	1.27837	177,918	2,389	1.41784	3,42
16	Total Periodicals	183,425		236,940	3,136		4,49
Standard A Mail							
17	Single Piece	20,459	1.29747	0	2,828	1.41902	
18	Commercial Regular	570,875	1.27869	737,270	29,333	1.41860	42,02
19	Commercial ECR	349,354	1.27657	450,436	5,956	1.41834	8,53
20	Total Commercial	940,688		1,187,706	38,117		50,56
21	Nonprofit	114,711	1.27847	148,121	9,685	1.41852	13,87
22	Nonprofit ECR	22,172	1.27543	28,562	878	1.42001	1,25
23	Total Nonprofit	136,883		176,683	10,563		15,13
24	Total Standard A Mail	1,077,571		1,364,388	48,680		65,69
Standard B Mail							
25	Parcel Post	7,865	1.33610	10,614	6,623	1.44380	9,65
26	Bound Printed Matter	9,492	1.37472	13,179	720	1.42112	1,03
27	Special Rate	6,921	1.34638	9,411	3,592	1.41863	5,14
28	Library Rate	596	1.35829	818	101	1.38679	14
29	Total Standard B Mail	24,874		34,022	11,036		15,97
30	USPS Penalty Mail	8,120	1.27571	0	12,599	1.41851	
31	Free-for-the-Blind, etc.	1,596	1.27139	2,049	216	1.41935	31
32	International Mail	10,496	1.32444	14,040	24,292	1.41854	34,80
33	TOTAL ALL MAIL	3,109,466		3,996,030	762,377		1,070,35
34	Special Services	42,433	1.26763	54,327	230,461	1.41855	330,19
35	TOTAL ATTRIBUTABLE COSTS	3,151,899		4,050,357	992,838		1,400,54
36	INSTITUTIONAL COSTS	407,192	1.26767	521,349	1,058,584	1.36972	1,464,467
1.0%	Contingency Fee included in totals for each service.		0.97833				

Exhibit NAA-1A
ATTRIBUTABLE COSTS BY FUNCTION
 After Rates, Totals Include Contingency Fee

Attachment to
 USPS/NAA-T1-1(b)
 Page 3 of 5

Line No.	Description	Transportation Costs CS 14	City Delivery Street Time CS 7	Delivery Costs Piggyback Factor	Vehical Service Drivers CS 8	VS Drivers Piggyback Factor
First-Class Mail						
1	Single-Piece Letters	625,377	589,656	1.34772	30,419	1.57417
2	Worksharing Letters	274,740	410,951	1.35644	20,191	1.56117
3	Total Letters	900,117	1,000,607		50,610	
4	Single-Piece Cards	9,292	35,078	1.35324	242	1.55307
5	Worksharing Postcards	3,070	20,548	1.35437	241	1.50568
6	Total Cards	12,362	55,626		483	
7	Total First-Class Mail	912,479	1,056,233		51,093	
8	Priority Mail	801,977	91,670	1.41691	24,852	1.53564
9	Express Mail	68,466	21,055	1.45732	1,718	1.55041
10	Mailgrams	0	194	1.45640	1	1.00000
Periodicals						
11	In-County	66	12,021	1.34526	2,484	1.56783
12	Outside County					
13	Nonprofit	64,043	28,889	1.34528	6,167	1.57706
14	Classroom	1,993	663	1.34227	245	1.60828
15	Regular Rate	279,349	100,320	1.34271	32,339	1.56908
16	Total Periodicals	345,450	141,893		41,235	
Standard A Mail						
17	Single Piece	0	9,643	1.36277	498	1.54661
18	Commercial Regular	317,864	416,889	1.34304	49,525	1.54612
19	Commercial ECR	61,321	386,059	1.34082	39,615	1.55147
20	Total Commercial	379,185	812,591		89,638	
21	Nonprofit	60,529	92,484	1.34281	7,568	1.55569
22	Nonprofit ECR	7,160	21,095	1.33962	1,800	1.55785
23	Total Nonprofit	67,689	113,579		9,368	
24	Total Standard A Mail	446,875	926,170		99,006	
Standard B Mail						
25	Parcel Post	327,576	41,431	1.40335	29,452	1.54678
26	Bound Printed Matter	64,762	48,823	1.44390	15,584	1.55389
27	Special Rate	60,023	23,809	1.41414	5,520	1.56238
28	Library Rate	13,062	3,997	1.42665	625	1.57491
29	Total Standard B Mail	465,424	118,060		51,181	
30	USPS Penalty Mail	0	3,577	1.33991	994	1.62076
31	Free-for-the-Blind, etc.	4,242	2,241	1.33537	620	1.54646
32	International Mail	763,912	12,623	1.39110	5,606	1.58193
33	TOTAL ALL MAIL	3,808,826	2,373,716		276,306	
34	Special Services	0	84,326	1.33143	0	
35	TOTAL ATTRIBUTABLE COSTS	3,808,826	2,458,042		276,306	
36	INSTITUTIONAL COSTS	556,090	5,943,399	1.33240	172,666	1.54511
1.0%	Contingency Fee included in totals for each service.			1.02757		

Exhibit NAA-1A
ATTRIBUTABLE COSTS BY FUNCTION
 After Rates, Totals Include Contingency Fee

Attachment to
 USPS/NAA-T1-1(b)
 Page 4 of 5

Line No.	Description	Special Delivery CS 9	Spec. Del. Piggyback Factor	Rural Carriers CS 10	Rural Carrier Piggyback Factor	Total Delivery Costs
First-Class Mail						
1	Single-Piece Letters	729	1.49657	308,636	1.19701	1,225,241
2	Worksharing Letters	346	1.48285	286,874	1.19693	942,161
3	Total Letters	1,075		595,510		2,167,401
4	Single-Piece Cards	39	1.45000	19,991	1.19702	72,549
5	Worksharing Postcards	22	1.31818	14,421	1.19661	45,933
6	Total Cards	61		34,412		118,482
7	Total First-Class Mail	1,136		629,922		2,285,883
8	Priority Mail	1,164	1.49376	15,607	1.19650	190,349
9	Express Mail	50,446	1.49538	5,397	1.19693	116,396
10	Mailgrams	53	1.43396	13	1.07692	377
Periodicals						
11	In-County	3	1.00000	14,487	1.19696	37,783
12	Outside County					0
13	Nonprofit	5	1.20000	34,714	1.19697	91,049
14	Classroom	0	0.00000	763	1.19805	2,220
15	Regular Rate	23	1.39130	114,811	1.19696	326,128
16	Total Periodicals	31		164,775		457,180
Standard A Mail						
17	Single Piece	8	1.50000	1,320	1.19660	0
18	Commercial Regular	8	1.28571	393,561	1.19684	1,118,584
19	Commercial ECR	5	1.20000	264,433	1.19686	904,548
20	Total Commercial	21		659,314		2,023,132
21	Nonprofit	3	1.00000	82,285	1.19691	236,797
22	Nonprofit ECR	3	1.00000	12,670	1.19672	46,691
23	Total Nonprofit	6		94,955		283,488
24	Total Standard A Mail	27		754,269		2,306,621
Standard B Mail						
25	Parcel Post	44	1.38297	11,068	1.19684	118,175
26	Bound Printed Matter	3	1.00000	11,706	1.19687	109,812
27	Special Rate	3	1.00000	5,691	1.19676	49,598
28	Library Rate	3	1.00000	1,228	1.19783	8,242
29	Total Standard B Mail	53		29,693		285,828
30	USPS Penalty Mail	1	1.00000	1,317	1.19741	0
31	Free-for-the-Blind, etc.	0	0.00000	786	1.19592	4,940
32	International Mail	8,071	1.49531	2,560	1.19639	41,975
33	TOTAL ALL MAIL	60,982		1,604,339		5,689,550
34	Special Services	60	1.44615	70,136	1.19682	198,264
35	TOTAL ATTRIBUTABLE COSTS	61,042		1,674,475		5,887,814
36	INSTITUTIONAL COSTS	53,072	1.47535	2,047,129	1.18276	10,792,205

1.0% Contingency Fee included in totals for each service.

Exhibit NAA-1A
ATTRIBUTABLE COSTS BY FUNCTION
After Rates, Totals Include Contingency Fee

Line No.	Description	Other Costs & Adjustments	Total Attributable
First-Class Mail			
1	Single-Piece Letters	834,500	12,758,664
2	Worksharing Letters	179,890	4,047,084
3	Total Letters	1,014,389	16,805,748
4	Single-Piece Cards	26,896	432,261
5	Worksharing Postcards	6,977	160,123
6	Total Cards	33,873	592,384
7	Total First-Class Mail	1,048,263	17,398,132
8	Priority Mail	305,076	2,266,217
9	Express Mail	30,707	410,564
10	Mailgrams	7	508
Periodicals			
11	In-County	2,111	81,360
12	Outside County	0	
13	Nonprofit	7,703	331,471
14	Classroom	73	12,755
15	Regular Rate	34,768	1,577,889
16	Total Periodicals	44,654	2,003,475
Standard A Mail			
17	Single Piece	-298	-298
18	Commercial Regular	-24,255	5,191,674
19	Commercial ECR	32,669	1,885,248
20	Total Commercial	8,117	7,076,624
21	Nonprofit	13,794	1,107,105
22	Nonprofit ECR	-539	125,121
23	Total Nonprofit	13,256	1,232,226
24	Total Standard A Mail	21,372	8,308,850
Standard B Mail			
25	Parcel Post	10,746	753,327
26	Bound Printed Matter	18,700	346,013
27	Special Rate	4,219	256,860
28	Library Rate	63	49,085
29	Total Standard B Mail	33,728	1,405,285
30	USPS Penalty Mail	0	0
31	Free-for-the-Blind, etc.	363	31,757
32	International Mail	17,300	1,206,030
33	TOTAL ALL MAIL	1,501,471	33,030,818
34	Special Services	481,795	1,284,854
35	TOTAL ATTRIBUTABLE COSTS	1,983,266	34,315,672
36	INSTITUTIONAL COSTS	0	26,997,063

1.0% Contingency Fee included in totals for each service.

Exhibit NAA-1B
ATTRIBUTABLE COSTS BY FUNCTION AND SUBCLASS
 (Test Year After Rates)

Page 1 of 2

Line No.	Description	Mail Processing	In-Office City Delivery	Window Service	Transportation Costs	Delivery Costs	Other Costs & Adjustment	Total Attributable Costs
First-Class Mail								
1	Single-Piece Letters	7,757,963	1,562,850	752,734	625,377	1,225,241	834,500	12,758,664
2	Worksharing Letters	1,979,885	635,860	34,548	274,740	942,161	179,890	4,047,084
3	Total Letters	9,737,848	2,198,710	787,283	900,117	2,167,401	1,014,389	16,805,748
4	Single-Piece Cards	212,870	62,425	48,228	9,292	72,549	26,896	432,261
5	Worksharing Postcards	77,574	25,112	1,456	3,070	45,933	6,977	160,123
6	Total Cards	290,445	87,538	49,684	12,362	118,482	33,873	592,384
7	Total First-Class Mail	10,028,292	2,286,248	836,967	912,479	2,285,883	1,048,263	17,398,132
8	Priority Mail	842,064	53,414	73,337	801,977	190,349	305,076	2,266,217
9	Express Mail	151,294	4,927	38,774	68,466	116,396	30,707	410,564
10	Mailgrams	123	0	0	0	377	7	508
Periodicals								
11	In-County	23,841	16,838	722	66	37,783	2,111	81,360
12	Outside County	0	0			0	0	0
13	Nonprofit	127,292	41,035	349	64,043	91,049	7,703	331,471
14	Classroom	7,319	1,150	0	1,993	2,220	73	12,755
15	Regular Rate	756,306	177,918	3,421	279,349	326,128	34,768	1,577,889
16	Total Periodicals	914,758	236,940	4,492	345,450	457,180	44,654	2,003,475
Standard A Mail								
17	Single Piece	0	0	0	0	0	-298	-298
18	Commercial Regular	3,000,182	737,270	42,028	317,864	1,118,584	-24,255	5,191,674
19	Commercial ECR	427,742	450,436	8,532	61,321	904,548	32,669	1,885,248
20	Total Commercial	3,427,924	1,187,706	50,560	379,185	2,023,132	8,117	7,076,624
21	Nonprofit	633,987	148,121	13,876	60,529	236,797	13,794	1,107,105
22	Nonprofit ECR	41,988	28,562	1,259	7,160	46,691	-539	125,121
23	Total Nonprofit	675,975	176,683	15,135	67,689	283,488	13,256	1,232,226
24	Total Standard A Mail	4,103,899	1,364,388	65,695	446,875	2,306,621	21,372	8,308,850
Standard B Mail								
25	Parcel Post	276,558	10,614	9,658	327,576	118,175	10,746	753,327
26	Bound Printed Matter	138,525	13,179	1,033	64,762	109,812	18,700	346,013
27	Special Rate	128,461	9,411	5,147	60,023	49,598	4,219	256,860
28	Library Rate	26,759	818	141	13,062	8,242	63	49,085
29	Total Standard B Mail	570,303	34,022	15,979	465,424	285,828	33,728	1,405,285
30	Free-for-the-Blind, etc.	19,852	2,049	310	4,242	4,940	363	31,757
31	International Mail	333,998	14,040	34,804	763,912	41,975	17,300	1,206,030
32	TOTAL ALL MAIL	16,964,584	3,996,030	1,070,358	3,808,826	5,689,550	1,501,471	33,030,818
33	Special Services	220,278	54,327	330,190	0	198,264	481,795	1,284,854
34	TOTAL ATTRIBUTABLE COSTS	17,184,862	4,050,357	1,400,548	3,808,826	5,887,814	1,983,266	34,315,672

Exhibit NAA-1B
ATTRIBUTABLE COSTS BY FUNCTION AND SUBCLASS
(Test Year After Rates)

Page 2 of 2

Line No.	Description	Mail Processing	In-Office City Delivery	Window Service	Transportation Costs	Delivery Costs	Other Costs & Adjustment	Total Attributable Costs
First-Class Mail								
1	Single-Piece Letters	60.81%	12.25%	5.90%	4.90%	9.60%	6.54%	100.00%
2	Worksharing Letters	48.92%	15.71%	0.85%	6.79%	23.28%	4.44%	100.00%
3	Total Letters	57.94%	13.08%	4.68%	5.36%	12.90%	6.04%	100.00%
4	Single-Piece Cards	49.25%	14.44%	11.16%	2.15%	16.78%	6.22%	100.00%
5	Worksharing Postcards	48.45%	15.68%	0.91%	1.92%	28.69%	4.36%	100.00%
6	Total Cards	49.03%	14.78%	8.39%	2.09%	20.00%	5.72%	100.00%
7	Total First-Class Mail	57.64%	13.14%	4.81%	5.24%	13.14%	6.03%	100.00%
8	Priority Mail	37.16%	2.36%	3.24%	35.39%	8.40%	13.46%	100.00%
9	Express Mail	36.85%	1.20%	9.44%	16.68%	28.35%	7.48%	100.00%
10	Mailgrams	24.29%	0.00%	0.00%	0.00%	74.27%	1.44%	100.00%
Periodicals								
11	In-County	29.30%	20.70%	0.89%	0.08%	46.44%	2.59%	100.00%
12	Outside County							
13	Nonprofit	38.40%	12.38%	0.11%	19.32%	27.47%	2.32%	100.00%
14	Classroom	57.38%	9.02%	0.00%	15.62%	17.41%	0.57%	100.00%
15	Regular Rate	47.93%	11.28%	0.22%	17.70%	20.67%	2.20%	100.00%
16	Total Periodicals	45.66%	11.83%	0.22%	17.24%	22.82%	2.23%	100.00%
Standard A Mail								
17	Single Piece	0.00%	0.00%	0.00%	0.00%	0.00%	100.00%	100.00%
18	Commercial Regular	57.79%	14.20%	0.81%	6.12%	21.55%	-0.47%	100.00%
19	Commercial ECR	22.69%	23.89%	0.45%	3.25%	47.98%	1.73%	100.00%
20	Total Commercial	48.44%	16.78%	0.71%	5.36%	28.59%	0.11%	100.00%
21	Nonprofit	57.27%	13.38%	1.25%	5.47%	21.39%	1.25%	100.00%
22	Nonprofit ECR	33.56%	22.83%	1.01%	5.72%	37.32%	-0.43%	100.00%
23	Total Nonprofit	54.86%	14.34%	1.23%	5.49%	23.01%	1.08%	100.00%
24	Total Standard A Mail	49.39%	16.42%	0.79%	5.38%	27.76%	0.26%	100.00%
Standard B Mail								
25	Parcel Post	36.71%	1.41%	1.28%	43.48%	15.69%	1.43%	100.00%
26	Bound Printed Matter	40.03%	3.81%	0.30%	18.72%	31.74%	5.40%	100.00%
27	Special Rate	50.01%	3.66%	2.00%	23.37%	19.31%	1.64%	100.00%
28	Library Rate	54.51%	1.67%	0.29%	26.61%	16.79%	0.13%	100.00%
29	Total Standard B Mail	40.58%	2.42%	1.14%	33.12%	20.34%	2.40%	100.00%
30	Free-for-the-Blind, etc.	62.51%	6.45%	0.98%	13.36%	15.56%	1.14%	100.00%
31	International Mail	27.69%	1.16%	2.89%	63.34%	3.48%	1.43%	100.00%
32	TOTAL ALL MAIL	51.36%	12.10%	3.24%	11.53%	17.22%	4.55%	100.00%
33	Special Services	17.14%	4.23%	25.70%	0.00%	15.43%	37.50%	100.00%
34	TOTAL ATTRIBUTABLE COSTS	50.08%	11.80%	4.08%	11.10%	17.16%	5.78%	100.00%

**Exhibit NAA-1C
DERIVATION OF WEIGHTING FACTORS**

Line No.		Mail Processing	In-Office City Delivery	Window Service	Transportation	Street Time Delivery	Other	Total
1	Total Attributable Costs	17,184,862	4,050,357	1,400,548	3,808,826	5,887,814	1,983,266	34,315,672
2	Percent of Total Attributable	50.08%	11.80%	4.08%	11.10%	17.16%	5.78%	100.00%
3	Total Institutional Costs	5,132,943	521,349	1,464,467	556,090	10,792,205	0	18,467,054
4	Percent of Total Institutional	27.80%	2.82%	7.93%	3.01%	58.44%	0.00%	100.00%
5	% Institutional/% Attributable	55.50%	23.92%	194.30%	27.13%	340.61%	0.00%	

Line 1: Exhibit NAA-1B, page 1, line 34.

Line 2: Attributable Costs for each function in Line 1 divided by Total Attributable Cost.

Line 3: Exhibit NAA-1A, line 36.

Line 4: Institutional Costs for each function in Line 3 divided by Total Institutional Costs for these four function.

Line 5: Line 4 divided by Line 2.

Exhibit NAA-1D
WEIGHTED ATTRIBUTABLE COSTS BY FUNCTION AND SUBCLASS
 (Test Year After Rates)

Line No.	Description	Mail Processing	In-Office Delivery	Window Service	Transportation Costs	Street Time Delivery	Other Costs	Total Attributable Costs
1	First-Class Mail							
2	Single-Piece Letters	4,305,890	373,807	1,462,576	169,664	4,173,231	0	10,485,169
3	Worksharing Letters	1,098,892	152,087	67,128	74,537	3,209,046	0	4,601,690
4	Total Letters	5,404,783	525,894	1,529,704	244,201	7,382,277	0	15,086,859
5	Single-Piece Cards	118,149	14,931	93,707	2,521	247,107	0	476,415
6	Worksharing Postcards	43,056	6,006	2,830	833	156,449	0	209,174
7	Total Cards	161,205	20,937	96,537	3,354	403,555	0	685,589
8	Total First-Class Mail	5,565,988	546,831	1,626,241	247,555	7,785,833	0	15,772,448
9	Priority Mail	467,369	12,778	142,494	217,576	648,338	0	1,488,554
10	Express Mail	83,972	1,179	75,339	18,575	396,450	0	575,515
11	Mailgrams	68	0	0	0	1,285	0	1,354
12	Periodicals							
13	In-County	13,232	4,027	1,403	18	128,692	0	147,372
14	Outside County							
15	Nonprofit	70,651	9,815	679	17,375	310,116	0	408,635
16	Classroom	4,062	275	0	541	7,562	0	12,440
17	Regular Rate	419,771	42,555	6,647	75,787	1,110,809	0	1,655,570
18	Total Periodicals	507,717	56,672	8,729	93,720	1,557,179	0	2,224,016
19	Standard A Mail							
20	Single Piece	0	0	0	0	0	0	0
21	Commercial Regular	1,665,187	176,342	81,661	86,236	3,809,955	0	5,819,381
22	Commercial ECR	237,409	107,737	16,578	16,636	3,080,935	0	3,459,295
23	Total Commercial	1,902,596	284,079	98,239	102,873	6,890,890	0	9,278,676
24	Nonprofit	351,881	35,428	26,961	16,422	806,544	0	1,237,235
25	Nonprofit ECR	23,304	6,831	2,447	1,942	159,032	0	193,557
26	Total Nonprofit	375,185	42,260	29,408	18,364	965,576	0	1,430,792
27	Total Standard A Mail	2,277,781	326,338	127,647	121,237	7,856,466	0	10,709,468
28	Standard B Mail							
29	Parcel Post	153,497	2,539	18,765	88,871	402,511	0	666,184
30	Bound Printed Matter	76,886	3,152	2,008	17,570	374,026	0	473,642
31	Special Rate	71,300	2,251	10,000	16,284	168,934	0	268,769
32	Library Rate	14,852	196	275	3,544	28,073	0	46,939
33	Total Standard B Mail	316,534	8,137	31,048	126,269	973,545	0	1,455,535
34	Free-for-the-Blind, etc.	11,019	490	602	1,151	16,827	0	30,088
35	International Mail	185,378	3,358	67,624	207,249	142,969	0	606,579
36	TOTAL ALL MAIL	9,415,827	955,782	2,078,724	1,033,332	19,378,892	0	32,863,556
37	Special Services	122,261	12,994	641,564	0	675,297	0	1,452,116
38	TOTAL ATTRIBUTABLE COSTS	9,538,088	968,776	2,721,288	1,033,332	20,054,188	0	34,315,672
39	WEIGHTING FACTORS	55.50%	23.92%	194.30%	27.13%	340.61%	0.00%	

Exhibit NAA-1E
USPS MARKUPS BASED UPON WEIGHTED ATTRIBUTABLE COSTS
(Test Year After Rates)

Line No.	Description	USPS Contribution at Proposed Rates	Weighted Attributable Costs	Weighted Markup
	First-Class Mail			
1	Single-Piece Letters	9,390,095	10,485,169	89.56%
2	Worksharing Letters	7,418,926	4,601,690	161.22%
3	Total Letters	16,809,021	15,086,859	111.41%
4	Single-Piece Cards	228,751	476,415	48.02%
5	Worksharing Postcards	267,843	209,174	128.05%
6	Total Cards	496,594	685,589	72.43%
7	Total First-Class Mail	17,305,615	15,772,448	109.72%
8	Priority Mail	2,086,476	1,488,554	140.17%
9	Express Mail	430,652	575,515	74.83%
10	Mailgrams	4,168	1,354	307.94%
	Periodicals			
11	In-County	2,305	147,372	1.56%
12	Outside County			
13	Nonprofit	11,160	408,635	2.73%
14	Classroom	-2,215	12,440	-17.81%
15	Regular Rate	111,057	1,655,570	6.71%
16	Total Periodicals	122,307	2,224,016	5.50%
	Standard A Mail			
17	Single Piece	298	0	
18	Commercial Regular	2,830,371	5,819,381	48.64%
19	Commercial ECR	2,418,756	3,459,295	69.92%
20	Total Commercial	5,249,425	9,278,676	56.58%
21	Nonprofit	244,328	1,237,235	19.75%
22	Nonprofit ECR	76,287	193,557	39.41%
23	Total Nonprofit	320,615	1,430,792	22.41%
24	Total Standard A Mail	5,570,040	10,709,468	52.01%
	Standard B Mail			
25	Parcel Post	29,589	666,184	4.44%
26	Bound Printed Matter	178,595	473,642	37.71%
27	Special Rate	95,470	268,769	35.52%
28	Library Rate	3,342	46,939	7.12%
29	Total Standard B Mail	306,996	1,455,535	21.09%
30	Free-for-the-Blind, etc.	-31,757	30,088	-105.55%
31	International Mail	437,814	606,579	72.18%
32	TOTAL ALL MAIL	26,232,311	32,863,556	79.82%
33	Special Services	764,752	1,452,116	52.66%
34	TOTAL	26,997,063	34,315,672	78.67%

**Exhibit NAA-1F
DERIVATION OF PIGGYBACK FACTORS FOR
INSTITUTIONAL COSTS BY COST COMPONENT***

Line No.		Mail Processing	Window Service	City Delivery In-Office Carriers	City Delivery Street Time	Vehicle Service Drivers	Special Delivery Messengers	Rural Carriers
1	Direct Labor	10,910,433	1,008,886	3,157,230	2,482,132	280,125	62,011	1,683,448
2	Total Estimated Attr. Costs	17,169,421	1,431,357	4,060,825	3,353,178	435,876	92,719	2,014,932
3	Piggyback Factor	1.57367	1.41875	1.28620	1.35093	1.55601	1.49520	1.19691
4	Total Estimated Attr. Costs	17,169,421	1,431,357	4,060,825	3,353,178	435,876	92,719	2,014,932
5	Less: Imputed Rents	246,796	24,683	29,185	22,945	1,524	614	11,885
6	Bldg. Depreciation	208,505	20,854	24,658	19,385	1,287	519	10,042
7	Bldg. Interest	39,239	3,925	4,641	3,648	242	98	1,890
8	Adjusted Attributable Costs	16,674,881	1,381,895	4,002,341	3,307,200	432,823	91,488	1,991,115
9	Piggyback Factor for Institutional Costs	1.52834	1.36972	1.26767	1.33240	1.54511	1.47535	1.18276

Source: Direct Labor and all Attributable Cost figures on Lines 1, 2, 4-7 from Library Reference H-77.

Line 3 = Line 2 divided by Line 1

Line 8 = Line 4 less Lines 5-7

Line 9 = Line 8 divided by Line 1

- * The piggyback factor for institutional costs in each cost segment equals the corresponding piggyback factor for the total attributable costs in the cost segment, except for the imputed rental costs and related building depreciation and interest. Since rental costs, building depreciation and building interest are 100 percent attributable based upon market values, there are no corresponding institutional costs for these cost components. Therefore, these costs are removed and the piggyback factors are recomputed to derive the appropriate piggyback factors for institutional costs.

Exhibit NAA-1A
ATTRIBUTABLE COSTS BY FUNCTION
 After Rates, Totals Include Contingency Fee

Attachment to
 USPS/NAA-T1-1(c)
 Page 1 of 5

Line No.	Description	Mail Processing Costs		Piggyback Factor	In-Office	Piggyback Factor	Mail
		CS 3.1	CS 4		City Delivery CS 6		Processing Total
First-Class Mail							
1	Single-Piece Letters	4,899,112	2,645	1.56702	1,205,922	1.28315	9,320,812
2	Worksharing Letters	1,221,871	631	1.60350	487,489	1.29144	2,615,745
3	Total Letters	6,120,983	3,276		1,693,411		11,936,558
4	Single-Piece Cards	137,636	77	1.53045	47,972	1.28840	275,296
5	Worksharing Postcards	49,979	26	1.53597	19,282	1.28948	102,687
6	Total Cards	187,615	103		67,254		377,982
7	Total First-Class Mail	6,308,598	3,379		1,760,665		12,314,540
8	Priority Mail	534,646	137	1.55900	39,203	1.34902	895,478
9	Express Mail	96,575	0	1.55108	3,516	1.38750	156,221
10	Mailgrams	95	0	1.28619	0	1.38662	123
Periodicals							
11	In-County	15,977	3	1.47714	13,016	1.28080	40,678
12	Outside County						
13	Nonprofit	82,589	16	1.52572	31,721	1.28082	168,328
14	Classroom	4,765	1	1.52048	891	1.27795	8,469
15	Regular Rate	493,023	97	1.51853	137,797	1.27837	934,223
16	Total Periodicals	596,354	117		183,425		1,151,698
Standard A Mail							
17	Single Piece	87,560	23	1.58271	20,459	1.29747	0
18	Commercial Regular	1,900,197	495	1.56284	570,875	1.27869	3,737,452
19	Commercial ECR	270,838	66	1.56331	349,354	1.27657	878,178
20	Total Commercial	2,258,595	584		940,688		4,615,630
21	Nonprofit	404,828	107	1.55015	114,711	1.27847	782,108
22	Nonprofit ECR	26,167	6	1.58836	22,172	1.27543	70,549
23	Total Nonprofit	430,995	113		136,883		852,658
24	Total Standard A Mail	2,689,590	697		1,077,571		5,468,288
Standard B Mail							
25	Parcel Post	157,448		1.73911	7,865	1.33610	287,171
26	Bound Printed Matter	80,829		1.69684	9,492	1.37472	151,705
27	Special Rate	72,355		1.75785	6,921	1.34638	137,873
28	Library Rate	15,581		1.70038	596	1.35829	27,576
29	Total Standard B Mail	326,213			24,874		604,325
30	USPS Penalty Mail	80,180		1.49609	8,120	1.27571	0
31	Free-for-the-Blind, etc.	12,075		1.62782	1,596	1.27139	21,902
32	International Mail	212,491		1.55626	10,496	1.32444	348,039
33	TOTAL ALL MAIL	10,856,817	4,330		3,109,466		20,960,613
34	Special Services	119,150	98	1.82894	42,433	1.26763	274,606
35	TOTAL ATTRIBUTABLE COSTS	10,975,967	4,428	1.93392	3,151,899		21,235,219
36	INSTITUTIONAL COSTS	3,319,599	5,651	1.52834	407,192	1.26767	5,654,292

1.0% Contingency Fee included in totals for each service.

Piggyback Adjustment Factor

0.97833

Exhibit NAA-1A
ATTRIBUTABLE COSTS BY FUNCTION
After Rates, Totals Include Contingency Fee

Line No.	Description	Window Service CS 3.2	Piggyback Factor	Window Service Total	Transportation Costs CS 14
First-Class Mail					
1	Single-Piece Letters	525,379	1.41856	752,734	625,377
2	Worksharing Letters	24,113	1.41858	34,548	274,740
3	Total Letters	549,492		787,283	900,117
4	Single-Piece Cards	33,661	1.41856	48,228	9,292
5	Worksharing Postcards	1,016	1.41920	1,456	3,070
6	Total Cards	34,677		49,684	12,362
7	Total First-Class Mail	584,169		836,967	912,479
8	Priority Mail	51,186	1.41856	73,337	801,977
9	Express Mail	27,063	1.41856	38,774	68,466
10	Mailgrams	0	1.41854	0	0
Periodicals					
11	In-County	502	1.42406	722	66
12	Outside County				
13	Nonprofit	245	1.41129	349	64,043
14	Classroom	0	0.00000	0	1,993
15	Regular Rate	2,389	1.41784	3,421	279,349
16	Total Periodicals	3,136		4,492	345,450
Standard A Mail					
17	Single Piece	2,828	1.41902	0	0
18	Commercial Regular	29,333	1.41860	42,028	317,864
19	Commercial ECR	5,956	1.41834	8,532	61,321
20	Total Commercial	38,117		50,560	379,185
21	Nonprofit	9,685	1.41852	13,876	60,529
22	Nonprofit ECR	878	1.42001	1,259	7,160
23	Total Nonprofit	10,563		15,135	67,689
24	Total Standard A Mail	48,680		65,695	446,875
Standard B Mail					
25	Parcel Post	6,623	1.44380	9,658	327,576
26	Bound Printed Matter	720	1.42112	1,033	64,762
27	Special Rate	3,592	1.41863	5,147	60,023
28	Library Rate	101	1.38679	141	13,062
29	Total Standard B Mail	11,036		15,979	465,424
30	USPS Penalty Mail	12,599	1.41851	0	0
31	Free-for-the-Blind, etc.	216	1.41935	310	4,242
32	International Mail	24,292	1.41854	34,804	763,912
33	TOTAL ALL MAIL	762,377		1,070,358	3,808,826
34	Special Services	230,461	1.41855	330,190	0
35	TOTAL ATTRIBUTABLE COSTS	992,838		1,400,548	3,808,826
36	INSTITUTIONAL COSTS	1,058,584	1.36972	1,464,467	556,090

1.0% Contingency Fee included in totals for each service.

Exhibit NAA-1A
ATTRIBUTABLE COSTS BY FUNCTION
After Rates, Totals Include Contingency Fee

Line No.	Description	City Delivery Street Time CS 7	Delivery Costs Piggyback Factor	Vehical Service Drivers CS 8	VS Drivers Piggyback Factor
First-Class Mail					
1	Single-Piece Letters	589,656	1.34772	30,419	1.57417
2	Worksharing Letters	410,951	1.35644	20,191	1.56117
3	Total Letters	1,000,607		50,610	
4	Single-Piece Cards	35,078	1.35324	242	1.55307
5	Worksharing Postcards	20,548	1.35437	241	1.50568
6	Total Cards	55,626		483	
7	Total First-Class Mail	1,056,233		51,093	
8	Priority Mail	91,670	1.41691	24,852	1.53564
9	Express Mail	21,055	1.45732	1,718	1.55041
10	Mailgrams	194	1.45640	1	1.00000
Periodicals					
11	In-County	12,021	1.34526	2,484	1.56783
12	Outside County				
13	Nonprofit	28,889	1.34528	6,167	1.57706
14	Classroom	663	1.34227	245	1.60828
15	Regular Rate	100,320	1.34271	32,339	1.56908
16	Total Periodicals	141,893		41,235	
Standard A Mail					
17	Single Piece	9,643	1.36277	498	1.54661
18	Commercial Regular	416,889	1.34304	49,525	1.54612
19	Commercial ECR	386,059	1.34082	39,615	1.55147
20	Total Commercial	812,591		89,638	
21	Nonprofit	92,484	1.34281	7,568	1.55569
22	Nonprofit ECR	21,095	1.33962	1,800	1.55785
23	Total Nonprofit	113,579		9,368	
24	Total Standard A Mail	926,170		99,006	
Standard B Mail					
25	Parcel Post	41,431	1.40335	29,452	1.54678
26	Bound Printed Matter	48,823	1.44390	15,584	1.55389
27	Special Rate	23,809	1.41414	5,520	1.56238
28	Library Rate	3,997	1.42665	625	1.57491
29	Total Standard B Mail	118,060		51,181	
30	USPS Penalty Mail	3,577	1.33991	994	1.62076
31	Free-for-the-Blind, etc.	2,241	1.33537	620	1.54646
32	International Mail	12,623	1.39110	5,606	1.58193
33	TOTAL ALL MAIL	2,373,716		276,306	
34	Special Services	84,326	1.33143	0	
35	TOTAL ATTRIBUTABLE COSTS	2,458,042		276,306	
36	INSTITUTIONAL COSTS	5,943,399	1.33240	172,666	1.54511
1.0%	Contingency Fee included in totals for each service.		1.02757		

Exhibit NAA-1A
ATTRIBUTABLE COSTS BY FUNCTION
 After Rates, Totals Include Contingency Fee

Attachment to
 USPS/NAA-T1-1(c)
 Page 4 of 5

Line No.	Description	Special Delivery CS 9	Spec. Del. Piggyback Factor	Rural Carriers CS 10	Rural Carrier Piggyback Factor	Total Delivery Costs
First-Class Mail						
1	Single-Piece Letters	729	1.49657	308,636	1.19701	1,225,241
2	Worksharing Letters	346	1.48285	286,874	1.19693	942,161
3	Total Letters	1,075		595,510		2,167,401
4	Single-Piece Cards	39	1.45000	19,991	1.19702	72,549
5	Worksharing Postcards	22	1.31818	14,421	1.19661	45,933
6	Total Cards	61		34,412		118,482
7	Total First-Class Mail	1,136		629,922		2,285,883
8	Priority Mail	1,164	1.49376	15,607	1.19650	190,349
9	Express Mail	50,446	1.49538	5,397	1.19693	116,396
10	Mailgrams	53	1.43396	13	1.07692	377
Periodicals						
11	In-County	3	1.00000	14,487	1.19696	37,783
12	Outside County					0
13	Nonprofit	5	1.20000	34,714	1.19697	91,049
14	Classroom	0	0.00000	763	1.19805	2,220
15	Regular Rate	23	1.39130	114,811	1.19696	326,128
16	Total Periodicals	31		164,775		457,180
Standard A Mail						
17	Single Piece	8	1.50000	1,320	1.19660	0
18	Commercial Regular	8	1.28571	393,561	1.19684	1,118,584
19	Commercial ECR	5	1.20000	264,433	1.19686	904,548
20	Total Commercial	21		659,314		2,023,132
21	Nonprofit	3	1.00000	82,285	1.19691	236,797
22	Nonprofit ECR	3	1.00000	12,670	1.19672	46,691
23	Total Nonprofit	6		94,955		283,488
24	Total Standard A Mail	27		754,269		2,306,621
Standard B Mail						
25	Parcel Post	44	1.38297	11,068	1.19684	118,175
26	Bound Printed Matter	3	1.00000	11,706	1.19687	109,812
27	Special Rate	3	1.00000	5,691	1.19676	49,598
28	Library Rate	3	1.00000	1,228	1.19783	8,242
29	Total Standard B Mail	53		29,693		285,828
30	USPS Penalty Mail	1	1.00000	1,317	1.19741	0
31	Free-for-the-Blind, etc.	0	0.00000	786	1.19592	4,940
32	International Mail	8,071	1.49531	2,560	1.19639	41,975
33	TOTAL ALL MAIL	60,982		1,604,339		5,689,550
34	Special Services	60	1.44615	70,136	1.19682	198,264
35	TOTAL ATTRIBUTABLE COSTS	61,042		1,674,475		5,887,814
36	INSTITUTIONAL COSTS	53,072	1.47535	2,047,129	1.18276	10,792,205

1.0% Contingency Fee included in totals for each service.

Exhibit NAA-1A
ATTRIBUTABLE COSTS BY FUNCTION
After Rates, Totals include Contingency Fee

Line No.	Description	Other Costs & Adjustments	Total Attributable
First-Class Mail			
1	Single-Piece Letters	834,500	12,758,664
2	Worksharing Letters	179,890	4,047,084
3	Total Letters	1,014,389	16,805,748
4	Single-Piece Cards	26,896	432,261
5	Worksharing Postcards	6,977	160,123
6	Total Cards	33,873	592,384
7	Total First-Class Mail	1,048,263	17,398,132
8	Priority Mail	305,076	2,266,217
9	Express Mail	30,707	410,564
10	Mailgrams	7	508
Periodicals			
11	In-County	2,111	81,360
12	Outside County	0	
13	Nonprofit	7,703	331,471
14	Classroom	73	12,755
15	Regular Rate	34,768	1,577,889
16	Total Periodicals	44,654	2,003,475
Standard A Mail			
17	Single Piece	-298	-298
18	Commercial Regular	-24,255	5,191,674
19	Commercial ECR	32,669	1,885,248
20	Total Commercial	8,117	7,076,624
21	Nonprofit	13,794	1,107,105
22	Nonprofit ECR	-539	125,121
23	Total Nonprofit	13,256	1,232,226
24	Total Standard A Mail	21,372	8,308,850
Standard B Mail			
25	Parcel Post	10,746	753,327
26	Bound Printed Matter	18,700	346,013
27	Special Rate	4,219	256,860
28	Library Rate	63	49,085
29	Total Standard B Mail	33,728	1,405,285
30	USPS Penalty Mail	0	0
31	Free-for-the-Blind, etc.	363	31,757
32	International Mail	17,300	1,206,030
33	TOTAL ALL MAIL	1,501,471	33,030,818
34	Special Services	481,795	1,284,854
35	TOTAL ATTRIBUTABLE COSTS	1,983,266	34,315,672
36	INSTITUTIONAL COSTS	0	26,997,063

1.0% Contingency Fee included in totals for each service.

Exhibit NAA-1B
ATTRIBUTABLE COSTS BY FUNCTION AND SUBCLASS
(Test Year After Rates)

Line No.	Description	Mail Processing	Window Service	Transportation Costs	Delivery Costs	Other Costs Adjustment	Total Attributable Costs
First-Class Mail							
1	Single-Piece Letters	9,320,812	752,734	625,377	1,225,241	834,500	12,758,664
2	Worksharing Letters	2,615,745	34,548	274,740	942,161	179,890	4,047,084
3	Total Letters	11,936,558	787,283	900,117	2,167,401	1,014,389	16,805,748
4	Single-Piece Cards	275,296	48,228	9,292	72,549	26,896	432,261
5	Worksharing Postcards	102,687	1,456	3,070	45,933	6,977	160,123
6	Total Cards	377,982	49,684	12,362	118,482	33,873	592,384
7	Total First-Class Mail	12,314,540	836,967	912,479	2,285,883	1,048,263	17,398,132
8	Priority Mail	895,478	73,337	801,977	190,349	305,076	2,266,217
9	Express Mail	156,221	38,774	68,466	116,396	30,707	410,564
10	Mailgrams	123	0	0	377	7	508
Periodicals							
11	In-County	40,678	722	66	37,783	2,111	81,360
12	Outside County	0			0	0	0
13	Nonprofit	168,328	349	64,043	91,049	7,703	331,471
14	Classroom	8,469	0	1,993	2,220	73	12,755
15	Regular Rate	934,223	3,421	279,349	326,128	34,768	1,577,889
16	Total Periodicals	1,151,698	4,492	345,450	457,180	44,654	2,003,475
Standard A Mail							
17	Single Piece	0	0	0	0	-298	-298
18	Commercial Regular	3,737,452	42,028	317,864	1,118,584	-24,255	5,191,674
19	Commercial ECR	878,178	8,532	61,321	904,548	32,669	1,885,248
20	Total Commercial	4,615,630	50,560	379,185	2,023,132	8,117	7,076,624
21	Nonprofit	782,108	13,876	60,529	236,797	13,794	1,107,105
22	Nonprofit ECR	70,549	1,259	7,160	46,691	-539	125,121
23	Total Nonprofit	852,658	15,135	67,689	283,488	13,256	1,232,226
24	Total Standard A Mail	5,468,288	65,695	446,875	2,306,621	21,372	8,308,850
Standard B Mail							
25	Parcel Post	287,171	9,658	327,576	118,175	10,746	753,327
26	Bound Printed Matter	151,705	1,033	64,762	109,812	18,700	346,013
27	Special Rate	137,873	5,147	60,023	49,598	4,219	256,860
28	Library Rate	27,576	141	13,062	8,242	63	49,085
29	Total Standard B Mail	604,325	15,979	465,424	285,828	33,728	1,405,285
30	Free-for-the-Blind, etc.	21,902	310	4,242	4,940	363	31,757
31	International Mail	348,039	34,804	763,912	41,975	17,300	1,206,030
32	TOTAL ALL MAIL	20,960,613	1,070,358	3,808,826	5,689,550	1,501,471	33,030,818
33	Special Services	274,606	330,190	0	198,264	481,795	1,284,854
34	TOTAL ATTRIBUTABLE COSTS	21,235,219	1,400,548	3,808,826	5,887,814	1,983,266	34,315,672

Exhibit NAA-1B
ATTRIBUTABLE COSTS BY FUNCTION AND SUBCLASS
 (Test Year After Rates)

Line No.	Description	Mail Processing	Window Service	Transportation Costs	Delivery Costs	Other Costs Adjustment	Total Attributable Costs
First-Class Mail							
1	Single-Piece Letters	73.05%	5.90%	4.90%	9.60%	6.54%	100.00%
2	Worksharing Letters	64.63%	0.85%	6.79%	23.28%	4.44%	100.00%
3	Total Letters	71.03%	4.68%	5.36%	12.90%	6.04%	100.00%
4	Single-Piece Cards	63.69%	11.16%	2.15%	16.78%	6.22%	100.00%
5	Worksharing Postcards	64.13%	0.91%	1.92%	28.69%	4.36%	100.00%
6	Total Cards	63.81%	8.39%	2.09%	20.00%	5.72%	100.00%
7	Total First-Class Mail	70.78%	4.81%	5.24%	13.14%	6.03%	100.00%
8	Priority Mail	39.51%	3.24%	35.39%	8.40%	13.46%	100.00%
9	Express Mail	38.05%	9.44%	16.68%	28.35%	7.48%	100.00%
10	Mailgrams	24.29%	0.00%	0.00%	74.27%	1.44%	100.00%
Periodicals							
11	In-County	50.00%	0.89%	0.08%	46.44%	2.59%	100.00%
12	Outside County						
13	Nonprofit	50.78%	0.11%	19.32%	27.47%	2.32%	100.00%
14	Classroom	66.40%	0.00%	15.62%	17.41%	0.57%	100.00%
15	Regular Rate	59.21%	0.22%	17.70%	20.67%	2.20%	100.00%
16	Total Periodicals	57.49%	0.22%	17.24%	22.82%	2.23%	100.00%
Standard A Mail							
17	Single Piece	0.00%	0.00%	0.00%	0.00%	100.00%	100.00%
18	Commercial Regular	71.99%	0.81%	6.12%	21.55%	-0.47%	100.00%
19	Commercial ECR	46.58%	0.45%	3.25%	47.98%	1.73%	100.00%
20	Total Commercial	65.22%	0.71%	5.36%	28.59%	0.11%	100.00%
21	Nonprofit	70.64%	1.25%	5.47%	21.39%	1.25%	100.00%
22	Nonprofit ECR	56.38%	1.01%	5.72%	37.32%	-0.43%	100.00%
23	Total Nonprofit	69.20%	1.23%	5.49%	23.01%	1.08%	100.00%
24	Total Standard A Mail	65.81%	0.79%	5.38%	27.76%	0.26%	100.00%
Standard B Mail							
25	Parcel Post	38.12%	1.28%	43.48%	15.69%	1.43%	100.00%
26	Bound Printed Matter	43.84%	0.30%	18.72%	31.74%	5.40%	100.00%
27	Special Rate	53.68%	2.00%	23.37%	19.31%	1.64%	100.00%
28	Library Rate	56.18%	0.29%	26.61%	16.79%	0.13%	100.00%
29	Total Standard B Mail	43.00%	1.14%	33.12%	20.34%	2.40%	100.00%
30	Free-for-the-Blind, etc.	68.97%	0.98%	13.36%	15.56%	1.14%	100.00%
31	International Mail	28.86%	2.89%	63.34%	3.48%	1.43%	100.00%
32	TOTAL ALL MAIL	63.46%	3.24%	11.53%	17.22%	4.55%	100.00%
33	Special Services	21.37%	25.70%	0.00%	15.43%	37.50%	100.00%
34	TOTAL ATTRIBUTABLE COSTS	61.88%	4.08%	11.10%	17.16%	5.78%	100.00%

**Exhibit NAA-1C
DERIVATION OF WEIGHTING FACTORS**

Line No.		Mail Processing	Window Service	Transportation	Delivery	Other	Total
1	Total Attributable Costs	21,235,219	1,400,548	3,808,826	5,887,814	1,983,266	34,315,672
2	Percent of Total Attributable	61.88%	4.08%	11.10%	17.16%	5.78%	100.00%
3	Total Institutional Costs	5,654,292	1,464,467	556,090	10,792,205	0	18,467,054
4	Percent of Total Institutional	30.62%	7.93%	3.01%	58.44%	0.00%	100.00%
5	% Institutional/% Attributable	49.48%	194.30%	27.13%	340.61%	0.00%	

Line 1: Exhibit NAA-1B, page 1, line 34.

Line 2: Attributable Costs for each function in Line 1 divided by Total Attributable Cost.

Line 3: Exhibit NAA-1A, line 36.

Line 4: Institutional Costs for each function in Line 3 divided by Total Institutional Costs for these four function.

Line 5: Line 4 divided by Line 2.

Exhibit NAA-1D
WEIGHTED ATTRIBUTABLE COSTS BY FUNCTION AND SUBCLASS
(Test Year After Rates)

Line No.	Description	Mail Processing	Window Service	Transportation Costs	Delivery Costs	Other Costs	Total Attributable Costs
1	First-Class Mail						
2	Single-Piece Letters	4,611,796	1,462,576	169,664	4,173,231	0	10,417,268
3	Worksharing Letters	1,294,231	67,128	74,537	3,209,046	0	4,644,942
4	Total Letters	5,906,027	1,529,704	244,201	7,382,277	0	15,062,210
5	Single-Piece Cards	136,212	93,707	2,521	247,107	0	479,547
6	Worksharing Postcards	50,808	2,830	833	156,449	0	210,919
7	Total Cards	187,020	96,537	3,354	403,555	0	690,466
8	Total First-Class Mail	6,093,047	1,626,241	247,555	7,785,833	0	15,752,676
9	Priority Mail	443,069	142,494	217,576	648,338	0	1,451,477
10	Express Mail	77,296	75,339	18,575	396,450	0	567,660
11	Mailgrams	61	0	0	1,285	0	1,346
12	Periodicals						
13	In-County	20,127	1,403	18	128,692	0	150,240
14	Outside County						
15	Nonprofit	83,286	679	17,375	310,116	0	411,455
16	Classroom	4,190	0	541	7,562	0	12,293
17	Regular Rate	462,239	6,647	75,787	1,110,809	0	1,655,483
18	Total Periodicals	569,843	8,729	93,720	1,557,179	0	2,229,470
19	Standard A Mail						
20	Single Piece	0	0	0	0	0	0
21	Commercial Regular	1,849,234	81,661	86,236	3,809,955	0	5,827,086
22	Commercial ECR	434,509	16,578	16,636	3,080,935	0	3,548,659
23	Total Commercial	2,283,743	98,239	102,873	6,890,890	0	9,375,745
24	Nonprofit	386,975	26,961	16,422	806,544	0	1,236,901
25	Nonprofit ECR	34,907	2,447	1,942	159,032	0	199,328
26	Total Nonprofit	421,882	29,408	18,364	965,576	0	1,435,230
27	Total Standard A Mail	2,705,625	127,647	121,237	7,856,466	0	10,810,975
28	Standard B Mail						
29	Parcel Post	142,088	18,765	88,871	402,511	0	652,236
30	Bound Printed Matter	75,061	2,008	17,570	374,026	0	468,666
31	Special Rate	68,217	10,000	16,284	168,934	0	263,436
32	Library Rate	13,644	275	3,544	28,073	0	45,536
33	Total Standard B Mail	299,011	31,048	126,269	973,545	0	1,429,874
34	Free-for-the-Blind, etc.	10,837	602	1,151	16,827	0	29,416
35	International Mail	172,204	67,624	207,249	142,969	0	590,047
36	TOTAL ALL MAIL	10,370,993	2,079,724	1,033,332	19,378,892	0	32,862,940
37	Special Services	135,871	641,564	0	675,297	0	1,452,732
38	TOTAL ATTRIBUTABLE COSTS	10,506,864	2,721,288	1,033,332	20,054,188	0	34,315,672
39	WEIGHTING FACTORS	49.48%	194.30%	27.13%	340.61%	0.00%	

Exhibit NAA-1E
USPS MARKUPS BASED UPON WEIGHTED ATTRIBUTABLE COSTS
 (Test Year After Rates)

<u>Line No.</u>	<u>Description</u>	<u>USPS Contribution at Proposed Rates</u>	<u>Weighted Attributable Costs</u>	<u>Weighted Markup</u>
	First-Class Mail			
1	Single-Piece Letters	9,390,095	10,417,268	90.14%
2	Worksharing Letters	7,418,926	4,644,942	159.72%
3	Total Letters	16,809,021	15,062,210	111.60%
4	Single-Piece Cards	228,751	479,547	47.70%
5	Worksharing Postcards	267,843	210,919	126.99%
6	Total Cards	496,594	690,466	71.92%
7	Total First-Class Mail	17,305,615	15,752,676	109.86%
8	Priority Mail	2,086,476	1,451,477	143.75%
9	Express Mail	430,652	567,660	75.86%
10	Mailgrams	4,168	1,346	309.64%
	Periodicals			
11	In-County	2,305	150,240	1.53%
12	Outside County			
13	Nonprofit	11,160	411,455	2.71%
14	Classroom	-2,215	12,293	-18.02%
15	Regular Rate	111,057	1,655,483	6.71%
16	Total Periodicals	122,307	2,229,470	5.49%
	Standard A Mail			
17	Single Piece	298	0	
18	Commercial Regular	2,830,371	5,827,086	48.57%
19	Commercial ECR	2,418,756	3,548,659	68.16%
20	Total Commercial	5,249,425	9,375,745	55.99%
21	Nonprofit	244,328	1,236,901	19.75%
22	Nonprofit ECR	76,287	198,328	38.47%
23	Total Nonprofit	320,615	1,435,230	22.34%
24	Total Standard A Mail	5,570,040	10,810,975	51.52%
	Standard B Mail			
25	Parcel Post	29,589	652,236	4.54%
26	Bound Printed Matter	178,595	468,666	38.11%
27	Special Rate	95,470	263,436	36.24%
28	Library Rate	3,342	45,536	7.34%
29	Total Standard B Mail	306,996	1,429,874	21.47%
30	Free-for-the-Blind, etc.	-31,757	29,416	-107.96%
31	International Mail	437,814	590,047	74.20%
32	TOTAL ALL MAIL	26,232,311	32,862,940	79.82%
33	Special Services	764,752	1,452,732	52.64%
34	TOTAL	26,997,063	34,315,672	78.67%

**Exhibit NAA-1F
DERIVATION OF PIGGYBACK FACTORS FOR
INSTITUTIONAL COSTS BY COST COMPONENT***

Line No.		Mail	Window	City Delivery	City Delivery	Vehicle	Special	Rural
		Processing	Service	In-Office Carriers	Street Time	Service Drivers	Delivery Messengers	Carriers
1	Direct Labor	10,910,433	1,008,886	3,157,230	2,482,132	280,125	62,011	1,683,448
2	Total Estimated Attr. Costs	17,169,421	1,431,357	4,060,825	3,353,178	435,876	92,719	2,014,932
3	Piggyback Factor	1.57367	1.41875	1.28620	1.35093	1.55601	1.49520	1.19691
4	Total Estimated Attr. Costs	17,169,421	1,431,357	4,060,825	3,353,178	435,876	92,719	2,014,932
5	Less: Imputed Rents	246,796	24,683	29,185	22,945	1,524	614	11,885
6	Bldg. Depreciation	208,505	20,854	24,658	19,385	1,287	519	10,042
7	Bldg. Interest	39,239	3,925	4,641	3,648	242	98	1,890
8	Adjusted Attributable Costs	16,674,881	1,381,895	4,002,341	3,307,200	432,823	91,488	1,991,115
9	Piggyback Factor for Institutional Costs	1.52834	1.36972	1.26767	1.33240	1.54511	1.47535	1.18276

Source: Direct Labor and all Attributable Cost figures on Lines 1, 2, 4-7 from Library Reference H-77.

Line 3 = Line 2 divided by Line 1

Line 8 = Line 4 less Lines 5-7

Line 9 = Line 8 divided by Line 1

* The piggyback factor for institutional costs in each cost segment equals the corresponding piggyback factor for the total attributable costs in the cost segment, except for the imputed rental costs and related building depreciation and interest. Since rental costs, building depreciation and building interest are 100 percent attributable based upon market values, there are no corresponding institutional costs for these cost components. Therefore, these costs are removed and the piggyback factors are recomputed to derive the appropriate piggyback factors for institutional costs.

NAA WITNESS CHOWN ANSWERS TO INTERROGATORIES
OF THE UNITED STATES POSTAL SERVICE

USPS/NAA-T1-2. Please refer to Opinion and Recommended Decision, Docket No. R94-1, paragraph 4010. Please explain how, if at all, your weighted attributable cost proposal would determine the " 'assignment' of the remainder [non-attributable cost] based upon non-cost factors."

Answer:

The Commission would judgmentally determine the assignment of the remainder [non-attributable cost] based upon the non-cost factors in the Act using the weighted attributable costs, rather than actual attributable costs, as the basis for this assignment. Please see my direct testimony at page 19, lines 10-18.

NAA WITNESS CHOWN ANSWERS TO INTERROGATORIES
OF THE UNITED STATES POSTAL SERVICE

USPS/NAA-T1-3. Please refer to your testimony at page 2, lines 10-11, where you state "This proposal is a refinement of the proposal I put forward in Docket No. R90-1."

- (a) Please confirm that the only substantive difference between the methodology developed by you in your testimony in Docket No. R90-1 and the one you advance in Docket No. R97-1 is that in the former you define three "unbundled elements" whereas in the current case you have defined four such "unbundled elements" (in addition to a category you call "Other Costs & Adjustments.") If you do not confirm, please describe full all differences between your current proposal and the method you propose in Docket No. R90-1.
- (b) Please provide a mathematical formula which describes the method you currently advocate to produce weighted attributable costs.

Answer:

- (a) Not confirmed. Please see my answer to ADVO/NAA-T1-4.
- (b) Please see my answer to AMMA/NAA-T1-4(e).

NAA WITNESS CHOWN ANSWERS TO INTERROGATORIES
OF THE UNITED STATES POSTAL SERVICE

USPS/NAA-T1-4. Please refer to your testimony at page 8, lines 2-4. You state that:

"...the appropriateness of applying a markup to a single pool of attributable costs can rest upon the implicit assumption that the ratio of institutional costs to the attributable costs for each function is constant across the four functions." Please confirm that the appropriateness of applying a markup to a simple (sic) pool of attributable costs can also rely upon other factors or assumptions. If you do not confirm, please explain fully.

Answer:

As explained in my direct testimony, the appropriateness of applying a markup to a single pool of unweighted attributable costs rests upon either one of two assumptions. As I state at page 4, lines 17-19 of my testimony,

"Applying a markup to total attributable costs is appropriate *only if* (1) all mailers buy approximately the same mix of the four basic functions *or* (2) the ratio of institutional costs to attributable costs is relatively constant across all four functions." (emphasis added)

One of these two assumptions *must* hold for it to be appropriate to apply the markup to total attributable costs. As demonstrated in my testimony, neither assumption is true today. Therefore, it is not appropriate to apply a markup to total attributable costs to determine the institutional cost contribution for each subclass.

NAA WITNESS CHOWN ANSWERS TO INTERROGATORIES
OF THE UNITED STATES POSTAL SERVICE

USPS/NAA-T1-5. Please refer to your testimony at pages 10-11, and in particular Table 4 on page 10. Please confirm that the current method used by the Postal Rate Commission to determine the coverage of institutional costs does not match that described in the example shown in Table 4; that is, that other considerations are taken into effect when the final assignment of institutional costs is determined. If you do not confirm, please cite specific references in the Opinion and Recommended Decision of recent rate cases that confirm the current method of assigning institutional costs as described on page 10 of your testimony.

Answer:

The example in Table 4 at page 10 assumes that the Commission finds no reason to differentiate among the classes with respect to the factors in Section 3622(b) of the Act and therefore determines that equal markups are appropriate for the three classes of mail. If the Commission determined that equal markups were appropriate for all subclasses based upon all the factors specified in the Act, then Table 4 would reflect the current method of assigning institutional costs. However, the Commission to date has never determined that all subclasses should bear equal markups.

NEWSPAPER ASSOCIATION OF AMERICA
WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
VAL-PAK/CAROL WRIGHT (VP-CW/NAA-T1-1-11)

VP-CW/NAA-T1-1. Please explain how your total weighted attributable cost methodology differs from the cost ascertainment system used by the former Post Office Department to allocate costs.

Answer:

I am not familiar with the cost ascertainment system used by the former Post Office Department to allocate costs. Therefore, I cannot answer your question.

NEWSPAPER ASSOCIATION OF AMERICA
WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
VAL-PAK/CAROL WRIGHT (VP-CW/NAA-T1-1-11)

VP-CW/NAA-T1-2. Please refer to page 18 of your testimony, where you compare a systemwide markup to the markups of individual mail classes and subclasses.

- (a) What purpose does a systemwide markup serve when each class and subclass is already allocated its respective share of "institutional costs"?
- (b) As an illustration of how your proposal operates, please explain why your allocation of institutional costs to Standard A ECR reduces the markup of that subclass.

Answer:

- (a) My method does not "already allocate a respective share of institutional costs to each class and subclass." My method simply provides a better metric for the assignment of institutional costs. Using my method, the Commission will continue to assign institutional costs based upon its assessment of the factors in Section 3622(b) of the Postal Reorganization Act.
- (b) I do not propose any specific "allocation" of institutional costs to Standard A ECR mail. Exhibit NAA-1E shows the weighted markups that result from the Postal Service's proposed institutional cost contributions. The weighted markup is lower than the unweighted markup for Standard A ECR mail since Standard A ECR mail heavily relies upon functions which account for a large share of the institutional costs of the Postal Service.

NEWSPAPER ASSOCIATION OF AMERICA
WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
VAL-PAK/CAROL WRIGHT (VP-CW/NAA-T1-1-11)

VP-CW/NAA-T1-3. Please refer to page 19, lines 16-18 of your testimony, where you discuss, under your proposal the Commission's application of "its judgmental assessment of the factors under Section 3622(b) of the Act to derive the appropriate markup for each class (sic) of mail."

- (a) Is it your view that, under your proposal, the Commission should somehow take institutional costs allocated to one subclass and shift them to another subclass? If so, how should the Commission determine, for example:
- i. which class/subclass' institutional costs should be shifted to First-Class letters, or which subclass should receive institutional costs belonging to Standard A Nonprofit?
 - ii. how much of the institutional costs otherwise assigned to Periodicals should be covered by other classes or subclasses of mail?
 - iii. having your metric, should or would institutional costs assigned to Periodicals be increased?
- (b) Is it your view that the Commission is only distributing "system-wide" institutional costs (p. 8, l. 17)?

Answer:

- (a) No. I am not proposing any specific assignment of institutional costs to each subclass of mail. Hence, I am not proposing any specific "shift" of institutional costs from one subclass to another.
- (b) No. I am proposing that the Commission assign total institutional costs to subclasses of mail based upon the factors in the Act using weighted attributable costs, rather than actual attributable costs.

NEWSPAPER ASSOCIATION OF AMERICA
WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
VAL-PAK/CAROL WRIGHT (VP-CW/NAA-T1-1-11)

VP-CW/NAA-T1-4. Please refer to page 11, lines 15-18 of your testimony.

- (a) Is it your testimony that your total weighted attributable cost methodology would supplant the Commission's judgmental assessment of the factors under Section 3622(b) of the Act as the means which governs allocation of institutional costs? Please explain your answer.
- (b) Is it your testimony that your total weighted attributable cost methodology should have more weight than the Commission's judgmental assessment of the factors under Section 3622(b) of the Act in setting class/subclass markups? Please explain your answer.

Answer:

- (a) & (b) No. As explained at page 19, lines 10-18 of my testimony, I am proposing that the Commission continue to apply its judgmental assessment of the factors under Section 3622(b) of the Act when determining institutional cost assignments. The only difference is that I am proposing that the Commission use weighted attributable costs, rather than actual attributable costs, when making this assignment.

NEWSPAPER ASSOCIATION OF AMERICA
WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
VAL-PAK/CAROL WRIGHT (VP-CW/NAA-T1-1-11)

VP-CW/NAA-T1-5. Please refer to page 17, lines 11-12 of your testimony. Is it your testimony that the Commission should calculate the total weighted attributable cost for each class and subclass of mail, but that the institutional costs for the four basic functions should not be allocated to each class and subclass of mail in accordance with that methodology? Please explain your answer.

Answer:

As I explain in my answers to VP-CW/NAA-T1-4, I am proposing that the Commission assign total institutional costs judgmentally to subclasses of mail using my weighted attributable costs as the basis for the markup. I am not proposing that the institutional costs associated with each function be assigned to subclasses based upon the attributable costs of that function only. See also my response to ADVO/NAA-T1-4.

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VP-CW/NAA-T1-6. Please refer to page 17, lines 9-10 of your testimony. Is it your view that your method provides a better cost figure to which the Commission can apply its judgment (to allocate the remaining institutional costs) for the reason that a larger portion of costs (both certain institutional and volume variable) have been assigned by class and subclass than under either the Postal Service's proposed, or the Commission's methodology? Please explain your answer.

Answer:

No. My method does not assign or attribute a larger portion of costs – both certain institutional costs and volume variable – to the subclasses of mail. As noted in my response to VP-CW/NAA-T1-3(b), I propose that the Commission judgmentally assign total institutional costs to subclasses of mail using my weighted attributable costs. It is my view that this metric is a better measure of how each subclass of mail benefits from institutional effort. Please see my response to AMMA/NAA-T1-6(b).

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VP-CW/NAA-T1-7.

- (a) Is it your testimony that the Commission should partition the total pool of institutional costs into two separate pools, described by you as "identifiable" and "system-wide" institutional costs (page 8, lines 15-17). Please explain fully any answer that is not an unqualified affirmative.
- (b) Is it your testimony that what you describe as "identifiable" institutional costs should be reasonably assigned to the classes and subclasses of mail using your "metric" of weighted attributable costs, and that "system-wide" institutional costs should be allocated according to the non-cost criteria in Section 3622(b) of the Act? Please explain fully any answer that is not an unqualified affirmative.

Answer:

- (a) For the purposes of deriving the weighting factors in Exhibit NAA-1C, I identify the institutional costs associated with providing each function. Then, as explained in my response to VP-CW/NAA-T1-3(b), I am proposing that the Commission assign the total institutional costs based upon its judgmental assessment of the factors in Section 3622(b) of the Act using weighted attributable costs, rather than actual attributable costs. The institutional cost contribution determined by the Commission using this approach would then be added to the actual (unweighted) attributable costs to arrive at the revenues for a subclass. For a step-by-step description of my recommended method, please refer to DMA/NAA-T1-1(a).
- (b) No. Please see my response to part (a) above.

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VP-CW/NAA-T1-8. Please explain how using your "metric" of weighted attributable costs to assign institutional costs to the classes and subclasses of mail comports with each of the criteria in Section 3622(b) of the Postal Reorganization Act.

Answer:

As explained in my response to AMMA/NAA-T1-6(b), my "metric" of weighted attributable costs provides a better measure of how each subclass of mail benefits from institutional effort. I recommend that the Commission apply the criteria in Section 3622(b) of the Postal Reorganization Act to assign the institutional costs using weighted attributable costs. The institutional cost contribution determined by the Commission using this approach would then be added to the actual (unweighted) attributable costs to arrive at the revenues for a subclass. The institutional costs assigned in this manner will "comport" with each of the criteria in Section 3622(b) of the Act, since the Commission will take each of these criteria into account when making its institutional cost assignment.

In my view, it is inaccurate to state that either weighted or unweighted attributable costs "comport" with the criteria in the Act. It is the institutional costs assigned using these metrics that must comport with the criteria in the Act.

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VAL-PAK/CAROL WRIGHT (VP-CW/NAA-T1-1-11)

VP-CW/NAA-T1-9. Should weighted attributable costs be used as the basis for allocating system-wide institutional costs? If your answer is affirmative, please explain why this is more fair and equitable than using actual attributable costs.

Answer:

As I explain in my response to VP-CW/NAA-T1-3, I propose that the Commission use weighted attributable costs as the basis for assigning total institutional costs. As I explain in my response to AMMA/NAA-T1-6(b), the use of weighted attributable costs will result in a more fair and equitable assignment of institutional costs since this metric provides a better measure of how each subclass of mail benefits from institutional effort.

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ANSWERS TO INTERROGATORIES OF
VAL-PAK/CAROL WRIGHT (VP-CW/NAA-T1-1-11)

VP-CW/NAA-T1-10. Please refer to Exhibit NAA-1E.

- (a) Confirm that the weighted markup for Standard A Commercial ECR is 77.75 percent, and for Nonprofit ECR it is 41.06 percent.
- (b) Confirm that the weighted markup for Standard A Commercial Regular is 49.19 percent, and for Nonprofit Regular it is 20.23 percent.
- (c) Do you agree that the nonprofit markups do not conform with the requirements of the RFRA? Explain fully any negative answer.
- (d) Would you bring the nonprofit markups into compliance with RFRA by (i) adjusting the nonprofit markups, or (ii) adjusting the commercial rate markups so that the nonprofit markups are equal to 50 percent of the corresponding regular rate markup?

Answer:

- (a) & (b) Confirmed. These figures represent the weighted markups using the Postal Service's proposed institutional cost contributions.
- (c) I am not qualified to render a legal opinion. However, based upon my understanding of the Revenue Forgone Reform Act, the relevant markups as defined by the Act are the unweighted markups. Please see my responses to NNA/NAA-T1-6 and DMA/NAA-T1-6.
- (d) If the proposed nonprofit unweighted markups do not conform to the requirements of RFRA, I leave it for the Commission to determine the appropriate adjustments in the markups for these subclasses of mail. As stated clearly in my testimony at page 19, lines 20-22, I am not making a specific

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ANSWERS TO INTERROGATORIES OF
VAL-PAK/CAROL WRIGHT (VP-CW/NAA-T1-1-11)

recommendation on the institutional costs to be recovered from each subclass of
mail.

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ANSWERS TO INTERROGATORIES OF
VAL-PAK/CAROL WRIGHT (VP-CW/NAA-T1-1-11)

VP-CW/NAA-T1-11. Refer to your testimony at page 11, line 7.

- (a) Define the term "reasonable share" as you use it there, and explain whether that is solely your interpretation, or whether you believe it derives from some criterion or criteria in Section 3622(b) of the Act.
- (b) Define the word "escapes" as you use it there. Would you agree that your statement assumes that Class C should be paying a higher share of institutional costs.

Answer:

- (a) By "reasonable share" I am referring to a share of institutional costs that reflects how much the class benefits from institutional cost effort. The example at page 10, lines 12-15 is a special case in that it assumes that:

"...the Commission decides that there is no reason to differentiate among the classes with respect to the factors in Section 3622(b) and therefore, that each subclass should be assigned institutional costs on an 'equal' basis."

Given the assumption in this example that institutional costs should be borne on an equal basis, it is reasonable to expect each class to pay an equal share of the institutional costs associated with the functions used by that class.

- (b) "Escapes" refers to the fact that Class C is assigned less than its "reasonable share" of institutional costs as defined in part (a) above. Therefore, Class C avoids institutional costs that should be assigned to this class.

1 CHAIRMAN GLEIMAN: Does any participant have
2 additional written cross-examination for the witness?

3 [No response.]

4 CHAIRMAN GLEIMAN: If not, we'll move on to oral
5 cross-examination, and if my memory serves me correctly, it
6 appears that so far, you're the winner in the pool. Five
7 participants have requested oral cross-examination of you,
8 Ms. Chown: the Advertising Mail Marketing Association,
9 ADVO, Inc., the Mail Order Association of America, ValPak
10 Direct Marketing Association, ValPak Dealers Association,
11 Carol Wright Promotions, Inc., and the United States Postal
12 Service.

13 Does any other party wish to cross-examine this
14 witness?

15 [No response.]

16 CHAIRMAN GLEIMAN: If not and I have the
17 alphabetical order right and counsel's names right, Mr.
18 Wiggins, you can begin on behalf of AMMA when you're ready.

19 MR. WIGGINS: Thank you, Mr. Chairman.

20 CROSS-EXAMINATION

21 BY MR. WIGGINS:

22 Q Ms. Chown, Frank Wiggins for the Advertising Mail
23 Marketing Association.

24 A Good morning.

25 Q Help me out with a sort of technical thing, if you

1 could, Ms. Chown. Take a look at your answer to the Postal
2 Service interrogatory number 1 to you, and particularly to
3 page 1 of 2 of what is labelled NAA-1B. You replicated at
4 the request of the Postal Service an exhibit to your
5 testimony, page 1 of 2 to the replicated NAA-1B that you
6 created. Do you have that?

7 A I have that. I wouldn't call it a replicate. I
8 was doing a new analysis that the Postal Service requested.
9 But it's -- yes.

10 Q Precisely.

11 A Okay.

12 Q They asked you to do a different version is what I
13 mean by replicated.

14 A That's correct. Okay. Just so we're clear.

15 Q Exactly. And when I compare the new version
16 NAA-1B, with the original version NAA-1B, in addition to the
17 changes that resulted from what the Postal Service requested
18 that you do, I see certain differences in the column Other
19 Costs and Adjustments.

20 A Yes.

21 Q Why is that?

22 A The other costs and adjustments in my analysis are
23 derived from taking the total attributable costs and backing
24 out the costs of each of these functions. They have asked
25 me in this analysis to split apart cost segment 6 and cost

1 segment 7.

2 Q Right.

3 A In so doing, I then applied separate piggyback
4 factors to each of those cost elements. So while the
5 attributable costs in cost segment 6 and cost segment 7
6 stayed the same, they were then marked up by slightly
7 different piggyback factors, which, as I explain in my
8 answer, I had to estimate because they don't have separate
9 piggyback factors for each subclass.

10 Q Right.

11 A In so doing, it ended up with small differences in
12 the total attributable cost for those subclasses.

13 Q And that --

14 A And that then falls, because I don't change the
15 total, that then falls in the other costs and adjustments.

16 Q It makes perfectly good sense, but I never would
17 have guessed it. I appreciate that. Thank you.

18 A No, I looked at that too, because I thought
19 ideally if we had really accurate piggyback factors, you
20 shouldn't have that occur. You should be able to split
21 those. But because we don't have enough information on the
22 piggyback factors to split those accurately.

23 Q Good. Take a look with me if you would please at
24 your answer to ADVO Interrogatory 6(a). And I'm looking at
25 page 12, the second page of that answer.

1 The first full sentence on page 12 reads: Using
2 unweighted attributable costs as the basis for the markups
3 implicitly assumes that institutional costs are incurred to
4 provide the different functions of the Postal Service in
5 proportion to the attributable costs of these functions.

6 If I were to change the beginning of that sentence
7 to read using weighted attributable costs -- and then
8 reading on -- what other changes would I need to make to the
9 sentence to have it be accurate?

10 A Does not implicitly assume that the institutional
11 costs are incurred to provide the different functions of the
12 Postal Service.

13 That's precisely the point, Mr. Wiggins, is that
14 by weighting the attributable costs I don't rely on that
15 erroneous assumption. I correct the problem that is
16 inherent in using unweighted attributable costs.

17 Q You need to explain that for me further, if you
18 could, Ms. Chown.

19 A Okay. Let's go back to my testimony. Let's look
20 at table 3 at page 9.

21 As this table shows, the proportion of
22 institutional costs identified with any particular function
23 is very different than the proportion of attributable costs
24 associated with providing that function. For example, 50
25 percent of all attributable costs are associated with mail

1 processing. However, mail processing does not account for
2 50 percent of the institutional costs. It accounts for only
3 28 percent of those institutional costs that can be
4 identified with a particular function.

5 In contrast, when you look at delivery, 29 percent
6 of the attributable costs are delivery. But over 60 percent
7 of the identifiable costs -- identifiable institutional
8 costs -- are associated with providing the delivery
9 function.

10 This points out precisely what the problem is in
11 the current method we use to assign institutional costs. In
12 the current method where we use the total attributable cost
13 base as our measure for assigning institutional cost, we
14 assume that the -- each function gives rise to institutional
15 costs that are roughly proportional to the attributable
16 costs of that function. So that we can use a total dollar.
17 So that a dollar of mail processing cost should receive the
18 same weight as a dollar of delivery cost.

19 Now consider a subclass of mail that only used
20 delivery. Now we know we don't attribute very many delivery
21 costs. When you get out on the street the bulk of those
22 costs are considered institutional. That class would have
23 very low attributable costs. Should that class as a result
24 of avoiding all its mail processing costs, avoiding all the
25 transportation costs, should it be allowed to avoid the

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1 institutional costs associated with delivery? And my
2 response is no. They should take that into account[^] that a
3 large portion of institutional costs are associated with
4 delivery.

5 By weighting the attributable costs I give greater
6 weight to the attributable costs of delivery, so if you are
7 a subclass that only uses delivery, you are going to have a
8 higher weighted attributable cost. Therefore, you will be
9 assigned a greater proportion of institutional costs, all
10 other things being equal. That's the problem I'm trying to
11 correct here, is this[^] by an unweighted cost giving
12 greater -- what happens with nonweighted cost, ^{is it} ~~if it~~ gives
13 greater weight to those functions that are already very
14 attributed.

15 Q I understood your methodology. I think I was just
16 confused in this sentence by your association with markup
17 and function, which is not what the Commission has ever
18 done.

19 A By the function I'm referring to the four basic --

20 Q To your categories --

21 A Services.

22 Q Not the bases on which the Commission has
23 traditionally marked up.

24 A The Commission has traditionally marked up total
25 attributable costs.

1 Q Yes. On page 4 of your testimony, beginning at
2 line 10, there is a sentence that concludes: Even if the
3 provision of these functions causes the Postal Service to
4 incur substantial institutional costs -- do you have that?

5 A I'm sorry, where are we? Page --

6 Q Page 4. There's a sentence beginning on line 10.

7 A Oh, beginning -- beginning. Okay, yes.

8 Q Yes, which concludes --

9 A Um-hum.

10 Q On lines 12 and 13 --

11 A Yes.

12 Q With the passage I just read to you.

13 A That's fine.

14 Q You in answer to our Interrogatory 5(c) gave me a
15 definition of the word "cause" as you interpreted that word
16 in rejoining to our interrogatory.

17 A Yes.

18 Q Do you have that? And as you use the word "cause"
19 in the passage of your testimony that I just read to you --

20 A Um-hum.

21 Q Did you intend the same meaning for that word?

22 A Well, your question in question 5 refers to when a
23 subclass causes a cost.

24 Q Right.

25 A The passage you just read to me was when a

1 function causes a cost to be incurred. The same
2 interpretation can apply. If I remove that function from
3 the Postal Service, would those costs be eliminated? Then
4 in my view they are caused by that function.

5 Q So you're using the word in that --

6 A Using the same -- in the same sense. I just want
7 to make it clear that I'm --

8 Q Sure.

9 A That you were referring to functions earlier. Now
10 we've switched to subclasses, which is a very different
11 thing.

12 Q I understand.

13 A Okay.

14 Q But the short of it is that though you answered
15 our question by saying that subclasses do not cause
16 institutional cost -- correct?

17 A That's correct, because that was your question.

18 Q Exactly.

19 A You dealt with subclasses. Um-hum.

20 Q Understood. But it's your testimony here that
21 functions do cause institutional costs in that incremental
22 cost sense that if you eliminate the function, you eliminate
23 the institutional costs. Is that right?

24 A Yes, that is correct.

25 If I don't have a delivery function and I don't

1 have the carrier walking the street, his institutional
2 costs, as well as his attributable costs, would be
3 eliminated.

4 Q In your answer to our Interrogatory 6-A, you say
5 that, in part, you agree with a passage that we quoted to
6 you from Professor Panzar, and you say I disagree with the
7 term, quote, "unnecessarily," end quote.

8 A Yes.

9 Q Had Dr. Panzar omitted that word from the passage
10 is set out right above that answer on your part, just strike
11 the word "unnecessarily."

12 A Yes.

13 Q And the quotation.

14 A Yes.

15 Q Would you then unqualifiably agree with Dr.
16 Panzar?

17 A No.

18 Q What else about --

19 A I would agree -- here's the basic problem I have.
20 Applying a mark-up to average incremental costs, or applying
21 a mark-up to marginal costs, what determines your economic
22 efficiency is the end point you end up at. Either one, in
23 the true economic sense, reduces economic efficiency,
24 because you have deviated from marginal costs. So either
25 one reduces economic efficiency.

1 I could mark-up incremental costs, I would mark-up
2 marginal costs by a slightly different mark-up, I could end
3 up at the same point. I could end up with the same revenue.
4 It depends on the end point I get to. So just because you
5 have marked up marginal costs doesn't assure you have met or
6 have greater chance of meeting economic efficiency than if
7 you mark-up incremental costs. So I would not agree if you
8 just strike the word "unnecessarily".

9 And I think I pointed that out later in my answer,
10 that because you have deviated from marginal costs, or from
11 average incremental costs, you are not assured of economic
12 efficiency.

13 Q Take a look, if you would, please, at the two
14 tables at the close of your answer to Advo Interrogatory No.
15 4 to you. Do you have that?

16 A Yes.

17 Q It's an illustration, if I have it right, that
18 even if one has the same mark-up assumptions, that is that
19 each of Classes A and B will be marked up by half as much as
20 Class C, is that right?

21 A That was their assumption, yes.

22 Q Exactly. That's what they asked you to analyze.

23 A Yes.

24 Q And you then did that, as illustrated by these two
25 tables, employing on the table at the top of the page,

1 called Table 1, the methodology that you advocated to the
2 Commission in the R90 proceeding, and in the second table,
3 labeled Table 2, the methodology that you are advocating in
4 this case, is that right?

5 A That's correct.

6 Q And you got different answers.

7 A That's correct.

8 Q Even though the mark-up methodologies were the
9 same.

10 A The mark-up methodologies are not the same.

11 Q I'm sorry. The mark-up assumptions. The
12 proportions of mark-up for each.

13 A That's correct.

14 Q Are the same. You come to different answers.

15 A That's correct.

16 Q That's an illustration, is it not, of the point
17 that you just made to me that whether one marks up marginal
18 costs or whether one marks up incremental costs, you can
19 come to the same or different answers depending upon what
20 you choose as the mark-up?

21 A I don't think that that's really the same analogy.
22 Here we have -- it's a different question here. We have the
23 same costs underlying this, this example, and we have used a
24 slightly different method to mark them up. In our -- in
25 your previous question, we were dealing with different costs

1 that we were starting from and marking them up, so it is
2 really a different question.

3 Q They are reciprocals, aren't they? You can either
4 employ different methodologies and the same mark-up and get
5 to different places, or you can apply a uniform methodology
6 and different mark-ups and get to the same place?

7 A I think you are confusing the two issues. I
8 really think they are separate points that we are making
9 here.

10 MR. WIGGINS: Mr. Chairman, I have nothing
11 further.

12 CHAIRMAN GLEIMAN: Mr. McLaughlin, I assume you
13 will cross on the AMMA Interrogatories now.

14 MR. WIGGINS: Mr. Chairman, I did use one of ours.

15 CROSS-EXAMINATION

16 BY MR. McLAUGHLIN:

17 Q Good morning, Ms. Chown.

18 A Good morning, Mr. McLaughlin.

19 Q I would like to refer you first to your response
20 to Advo Interrogatory No. 1, where we asked you to confirm
21 that of all the rate classes and categories that you had
22 listed in your exhibits, that the two that had the highest
23 ratio of weighted attributable costs to actual attributable
24 costs were in-county periodicals and Standard A ECR mail.

25 In your answer, you don't confirm, because you

1 discovered that mailgrams have an even higher ratio.

2 A That's correct.

3 Q Does the Postal Rate Commission set rates for
4 mailgrams?

5 A I honestly don't know.

6 Q If they didn't --

7 A They would -- they would set the cost coverage, I
8 believe. But I --

9 Q If they didn't, in fact, recommend rates for
10 mailgrams, would it be correct then, that among the classes
11 and categories shown in your exhibits, for which the
12 Commission does recommend rates, that those two classes
13 identified in our question do have the highest ratio?

14 A Yes. As I make it clear that those are the next
15 two.

16 Q Yes.

17 A I was just trying to be accurate.

18 Q Just for a moment, I would like to you to your
19 Exhibit NAA-1B and 1D. Now, Exhibit 1B is actual
20 attributable costs and Exhibit 1D is your weighted
21 attributable costs?

22 A That's correct.

23 Q And if you look at total attributable costs on
24 each of those pages, total attributable costs for all
25 classes are exactly the same?

1 A That is correct.

2 Q Totalling up to \$34-and-some-odd billion dollars?

3 A That is correct.

4 Q But for individual classes, the weighted
5 attributable costs vary up or down from actual attributable
6 costs, is that correct?

7 A Yes.

8 Q In some cases by significant amounts, and I will
9 define significant as greater than 50 percent?

10 A That is correct.

11 Q So since total attributable costs between these
12 two exhibits are the same, isn't it somewhat like a bowl of
13 Jello in the sense that if your methodology results in a \$1
14 billion increase in weighted attributable costs compared to
15 actual attributable costs, that means that there is a \$1
16 billion reduction among other classes somewhere in the
17 system?

18 A Okay. Let's look at exactly why the totals are
19 the same, and that may help you with your question. When I
20 derived weights for these functions, in a sense, the weights
21 scaled the attributable costs to arrive back at the same
22 number. And so that there's -- and I thought that that was
23 a useful thing to do because then you would have a framework
24 that wasn't -- you wouldn't have to always be adjusting,
25 well, instead of having \$60 million in total attributable

1 costs when I weighted them, you wouldn't have to say, okay,
2 so the mark-ups are all going to be roughly half of what
3 they were before or whatever. We wouldn't have this problem
4 with having to weight the mark-ups in our mind.

5 So the weights I designed, I designed to result in
6 the same total. But it is not the case that I am taking
7 some subclasses' attributable costs and giving them to
8 somebody else. Your attributable costs are what they are as
9 a subclass, and then if you have \$10 of mail processing
10 attributable costs, they are given less weight. If you have
11 got \$20 of delivery attributable costs, they are given
12 greater weight. So I have scaled them within their
13 functions.

14 If you think of it as an index, like a Consumer
15 Price Index, for example, it is a weighted basket of goods
16 where you have different weights assigned to different costs
17 of different things in the economy. We can scale the
18 Consumer Price Index, and we do to function, to be one
19 around a given, a particular year, but that is just a
20 scaling factor. That's the same thing here. I have picked
21 a scale that will put it on the same scale it is today, but
22 I am not shifting somebody's attributable costs from
23 somebody -- from somebody else to somebody.

24 Q Excuse me. I think that --

25 A If I change the weights --

1 Q Perhaps I may not -- either you misunderstood my
2 question, or I may not have phrased it precisely. I wasn't
3 talking about shifting attributable costs. I was talking
4 about, to the extent that, under your methodology, the
5 difference between attributable and weighted attributable
6 costs increased by a billion dollars for one class, there
7 must somewhere be a \$1 billion change in the other direction
8 for other classes.

9 A True, but --

10 Q In other words, it totals up to zero. It totals
11 up to the same in the end, it is just that your weighted
12 attributable costs are higher for some classes and lower for
13 others, proportionally it all comes out to the same total?

14 A That's true. But it is not because we are
15 shifting in any sense, we are just giving them different
16 weights. So somebody's attributable costs are weighted by
17 90 percent and somebody -- on whole, and somebody else's are
18 weighted by 110 on average.

19 Q Now, under your proposal, when it comes -- when
20 the Commission comes to setting rates, the number that the
21 Commission would mark-up is your weighted attributable
22 costs?

23 A That's my proposal.

24 Q To arrive at revenues, is that correct?

25 A Yes, that's my proposal.

1 Q And it would not be a markup of actual
2 attributable costs?

3 A That's my proposal.

4 MR. BAKER: Was the question what the Commission
5 would mark up for target in institutional costs or for
6 target revenues from a subclass?

7 MR. McLAUGHLIN: I believe I said revenues.

8 THE WITNESS: Oh, I'm sorry. Then for the -- I
9 misunderstood the question.

10 For deriving the institutional cost contribution
11 they would mark up weighted attributable costs. They would
12 then add that institutional cost contribution to
13 attributable costs to arrive at the revenues for a subclass.

14 BY MR. McLAUGHLIN:

15 Q Yes. Let me perhaps rephrase that, because I may
16 have created some confusion there.

17 If we're talking about markups as opposed to, for
18 example, cost coverages, the Commission would take your
19 weighted attributable costs and apply markup factors to
20 those weighted attributable costs, and those markup factors
21 would produce institutional contribution? Is that correct?

22 A That's correct. Which would then be added to
23 actual attributable costs to arrive at the revenue for the
24 subclass.

25 Q Right.

1 Now I'd like to refer you to your Exhibit 1-E.

2 Now this exhibit basically compares USPS
3 contributions at its proposed rates with your weighted
4 attributable costs; is that correct?

5 A That's correct.

6 Q If you look at the figure for commercial ECR mail
7 it shows as a contribution from institutional costs of about
8 \$2.4 billion at the USPS proposed rates.

9 A That's correct.

10 Q Now that is a \$2.4 billion contribution above the
11 actual attributable costs of about \$1.885 billion; is that
12 correct?

13 A As computed by the Postal Service; yes.

14 Q Right. So in terms of a markup over actual
15 attributable costs, that represents a markup of nearly 130
16 percent.

17 A 128.3, to be precise.

18 Q Or a cost coverage of 228.3 percent.

19 A That's correct.

20 Q Okay.

21 A Again assuming the Postal Service's costs.

22 Q Now you show in this Exhibit 1-E that at the
23 Postal Service's proposed rates the ECR would make a
24 contribution -- would have a markup above your weighted
25 attributable costs of 78 percent.

1 A That's correct.

2 Q Now just hypothetically, if the Commission adopted
3 a zero-markup factor above weighted attributable costs for
4 ECR, would that mean that ECR was not making a contribution
5 to institutional costs?

6 A It means it would be making a zero contribution to
7 institutional costs if there was zero markup.

8 Q Well, let's look at that a little bit. I'm
9 talking now about a zero markup over your weighted
10 attributable costs.

11 A Yes. I understand.

12 Q And you're saying that if there's zero markup over
13 weighted attributable costs, that would result in zero
14 institutional cost contribution for ECR mail?

15 A That's correct, because you would take zero and
16 you'd apply it to my markup. You would get zero dollars.
17 Or you'd apply it to my weighted attributable cost. You
18 would get zero dollars of institutional cost contribution.
19 You would then add that to the actual attributable costs,
20 and they would come up with a revenue requirement of about
21 1.88, whatever their actual attributable costs are, 1.885
22 billion, and that would be their revenue requirement.

23 Q Well, I want to think about that for a minute
24 here.

25 A Okay.

1 Q A zero markup means that the revenue for ECR mail
2 would be equal to your weighted attributable costs; is that
3 correct?

4 A No, it does not. We went through that before.
5 You take the markup. You apply it to weighted attributable
6 cost to arrive at the institutional cost contribution. In
7 your case, your example, zero. You then add that to the
8 actual attributable costs to arrive at the revenue
9 requirement for that subclass. So you would take that zero
10 institutional cost contribution, we would add it to the
11 1.885 billion of actual attributable costs, and arrive at a
12 revenue of 1.885 billion for the subclass, so the subclass
13 would have zero institutional cost contribution.

14 Q Well, let's take a look at -- isn't a zero markup
15 equivalent to a 100-percent cost coverage?

16 A On the traditional attributable cost, yes, but you
17 cannot calculate cost coverages in the same way on my
18 method. Because I am not adding the institutional cost
19 contribution to the weighted attributable cost; they get
20 added to the actual attributable costs when determining the
21 revenue requirement.

22 Q In other words, you're saying that the -- under
23 your numbers, there is a \$1.2 billion differential between
24 ECR actual attributable costs and your weighted attributable
25 cost; is that correct?

1 A That's correct, for use only in assigning the
2 institutional cost.

3 Q And you are saying that the mark-up under your
4 method -- explain to me once again how you get your mark-up.

5 A The mark-up as shown in Exhibit NA-1(e), you take
6 the contribution that's been proposed, you divide by the
7 weighted attributable cost to arrive at the mark-up.

8 Now, when the Commission actually does it in
9 practice, they would do it, of course, in the reverse order.
10 They would determine the mark-up that they would like to
11 apply, they would multiply that mark-up by the weighted
12 attributable costs, they would arrive at the institutional
13 cost contribution for each subclass. They then add that to
14 the actual attributable cost to arrive at the revenue for
15 the subclass.

16 MR. McLAUGHLIN: I have no further questions.

17 CHAIRMAN GLEIMAN: Mail Order Association of
18 America? It doesn't appear that anyone is here from that
19 organization. Next is ValPak Direct Marketing Association,
20 et al., but I think we'll take a ten-minute break now and
21 come back at five after the hour and we will pick up with
22 ValPak's cross-examination.

23 [Recess.]

24 CHAIRMAN GLEIMAN: Mr. Olson, whenever you are
25 ready.

CROSS-EXAMINATION

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BY MR. OLSON:

Q Good morning, Ms. Chown.

Now that I have gotten that out of the way, I want to ask you some questions on behalf of ValPak/Carol Wright and ask you if you can turn to your response to USPS-NAA-T1-4.

A Yes.

Q That question began with a quotation from your testimony at page 8 discussing the appropriateness of applying a mark-up to a single pool of attributable costs, correct?

A That's correct.

Q Okay. And that is the current practice of the Commission, is it not, to apply a mark-up to a single pool of attributable costs?

A That's correct.

Q And it has been the practice of the Commission for some time, and also the proposal of the Postal Service in this docket, correct?

A That's correct.

Q Okay. And I want to ask you what it is you had in mind when you talked about appropriateness. Are you saying what the Commission has done heretofore is inappropriate?

A I'm saying that it's difficult, I think, to apply

1 a mark-up to a single pool of attributable costs, a single
2 pool of unweighted attributable costs, because those
3 attributable costs, as the Commission has rightfully
4 recognized, are not comparable to one another, and they have
5 said that themselves in their decisions.

6 Q Okay. Let me go back to the question --

7 A And so I don't want to say that what they have
8 done is inappropriate. I think in applying their judgment,
9 I hope and I trust that, given that they're aware of the
10 problem, that they have taken some account of the fact that
11 the different subclasses have used the different functions
12 of the Postal Service in different mixes. So I think it
13 makes their job more difficult because they don't have a
14 good measure that's comparable across the different
15 subclasses.

16 Q Okay. So you are saying that in the past, the
17 Commission has taken into account the factors that are in
18 your testimony with respect to this relative benefit of
19 institutional costs, but they may have done it in a
20 different way by adjusting coverage factors; is that
21 correct?

22 A I can't say for sure whether they have or have
23 not. I'm not privy to how the Commission has determined
24 their mark-ups in the past. But I know from their decisions
25 that they are aware of the problem, and therefore I would

1 assume that they have made some judgmental adjustment to
2 account for it, but that's my assumption.

3 Q Okay.

4 A I'm just -- I'm trying to give them better data to
5 make that assessment.

6 Q Let's assume for the moment that they have not
7 made those adjustments to coverage factors based on the
8 argument set out in your testimony. Would that mean that
9 they would have inappropriately determined rates in prior
10 dockets?

11 A In my view, yes.

12 Q Okay. Now, by inappropriate, do you also mean,
13 and I know you're not a lawyer, so it's a difficult question
14 to ask and to answer, but are you saying that this is
15 illegal?

16 A I can't answer it. As you point out, I'm not a
17 lawyer. I'm saying that --

18 Q Well, I thought I would say it before you did, but
19 --

20 A But --

21 Q Let me ask you this: Have you reviewed the Postal
22 Reorganization Act with respect to 39 USC Section 3622(b)
23 and the factors in the act?

24 A I reviewed the factors in the act. But let me put
25 it this way: Commissions make the best assessment they can

1 based on the data at hand. In later cases, better data
2 become available. Does that mean everything they did was
3 wrong before? It means that they did what was right at that
4 time given the data they have available.

5 Q Okay. Let me --

6 A So I'm not saying that what they did was illegal
7 or illegitimate in any way; they made the best assessment on
8 the data they had at hand.

9 Q Okay.

10 A My goal in this case --

11 Q Let me just focus on the illegal --

12 A Can I finish my answer?

13 Q Well, I'm afraid you've gone way beyond the
14 illegal issue, which was what the question was, and I just
15 want to focus you back on the question.

16 A Okay.

17 Q I asked you if you could make a judgment about
18 illegality, and I think your answer was you didn't care to.
19 I asked you if you -- correct?

20 A I'm not a lawyer.

21 Q You're not a lawyer. And I asked you if you had
22 reviewed the act --

23 A Yes, I have.

24 Q -- and you said yes. And my question is, when you
25 say inappropriate, are you using an economic term or a legal

1 term or some other term?

2 A Common sense term. It's --

3 Q So it's not an economic term, which has an
4 independent meaning to you as an economist?

5 A As we know from many times we've sat through these
6 hearings, there's no economically correct way to attribute
7 or to assign institutional costs. If there were, we might
8 be done with this argument by now and all have gone home.

9 Q Okay. Do you believe that the law requires the
10 use of weighted attributable costs?

11 A No. I think that the law requires that the
12 Commission make ^{certain}~~certain~~ judgments about how much the
13 subclasses benefit from the institutional cost effort of the
14 Postal Service. I think my measure gives them a better
15 means of making that assessment, and it's more comparable
16 from subclass to subclass.

17 Q And in your testimony that is quoted in this
18 interrogatory where you talk about the implicit assumption,
19 that certain factors are accurate, who makes that implicit
20 assumption? Are you saying that the Congress has made that
21 implicit assumption or the courts have made an implicit
22 assumption or the Commission has made an implicit
23 assumption?

24 A I'm saying when you use attributable costs, actual
25 attributable costs unweighted, you are making the assumption

1 -- anybody who uses them is making the same assumption --
2 that a dollar of transportation cost should be given the
3 same weight as a dollar of mail processing costs, the same
4 weight as a dollar of delivery cost when making
5 institutional cost assignment. That's the assumption that
6 anybody makes when they use that pool of attributable costs
7 to do their mark-ups.

8 Q And if the -- well, strike that. Let me ask you
9 to go to your response to Advo No. 6. And, specifically,
10 6-A, in the first paragraph there, and you are asked to
11 explain the economic significance of weighted attributable
12 costs.

13 A That's correct.

14 Q Do you recall this response?

15 A Yes, I do.

16 Q And in your answer, you talk to -- you talk about
17 how it is a better measure of how each subclass of mail
18 benefits from institutional effort, correct?

19 A That's correct.

20 Q And you use this phrase many times in your
21 testimony in response to Interrogatories, how mail benefits
22 from institutional effort, correct?

23 A Yes, I do.

24 Q Okay. Let's just go through this briefly as to --

25 A I should point out, though, it is not my phrase,

1 it is really the Commission's phrase. I borrowed it from
2 them.

3 Q Did -- I don't recall, did you cite it somewhere?

4 A Yes. Uh-huh. At the very beginning of my
5 testimony.

6 Q The R90-1 analysis of your -- where they rejected
7 the proposal before, is that the cite?

8 A That's correct. They make the statement that --
9 they make the statement in their R90 decision that total
10 attributable costs are not a completely accurate measure of
11 how much various subclasses benefit from institutional
12 effort. So it is their phraseology that I have borrowed to
13 say this is a better measure of how the subclasses benefit
14 from institutional effort.

15 Q Okay. Let's see what that benefit means by going
16 through a brief description of the way that the system works
17 now, and then how you would change it. First of all, under
18 the existing procedure, the Commission determines
19 attributable costs for each class and subclass of mail,
20 correct?

21 A That is correct.

22 Q Okay. And then the Commission determines an
23 appropriate mark-up for each class and subclass of mail
24 using the criteria of the Act, 1, 2 and 4 through 9,
25 correct?

1 A That is correct.

2 Q Okay. And it is the mark-up that determines the
3 aggregate contribution to institutional costs that is
4 required from each class and subclass, correct?

5 A That is correct.

6 Q So if you add the attributable costs to the
7 contribution to institutional costs, you get total revenue
8 requirement, basically?

9 A That is correct.

10 Q Okay. Now, under your proposal, the Commission
11 would attribute institutional -- excuse me -- would
12 attribute costs in exactly the same way that it has done in
13 the past, correct?

14 A That is correct.

15 Q So you are not making some attack on the way that
16 costs are attributed, you are not saying that volume
17 variability has been overlooked or misused, that is not the
18 thrust of your testimony, correct?

19 A That is not the thrust of my testimony. I don't
20 deal with how attributable costs are calculated.

21 Q Okay. And then you advise the Commission to
22 determine the weighted attributable costs before you mark-up
23 each class of mail, correct?

24 A For the purposes of mark-ups, yes.

25 Q Right. Now, if you were to take the mark-ups for

1 each class and subclass of mail that the Commission
2 determined were accurate under the current procedure and
3 apply those exact percentages to the weighted attributable
4 costs, you would get different contributions to
5 institutional costs from different subclasses and classes,
6 correct?

7 A Yes.

8 Q So something has changed as between their
9 methodology, the current methodology, and your methodology,
10 correct? Something has changed, obviously.

11 A Yes.

12 Q Okay. And the difference is that the contribution
13 that each class and subclass of mail would be contributing
14 reflects the injection of a new criteria into the rate
15 setting process, does it not?

16 A No, I would --

17 Q Well, there is a change, is there not, between
18 their approach and your approach, if they use the same exact
19 coverages --

20 A But that is your --

21 Q -- for each class and subclass of mail?

22 A That is your assumption that they use the same
23 exact mark-ups.

24 Q The reason I am making that assumption, Ms. Chown,
25 is to demonstrate that you are injecting a new criterion to

1 the Act, and I am just, for the purpose of laying the
2 predicate, just reconfirming that if they do use the same
3 coverage factors for each class and subclass of mail, that
4 it results in different contributions to institutional costs
5 from different classes and subclasses of mail. I think you
6 agreed to that, didn't you?

7 A If they use the same mark-ups, it will result in
8 different contributions, that is true.

9 Q Okay. Now, isn't it true that the difference
10 between the current way that it is done and your proposal is
11 that the contribution to institutional costs is altered by
12 the degree to which the various classes and subclasses of
13 mail benefit from institutional effort, as you discuss in
14 your testimony?

15 A I would say this is a better measure than the
16 current unweighted attributable costs.

17 Q Yeah, that wasn't the question. The question was,
18 isn't it true that the difference between the result based
19 on the current methodology and your methodology is that the
20 new methodology takes into account the benefit that each
21 class and subclass of mail receives from institutional
22 effort?

23 A Both methods, appropriately applied, reflect the
24 benefit each class receives from institutional costs, that
25 is the whole reason for those criteria. That is what you

1 are trying to do when you make the judgment, is make that
2 assessment and assign the costs. Both methods do that.

3 What I am saying here, I am not injecting any new
4 criteria, any new -- what I am giving is better information
5 --

6 Q Okay. But we are not changing any --

7 A -- to make a judgment.

8 Q We are not changing any of the interpretation of
9 any of the other factors of the Act.

10 A No.

11 Q We are making, we are adopting your proposal, and
12 what I am trying to get you to focus on and discuss, and
13 explain to us, is what changes between the way the
14 Commission has done it in the past, using a certain set of
15 mark-ups, they get certain contributions to institutional
16 costs from each class and subclass, and when you do it using
17 weighted attributable costs, you get different
18 contributions. And I am asking --

19 A If those same mark-ups are used. I keep going
20 back to that.

21 Q Of course, but that is my assumption. The same
22 mark-ups are being used.

23 A That's right.

24 Q Because the Commission determined those mark-ups
25 by the -- by its analysis of 36 USC 3622(b), 1 through 9,

1 excluding 3, which is otherwise dealt with, and it has
2 determined the proper coverage for each subclass and
3 subclass of mail. And I am suggesting to you that if that
4 is the Commission's judgment about what the proper mark-up
5 is for each class and subclass of mail, and your numbers are
6 different, then something has been changed. There has been
7 another tenth factor added, --

8 A No.

9 Q -- which is the benefit received, as you describe
10 in your testimony.

11 A No, absolutely not. You are confusing things
12 there. The Commission has made a judgment based on the data
13 at hand about the appropriate mark-ups, given those, all
14 those factors under the Act, and they have applied that
15 mark-up. They have arrived at an institutional cost
16 contribution. They know, because they have stated in their
17 decision, that attributable costs are not a great measure,
18 but it is what they have. And they have made the judgment
19 bearing that in mind.

20 Now, what I am saying is let me give you a better
21 measure of attributable costs for assigning institutional
22 costs, for the purposes of assigning institutional costs
23 only. Now go and look at your criteria. Make a judgment
24 about how much each class should bear in the way of
25 institutional costs -- the same criteria, the very same

1 criteria.

2 They then apply that to the weighted attributable
3 costs.

4 You are assuming the markups would be the same. I
5 am not making that assumption.

6 The Commission may determine that, well, last
7 time -- say for example the Commission determined last time,
8 well, this is kind of a high markup, but we are going to
9 accept it because we know this class, this subclass of mail,
10 uses a lot of delivery, which has a lot of institutional
11 costs associated with it.

12 This time they look at my weight attributable
13 costs and they say, ah, that's already been taken into
14 account, so I can change my markup based on the fact that I
15 know that that consideration we considered last time has
16 already been taken into account so I have a better number to
17 apply judgment based on the same criteria under the act.

18 I am not changing the criteria at all. I am not
19 adding to them or anything else. I am giving them better
20 information.

21 Q A moment ago didn't you say you could not speak
22 with specificity as to whether the Commission did take this
23 factor of relative benefit of institutional costs into
24 consideration. You don't know.

25 A I did say that and I said I didn't know --

1 Q Okay.

2 A -- but I am saying --

3 Q And I am saying --

4 A -- hypothetically they may have so they may not
5 arrive at the same markups. You can't assume the same
6 markups.

7 Q Let me ask you to assume that. Let me ask you to
8 assume that the Commission --

9 A -- ignored it.

10 Q Not -- has ignored this concept that you have of
11 relative benefit of institutional costs in the ~~past~~ ^{past, for} ~~and~~
12 they apply the factors of the act and they say these are the
13 relative markups that we think each class and subclass
14 should bear and then they take a look at your proposal,
15 which uses weighted attributable costs, and it changes
16 things, and I am saying to you simply -- all I am trying to
17 get you to acknowledge is one thing, that it changes things
18 because you are adding a new factor to the act which is
19 relative benefit from institutional costs.

20 A No. All the factors address the relative benefit
21 of institutional costs of the class. That is what the
22 criteria are supposed to do, so you can judge the relative
23 benefit that each class gets of the institutional costs.

24 Q You are saying each of these --

25 A I am not adding any criteria.

1 Q Okay. Does simplicity of structure address the
2 *relative*
~~relevant~~ benefit of --

3 A All right, well, maybe not each one of them but --

4 Q Does degree of mail preparation?

5 A Yes, because --

6 Q It does?

7 A -- they have noticed that -- precisely that one
8 because this is where I think you can't say the Commission
9 has ignorantly applied markups knowing that people --

10 Q Just to correct the record, I did not say that.

11 [Laughter.]

12 THE WITNESS: -- ignoring the relative mix of
13 functions.

14 They know that when a class engages in work
15 sharing, they have stated on their past decisions when a
16 class engages in work sharing it shouldn't be allowed to
17 escape its institutional cost contribution.

18 They have stated that.

19 What happens when a subclass as a whole engages in
20 work sharing? Its attributable costs decline. It therefore
21 gets a lower assignment of institutional costs.

22 My method is trying to correct that.

23 BY MR. OLSON:

24 Q Okay. Your method is to give the Commission
25 another way to do what it can do already under the act,

1 because you said, I believe, that your approach of relative
2 benefit of institutional costs is subsumed in the act under
3 your reading of the act, correct?

4 A I think that yes, they could do it without this
5 method, except for the fact that we are dealing with a
6 multitude of subclasses, a lot of functions, so why not give
7 them a number that would help them make that comparison,
8 that would give them information?

9 Q So you think it is a better way but it could be
10 done under the existing approach?

11 A It could be done subjectively if you really got a
12 ability to keep a lot of different factors in your head at
13 the same time and make those judgments.

14 I think that is difficult.

15 Q Let me ask you to look at your response to NNA
16 Number 5. No, I'm sorry -- I am going to skip that.

17 A Okay.

18 Q Let's discuss for a moment the concept of these
19 different categories of institutional cost that are
20 associated with different postal functions and you identify
21 four this time, correct?

22 A That's correct.

23 Q One of those is transportation, correct?

24 A That is correct.

25 Q Now transportation is I believe a function where

1 most of the costs if not all the costs are attributed, are
2 they not?

3 A Slightly less than 90 percent, I believe, are
4 attributed.

5 Q A very high percentage are attributed?

6 A A high percentage are attributed, that's correct.

7 Q If a high percentage of -- 90 percent or so of
8 transportation costs are attributed, then there are -- and
9 there are very few nonattributed institutional costs
10 associated with that then --

11 A That's correct.

12 Q Under your approach is not the effect that you
13 basically do not mark up costs associated with
14 transportation very much then?

15 A They would get marked up -- the effect of my
16 method would be those costs would be marked up less because
17 you would give them lower weight in the weight of the
18 attributable costs, yes.

19 Q And let's just take the world before the Postal
20 Service's proposal -- in this case when mail processing
21 costs were marked up to a very high degree, if not 100
22 percent --

23 A Mail processing costs were attributed, I think you
24 meant to say.

25 Q Excuse me, I'm sorry, of course, were attributed

1 to 100 percent. Do you recall the costs?

2 A Yes. There were still some portions of mail
3 processing that were not 100 percent attributed but it
4 was -- there was a much higher level of attribution of mail
5 processing costs, yes.

6 Q Okay, so under the approach where mail processing
7 costs have 90 or 95 percent attributed, they too under your
8 method would get very little markup, is that correct?

9 A That's correct.

10 Q Why is it that mail that uses much of the Postal
11 Service network then of transportation and processing would
12 not be asked to contribute very much institutional -- to
13 share in the institutional burden of the Postal Service?

14 A Because the bulk of the institutional costs are
15 incurred to provide the delivery function.

16 Q I understand that that is your proposal but I am
17 asking you, looking at mail processing and transportation,
18 if you can give us a reason as to why it is unfair or unwise
19 or otherwise inappropriate to ask those classes of mail
20 which use mail processing and transportation to pay a share
21 of the Postal Service's costs, institutional costs?

22 A Well, let me ask the question a different way.

23 Why should those subclasses that have very high
24 mail processing costs and very high transportation costs
25 because they use those services from beginning to end, why

1 should they pay a large portion of the institutional costs
2 associated with delivery?

3 In the simple example I provide in my testimony, I
4 show a case where a subclass that doesn't use a function at
5 all has to pay a portion of the institutional costs
6 associated with that function.

7 Why is that fair? That, to me, is not fair. Why
8 should I pay institutional costs for a function that I don't
9 use.

10 Q Okay, so you believe it is unfair to have the
11 Commission impose some of the -- to extract, as an economist
12 would say, some profit from the mail processing or
13 transportation functions?

14 A There are -- first of all, we haven't eliminated
15 all of the institutional costs associated with mail
16 processing and transportation so there is a markup on those
17 costs, but I think that it is unfair to ask people with high
18 mail processing and transportation costs to contribute large
19 amounts to the institutional costs of the delivery function.

20 Q Let's go to that issue of who benefits from mail
21 processing or transportation or window service or delivery.
22 Those are the four categories you use for institutional
23 costs, isn't it?

24 A That's correct.

25 Q And you are saying, are you not -- just to get

1 Val-Pak into the transcript -- in response to Val-Pak, Carol
2 Wright, NAA, T-1-8, we asked you to explain how your metric
3 comports with the act and the criteria of 3622(b); correct?

4 A That's correct.

5 Q Okay. And there you say "my metric of weighted
6 attributable costs provides a better measure of how each
7 subclass of mail benefits from institutional effort;"
8 correct?

9 A That's correct.

10 Q Aren't you assuming that those benefits that you
11 perceive are somehow traceable to classes and subclasses of
12 mail?

13 A Well, in the end we have to assign attributable
14 costs, so while they're not directly traceable, because then
15 you would attribute those costs, they can -- they have to be
16 indirectly assigned to those classes of mail. So in the end
17 yes, you have to -- you have to figure out which classes are
18 going to pay those institutional costs.

19 Q Okay. So you determine that based on some type of
20 causal relationship; correct?

21 A No.

22 Q You wouldn't call --

23 A If it was causal, I would attribute it.

24 Q Okay. If it isn't causal, what would you call it?

25 A The same thing it is today. I haven't changed

1 what it is. It's a judgmental assignment of institutional
2 costs.

3 Q Well, the current system is to attribute
4 volume-variable costs; correct?

5 A Not correct. That's the current proposal. The
6 current system is to attribute incremental costs or a closer
7 measure I would say of incremental costs. It is not
8 strictly volume-variable.

9 Q All right. Well, let's say -- let's use the
10 word -- let's just say the current method then, not to get
11 into that discussion, but -- is to attribute costs that have
12 been determined to be causally linked by virtue of volume
13 variability or specific fixed or --

14 A Or an incremental analysis. Right.

15 Q Well -- okay, let's -- if that's your answer,
16 that's your answer, but then -- and to take institutional
17 costs and to make a judgmental assessment as to how to
18 divide them. There's been two pools of costs; correct?

19 A Right, and I haven't changed that.

20 Q Haven't you really added a third in between.
21 Haven't you really tried to create a middle class -- do you
22 remember the days when we had reasonably assignable costs?

23 A Yes.

24 Q Do you recall that those were eventually
25 determined not to be required by the act or perhaps even

1 prohibited by the act by virtue of the NAGCP Supreme Court
2 case in 1982 I think it was or '83?

3 A Yes, I recall that, and I even addressed that in
4 one of my interrogatory responses to NNA.

5 Q Aren't you saying though that there is -- that
6 under your proposal that there is a kind of linkage which
7 you're asking the Commission to make which is something
8 short of attributable costs?

9 A No. I have attributable costs, I have
10 institutional costs. I'm saying let me give you a better
11 measure for assigning those institutional costs. Use your
12 judgment, apply the factors under the act, but let me give
13 you a better measure that takes into account the fact that
14 the total attributable costs as they're assessed today are
15 not comparable from class to class because they use
16 different mixes of the functions, and those functions have
17 associated with them different amounts of institutional
18 costs.

19 So all I'm saying is let me give you slightly
20 better data to make your assessment easier. That's all I'm
21 doing here. I'm not adding any criteria to the act.

22 Q Okay --

23 A I'm not making any new category of costs. Just --
24 we still have attributable and institutional. I'm giving
25 you a better measure for assigning those institutional

1 costs.

2 MR. OLSON: Mr. Chairman, that's all I have.

3 Thank you.

4 CHAIRMAN GLEIMAN: Postal Service?

5 MR. COOPER: I have no questions.

6 CHAIRMAN GLEIMAN: Is there any follow-up?

7 Questions from the bench?

8 Commissioner LeBlanc?

9 CHAIRMAN LeBLANC: Ms. Chown, this is definitely
10 an intriguing situation here. You get your weighted
11 attributable cost using a judgment factor; is that right?

12 THE WITNESS: I arrive at my weighted attributable
13 cost by weighting each of the attributable costs in the
14 function by their relative share of institutional costs and
15 their relative share of attributable costs.

16 CHAIRMAN LeBLANC: And that relative share comes
17 from where?

18 THE WITNESS: That comes from my table 1A, where I
19 break out -- in each case, I derive --

20 CHAIRMAN LeBLANC: Can you cite that one for me,
21 please?

22 THE WITNESS: Yes. It's the very first table, ~~NNA~~^{NAA}
23 -- Exhibit ~~NNA~~^{NAA}-1A, in the back of my testimony where I have
24 all those exhibits.

25 CHAIRMAN LeBLANC: Okay.

1 THE WITNESS: In these exhibits, I compute -- for
2 example, on page 1, I show how I arrive at the attributable
3 costs associated with mail processing. I take the
4 attributable costs in cost segment 3.1 and the cost segment
5 4, add those together, I apply the piggyback factor that's
6 --

7 CHAIRMAN LeBLANC: So they come from the cost
8 segment?

9 THE WITNESS: So they come from the cost segment,
10 and down at the bottom, on line 36, you'll see I have
11 institutional costs, because each of those cost segments has
12 institutional costs associated with it.

13 CHAIRMAN LeBLANC: Right.

14 THE WITNESS: So that tells me I have \$17.2
15 billion worth of attributable costs in mail processing, and
16 I have \$5.1 billion costs of institutional costs associated
17 with mail processing. So I know how much institutional
18 costs I have relative to attributable costs. I do the same
19 thing for the other four functions. And because we
20 attribute vastly different amounts of costs in the different
21 cost segments, mail processing is -- and transportation are
22 more highly attributed than is delivery, delivery has far
23 more institutional costs associated with it, so that means
24 when I derive my weighted attributable cost, I give the
25 delivery costs greater weight because they are the costs

1 that have more institutional costs associated with them.

2 CHAIRMAN LeBLANC: So let me put it in my language
3 just a minute, then.

4 THE WITNESS: Okay.

5 CHAIRMAN LeBLANC: What we're saying is that some
6 subclasses tend to use more fixed costs than others, and
7 therefore, because of that, it's assigned more based on the
8 weighting factor.

9 THE WITNESS: Okay. Let me just rephrase it a
10 little bit differently, because it's hard to use a fixed
11 cost. Some subclasses use functions, a greater proportion
12 of functions that give rise to more fixed costs.

13 CHAIRMAN LeBLANC: Okay.

14 THE WITNESS: So some subclasses use a lot of
15 delivery and not much else of the system because they
16 presort and they drop ship and they bypass everything else
17 and they use the delivery end. Those subclasses, in my
18 view, should -- you have to take that into account when
19 assigning institutional costs because there is a huge amount
20 of institutional costs associated with delivery function,
21 and if you assign those large volumes of delivery
22 institutional costs based on everybody's mail processing and
23 transportation attributable costs, then the people who use a
24 lot of mail processing and transportation end up paying a
25 large portion of the institutional cost of delivery. That's

1 what I'm trying to avoid here by giving a better number for
2 those subclasses that bypass all the highly attributable
3 costs.

4 CHAIRMAN LeBLANC: Could you also say, then, that
5 more costs -- the more costs are spread, the less they're
6 weighted?

7 THE WITNESS: Yes. The more you attribute the
8 cost, the lower that weight gets because there isn't much
9 left in the institutional cost pool.

10 CHAIRMAN LeBLANC: Okay. I got you. Thank you
11 very much.

12 Thank you, Mr. Chairman.

13 CHAIRMAN GLEIMAN: Is there any follow-up as a
14 consequence of questions from the bench?

15 [No response.]

16 CHAIRMAN GLEIMAN: Mr. Baker, would you like some
17 time for redirect?

18 MR. BAKER: A few minutes, Mr. Chairman.

19 CHAIRMAN GLEIMAN: Certainly.

20 [Off the record.]

21 CHAIRMAN GLEIMAN: Mr. Baker?

22 MR. BAKER: Thank you, Mr. Chairman. We have a
23 little bit of redirect.

24 REDIRECT EXAMINATION

25 BY MR. BAKER:

1 Q Ms. Chown, during your cross-examination by
2 counsel for ValPak, you were asked about your use of the
3 term appropriate and whether weighted attributable costs are
4 more appropriate.

5 My question is, the assumptions that he referred
6 to in your -- that underlie the use of unweighted
7 attributable costs, the present methodology, is that -- are
8 those assumptions any more or less appropriate now than they
9 once may have been?

10 A The assumption we were referring to is that, you
11 know, your institutional costs do not follow from your --
12 attributable costs are not in the same proportions.

13 In the past, when subclasses -- when there weren't
14 as many work-sharing discounts, there wasn't the ability to
15 escape in a sense these attributable costs of mail
16 processing and transportation, so it was less of a problem
17 in the past than it is today. It has become exacerbated,
18 the use of total attributable costs as a measure has become
19 less and less appropriate the more you introduce
20 work-sharing discounts into the system and the more people
21 can just purchase the services they want, individual
22 services they want.

23 Q And do you recall whether at the time the mark-up
24 on unweighted attributable costs was first adopted, whether
25 there were many -- or any presort discounts and destination

1 entry discounts?

2 A There certainly were no destination entry
3 discounts. There were, to the best of my recollection, no
4 presort discounts either at that time, that those have all
5 been introduced in the late '70s and '80s, and the
6 destination entry discounts were introduced in R90.

7 Q Also, counsel for ValPak asked you a line of
8 questions about a subclass, a hypothetical subclass that had
9 heavy or large mail processing and transportation
10 attributable costs. Would such a subclass escape, if you
11 will, making a fair institutional cost contribution under
12 your approach?

13 A Well, if you use mail processing and
14 transportation services, you need to use delivery too. You
15 don't take it back out of the Postal Service after they have
16 transported it and sorted it for you. So no subclass would
17 be able to escape making an institutional cost contribution
18 even if mail processing and transportation were 100 percent
19 attributed.

20 Q Ultimately, who would make the decision as to what
21 the appropriate amount of institutional costs for such a
22 hypothetical subclass would be?

23 A The Commission.

24 MR. BAKER: No more redirect, Mr. Chairman.

25 CHAIRMAN GLEIMAN: Is there any recross?

1 [No response.]

2 CHAIRMAN GLEIMAN: There doesn't appear to be any,
3 and if that's the case, Ms. Chown, I want to thank you for
4 your appearance here today and your contributions to our
5 record, and if there is nothing further, you're excused.

6 THE WITNESS: Thank you very much.

7 [Witness excused.]

8 CHAIRMAN GLEIMAN: We have had a request to modify
9 the order of witnesses and we will hear from the Parcel
10 Shippers Association witness next.

11 Mr. May, if you would identify your witness so
12 that I can swear him in?

13 MR. MAY: Yes. Stephen Zwieg, who works for
14 Parcel Direct, which is a subdivision of Quadgraphics.

15 Mr. Zwieg, would you please take the stand.
16 Whereupon,

17 STEVE ZWIEG,
18 a witness, was called for examination by counsel for the
19 Parcel Shippers Association and, having been first duly
20 sworn, was examined and testified as follows:

21 DIRECT EXAMINATION

22 BY MR. MAY:

23 Q Mr. Zwieg, I'm going to hand you two copies of a
24 document captioned Direct Testimony of Steve Zwieg on behalf
25 of Parcel Shippers Association. I would ask you to examine

1 that and see if that is the testimony you are offering in
2 this proceeding.

3 A Yes.

4 MR. ZWIEG: Mr. Chairman, I am handing these two
5 copies --

6 BY MR. MAY:

7 Q Well, first of all, do you adopt this as your
8 testimony in this proceeding?

9 A Yes.

10 MR. MAY: Mr. Chairman, I am handing these two
11 copies of Mr. Zwieg's testimony to the reporter and ask that
12 they be transcribed in the record and admitted into
13 evidence.

14 CHAIRMAN GLEIMAN: Are there any objections?

15 [No response.]

16 CHAIRMAN GLEIMAN: Hearing none, Mr. Zwieg's
17 testimony and exhibits are received into evidence and I
18 direct that they be transcribed into the record at this
19 point.

20 [Direct Testimony and Exhibits of
21 Steve Zwieg, PSA-T-3, was received
22 into evidence and transcribed into
23 the record.]

24

25

PSA-T-3

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

POSTAL RATE AND FEE CHANGES, 1997

DOCKET NO. R97-1

DIRECT TESTIMONY

OF

STEVE ZWIEG

ON BEHALF OF

PARCEL SHIPPERS ASSOCIATION

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December 29, 1997

TABLE OF CONTENTS

	Page
AUTOBIOGRAPHICAL SKETCH	1
PURPOSE OF TESTIMONY	1
I. DELIVERY AND SERVICE CONCERNS	2
II. THE PROPOSED RATES HOLD OUT THE PROMISE OF AFFORDABLE DELIVERY TO THE DIRECT MAIL INDUSTRY	4
III. VOLUME QUALICATIONS FOR THE DISCOUNT LEVELS	7
IV. THE OPPORTUNITY FOR TRULY REMARKABLE TRANSPORTATION EFFICIENCIES	8
V. CONCLUSION	10

AUTOBIOGRAPHICAL INFORMATION

My name is Steve Zwieg. My address is 1655 West Rogers Drive, New Berlin, Wisconsin 53151. I am the Manager of Parcel/Direct. Parcel/Direct is a subdivision of Quad/Graphics. I have been a member of the Quad/Graphics team for sixteen (16) years. Thirteen (13) of those years were spent in the mail/distribution division of the Company. My responsibilities included operations, sales and marketing, and postal committees. From 1990 through 1996 I was the Director of Mailing Services. During that period of time Quad/Graphics built an industry leader destination entry mail program. Parcel/Direct will launch two (2) facilities in 1998, one in New Berlin, Wisconsin, and one in Martinsburg, West Virginia. My Postgraduate Studies have emphasized marketing. We are a member of the Parcel Shippers Association and I am actively involved in several working committees of the Mailers Technical Advisory Committee.

PURPOSE OF TESTIMONY

The purpose of this testimony is to demonstrate to the Commission the power of drop ship discounts such as proposed in this case to increase competition, improve efficiency and delivery times, and save money for the Postal Service and for mailers. We also hope to show the Commission that it will not work if the discounts are watered down, or if the operational rules such as minimums are dictated arbitrarily with no recognition of actual operating conditions at destination facilities.

I. DELIVERY AND SERVICE CONCERNS.

Direct marketers today are very dependent upon consistent delivery service from their parcel shipping providers. Yet, what is very much lacking is a level of parity between the competitors. Many direct marketers believe, and we agree with them, that when they shop for a consistent, reliable service they have only one option: UPS. This, of course, means that they have only one price. Certainly it should be understandable why no business wants to be held over a barrel by only one provider of an essential service. We believe that we at Parcel/Direct can provide an additional competitive option for direct marketers who are searching for an option, an opportunity that exists largely due to the DSCF discounts proposed in this proceeding.

Parcel/Direct combines the mailings of numerous customers and transports that mail to down-stream postal distribution and delivery facilities. Our company grew out of the rate incentives for destination entry that this Commission created in its recommendations in the R90-1 rate proceeding. The discounts from destination entry spawned by that decision have saved catalogers tens of millions of dollars in distribution costs, while at the same time giving Parcel/Direct the opportunity to develop a network capable of shipping fifteen million pounds of printed materials each week. Because seventy percent (70%) of this volume was transported by us to destination sectional center facilities, catalogers have experienced a higher degree of on time delivery, as well as cost savings. This is illustrated in Table 1 below. This Table shows the results of samples from our Standard A Seed Tracking Program. It rather

graphically illustrates that the catalogs entered at BMC and SCF levels dramatically reduce the number of days from entry to in home delivery.

Table 1

A summary of Seed responses from July '97 through September '97 illustrates the service gains associated with entering mail at the SCF level versus BMC levels.

Quad/Graphics seed tracking program consists of 500 seeds located nation wide.

<u>Destination entry level</u>	<u>Average number of days from the facility to home</u>
BMC	7.93 days
SCF	4.67 days

Parcel/Direct's mission is to achieve these same results that were achieved for catalogs with parcel post. Through the DSCF rates Parcel/Direct will team with the Postal Service to provide a premiere residential delivery program. Parcel/Direct's docking of parcels at the SCF facility will reduce postal handling and improve the level of service to the direct mail industry. We believe that both the financial health of the Postal Service and the continued vitality of direct mail depend on the ability to achieve these results. More competition is absolutely essential in the delivery of residential parcels. DDU and SCF entry destination entry rates provide that means. Under the proposed rates in this case we estimate that 50% of the destination entry volumes will enter at the SCF. This estimate is based on actual case studies conducted for our clients. The proposed rates are what provide the economic incentive to reach this level of SCF entry. To really make it work, however, it is essential that the Commission allow the postal operations people to work with the industry to take practical advantage of the rates it will recommend.

II. THE PROPOSED RATES HOLD OUT THE PROMISE OF AFFORDABLE DELIVERY TO THE DIRECT MAIL INDUSTRY.

The success of the DBMC rate that this Commission recommended in R90-1 demonstrates that direct mailers are looking for residential delivery at a rate they can afford. Destination entry to the BMC provided the first step in that search. The core competency of the Postal Service is residential delivery. And this Commission's recommendation in R90-1 created the first opportunity for the service to aggressively employ this core competency. And the response from the industry was overwhelming. Parcel post volumes have increased sixty-five percent (65%) since the implementation of the Commission's DBMC rate recommendation. We strongly advocate the continuation of this recognition that different partners have different competencies and that a rate schedule should be designed to maximize the competencies of each of the partners in the distribution process.

Maximizing core competencies in a distribution network is neither easy nor cheap. Volume is always the decisive factor; thus, destination entry discounts must be designed to encourage those who can accumulate large masses of volume. Only in this way will the market be able to benefit from the core competencies of the industry partners. This requires a large shift in parcel volume that is directed solely to the delivery unit. Three things must happen:

1. The industry must make a substantial investment in buildings and equipment to reach the impact level necessary for SCF sortation. For example, Parcel/Direct will have to invest \$45 million in 1998 in order to achieve fifty percent (50%) SCF penetration. The industry will not make investments of that size unless

there are rates recommended by this Commission that encourage mailers to make the large volume shifts to that kind of entry. Table 2 summarizes the SCF percentages that can be achieved based on volume increases. This Table shows the rapid increase in the percentage of SCF destination delivery as the volume of parcels to be shipped increases.

TABLE 2

Parcel Level	SCF%	# Parcels SCF*	# of Zips	#SCF's
50,000	6%	2,847	142	46
100,000	27%	26,943	1,226	129
200,000	51%	101,944	3,646	150

* Figures based on minimum of 30 parcels per pallet with a minimum weight of 150lbs.

We cannot emphasize too strongly how important it is that the Rate Commission not water down the discounts proposed for the different stages of drop shipping in this proceeding. If the Commission waters down the discounts it will cause more damage than good. A gradual transition with moderate discounts as a test will benefit no one. The Postal Service will not reduce its labor costs, and private distribution companies such as ours will fail to achieve the economies of scale that we must have in order to meet the downstream destinations. Unless the incentives are substantial the direct mail industry will not make the investments and take on the costs that are required to make the change. We will not see improvement in service nor will we see the affordable delivery that the industry is looking for unless this Commission creates adequate incentives. Table 3 illustrates the savings that can result with higher SCF volumes. This Table shows that a smaller minimum number of parcels per pallet and lower

minimum weight produces a greater potential cost saving than do higher minimum parcels per pallet with a heavier minimum weight, because it increases the number of DSCF parcels.

TABLE 3

COMPANY	BMC (only)	BMX/SCF*		BMC/SCF**	
XYZ	\$54,331.55	\$51,010.10	41% SCF	\$53,015.22	17% SCF
DFG	\$94,580.96	\$88,863.72	39% SCF	\$92,422.15	17% SCF
GLT	\$114,481.80	\$103,666.22	38% SCF	\$109,657.07	29% SCF
ABC	\$279,945.32	\$249,341.59	65% SCF	\$264,714.35	35% SCF
TLR	\$169,106.78	\$125,976.14	47% SCF	\$131,735.05	22% SCF

* Based on the Proposed Rates with a minimum of 30 parcels on a pallet and minimum weight of 150lbs.

** Based on the Proposed Rates with a minimum of 60 parcels on a pallet and minimum weight of 250lbs

On average these customers are savings 7% - 11% when using the BMC/SCF* service level. These savings are reduced by 50% to 60% using the BMC/SCF** service level.

Quad/Graphics and Parcel/Direct are strong believers in the kind of public private partnership that worksharing opportunities created by this Commission in the past have offered. Quad/Graphics has spent \$10 million on an Automated Storage and Retrieval System (AS/RS) to improve its ability to sort Standard A mail for entry destination SCF. Quad/Graphics wholly-owned trucking company, Duplainville Transport, has grown from a thirteen (13) unit fleet to two hundred eighty-five (285) units to support destination entry. All of this economic activity and opportunity was created when the PRC recommended the very same kind of discount levels for Standard A that the Postal Service now proposes be offered to Standard B. Because of the success of these programs, Parcel/Direct supports strongly the DSCF and DDU rate proposals in this case. Our confidence in the business direction that the Postal Service is taking parcel post has given us the confidence again to invest \$45 million in plant and equipment. As

with other destination entry programs, the level of service and the affordability of service provided will be greatly advanced.

This is not only good business for us but it is good business for the Postal Service. By entering forty-seven percent (47%) of its mail at DSCF rates, a mailer could reduce its costs over current rates by eight percent (8%). We illustrate this in our Table 4 with an actual example of the results that would be achieved for a customer under the Postal Service's proposal.

TABLE 4

Company	BMC (only)	Service Level
		BMC/SCF**
ABC*	\$136,106.78	\$125,916.14

*Customer ABC achieved an 8% saving in total cost.
ABC achieved a 47% SCF level (i.e. 47% of ABC parcels entered the postal system at the SCF level.)

** Total cost based on the Proposed Rates.

This kind of opportunity to save will ensure that current users will remain with the Postal Service. This will also give those mailers an opportunity to invest the savings back into the business which will, of course, lead to more Standard A mail and parcel shipments. And, these kinds of rates also increase competition which will lead again to an increase in residential deliveries for the Postal Service. Because the competition (UPS) continues to raise its rates for residential shipments, this creates a real opportunity through worksharing for the Postal Service to gain market share.

III. VOLUME QUALIFICATIONS FOR THE DISCOUNT LEVELS.

Our customers, *i.e.*, the mailers, must be able to take practical advantage of new rate categories issuing from this proceeding. The minimum volumes for destination

entry rates must not be set at such a high qualification level that it is beyond the capacities of the mailers. Meeting the minimum requirements is going to require mailers to invest in sortation equipment and incur higher labor costs. Volume levels necessary to qualify should be an operational decision made jointly by mailers and postal operations people. The size and operational capabilities of a particular destination entry facility should determine the qualifying level rather than a level arbitrarily imposed by the Commission.

Parcel/Direct will focus its SCF and DDU sortation and distribution on the top four thousand (4,000) five digit zip codes. The qualification levels should be based on the operational abilities of the facilities serving those zip codes, and not on a worst-case scenario that will cover the entire national scene. Material handling equipment, dock space, transportation are all essential factors to be weighed for each destination. An example of the kind of minimum qualification that would be a disaster would be a minimum of sixty (60) parcels for a five digit pallet container. This would virtually eliminate the ability to achieve SCF rates, at least at rate levels that would meet the competition. A thirty (30) package minimum, as illustrated in Table 3, above, allows for a thirty-eight percent (38%) to sixty-five percent (65%) distribution. Whereas, a sixty (60) package minimum limits Parcel/Direct, or any other consolidator, to a seventeen (17%) to thirty-five (35%) SCF distribution.

IV. THE OPPORTUNITY FOR TRULY REMARKABLE TRANSPORTATION EFFICIENCIES

Destination SCF discounts for parcel post are an essential step in the efforts to consolidate all mail types into single shipments. As the entire direct mail industry is

looking at efforts to improve delivery, nothing is more essential than efficient transportation. For example, parcel post that is combined with Standard A and periodical mail and entered at SCF destinations altogether addresses that objective. The opportunity to combine all classes of mail on the same truck will significantly reduce transportation costs and improve time of delivery. The average three stop load will become a two stop load if parcel post can be added. By reducing the number of stops the average cost for each load will be reduced by \$55.00. A reduction for distance traveled accounts for another \$156.00 savings. This is a combined reduction of \$211.00 per load. This is illustrated in Table 5.

TABLE 5
Flat Stop Charge Scenario (Three Stops)

Load No	Stop No	Name	City	State	Weight	Stop Cost	Line Cost	Total Cost	
1	1	SCF Chicago	Chicago	IL	20,000	\$ 55			
1	2	SCF Indianapolis	Indianapolis	IN	11,500	\$ 55			
1	3	SCF Louisville	Louisville	KY	11,500	\$			
					43,000	\$	110	\$ 545.80	\$655.80

Flat Stop Charge Scenario (Two Stops)

Load No	Stop No	Name	City	State	Weight	Stop Cost	Line Cost	Total Cost	
1	1	SCF Chicago	Chicago	IL	27,000	\$ 55			
1	2	SCF Indianapolis	Indianapolis	IN	16,000	\$ -			
					43,000	\$	55	\$ 389.47	\$444.47

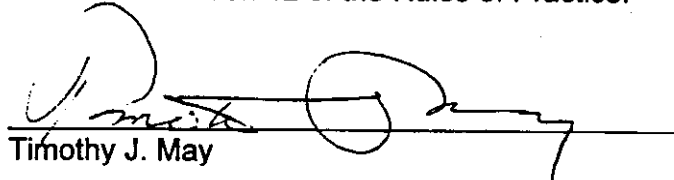
And, of course, there will be improvements in speed of delivery through the reduction in transit times that result from stop off delays. Products will take a more direct route to final destinations. Thus, not only will parcel shippers benefit from the proposals in this case, but so will Standard A and periodical mailers benefit as well. The increased volumes create the destination entry for all classes of mail.

V. CONCLUSION.

Parcel/Direct Quad/Graphics wants to be the leader in this industry for the destination entry worksharing program. Our business objective is to become a partner with the Postal Service so that together we can improve their bottom line and the bottom line of every direct mailer. We have no doubts that, if the Commission will provide the leadership necessary to create these worksharing opportunities, the Postal Service can have significant growth and become a major competitive factor. We are so confident of that we are spending \$45 million on our first two facilities in New Berlin, Wisconsin and Martinsburg, West Virginia. The New Berlin facility will be a 360,000 square foot distribution facility with the ability to sort 200,000 packages per day. The West Virginia facility will be a 400,000 square foot distribution facility with the ability also to sort 200,000 packages per day. Whether these operations are successful depends completely upon what the PRC recommends in this proceeding. We cannot justify this investment if the Commission waters down the proposed SCF rates; and the qualification levels must be decided at an operational level based on the ability of the facilities that are affected, and not imposed in the absence of marketplace realities by the Commission, or by Postal Service Headquarters for that matter.

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing upon all participants of record in this proceeding in accordance with Section 12 of the Rules of Practice.



Timothy J. May

Dated: December 29, 1997

1 CHAIRMAN GLEIMAN: As best I can determine, having
2 shuffled things around from yesterday, there was no
3 designated written cross-examination, at least as of
4 yesterday. Does any participant have designated written
5 cross-examination for this witness?

6 [No response.]

7 CHAIRMAN GLEIMAN: If not, then we'll proceed to
8 oral cross-examination. One participant, United Parcel
9 Service, has requested to cross-examine the witness. Anyone
10 else wish to cross-examine the witness.

11 [No response.]

12 CHAIRMAN GLEIMAN: Mr. McKeever, when you're
13 ready.

14 CROSS-EXAMINATION

15 BY MR. McKEEVER:

16 Q Mr. Zwieg, my name is John McKeever and I
17 represent United Parcel Service.

18 In your testimony, Mr. Zwieg, you state that you
19 are the manager of Parcel Direct, correct?

20 A Correct.

21 Q Parcel Direct, is that a consolidator, what's
22 known as a consolidator?

23 A Yes, a consolidator.

24 Q It's like CTC Distribution Services, for example?

25 A Very similar, yes.

1 Q Okay. Is Parcel Direct in operation yet?

2 A Parcel Direct will begin operation on the 13th of
3 April of this year.

4 Q Does Parcel Direct plan to make final delivery of
5 any packages itself at all?

6 A Not at this particular time.

7 Q You would use other carriers to make final
8 delivery?

9 A Final delivery -- if I'm understanding you
10 correctly, final delivery would be the package to the
11 consumer?

12 Q Yes.

13 A Yes, we would use the Postal Service for that
14 delivery.

15 Q Your intention is to use only the Postal Service
16 at this point in time?

17 A At this point in time.

18 Q Could I ask you to turn to page 1 of your
19 testimony, please, Mr. Zwieg.

20 A Okay.

21 Q There you state right under the heading Purpose of
22 Testimony that the purpose of your testimony is to
23 demonstrate the power of drop ship discounts to increase
24 competition; is that correct?

25 A I don't have that --

1 MR. MAY: It's on page 1.

2 THE WITNESS: Okay. I'm not --

3 BY MR. McKEEVER:

4 Q Look right under the heading Purpose of Testimony.

5 Do you have your testimony?

6 A I don't have the page there, page 1, I'm sorry.

7 Okay. Could you rephrase that or --

8 Q Sure.

9 A -- give me the question again, please?

10 Q Right under the heading Purpose of Testimony, you
11 state the purpose of this testimony is to demonstrate to the
12 Commission the power of drop ship discounts such as proposed
13 in this case to increase competition, among other things; is
14 that correct?

15 A That's correct.

16 Q Now, Parcel Direct is a subdivision of
17 Quadgraphics, right?

18 A That's correct.

19 Q And up until now, Quadgraphics' experience with
20 drop ship discounts has involved drop ship discounts for
21 standard A mail; is that correct?

22 A Standard A mail and periodicals.

23 Q Okay. Can you identify for me any companies that
24 have entered the market for the final delivery to the
25 addressee of standard A mail since the Postal Service

1 instituted drop shipping discounts for standard A mail?

2 Companies that make final delivery now.

3 A That make final delivery.

4 Q Yes.

5 A Can I identify?

6 Q Any that have come into existence since the Postal
7 Service instituted drop shipping discounts for standard A
8 mail.

9 A No, I cannot.

10 Q In fact, haven't some businesses disappeared from
11 that market since the standard A discounts were approved?

12 A I'm not able to answer that question.

13 Q Okay. Could I ask you to turn to page 3 of your
14 testimony, please?

15 A Okay.

16 Q Well, you've already answered my question, Mr.
17 Zwieg, so let me move on to page 8 of your testimony.

18 Do you have that?

19 A Yes.

20 Q At the beginning of the first full paragraph
21 there, just above about the middle of the page, you indicate
22 that Parcel Direct will focus its SCF and DDU sortation and
23 distribution on the top 4,000 five-digit zip codes. Do you
24 see that?

25 A Yes, I do.

1 Q What do you mean by the top 4,000 five-digit zip
2 codes? What zip codes are the top ones?

3 A Those zip codes will be determined on a daily
4 basis based on volume.

5 Q So it's volume that is the determinant?

6 A Volume is the determinant; yes.

7 Q The more volume, the more likely a zip code is to
8 be one of the top zip codes?

9 A That's correct.

10 Q Why focus there? On the ones with the most
11 volume?

12 A Why focus -- I'm sorry, could you restate there
13 question?

14 Q Yes. Why will Parcel Direct focus on those zip
15 codes with the most volume?

16 A To create the largest percentage of SCF delivery
17 of the packages that are delivered on a day-to-day basis.

18 Q Is it cheaper to make final delivery in areas
19 where the greatest volume is because of greater delivery
20 densities?

21 A I have nothing to support that, so I cannot answer
22 that question.

23 Q You don't know one way or the other?

24 A No.

25 Q Could you please turn to page 9 of your testimony?

1 There you indicate about four lines down from the
2 top that the opportunity to combine Parcel Post, Standard A,
3 and periodicals mail on the same truck will significantly
4 reduce transportation costs and improve time of delivery; is
5 that correct?

6 A That is correct.

7 Q Parcel Post, Standard A, and periodicals mail can
8 now be combined on the same truck, can't they?

9 A As of today?

10 Q Yes.

11 A Yes, they could be.

12 Q Okay.

13 A The point I was making there is to the SCF level
14 at this particular point there is no incentive to deliver a
15 parcel to the SCF, so currently you can combine them on the
16 same trailer, but the destinations vary based on the rate
17 incentives.

18 Q Okay. It can be done, but you don't have an
19 incentive to do it.

20 A Correct.

21 Q Okay. On pages 1 and 10 of your testimony you
22 refer to Parcel Direct's new Wisconsin and West Virginia
23 facilities; is that correct?

24 A Correct.

25 Q Do those facilities -- are they now operating at

1 all? For any product?

2 A For any product the New Berlin facility is
3 currently operating; yes.

4 Q Okay. And what does that do right now?

5 A That is a consolidation point for our printed
6 materials.

7 Q So it handles periodical drop shipments?

8 A Periodical and Standard A.

9 Q The other facility is not operating yet?

10 A The other facility is under construction.

11 Q When will that be operating?

12 A That will be operating in the latter half of the
13 fourth quarter of 1998.

14 Q When that facility begins operation, will it
15 handle Standard A mail and periodicals as well as parcels?

16 A Yes, it will.

17 Q Have you ever heard of the Advertising Mail
18 Marketing Association?

19 A Yes.

20 Q Do you receive a publication called the AMMA
21 Bulletin?

22 A Yes.

23 Q Have you -- do you read that fairly currently,
24 keep up to date in reading it as soon as it comes in?

25 A Relatively; yes.

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1 Q Are you aware that in the February 13, 1998 issue
2 the AMMA Bulletin reported on a study by the Postal Service
3 known as the household diary study?

4 MR. MAY: I object to the question, Mr. Chairman.
5 What is reported in the AMMA Bulletin is not competent to be
6 in this proceeding and hasn't been documented. I wouldn't
7 object if the witness is asked whether he has personal
8 knowledge of the truth of what is contained in the AMMA
9 Bulletin.

10 MR. McKEEVER: I'll withdraw the question, Mr.
11 Chairman. That's all I have.

12 CHAIRMAN GLEIMAN: Is there any followup?
13 Questions from the bench?

14 Commissioner LeBlanc?

15 COMMISSIONER LeBLANC: Mr. -- is it Zweig?

16 THE WITNESS: Zweig.

17 COMMISSIONER LeBLANC: I'm getting closer. I'm
18 getting better.

19 Just clarify for me if you will please, at the
20 bottom of page 1 in your testimony under the purpose of your
21 testimony about the middle, halfway down where you say we
22 also hope to show the Commission that it will not work if
23 the discounts are watered down.

24 What is "it"?

25 THE WITNESS: The improvement of the efficiency in

1 delivery times and the savings in postage for parcel post
2 product.

3 COMMISSIONER LeBLANC: Okay. And then you talk
4 about, if the operational rules such as minimums are
5 dictated arbitrarily.

6 THE WITNESS: Where is that located?

7 COMMISSIONER LeBLANC: The same sentence, please.

8 THE WITNESS: Okay.

9 COMMISSIONER LeBLANC: If operational rules such
10 as minimums are dictated arbitrarily with no recognition of
11 actual operating conditions at destination facilities. Are
12 you talking about being able to accept your products? Are
13 you talking about -- when you say arbitrarily, what are you
14 talking about there?

15 THE WITNESS: What I am referring to there is it
16 is our experience, if we are looking at a program such as
17 destination entry and the acceptance rules that come into
18 play, that if we try to set rules that are --

19 COMMISSIONER LeBLANC: Who is we now?

20 THE WITNESS: The industry.

21 COMMISSIONER LeBLANC: Oh, okay.

22 THE WITNESS: The Postal Service.

23 COMMISSIONER LeBLANC: All right.

24 THE WITNESS: The Postal Services tries to set
25 rules that cover every single destination facility versus

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1 focusing on the actual facilities that the product will be
2 directed to, that we can find ourselves in a situation where
3 we are not going to be able to take full advantage.

4 COMMISSIONER LeBLANC: Okay.

5 THE WITNESS: For example, I pointed out in my
6 testimony that we are focusing on 4,000 zip codes. Now, if
7 there's rules that are put into place governing the
8 40-some-thousand zip codes, destination delivery zip codes
9 that exist, versus the 4,000 that the majority of the
10 product is going to, that that could deter from the
11 effectiveness of our ability to take advantage of the rates
12 that are proposed.

13 COMMISSIONER LeBLANC: Okay. You seem to be
14 indicating, when you talk about this, and then at the very
15 conclusion of your testimony, on page 10, you talk about, I
16 think it's the third sentence, where it says, "If the
17 Commission will provide the leadership necessary to create
18 these work-sharing opportunities." Then you go on down and
19 you say, right after the 400,000 square foot distribution,
20 you say, "Whether these opportunities are successful depends
21 completely upon the PRC." And then you say, "We cannot
22 justify this investment is the Commission waters down the
23 proposed SCF."

24 What do you mean by waters down these
25 work-sharing? Because you talked about the work-sharing

1 opportunities, everything depends on us as to whether you
2 survive, is what you are saying in here, if I am reading
3 this correct. And then you say the Commission waters down
4 the proposed SCF. So just clarify that for me, if you can,
5 please?

6 THE WITNESS: Well, as I have indicated in my
7 testimony, there's a great deal of investment required to be
8 able to effectively take advantage of the rates that are
9 proposed. Investments in the sortation equipment and in the
10 buildings to support the volume that are necessary. And in
11 order to fully take advantage of the rates, you need to have
12 the ability to accumulate mass in order to make -- from an
13 economical standpoint, for the -- from a transportation
14 standpoint, so if the rates are less than what has been
15 proposed, that takes away the opportunity to make that type
16 of investment, because there will not be enough in the rates
17 in order to support the investment and to create the
18 critical mass.

19 COMMISSIONER LeBLANC: So you are not saying,
20 though, that if we change the discount any that is going to
21 put your business out of business?

22 THE WITNESS: It very well could.

23 COMMISSIONER LeBLANC: Any particular way of
24 knowing any percentage without giving away proprietary
25 information?

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1 THE WITNESS: I am not prepared to make that
2 statement at this point.

3 COMMISSIONER LeBLANC: I understand. I
4 understand.

5 Okay. I think that's it. Thank you very much
6 sir.

7 THE WITNESS: Thank you.

8 CHAIRMAN GLEIMAN: I just have one question. It
9 kind of follows on the heels of my colleague's questions.
10 we have to make some decisions about rates and discounts for
11 drop shipping, not only in the parcel area, but in other
12 areas, too. With respect to the parcel area, you are not
13 suggesting that we should set discounts based on rates that
14 would be necessary for a company such as yours to stay in
15 business, as opposed to setting discounts based on the costs
16 that the Postal Service avoids as a consequence of the
17 work-sharing that would be done?

18 I mean are you saying that if, for example, the
19 Postal Service is going to save five cents every time a
20 parcel is drop shipped to the SCF, that if you are going to
21 incur costs of 10 cents, that we ought to set a discount at
22 10 cents so that you can stay in business?

23 THE WITNESS: That is not my intent.

24 CHAIRMAN GLEIMAN: You're suggesting that --

25 THE WITNESS: The suggestion is that the rates

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1 that are proposed by the Postal Service are rates that would
2 create the interest in destination drop shipping, the SCF
3 and the BMC, if the rates were lowered, then the ability to
4 accumulate mass through the investments that are required
5 for sortation would not be covered.

6 CHAIRMAN GLEIMAN: I understand.

7 MR. MAY: Mr. Chairman, just so that the record is
8 clear, could you ask whether -- does the witness mean the
9 rates or the rates discounts? Because he keeps talking
10 about rates, and I don't --

11 CHAIRMAN GLEIMAN: Well, I understand that, you
12 know, that somebody reading this might get a little
13 confused, but I think he and I are pretty much on the same
14 wavelength.

15 I understand the need for you to -- for there to
16 be, from where you sit, an economic incentive, you and
17 others who are similarly situated to have rates that send
18 the right signals, that are economic incentive for other
19 businesses to do business with you, as it were.

20 But if we determine that the discounts for drop
21 shipping that the Postal Service proposed exceed the costs
22 that the Postal Service will avoid as a result of having you
23 do some of the transportation, you are not suggesting that
24 we should still stick with the Postal Service's discounts,
25 even if they are giving away more money than they are

1 saving? Am I -- if I am confusing you, I apologize, I don't
2 mean to. And I'll try again if you are confused, or I'll
3 just drop it.

4 THE WITNESS: I think I understand. I am
5 suggesting that the -- let's see how I can -- I am not
6 suggesting that any rates are implemented solely for the
7 purpose of keeping my company in business. Does that answer
8 your question?

9 CHAIRMAN GLEIMAN: Yes. Yeah. Okay. That's the
10 bottom line. And you and I know that what we are talking
11 about is discounts off the rates, so --

12 THE WITNESS: Correct.

13 CHAIRMAN GLEIMAN: -- in the event there is
14 somebody out there that missed what was transpiring, they
15 will understand.

16 I have no further questions. Is there any
17 follow-up as a consequence of questions from the bench?

18 MR. McKEEVER: Mr. Chairman, I have one question.

19 CHAIRMAN GLEIMAN: Certainly.

20 FURTHER CROSS-EXAMINATION

21 BY MR. McKEEVER:

22 Q Mr. Zwieg, I think you did say, and I just want to
23 be sure, that parcel direct will begin operations on April
24 3rd of this year?

25 A April 13th, I stated.

1 Q April 13th. Thank you.

2 A Correct.

3 CHAIRMAN GLEIMAN: Is there any further follow-up?

4 [No response.]

5 CHAIRMAN GLEIMAN: If not, that brings us to
6 redirect. Mr. May, would you --

7 MR. MAY: There is no redirect.

8 CHAIRMAN GLEIMAN: If there is no redirect, then,
9 Mr. Zwieg, I want to thank you. We appreciate your
10 appearance here today and your contributions to the record,
11 and especially in light of the difficulty you had getting
12 out of the northern reaches yesterday.

13 THE WITNESS: Okay.

14 CHAIRMAN GLEIMAN: And if there is nothing
15 further, you are excused.

16 THE WITNESS: Thank you.

17 [Witness excused.]

18 CHAIRMAN GLEIMAN: I would like to press ahead
19 with the next witness on the schedule. Let's see how far we
20 can get. Perhaps if the cross-examination is not too heavy,
21 we can finish another witness before we break for lunch.

22 Ms. Dreifuss, if you would identify your witness.

23 MS. DREIFUSS: OCA calls John O'Bannon to the
24 stand.

25 Whereupon,

1 JOHN H. O'BANNON,
2 a witness, was called for examination by counsel for the
3 Office of the Consumer Advocate and, having been first duly
4 sworn, was examined and testified as follows:

5 CHAIRMAN GLEIMAN: Please be seated.

6 MS. DREIFUSS: Mr. Chairman, before I move Mr.
7 O'Bannon's testimony into evidence, I just wanted to bring
8 to your attention, and I have already brought it to Mr.
9 Koetting's attention, and Mr. May's attention, they
10 designated several of Mr. O'Bannon's Interrogatory responses
11 as evidence.

12 Mr. O'Bannon changed slightly his answer to
13 Interrogatory USPS/OCA-T-200-11. In the second sentence, he
14 substituted for the two words "individual cells", the phrase
15 "the DBMC category as a whole" and that -- those revised
16 answers, I have substituted in the designated packet of
17 responses.

18 DIRECT EXAMINATION

19 BY MS. DREIFUSS:

20 Q Could you state your name fully for the record,
21 please?

22 A John H. O'Bannon.

23 Q Are you the author of a document entitled
24 "OCA-T-200, Direct Testimony of John H. O'Bannon"?

25 A I am, yes.

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1 Q Do you adopt that testimony today?

2 A Yes.

3 Q If you were to testify orally, would this be your
4 testimony?

5 A Yes.

6 MS. DREIFUSS: OCA moves the admission of
7 OCA-T-200 into evidence.

8 CHAIRMAN GLEIMAN: Are there any objections?

9 [No response.]

10 CHAIRMAN GLEIMAN: Hearing none, Mr. O'Bannon's
11 testimony and exhibits are received into evidence and I
12 direct that they be transcribed into the record at this
13 point.

14 [Direct Testimony and Exhibits of
15 John H. O'Bannon, OCA-T-200, was
16 received into evidence and
17 transcribed into the record.]

18

19

20

21

22

23

24

25

OCA-T-200
Docket No. R97-1

DIRECT TESTIMONY

OF

JOHN H. O'BANNON

ON BEHALF OF

THE OFFICE OF THE CONSUMER ADVOCATE

DECEMBER 30, 1997

TABLE OF CONTENTS

STATEMENT OF QUALIFICATIONS	1
I. PURPOSE AND SCOPE OF TESTIMONY	2
II. POSITIVE IMPLICIT OWN-PRICE ELASTICITIES	3
A. Postal Service Volume Distribution Method	4
III. ECONOMIC IMPLAUSIBILITY OF POSITIVE OWN-PRICE ELASTICITIES	6
A. Non-compensated demand analysis	6
B. Compensated demand analysis	8
IV. EMPIRICAL ANALYSIS	12
V. CONCLUSION	14
REFERENCES	15
APPENDICES	

1 DIRECT TESTIMONY OF

2
3 JOHN H. O'BANNON4
5 STATEMENT OF QUALIFICATIONS
6
7
8

9 My name is John H. O'Bannon. I am currently a student in the doctoral
10 program in the Department of Economics at the University of Virginia. I was
11 awarded the Master of Arts in Economics from the University of Virginia in January
12 of 1997. I received my Bachelor of Arts degree in May of 1995 from the College of
13 William and Mary. My graduate focus involves Industrial Organization and Public
14 Policy analysis.

1 I. PURPOSE AND SCOPE OF TESTIMONY

2

3 Upon close inspection, the testimony presented by Witness Mayes (USPS-T-
4 37) regarding the Parcel Post category of mail, particularly concerning volume
5 changes in particular rate cells in the test year that would prevail after the requested
6 rate change, is theoretically perplexing. In particular, for some subsets of Parcel
7 Post mail Witness Mayes' estimated volume changes in certain rate cells imply
8 positive implicit own-price elasticities. This computational result challenges simple
9 and universally accepted economic theory. Under typical assumptions (many of
10 which the Postal Service itself invokes) positive implicit own-price elasticities are a
11 theoretical and empirical impossibility. The Postal Service's current method of
12 allocation of volume estimates to different rate cells within a category of mail is
13 causing this problem.

1 II. POSITIVE IMPLICIT OWN-PRICE ELASTICITIES

2

3 In order to conduct my analysis, it was necessary to utilize the data presented
 4 in Witness Mayes' Workpapers (H197). In particular, I have used her Inter-BMC,
 5 Intra-BMC and DBMC information for four variables: TYBR volume, TYAR volume,
 6 R94-1 Rates, and her computed Phase Four (Final) Rates for these categories.¹
 7 There are three subsets of Parcel Post that would exist unchanged both before and
 8 after the imposition of R97-1 rates. Using this data I computed the resulting own-
 9 price elasticities using a constant elasticity formula.

10 *Own-Price Elasticity Formula:*

11
$$\frac{\text{Volume Before Rate Change (v1)}}{\text{Volume After Rate Change (v2)}} = \left(\frac{\text{Rate Before (p1)}}{\text{Rate After (p2)}} \right)^\epsilon$$

12 Solving for the value of the implicit own-price elasticity (ϵ) yields:

13
$$\epsilon = \frac{\ln\left(\frac{v1}{v2}\right)}{\ln\left(\frac{p1}{p2}\right)}$$

14 Notice that for any cell in which the rate is unchanged, the implicit own-price
 15 elasticity will be undefined due to division by zero.

16 The result of performing this calculation on every rate cell in each of the three
 17 categories of Parcel Post mail service is presented in Appendix 3 following the text.
 18 What is immediately striking is that only for the DBMC category does one see

¹ TYBR volumes can be found in WP I.A. on pages 8-13. R94-1 Rates can be found in WP I.C. on pages 1-4 and 7-8. Phase Four (Final) Rates can be found in WP I.N. pages 1-6. TYAR volumes can be found in WP II.A. on pages 2-7.

1 positive elasticities. This results from the method by which the Postal Service
2 distributes its volume change estimates across the rate cells.

3

4 A. Postal Service Volume Distribution Method.

5

6 It would be illustrative to briefly discuss how the Postal Service computes its
7 volume estimates for each rate cell for any given category of mail.² The Postal
8 Service knows the total volume for each category of mail for some historical period
9 of four consecutive postal quarters. It then uses historical growth in volume data to
10 estimate the total volume that would exist in the absence of a rate change. This
11 total volume figure is then distributed across all the cells in each category in the
12 exact proportion that existed during the historical year.

13 The Postal Service suggests new rates for each cell of service. It computes
14 an overall rate weighted by the historical volumes to determine an overall rate for
15 service. It uses this rate, in conjunction with the historical growth rate, to determine
16 a new overall volume level for that category of service. At no time, however, does
17 the Postal Service specifically examine the rate change in a particular cell and
18 attempt to generate a volume estimate directly related to that individual cell's rate
19 change.

² The method described is also the one employed by Witness Mayes in her Workpapers.

1 It is for this reason that one arrives at the economic anomaly that increasing
2 the rate on a particular cell of service produces an increase in volume for that cell of
3 service. This is true for almost all the cells in the DBMC category of service. This
4 results from the fact that the Postal Service believes the overall volume will increase
5 for DMBC despite the fact that all but two cells experience rate increases.³

³ As presented in Witness Mayes' Workpapers, the TYAR DBMC volume is slightly less than TYBR volume when approximated in WP. I.A., p.1 However, TYAR DBMC volume exceeds TYBR volume in WP. II.A. p.1.

1 III. ECONOMIC IMPLAUSIBILITY OF POSITIVE OWN-PRICE ELASTICITIES

2

3 Simple economic theory can be used to show that positive own-price
 4 elasticities, under a general and widely accepted set of assumptions, while not
 5 impossible are highly improbable. Their improbability is such that even if in some
 6 cells a raise in price does bring about a rise in volume for that cell, overall the sum
 7 of price changes times corresponding volume changes must be negative (as
 8 described in Equation 7 below.) Using the data presented in Witness Mayes'
 9 Workpapers, one can test whether the Postal Service's volume estimates meet the
 10 stringent requirements for positive own-price elasticities to exist.

11 A. Non-compensated demand analysis

12

13 I will first prove the necessity of negative own-price elasticities using
 14 Marshallian demand analysis. First, assume there is some composite good that
 15 serves as "all other goods" in this analysis. Its price does not change, $p_{AO} = p_{BO}$.
 16 The prices of the Postal Service rate cells under investigation can rise or fall. Thus,
 17 using vector notation, $\bar{p}_A \neq \bar{p}_B$, where some price elements have risen, some may
 18 have fallen, and some may be unchanged.⁴ The consumer's income, m , does not
 19 change. Thus, the consumer's total expenditure does not change after the price

⁴ The vectors \bar{p}_B and \bar{p}_A are the vector of rates before and after the rate change, respectively. More explicitly $\bar{p}_A = (p_{A0}, p_{A1}, p_{A2}, \dots, p_{AL})$ where L is the total number of goods.

1 change as one assumes the consumer spends all of his or her income to maximize
2 utility.

3 I then use the Marshallian demand function. This function, $x_i(\bar{p}, m)$ describes
4 the quantity of good x_i the consumer chooses in order to maximize his or her utility
5 when facing the price vector \bar{p} and endowed with income m . The term $x(\bar{p}, m)$ is
6 therefore the bundle of goods, the quantities of every particular Postal Service
7 good's cell and the composite good, that the consumer has chosen in order to
8 maximize his or her utility before the rate change.

9 The first basic assumption applied is that Postal Service goods are normal
10 goods.⁵ By the definition of a normal good we know:

$$11 \quad \frac{\partial x_i(\bar{p}, m)}{\partial m} \geq 0. \quad \text{Assumption 1}$$

12 The next basic assumption applied is that each Postal Service good's cell
13 within a category represents a good that is unrelated to every other cell in that
14 category.⁶ This implies:

$$15 \quad \frac{\partial x_i(\bar{p}, m)}{\partial p_j} = 0 \quad \forall i \neq j. \quad \text{Assumption 2}$$

16 One result, making direct use of the fact that the Marshallian demand function
17 is homogenous of degree zero, that can be derived from Euler's formula⁷ is:

⁵ This is certainly a restrictive assumption. In reality some cells of a particular category of parcel post may function as inferior goods. However, I do not believe that the Postal Service would argue this.

⁶ Each cell is neither a substitute nor a complement for any other cell in that category.

1
$$\sum_{k=1}^L \frac{\partial x_i(\bar{p}, m)}{\partial \bar{p}_k} p_k + \frac{\partial x_i(\bar{p}, m)}{\partial m} m = 0 \text{ for } i = 1, \dots, L. \quad \text{Equation 1}$$

2 Making use of Assumption 2, the fact that each cell is unrelated to each other
3 cell, the first term simplifies and one can state:

4
$$\frac{\partial x_i(\bar{p}, m)}{\partial \bar{p}_i} p_i + \frac{\partial x_i(\bar{p}, m)}{\partial m} m = 0. \quad \text{Equation 2}$$

5 My assumptions state that each cell is a normal good, that income is positive,
6 and that the rate for each cell is positive. Therefore, for the expression to equal
7 zero given that $\frac{\partial x_i(\bar{p}, m)}{\partial m} > 0 \Rightarrow \frac{\partial x_i(\bar{p}, m)}{\partial m} m > 0$ if $m > 0$, the own-price term must be
8 negative, and the resulting own-price elasticity would be negative. Thus, non-
9 compensated demand analysis shows that positive own-price elasticities are
10 theoretically impossible.

11

12 B. Compensated demand analysis

13

14 The use of Hicksian, or compensated demand analysis, allows one to
15 examine the reactions of the consumer given that his or her utility remains constant.
16 This is in contrast to the Marshallian analysis presented above, which holds the
17 consumers' income constant and allows him or her to maximize utility at some other
18 level. Thus, the proper application of Hicksian analysis requires one to always

⁷ This result is proved in Appendix 1.

1 compensate the consumer, by giving him or her a quantity of income, Δm , such that
 2 the original level of utility is still attainable under the new prices.⁸

3 I will now show the price change using vector notation in the following way:

$$4 \quad \bar{p}_A = \bar{p}_B + \Delta\bar{p}$$

5 In this expression, $\Delta\bar{p}$ is a vector of the magnitudes of the price changes. A
 6 cell that has its price increased will be represented in $\Delta\bar{p}$ by a positive number,
 7 while a cell that has its price decreased will be represented in $\Delta\bar{p}$ by a negative
 8 number.

9 My first assertion is that the bundle $x(\bar{p}_B + \Delta\bar{p}, m + \Delta m)$ is viewed with
 10 indifference by the consumer to his or her original bundle $x(\bar{p}_B, m)$. Since neither
 11 bundle can be strictly revealed preferred, using a simple analysis of preferences we
 12 can say:

$$13 \quad \bar{p}_B x(\bar{p}_B, m) \leq \bar{p}_B x(\bar{p}_B + \Delta\bar{p}, m + \Delta m) \quad \text{Equation 3}$$

$$14 \quad (\bar{p}_B + \Delta\bar{p})x(\bar{p}_B + \Delta\bar{p}, m + \Delta m) \leq (\bar{p}_B + \Delta\bar{p})x(\bar{p}_B, m) \quad \text{Equation 4}$$

15 A two-goods diagram is used to derive these two equations in Appendix 2.
 16 Figure 1 shows that as the price of one of good changes the consumer's income is
 17 changed in such a way that he or she remains on the original indifference curve.
 18 Equations 3 and 4 can then be determined from points on the original indifference
 19 curve and points elsewhere on the two budget lines.

20 Summing the two inequalities from Equations 3 and 4 yields:

⁸ Here the use of the term price is interchangeable with the term postal rates.

1
$$\Delta \bar{p} [x(\bar{p}_B + \Delta \bar{p}, m + \Delta m) - x(\bar{p}_B, m)] \leq 0. \quad \text{Equation 5}$$

2 Rewriting the term inside the brackets as Δx , then the expression simplifies

3 to:
$$\Delta \bar{p} \Delta x \leq 0. \quad \text{Equation 6}$$

4 Taking this out of vector form:

5
$$\sum_{i=1}^L \Delta p_i \Delta x_i \leq 0. \quad \text{Equation 7}$$

6 Next I can separate the cells by their price changes and the resulting
 7 changes in volume. Assume that I group all the cells for which the price has fallen
 8 into the first n of the L possible cells. All of these cells will experience an increase
 9 in volume. Cells $n+1$ through $n+j$ will be cells for which the price has risen, and
 10 the resulting volume change is negative. Cells $n+j+1$ through k will be cells for
 11 which the price has risen and the resulting volume change was positive. This is the
 12 type of cell that will generate positive own-price elasticities. Finally, cells $k+1$
 13 through L are cells for which there was no change in price.

14 Thus the expression from Equation 7 can be rewritten as:

15
$$\sum_{i=1}^n \Delta p_i \Delta x_i + \sum_{i=n+1}^{n+j} \Delta p_i \Delta x_i + \sum_{i=n+j+1}^k \Delta p_i \Delta x_i + \sum_{i=k+1}^L \Delta p_i \Delta x_i \leq 0 \quad \text{Equation 8}$$

16 The first term in Equation 8 is strictly negative, since volume increases from
 17 the price decreases. The last term in Equation 8 is zero, as I have not changed the
 18 prices of these cells and their resulting volume change is immaterial. The second
 19 term in Equation 8 is also strictly negative, as this term fits the standard economic
 20 implications that an increase in price brings about a decrease in consumption. The

1 third term will be positive under the Postal Service's assumption that positive own-
2 price elasticities exist.

3 Thus if the Postal Service's assertion is true, then the following regularity
4 must hold in the data:

5
$$\left| \sum_{i=1}^{n+j} \Delta p_i \Delta x_i \right| \geq \sum_{i=n+j+1}^k \Delta p_i \Delta x_i . \quad \text{Equation 9}$$

6 Equation 9 simply states that the magnitude of the sum of the product of the
7 change in price with the change in consumption for cells that show an inverse
8 relationship between the two variables must exceed the magnitude of this product
9 for cells that show a direct relationship between these two variables. This is
10 certainly a restrictive requirement that may or may not be supported by any
11 particular data set. Hicksian analysis shows that the assertion of positive own-price
12 elasticities, while not theoretically impossible, is highly restrictive.

1 IV. EMPIRICAL ANALYSIS

2

3 The result in Equation 9 shows that empirical analysis can be used, with the
4 Postal Service's data, to determine if their tacit acceptance of positive own-price
5 elasticities is supportable. From Equation 7, one sees that a simple calculation can
6 be undertaken to test whether the Postal Service's use of positive own-price
7 elasticities is supportable. If one multiplies each cell's price change with its
8 expected volume change, and sums these values across all the cells in a given
9 category of Parcel Post, then one should find the resulting quantity to be weakly
10 negative.⁹

11 I computed the SMD values implied by Equation 7 and described immediately
12 above for the Intra-BMC, Inter-BMC, and DBMC categories of Parcel Post.¹⁰ It
13 should be noted again that only the DBMC category revealed positive own-price
14 elasticities, and thus it was the only category that I am testing empirically against the
15 prior theoretical assumption implied by Equation 7. In line with expectations
16 resulting from the theoretical results, the computed SMD values for the Intra-BMC
17 and Inter-BMC categories were negative.¹¹ This agrees with the empirical fact that

⁹ The value resulting from the computation suggested by Equation 7 is hereafter referred to as the sum of multiplied differences (SMD).

¹⁰ Tables showing the multiplied differences for each rate cell, and the sum of multiplied differences for each category are presented in Appendix 4 following the text.

¹¹ For Intra-BMC this value was -2,406,031. For Inter-BMC this value was -14,084,407.

1 neither of their own-price elasticities were positive. However, when I performed the
2 calculation on the DBMC category of Parcel Post the resulting SMD quantity was
3 positive.¹² This result does not imply that positive own-price elasticities cannot occur
4 for cells within categories of Parcel Post. It only implies that the positive own-price
5 elasticities derived in the case of DBMC Parcel Post contradict economic theory as
6 revealed in the accompanying data.

¹² The value was 4,303,124.

1 V. CONCLUSION

2

3 Through the examinations of simple economic theories it is clear that when
4 considered theoretically, positive own-price elasticities are almost impossible.
5 Compensated (Hicksian) analysis has been shown to allow positive own-price
6 elasticities to exist. However, with the categories of Parcel Post under
7 consideration, the empirical result that must be present in the data is highly
8 restrictive. When this restriction is explored empirically in the data used by the
9 Postal Service, and by Witness Mayes in particular, the result tends to discourage
10 the possibility of positive own-price elasticities.

11 This result does not imply that positive own-price elasticities cannot occur for
12 cells within categories of Parcel Post. It only implies that the particular positive own-
13 price elasticities utilized in the case of DBMC Parcel Post are not theoretically
14 supportable by the accompanying data. This means that some step in the Postal
15 Service's process of allocating volume estimates to rate cells is flawed. A better
16 system of estimating the volume resulting in each cell from that particular cell's rate
17 change needs to be found.

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Appendix 1
Page 1 of 3

This appendix includes the derivation of Equation 1 using Euler's formula and the fact that Marshallian demand is homogenous of degree zero.

Definition of Homogeneity of degree r

If we say the function $f(\bar{x})$ is homogenous of degree r , where $\bar{x} = (x_1, x_2, \dots, x_I)$, then:

$$f(tx_1, tx_2, \dots, tx_I) = t^r f(x_1, x_2, \dots, x_I). \quad \text{Appendix Equation 1}$$

Thus saying the Marshallian demand function is homogenous of degree zero means that $x(t\bar{p}, tm) = t^0 x(\bar{p}, m) = x(\bar{p}, m)$. That is, if prices and income rise by the same proportion ($X\%$), then the quantities in the consumer's utility maximizing bundle are unchanged.

Euler's formula

Suppose that the function $f(x_1, x_2, \dots, x_I)$ is homogenous of degree r and once differentiable. Then at any \bar{x} , where $\bar{x} = (x_1, x_2, \dots, x_I)$, we have:

$$\sum_{n=1}^N \frac{\partial f(\bar{x})}{\partial x_n} x_n = r f(\bar{x}). \quad \text{Appendix Equation 2}$$

Proof of Euler's formula

Differentiate each side of Appendix Equation 1, from the definition of a homogenous function, with respect to t .

$$\frac{\partial}{\partial t} f(tx_1, tx_2, \dots, tx_i) = \frac{\partial f(t\bar{x})}{\partial x_1} x_1 + \frac{\partial f(t\bar{x})}{\partial x_2} x_2 + \dots + \frac{\partial f(t\bar{x})}{\partial x_i} x_i. \quad \text{Appendix Equation 3}$$

We simplify the left-hand side of this equation by directly applying the definition of homogeneity:

$$\frac{\partial}{\partial t} f(tx_1, tx_2, \dots, tx_i) = \frac{\partial}{\partial t} [t^r f(x_1, x_2, \dots, x_i)]. \quad \text{Appendix Equation 4}$$

Compute the derivative of the right-hand side of this expression with respect to t :

$$\frac{\partial}{\partial t} [t^r f(x_1, x_2, \dots, x_i)] = r t^{r-1} f(x_1, x_2, \dots, x_i). \quad \text{Appendix Equation 5}$$

Now we set our simplified right-hand side from Appendix Equation 5 equal to the right-hand side from Appendix Equation 3:

$$r t^{r-1} f(x_1, x_2, \dots, x_i) = \frac{\partial f(t\bar{x})}{\partial x_1} x_1 + \frac{\partial f(t\bar{x})}{\partial x_2} x_2 + \dots + \frac{\partial f(t\bar{x})}{\partial x_i} x_i. \quad \text{Appendix Equation 6}$$

We want to see how the function relates to itself identically, instead of how it relates to a proportional value of itself. For this reason we set $t = 1$ and find:

$$r f(x_1, x_2, \dots, x_i) = \frac{\partial f(\bar{x})}{\partial x_1} x_1 + \frac{\partial f(\bar{x})}{\partial x_2} x_2 + \dots + \frac{\partial f(\bar{x})}{\partial x_i} x_i. \quad \text{Appendix Equation 7}$$

This can be rewritten as:

$$rf(\bar{x}) = \sum_{n=1}^N \frac{\partial f(\bar{x})}{\partial x_n} x_n \quad \text{Appendix Equation 8}$$

Notice that Appendix Equation 8 is identical to Appendix Equation 2. Thus we have proven Euler's formula.

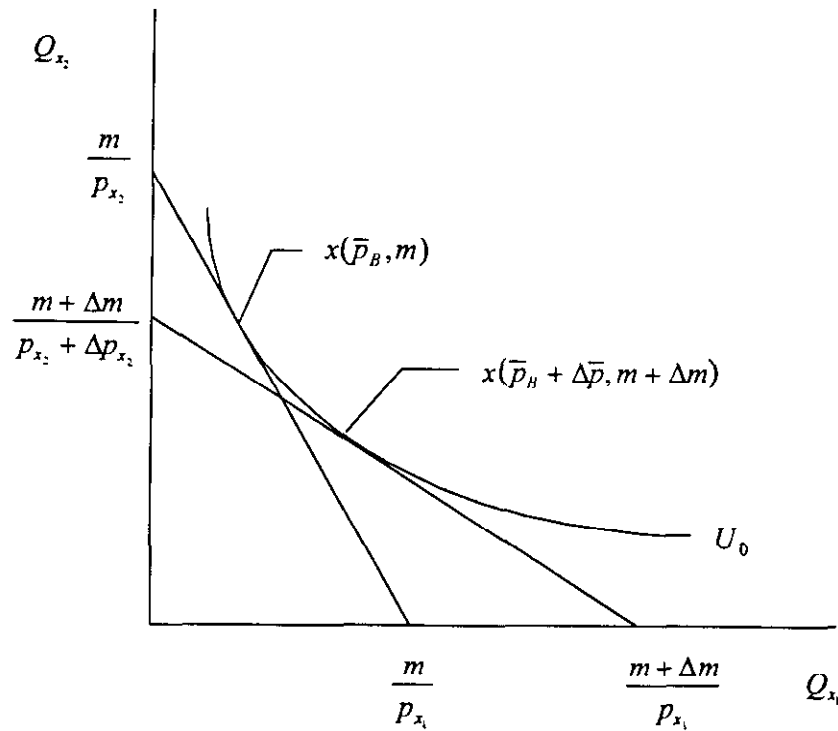
Next we substitute the Marshallian demand function for the function $f(\bar{x})$ in Appendix Equation 7, such that $f(\bar{x}) = x_i(\bar{p}, m)$ for each $i = 1, \dots, L$. We also make use of the fact that this function is homogenous of degree zero, such that $r = 0$. Appendix Equation 8 is now:

$$0 = \sum_{k=1}^L \frac{\partial x_i(\bar{p}, m)}{\partial p_k} + \frac{\partial x_i(\bar{p}, m)}{\partial m} \quad \text{for } i = 1, \dots, L \quad \text{Appendix Equation 9}$$

Appendix Equation 9 is identical to Equation 1 used in the body of the text.

This appendix includes the theoretical underpinnings for Equations 3 and 4 presented in the text.

Figure 1



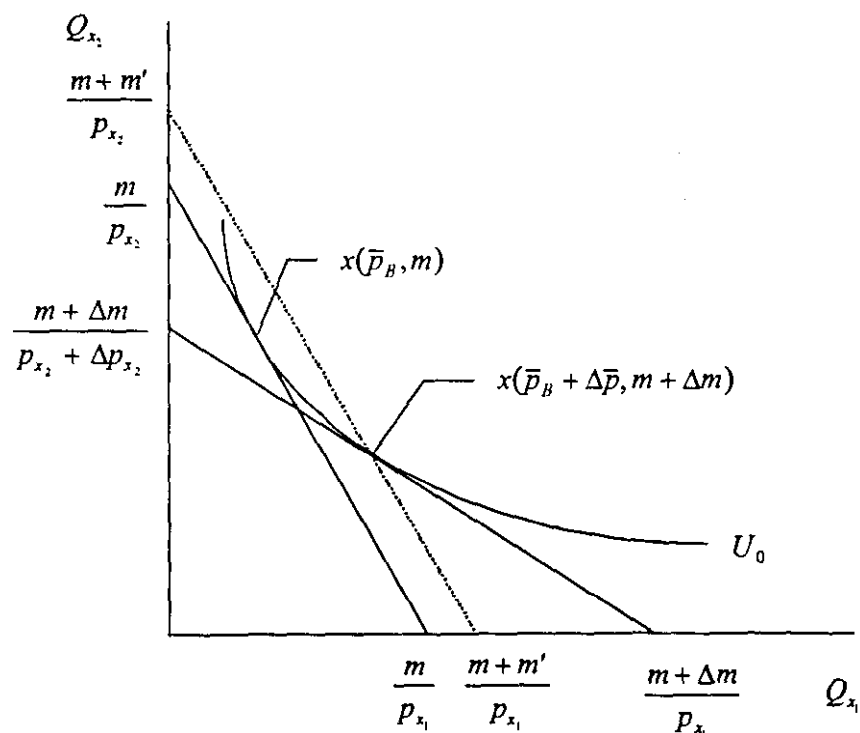
The above two-good graph depicts the situation described in the text dealing with the Compensated demand analysis. The bundle $x(\bar{p}_B, m)$ is the utility maximizing quantities of the two goods that the consumer chooses under the initial set of prices, \bar{p}_B , and his or her initial level of income, m . Hicksian analysis begins by describing the bundle $x(\bar{p}_B + \Delta \bar{p}, m + \Delta m)$. This is the bundle that the consumer would choose after the

Appendix 2

Page 2 of 4

price change in the good x_2 , from p_{x_2} to $p_{x_2} + \Delta p_{x_2}$, while simultaneously being given Δm such that he or she can exactly attain the original level of utility U_0 .

From this graph we can derive Equations 3 and 4 from the text. Consider if the consumer attempted to purchase the second bundle $x(\bar{p}_B + \Delta \bar{p}, m + \Delta m)$ at the original prices \bar{p}_B . He or she would find this bundle unaffordable given the original income m as depicted in Figure 1. In general, for well-behaved preferences, the new bundle will be more costly than the original bundle at the original prices. The consumer would have needed additional income, m' , in order to purchase the new bundle at the original prices. This is shown in Figure 2 below.

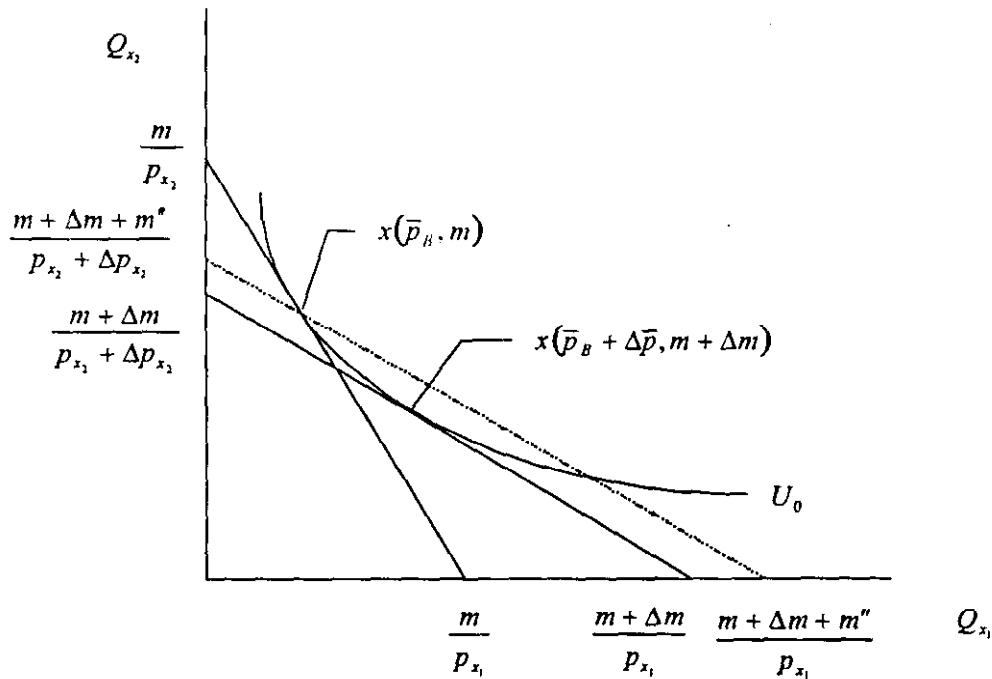


Thus Figure 2 graphically depicts the situation described by Equation 3 in the text. Specifically,

$$\bar{p}_B x(\bar{p}_B, m) \leq \bar{p}_B x(\bar{p}_B + \Delta\bar{p}, m + \Delta m). \quad \text{Equation 3}$$

Now consider if the consumer attempted to purchase the original bundle $x(\bar{p}_B, m)$ at the new prices $\bar{p}_B + \Delta\bar{p}$. Again as depicted in Figure 1, he or she would find this bundle unaffordable given income $m + \Delta m$, which is the amount required to purchase the new bundle at the new prices. For well-behaved preferences, the old bundle will be more costly than the new bundle at the new prices. The consumer would need some additional income, m'' , beyond the amount $m + \Delta m$, in order to be able to afford the old bundle at the new prices. This is depicted in Figure 3 below.

Figure 3



Appendix 2
Page 4 of 4

Thus Figure 3 graphically depicts the situation described by Equation 4 in the text. Specifically,

$$(\bar{p}_B + \Delta\bar{p})x(\bar{p}_B + \Delta\bar{p}, m + \Delta m) \leq (\bar{p}_B + \Delta\bar{p})x(\bar{p}_B, m). \text{ Equation 4}$$

This concludes the derivation of Equations 3 and 4 from the text.

Implicit Elasticities

Intra-BMC						
Weight		Zones				
(Pounds)	Local	1 & 2	Zone 3	Zone 4	Zone 5	
2	-1.236	-0.806	-1.413	-2.201	-4.789	
3	-0.916	-0.629	-1.186			
4	-0.813	-0.519	-1.041			
5	-0.690	-0.477	-0.936			
6	-0.627	-0.477	-0.874			
7	-0.584	-0.480	-0.823			
8	-0.542	-0.480	-0.777			
9	-0.512	-0.481	-0.730			
10	-0.493	-0.479	-0.707			
11	-0.479	-0.480	-0.695			
12	-0.477	-0.477	-0.675			
13	-0.481	-0.478	-0.647			
14	-0.477	-0.478	-0.651			
15	-0.479	-0.477	-0.633			
16	-0.477	-0.481	-0.623			
17	-0.478	-0.481	-0.607			
18	-0.479	-0.479	-0.597			
19	-0.480	-0.479	-0.593			
20	-0.478	-0.478	-0.583			
21	-0.477	-0.479	-0.580			
22	-0.478	-0.479	-0.574			
23	-0.479	-0.481	-0.571			
24	-0.480	-0.478	-0.566			
25	-0.481	-0.479	-0.557			
26	-0.480	-0.478	-0.556			
27	-0.481	-0.479	-0.548			
28	-0.481	-0.480	-0.547			
29	-0.477	-0.478	-0.547			
30	-0.478	-0.479	-0.539			
31	-0.478	-0.481	-0.530			
32	-0.478	-0.478	-0.533			
33	-0.478	-0.479	-0.528			
34	-0.478	-0.479	-0.523			
35	-0.478	-0.480	-0.525			
36	-0.481	-0.481	-0.518			
37	-0.481	-0.478	-0.516			
38	-0.480	-0.479	-0.518			
39	-0.481	-0.479	-0.513			
40	-0.481	-0.479	-0.512			
41	-0.480	-0.481	-0.513			
42	-0.480	-0.480	-0.506			
43	-0.479	-0.480	-0.507			
44	-0.480	-0.481	-0.502			
45	-0.479	-0.480	-0.503			
46	-0.478	-0.478	-0.502			
47	-0.478	-0.479	-0.500			

Implicit Elasticities

48		-0.478	-0.478	-0.501		
49		-0.481	-0.478	-0.499		
50		-0.480	-0.481	-0.495		
51		-0.480	-0.478	-0.493		
52		-0.479	-0.478	-0.496		
53		-0.478	-0.481	-0.494		
54		-0.478	-0.480	-0.492		
55		-0.478	-0.480	-0.488		
56		-0.481	-0.481	-0.491		
57			-0.480			
58		-0.479	-0.480			
59		-0.479	-0.480			
60			-0.479			
61			-0.480	-0.488		
62		-0.480	-0.480	-0.485		
63		-0.480	-0.479			
64			-0.478			
65		-0.478	-0.478			
66			-0.479	-0.484		
67			-0.478	-0.482		
68			-0.480	-0.480		
69		-0.479	-0.480			
70			-0.479	-0.483		

Implicit Elasticities

Appendix 3
Page 3 of 6

Inter-BMC								
Weight (Pounds)	Zones							
	1 & 2	Zone 3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8	
2	-0.51	-0.76	-0.99	-1.41	-1.41	-1.41	-1.41	
3	-0.35	-0.37	-0.39	-0.55	-0.96	-0.96	-0.96	
4	-0.35	-0.35	-0.39	-0.61	-0.96	-0.96	-0.96	
5	-0.35	-0.35	-0.36	-0.51	-0.56	-0.96	-0.96	
6	-0.35	-0.35	-0.35	-0.50	-0.80	-1.64	-1.03	
7	-0.35	-0.35	-0.35	-0.48	-0.53	-1.35	-0.71	
8	-0.35	-0.35	-0.35	-0.47	-0.54	-1.11	-1.38	
9	-0.35	-0.35	-0.35	-0.47	-0.53	-0.87	-1.89	
10	-0.35	-0.35	-0.35	-0.47	-0.53	-0.77	-1.66	
11	-0.35	-0.35	-0.35	-0.47	-0.54	-0.64	-1.44	
12	-0.35	-0.35	-0.35	-0.47	-0.54	-0.60	-2.01	
13	-0.35	-0.35	-0.35	-0.47	-0.54	-0.60	-26.48	
14	-0.35	-0.35	-0.35	-0.47	-0.54	-0.61	-24.09	
15	-0.35	-0.35	-0.35	-0.47	-0.55	-0.61		
16	-0.35	-0.35	-0.35	-0.47	-0.56	-0.62		
17	-0.35	-0.35	-0.35	-0.47	-0.56	-0.63		
18	-0.35	-0.35	-0.35	-0.48	-0.57	-0.64		
19	-0.35	-0.35	-0.35	-0.48	-0.57	-0.65		
20	-0.35	-0.35	-0.35	-0.48	-0.58	-0.65		
21	-0.35	-0.35	-0.35	-0.49	-0.59	-0.67		
22	-0.35	-0.35	-0.35	-0.49	-0.59	-0.67		
23	-0.35	-0.35	-0.35	-0.49	-0.60	-0.68		
24	-0.35	-0.35	-0.35	-0.49	-0.60	-0.69		
25	-0.35	-0.35	-0.35	-0.50	-0.61	-0.70		
26	-0.35	-0.35	-0.35	-0.50	-0.62	-0.71		
27	-0.35	-0.35	-0.35	-0.50	-0.62	-0.72		
28	-0.35	-0.35	-0.35	-0.51	-0.63	-0.73		
29	-0.35	-0.35	-0.35	-0.51	-0.64	-0.74		
30	-0.35	-0.35	-0.35	-0.52	-0.64	-0.75		
31	-0.35	-0.35	-0.35	-0.52	-0.65	-0.76		
32	-0.35	-0.35	-0.35	-0.53	-0.66	-0.77		
33	-0.35	-0.35	-0.35	-0.53	-0.67	-0.78		
34	-0.35	-0.35	-0.35	-0.53	-0.67	-0.79		
35	-0.35	-0.35	-0.35	-0.54	-0.68	-0.80		
36	-0.35	-0.35	-0.35	-0.54	-0.69	-0.81		
37	-0.35	-0.35	-0.35	-0.55	-0.69	-0.82		
38	-0.35	-0.35	-0.35	-0.55	-0.70	-0.83		
39	-0.35	-0.35	-0.35	-0.55	-0.71	-0.85		
40	-0.35	-0.35	-0.35	-0.56	-0.71	-0.85		
41		-0.35	-0.35	-0.56	-0.72	-0.86		
42	-0.35	-0.35	-0.35	-0.56	-0.73	-0.88		
43		-0.35	-0.35	-0.57	-0.74	-0.89		
44	-0.35		-0.35	-0.57	-0.75	-0.90		
45	-0.35	-0.35	-0.35	-0.58	-0.75	-0.91		

Implicit Elasticities

Appendix 3
Page 4 of 6

46	-0.35	-0.35	-0.35	-0.58	-0.76	-0.92
47	-0.35			-0.59	-0.77	-0.94
48	-0.35		-0.35	-0.59	-0.78	-0.95
49		-0.35	-0.35	-0.59	-0.78	-0.97
50	-0.35	-0.35	-0.35	-0.60	-0.79	-0.98
51		-0.35	-0.35	-0.61		-0.99
52		-0.35	-0.35	-0.61	-0.81	-1.00
53		-0.35	-0.35	-0.61	-0.82	-1.02
54	-0.35	-0.35	-0.35	-0.62	-0.82	-1.03
55		-0.35	-0.35	-0.62		-1.04
56		-0.35	-0.35	-0.63	-0.84	-1.06
57	-0.35		-0.35	-0.63	-0.85	
58		-0.35	-0.35			-1.09
59			-0.35	-0.64	-0.86	-1.10
60	-0.35		-0.35	-0.65	-0.88	-1.11
61		-0.35	-0.35		-0.88	-1.13
62		-0.35	-0.35	-0.66	-0.89	
63		-0.35	-0.35	-0.66	-0.90	-1.15
64						-1.17
65	-0.35			-0.67	-0.92	
66					-0.93	-1.20
67				-0.68		-1.22
68						-1.23
69				-0.69	-0.96	
70			-0.35	-0.69		

Implicit Elasticities

DBMC					
Weight (Pounds)	Zones 1 & 2	Zone 3	Zone 4	Zone 5	
2	-0.166	1.642	0.045	0.049	
3	-0.401	0.081	0.075	0.064	
4	1.701	0.055	0.078	0.072	
5	0.255	0.045	0.080	0.072	
6	0.156	0.039	0.079	0.071	
7	0.130	0.034	0.080		
8	0.107	0.031	0.080	0.070	
9	0.087	0.029	0.080	0.070	
10	0.080	0.028	0.080		
11	0.074	0.028	0.082		
12	0.067	0.028	0.081	0.070	
13	0.065	0.028	0.080		
14	0.062	0.028	0.081		
15	0.057	0.028	0.082	0.071	
16	0.056	0.028	0.081		
17	0.055	0.028	0.082		
18	0.051	0.028	0.082		
19	0.052	0.028	0.083		
20	0.049	0.028	0.083		
21	0.047	0.028	0.083		
22	0.047	0.028	0.083		
23	0.047	0.028	0.083		
24	0.044	0.028	0.083		
25	0.044	0.028	0.084		
26	0.044	0.028	0.084		
27	0.044	0.028	0.084		
28	0.042	0.028	0.084		
29	0.042	0.028	0.085		
30	0.042	0.028			
31	0.041	0.028	0.084		
32	0.041	0.028			
33	0.040	0.028			
34	0.040	0.028			
35	0.040	0.028			
36	0.039	0.028	0.087		
37	0.039	0.028			
38	0.039	0.028	0.087		
39	0.039	0.028	0.086		
40	0.039	0.028	0.087		
41	0.039	0.028			
42	0.039	0.028			
43	0.038	0.028	0.087		
44	0.038	0.028	0.087		
45	0.038	0.028	0.088		
46	0.038	0.028			
47	0.038	0.028			

Implicit Elasticities

48		0.038	0.028			
49		0.037	0.028			
50		0.037	0.028	0.089		
51		0.038	0.028			
52		0.037				
53		0.037	0.028			
54		0.037	0.028	0.090		
55		0.036	0.028	0.089		
56		0.037	0.028			
57		0.037	0.028			
58		0.036	0.028			
59		0.036				
60		0.036				
61		0.037	0.028			
62		0.037	0.028	0.091		
63		0.037	0.028			
64		0.036				
65		0.036	0.028			
66						
67						
68			0.028			
69						
70			0.028			

Test of Hicksian Analysis

Intra-BMC						Total Sum Equals
						-2406031
Weight	Zones					
(Pounds)	Local	1 & 2	Zone 3	Zone 4	Zone 5	
2	-40263.9892	-500914.776	-31003.5666	-2724.73826	-90.3332849	
3	-21166.2904	-403160.194	-24513.3679	0	0	
4	-13260.8005	-301551.724	-16374.4147	0	0	
5	-9466.60472	-192315.977	-15072.813	0	0	
6	-7050.18935	-122272.285	-15079.4281	0	0	
7	-3613.78066	-97456.6358	-8058.40199	0	0	
8	-4426.18028	-56237.2731	-6328.94481	0	0	
9	-1513.48926	-50996.421	-7237.08828	0	0	
10	-1105.74153	-47011.2727	-2652.59088	0	0	
11	-3144.45247	-41160.9779	-3834.34289	0	0	
12	-1134.69218	-44101.8745	-3979.23944	0	0	
13	-900.020691	-27504.6919	-3067.03411	0	0	
14	-738.641923	-17221.0812	-2403.34422	0	0	
15	-298.926262	-20066.4281	-3915.44318	0	0	
16	-1448.41269	-10275.2817	-2302.70377	0	0	
17	-816.9736	-17610.95	-1216.39333	0	0	
18	-347.491034	-11968.4475	-1125.49616	0	0	
19	-201.544356	-12615.6256	-1266.42606	0	0	
20	-980.247408	-13586.677	-1284.74046	0	0	
21	-330.298868	-6126.31612	-1315.10639	0	0	
22	-360.94119	-9074.78641	-1124.50889	0	0	
23	-425.782962	-6270.55449	-1420.70167	0	0	
24	-216.607607	-6513.15926	-728.759986	0	0	
25	-796.748448	-8785.47585	-563.86384	0	0	
26	-372.477819	-10697.7775	-590.740119	0	0	
27	-94.984913	-5042.472	-867.210628	0	0	
28	-105.119213	-5924.25502	-1582.77375	0	0	
29	-182.492278	-3544.81787	-242.054748	0	0	
30	-581.645779	-7436.58507	-622.857798	0	0	
31	-357.397929	-4537.38581	-2284.44669	0	0	
32	-177.237011	-4632.7978	-362.085609	0	0	
33	-101.172909	-2836.10648	-826.109538	0	0	
34	-279.851999	-3591.71871	-316.533488	0	0	
35	-64.8685797	-3949.5317	-180.360003	0	0	
36	-64.3462884	-2318.73858	-371.540468	0	0	
37	-76.2970529	-4066.02577	-570.179405	0	0	
38	-51.5589334	-3939.39092	-677.527369	0	0	
39	-45.1444566	-1293.41697	-352.998665	0	0	
40	-114.753408	-1682.10061	-650.756474	0	0	
41	-36.5419029	-2497.3659	-66.2330079	0	0	
42	-31.1313348	-1935.96561	-2281.14193	0	0	
43	-42.8186426	-2039.8757	-1111.86482	0	0	
44	-18.3439798	-3076.86705	-237.448416	0	0	
45	-43.7578426	-867.110792	-120.968212	0	0	
46	-34.679218	-558.210153	-528.449717	0	0	

Test of Hicksian Analysis

47		-9.39939461	-1190.78812	-160.396121	0	0
48		-25.3057069	-324.656273	-93.0325603	0	0
49		-38.3629894	-255.777606	-89.7167039	0	0
50		-55.3259016	-507.698575	-257.133714	0	0
51		-59.1695958	-1111.1031	-173.226923	0	0
52		-106.255312	-869.61779	-703.734375	0	0
53		-143.933314	-361.813833	-229.190667	0	0
54		-22.5925653	-427.981208	-125.017125	0	0
55		-17.4380586	-413.980103	-100.624735	0	0
56		-9.9300056	-138.841667	-191.131809	0	0
57		0	-646.772269	0	0	0
58		-28.277683	-131.199575	0	0	0
59		-16.3509532	-688.949372	0	0	0
60		0	-54.6769662	0	0	0
61		0	-105.160811	-41.5133766	0	0
62		-28.2869271	-197.794951	-32.3025615	0	0
63		-8.35850964	-93.1471871	0	0	0
64		0	-43.0941166	0	0	0
65		-9.25148911	-1995.40051	0	0	0
66		0	-78.7042149	-76.5937883	0	0
67		0	-27.6213524	-60.4193973	0	0
68		0	-247.057652	-43.7301103	0	0
69		-5.77570983	-1101.93851	0	0	0
70		0	-134.645773	-240.011803	0	0

Test of Hicksian Analysis

Inter-BMC	Total Sum Equals						
	-14084407						
Weight (Pounds)	Zones 1 & 2	Zone 3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8
2	-256508.124	-340408.2	-380617.609	-206668.705	-116776.425	-59299.4627	-115726.47
3	-242322.145	-512584.828	-890077.817	-609014.877	-121735.798	-80558.585	-137486.111
4	-157921.663	-365549.294	-641715.668	-336639.827	-83419.6264	-62406.9327	-92046.9581
5	-86941.7001	-207076.768	-411280.151	-295761.892	-127055.691	-48490.3537	-70345.1391
6	-66615.1087	-173913.248	-301212.054	-266228.816	-74880.6968	-17896.7212	-48098.6199
7	-43371.1812	-130250.841	-260079.556	-264374.962	-101899.036	-19315.4782	-57642.7536
8	-48051.4358	-86248.6561	-228751.747	-174098.959	-95480.9221	-25832.0986	-23964.2208
9	-24932.7492	-61490.946	-148927.998	-137827.412	-74095.6038	-31525.6794	-13982.6963
10	-28196.2864	-62555.6647	-114325.787	-99262.1742	-52910.26	-26324.5107	-10159.6618
11	-15907.9248	-47376.5822	-97790.2957	-90345.1019	-62459.2157	-29223.7626	-15357.2069
12	-27812.1285	-48470.3567	-104272.733	-101512.975	-52185.7117	-22920.3479	-9082.99562
13	-12093.1081	-33044.6747	-79480.384	-97165.6336	-48606.0336	-32336.1218	-914.941048
14	-19450.6037	-114291.676	-53414.7981	-83216.502	-32712.7609	-21049.7524	-895.058003
15	-13383.0187	-17221.0367	-51367.3646	-68561.2556	-41397.2466	-18237.1711	0
16	-7982.68568	-18468.901	-52482.4277	-41424.5787	-24590.3788	-13209.5481	0
17	-4374.03194	-9029.97762	-37323.2877	-31872.7242	-30440.5962	-24166.2814	0
18	-7007.69431	-14215.8808	-20091.1525	-48143.578	-58786.8104	-18680.8488	0
19	-5195.34253	-34054.4963	-24979.8608	-35052.0134	-13424.2317	-15665.2129	0
20	-2212.58802	-26684.1862	-129132.788	-26544.4924	-9748.57295	-12626.6555	0
21	-6291.80114	-13486.5985	-31272.4229	-39419.6937	-20347.0697	-12554.5982	0
22	-4718.7292	-19691.4909	-22321.1906	-27857.4438	-43367.2056	-9071.0249	0
23	-4382.3558	-4559.87449	-24791.0159	-36866.9767	-29513.1072	-13746.2713	0
24	-1535.89669	-12544.944	-12955.1683	-31502.1521	-8443.38895	-11697.9707	0
25	-2508.75274	-5829.51644	-12802	-21171.6467	-11275.1622	-6609.82634	0
26	-1937.74283	-10581.5488	-7008.02044	-29919.8814	-5854.56049	-9257.93123	0
27	-5314.01962	-3157.47529	-16097.9448	-16391.2909	-4941.52958	-5292.34291	0
28	-926.376	-3928.28108	-29574.2627	-13395.8203	-5767.71905	-7973.17899	0
29	-496.869082	-7194.46864	-10091.3212	-12146.4574	-4751.35428	-13378.849	0
30	-939.669325	-3859.74384	-3844.47308	-20087.2339	-8190.588	-9878.37957	0
31	-407.542907	-2817.24795	-6824.37532	-10696.8327	-9180.16942	-4686.62438	0
32	-2181.63756	-1042.65636	-14895.2639	-5779.594	-8169.85601	-10381.093	0
33	-350.761567	-1132.43807	-10635.3589	-16038.1482	-13381.326	-7915.61599	0
34	-226.033114	-2941.85476	-14824.2885	-5823.80414	-4993.66757	-5677.32909	0
35	-2036.78017	-1662.01504	-5149.40343	-6054.11566	-3008.97363	-7930.44157	0
36	-2730.1011	-219.526218	-11406.7159	-6224.84274	-3430.42328	-644.477791	0
37	-1362.70817	-3722.4416	-6851.35539	-6202.50085	-5707.07601	-6420.82093	0
38	-2156.59869	-318.17532	-5455.97039	-7399.87846	-5525.8794	-928.904734	0
39	-1944.81138	-1125.15987	-5534.4362	-4600.13494	-1707.94379	-2096.41637	0
40	-795.598774	-1157.92212	-11388.7353	-17077.6106	-765.546438	-1601.79908	0
41	0	-2722.01018	-11017.1796	-6620.1794	-5667.61016	-1532.73901	0
42	-190.724014	-1860.77562	-12678.4777	-4361.93957	-1750.39133	-1808.30115	0
43	0	-709.254279	-2262.94529	-4053.64107	-3880.17042	-842.715535	0
44	-8.31609294	0	-1945.13233	-3735.82293	-2987.27103	-514.961049	0

Test of Hicksian Analysis

45	-644.125787	-695.725422	-3952.35711	-370.660142	-1152.82582	-6006.68313	0
46	-89.4633527	-101.447016	-724.7761	-1850.88068	-2362.26734	-914.413043	0
47	-71.8709208	0	0	-2327.52766	-174.899366	-579.610713	0
48	-148.726839	0	-9158.97671	-5107.36225	-4612.89767	-307.444377	0
49	0	-133.70973	-2545.27315	-4416.42771	-436.187228	-3791.47061	0
50	-73.2530539	-216.472066	-1862.62623	-443.152247	-450.746214	-796.012896	0
51	0	-241.184813	-1655.50297	-2938.13542	0	-497.205557	0
52	0	-6820.26257	-1709.56146	-485.185657	-10.9172985	-1236.34911	0
53	0	-535.382454	-764.593957	-572.179806	-116.161298	-201.436839	0
54	-10.1252896	-1432.13836	-274.583774	-7124.55962	-924.165622	-347.055173	0
55	0	-96.0246025	-149.084019	-1036.1417	0	-236.368053	0
56	0	-9.96999377	-942.671711	-2274.64424	-441.801173	-509.981229	0
57	-41.6762305	0	-30.5855183	-106.688251	-412.349314	0	0
58	0	-344.943149	-2102.41597	0	0	-159.325781	0
59	0	0	-493.421514	-383.580757	-1759.57966	-201.926021	0
60	-77.8601642	0	-1265.93038	-689.767238	-527.312246	-117.403665	0
61	0	-643.442485	-344.70244	0	-1336.66247	-358.430594	0
62	0	-399.260462	-686.821793	-990.011064	-427.614896	0	0
63	0	-412.558964	-1001.34766	-257.961942	-110.353233	-190.483305	0
64	0	0	0	0	0	-987.101855	0
65	-2484.22635	0	0	-61.7585725	-417.481842	0	0
66	0	0	0	0	-107.713204	-267.318517	0
67	0	0	0	-300.303356	0	-133.419844	0
68	0	0	0	0	0	-139.507441	0
69	0	0	0	-127.549661	-153.225242	0	0
70	0	0	-1002.81521	-92.2457368	0	0	0

Test of Hicksian Analysis

DBMC				Total Sum Equals	
				4303124	
Weight (Pounds)	Zones				
	1 & 2	Zone 3	Zone 4	Zone 5	
2	-745053.619	12572.2352	94877.5065	49.4945075	
3	-339853.435	369097.152	62491.5319	607.053735	
4	53599.3746	312094.121	36442.059	187.276515	
5	233246.266	255042.101	28401.4095	46.9520401	
6	266764.385	242251.373	15688.4726	165.873484	
7	256074.137	205509.092	26186.8905	0	
8	222085.216	149235.252	17082.808	46.5533058	
9	191364.802	115158.55	5023.51243	219.604008	
10	149735.754	81995.1504	6085.61208	0	
11	139876.906	61317.0577	6017.86583	0	
12	119896.071	71916.4712	4584.97755	109.330383	
13	109133.691	76280.0654	1095.38754	0	
14	81431.34	17350.5002	3136.067	0	
15	68942.5475	42667.6611	2271.01071	308.174481	
16	58280.9401	24738.906	1795.84372	0	
17	44278.595	24546.2788	2071.66927	0	
18	42279.1524	25162.8292	4922.78271	0	
19	36714.6732	25319.1159	2894.86274	0	
20	48139.7968	23918.9925	468.975893	0	
21	43576.964	39749.0544	1183.18627	0	
22	47285.6521	13604.9614	581.556175	0	
23	48271.5935	6614.10229	1713.52866	0	
24	35461.5798	33544.165	1498.85952	0	
25	32262.4828	7040.92811	274.612197	0	
26	39101.5012	3839.7002	86.3924398	0	
27	11915.0567	15984.5908	1614.1795	0	
28	11472.7445	9981.11794	89.1792927	0	
29	14029.472	2876.58099	288.392113	0	
30	5917.66775	2129.97452	0	0	
31	19097.2653	9749.05455	67.9134614	0	
32	14063.1286	6254.74404	0	0	
33	30165.2388	109.74198	0	0	
34	9188.4598	2960.06652	0	0	
35	5940.72146	3490.06592	0	0	
36	4768.9913	162.833671	1765.6128	0	
37	7896.55197	5789.69118	0	0	
38	3483.1631	4591.30156	1730.93148	0	
39	5731.29161	1748.48866	237.396992	0	
40	4569.09249	1210.05153	27.9114036	0	
41	10618.424	647.964736	0	0	
42	7445.8021	68.5823061	0	0	
43	7977.8166	2011.57615	598.87325	0	
44	25769.2141	2597.63845	1527.74418	0	
45	3507.34012	121.489636	1769.14567	0	
46	8521.69881	14374.733	0	0	

Test of Hicksian Analysis

Appendix 4
Page 6 of 6

47	13930.0413	4579.77685	0	0
48	7935.78229	10656.8998	0	0
49	13124.2764	754.302468	0	0
50	4094.53003	1841.55239	711.324908	0
51	13010.7443	4023.46099	0	0
52	4978.03099	0	0	0
53	3189.05151	731.278775	0	0
54	2444.49874	4181.15828	408.702696	0
55	5025.09022	3605.43306	1867.43154	0
56	1150.72157	9839.03989	0	0
57	1101.02127	68.4279573	0	0
58	533.892416	68.7881044	0	0
59	1513.22682	0	0	0
60	1411.56243	0	0	0
61	5711.75362	1231.84901	0	0
62	2797.65731	32.6061789	817.083832	0
63	721.477628	3644.58191	0	0
64	3992.35114	0	0	0
65	2098.29872	154.430238	0	0
66	0	0	0	0
67	0	0	0	0
68	0	1351.93235	0	0
69	0	0	0	0
70	0	3053.37893	0	0

1 CHAIRMAN GLEIMAN: Mr. O'Bannon, have you had an
2 opportunity to examine the packet of designated written
3 cross-examination that was provided earlier today?

4 THE WITNESS: Yes.

5 CHAIRMAN GLEIMAN: And with that one change that
6 counsel spoke to a moment ago, if these questions were asked
7 of you today, would your answers be the same as those you
8 previously provided in writing?

9 THE WITNESS: Yes.

10 CHAIRMAN GLEIMAN: That being the case, I am going
11 to provide two copies of the corrected designated written
12 cross-examination of the witness to the reporter and I
13 direct that it be accepted into evidence and transcribed
14 into the record at this point.

15 [Designation of Written
16 Cross-Examination of John H.
17 O'Bannon, OCA-T-200, was received
18 into evidence and transcribed into
19 the record.]

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 1997

Docket No. R97-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF OFFICE OF THE CONSUMER ADVOCATE
WITNESS JOHN H. O'BANNON
(OCA-T200)

Party

Parcel Shippers Association

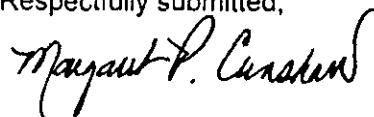
United States Postal Service

Interrogatories

USPS/OCA-T200-9-11

USPS/OCA-T200-1-11

Respectfully submitted,



Margaret P. Crenshaw
Secretary

ANSWERS OF OCA WITNESS JOHN H. O'BANNON
TO INTERROGATORIES USPS/OCA-T200-1

13511

USPS/OCA-T200-1. For any of the following subparts that you are unable to confirm, please explain fully.

(a) Please confirm that the formulas presented on page 3 of your testimony are used by you to compute "own price" elasticities.

(b) Please confirm that your testimony on pages 3-4 asserts that, when calculated on a cell-by-cell basis, only in the DBMC category does one find "positive implicit own price elasticities."

(c) Please confirm that you state on page 4 (as well as on page 2) that the "positive implicit own price elasticities" you have computed for certain DBMC cells result from the method by which the Postal Service distributes its volume change estimates across the rate cells.

(d) Please confirm that the forecasting methodology presented by Dr. Tolley in USPS-T-6 forecasts parcel post volumes only at the rate category level, and is independent of the method by which witness Mayes distributes volume change estimates across rate cells.

(e) Please confirm that Table 1 on page 6 of Dr. Tolley's testimony, DBMC volumes are forecast at 136.937 million pieces in the test year before rates (TYBR) scenario, and at 137.938 million pieces in the test year after rates (TYAR) scenario.

(f) Please confirm that, in computing his DBMC forecasts, Dr. Tolley was anticipating a rate increase for DBMC of approximately 1.7 percent (see pages 37 and 55 of Dr. Tolley's Workpaper 1, Data Used in Making Volume Forecasts).

(g) Please confirm that, with TYAR DBMC volumes higher than TYBR volumes (as described above), despite TYAR DBMC rates that are higher than TYBR rates (as described above), application of the formulas shown on page 3 of your testimony would suggest a "positive implicit own price elasticity" for the DBMC category as a whole.

(h) Please confirm that such a computed "positive implicit own price elasticity" for the DBMC category as a whole, based directly on inputs from Dr. Tolley's forecasts, would have to be the result of something other than the method used by witness Mayes to distribute volume changes across rate cells.

(i) Please confirm that among the factors that Dr. Tolley has identified which affect the volume of parcel post is the price of Priority Mail. (Please see USPS-T-6 at 154).

(j) Please confirm that in forecasting his TYAR volumes for DBMC, Dr. Tolley has taken account of the cross-price effects of proposed changes in Priority Mail rates as well as the own-price effects of proposed changes in DBMC rates. (Please see A-24 - A-29 of USPS-T-6.)

(k) Please explain exactly how you took account in your analysis of the cross-price effects of proposed changes in Priority Mail rates between TYBR and TYAR on DBMC volumes, and how such cross-price factors affect your conclusions regarding "implicit own price elasticities."

A. (a)-(g) Confirmed.

(h) This statement is true, but it does not address the same issue I addressed in my testimony. I was asserting that Witness Mayes distributed the total volume in a manner resulting in positive implicit own price elasticities being computed for some cells. Her use of the pre-rate change proportions does not take into account the effects of relative changes in rates between the cells in any one category. In effect, she ignores the cross-price elasticities among the cells in a given category.

(i)-(j) Confirmed.

(k) I did not take into account cross-price effects of Priority Mail rates with regard to Parcel Post volumes in my analysis, nor was it necessary to do so to show that Witness Mayes' volume distribution method was inappropriate. Consider a hypothetical case in which total volume for DMBC had fallen. If Witness Mayes used the same proportional distribution method, then positive implicit own price elasticities would still be found in two cells of the DBMC category, exactly the two cells that had negative implicit own price elasticities in the case in which the total volume increased. The existence of positive implicit own price elasticities is the indicator of the problem.

Also, I did not take into account any cross-price effects between categories in my analysis at any one category level (Inter-BMC, Intra-BMC, or DBMC). As noted above, Witness Mayes did not take them into account either. As a practical matter, I am not aware if cross-price elasticities between every pair of cells in any one category of Parcel Post are available. Considering that for the DBMC category alone there are 276

ANSWERS OF OCA WITNESS JOHN H. O'BANNON
TO INTERROGATORIES USPS/OCA-T200-1

13513

individual cells, and each cell has a cross-price elasticity with respect to every other cell's rate, computing all the cross-price elasticities is certainly a computationally intense task.

ANSWERS OF OCA WITNESS JOHN H. O'BANNON
TO INTERROGATORIES USPS/OCA-T200-2-5

USPS/OCA-T200-2. Please refer to your testimony at line 14 on page 6 where you refer to "some composite good." Does this composite good include Priority Mail? Please explain your answer fully.

A. The composite good mentioned in my testimony contains every other possible good an individual could purchase. Thus, it would necessarily include Priority Mail.

ANSWERS OF OCA WITNESS JOHN H. O'BANNON
TO INTERROGATORIES USPS/OCA-T200-2-5

USPS/OCA-T200-3. Please refer to your testimony at lines 12 through 14 on page 7 where you state that "the next basic assumption applied is that each Postal Service good's cell within a category represents a good that is unrelated to every other cell in that category." [footnote omitted]

(a) Is it your understanding that some mailers participate in "dropshipping" or "zone skipping" by which they arrange for transportation to enter their mail deeper into the postal system? If not, please explain.

(b) Please explain your understanding as to whether the rates charged for the same weight item shipped to different zones would have any bearing on the decision of the mailer to participate in dropshipping or zone-skipping activities as described in part a. Please also explain how such behavior is consistent with the assumption stated in your testimony at lines 12 through 14 of page 7.

(c) Is it your understanding that some mailers may split shipments to a particular address, sending part of the shipment in one box and part in another box? If not, please explain.

(d) Please explain your understanding as to whether the rates charged within the same zone for different weight items would have any bearing on the decision of the mailer to participate in shipment splitting activities as described in part c. Please also explain how such behavior is consistent with the assumption stated in your testimony at lines 12 through 14 of page 7.

(e) Is it your understanding that some mailers may consolidate shipments to a particular address, sending two items to the same address in one box? If not, please explain.

(f) Please explain your understanding as to whether the rates charged within the same zone for different weight items would have any bearing on the decision of the mailer to participate in consolidating activities described in part e. Please also explain how such behavior is consistent with the assumption stated in your testimony at lines 12 through 14 of page 7.

A. a.-f. Each of these situations is an independent empirical question. Arguments could be formulated to support either the agreeing or contrary position on each of these issues. An empirical study, perhaps a representative survey of mailers, could be

ANSWERS OF OCA WITNESS JOHN H. O'BANNON
TO INTERROGATORIES USPS/OCA-T200-2-5

conducted to answer these, but I do not have, nor am I aware of, the data necessary to answer these questions beyond spurious opinion or anecdotal evidence.

ANSWERS OF OCA WITNESS JOHN H. O'BANNON
TO INTERROGATORIES USPS/OCA-T200-2-5

USPS/OCA-T200-4. Please refer to your testimony at lines 10 and 11 on page 9 where you state, "Since neither bundle can be strictly revealed preferred," Please clarify the meaning of this statement.

A. This is an economic definition of preference relationships, whose underpinnings can be found in simple mathematics. In mathematics, one variable, call it x , can be described as being weakly greater than another, say y , and typically this situation is written as $x \geq y$. Similarly, if x is strictly greater than y , then we write $x > y$. This mathematical description can be extended to preference relations. One bundle can be strictly preferred over another by a consumer. If neither bundle can be strictly revealed preferred, then the equivalence case results. However, equivalence is not used to describe preference relations. Instead, we describe the consumer as being indifferent between two bundles. Lines 9 and 10 on page 9 of my testimony state that the consumer views the two bundles with indifference. The two bundles were selected precisely so that this situation would result. That is, the consumer was given enough income, under the new prices, to make him or her indifferent between the original bundle and the new bundle with the additional income. Figure 1 in Appendix 2 clearly shows the two bundles lying on the same indifference curve.

ANSWERS OF OCA WITNESS JOHN H. O'BANNON
TO INTERROGATORIES USPS/OCA-T200-2-5

USPS/OCA-T200-5. Please refer to your testimony at lines 6 through 12 of page 11.

(a) Is it your understanding that the volume changes by cell that appear after rates change is the result of decisions made by many mailers whose distributions of pieces by weight and zone vary? If your answer is not affirmative, please explain fully.

(b) Is it possible that the mailers in question make their mailing decisions based on the aggregate price of their total mailing, and not based on the individual price of any particular piece? If your answer is not affirmative, please explain fully.

(c) Is it possible that the cells for which you have observed "positive implicit own-price elasticities" represent only small portions of the total number of pieces sent by any particular mailer? If your answer is not affirmative, please explain fully.

A. (a) This statement may be true. It does not provide support for the proportional method of distribution that Witness Mayes used. Furthermore, it doesn't matter whether the market is examined at an individual or aggregate level. The aggregate relationship must hold for every individual. Specifically, each individual consumer's habits also need to satisfy Equation 9 on page 11 of my testimony. To apply the equation to an individual, we only have to put zero quantity values in for any goods the individual does not consume.

(b) Again, this seems to be an empirical question similar to those asked in USPS/OCA-T200-3 above. Either side of the argument could be the reality, but without evidence, any conclusion we draw is merely speculation. If the empirical fact is that mailers are looking only at the aggregate price of their total mailing, then cross-price elasticities among cells are immaterial, as I assumed in my testimony and as was addressed in USPS/OCA-T200-1.

(c) See my answers to parts a. and b. immediately above. Again this question does not address the issue of how Witness Mayes distributed the volume among the cells. See my answer to USPS/OCA-T200-1-k for an example detailing how

ANSWERS OF OCA WITNESS JOHN H. O'BANNON
TO INTERROGATORIES USPS/OCA-T200-2-5

it does not matter where the cells with positive implicit own price elasticities are, but it is the fact that they result in any cells that is indicative of the problem.

ANSWERS OF OCA WITNESS JOHN H. O'BANNON
TO INTERROGATORIES USPS/OCA-T200-6-11

USPS/OCA-T200-6.

(a) Please confirm that the purpose of attempting to measure "own price" elasticities is to estimate the effect of changes in price of the good or service in question on its own volume, holding constant all other factors also believed to affect its volume. If you do not confirm, please explain fully, and include citations to supporting literature.

(b) Please confirm that the purpose of attempting to measure "cross price" elasticities is to estimate the effect of changes in price of other goods or services on the volume of the good or service in question, holding constant all other factors also believed to affect volume of the good or service in question. If you do not confirm, please explain fully, and include citations to supporting literature.

(c) Please confirm that if own-price changes and cross-price changes occur simultaneously, it is **not** economically implausible that cross-price effects might supersede own-price effects on a particular category. If you do not confirm, please explain fully.

A. (a)-(c) Confirmed. Recall that my testimony addresses Witness Mayes' volume distribution method and the economic anomalies that result at the level of individual cells in Parcel Post.

ANSWERS OF OCA WITNESS JOHN H. O'BANNON
TO INTERROGATORIES USPS/OCA-T200-6-11

USPS/OCA-T200-7. Please confirm that the discussion on page 4 of your testimony which purports to describe the Postal Service's volume distribution method is less than totally accurate, at least to the extent that it omits to note that the after-rates forecasts (lines 13-19) may include the effects of cross-price changes (in other categories) as well as own-price changes. If you do not confirm, please explain fully.

A. My description of the Postal Service's volume distribution method was not intended to be comprehensive. The issue addressed in my testimony is the Postal Service's estimation technique with regard to individual cells of Parcel Post. As I state in lines 16-19 on page 4, "At no time, however, does the Postal Service specifically examine the rate change in a particular cell and attempt to generate a volume estimate directly related to that individual cell's rate change."

ANSWERS OF OCA WITNESS JOHN H. O'BANNON
TO INTERROGATORIES USPS/OCA-T200-6-11

USPS/OCA-T200-8.

(a) Please confirm that the results that you present in your Appendix 3 cannot properly be characterized as own-price elasticities because, while the price changes are restricted to proposed changes in own prices, the forecasted volume changes reflect proposed changes in cross prices as well as own prices. If you do not confirm, please explain fully.

(b) Please confirm that the results that you present in your Appendix 3 would have been different if you had backed out all Priority Mail cross price effects from the volume forecasts before applying your formula. If you do not confirm, please explain fully.

(c) Please confirm that the results you present in Appendix 4, including the SMD values, would have been different if you had backed out all Priority Mail cross price effects from the volume forecasts before computing that Appendix. If you do not confirm, please explain fully.

(d) Please confirm that Section IV of your testimony ("Empirical Analysis") would have been different if you had backed out all Priority Mail cross price effects from the volume forecasts before computing Appendix 4. If you do not confirm, please explain fully.

(e) Please confirm that certain statements in your Conclusion on page 14 (e.g., the last sentence in the first paragraph, the second sentence in the second paragraph) might have been different if you had backed out all Priority Mail cross price effects from the volume forecasts before computing Appendix 4. If you do not confirm, please explain fully.

A. (a)-(e) The specific numerical results arrived at in my testimony would have been different had cross-price elasticities been available for each cell in each category of Parcel Post with respect to Priority Mail and with respect to every other cell in Parcel Post. There is no way to assure that incorporating the cross-price effects of Priority Mail on individual cells of Parcel Post would be enough to ensure that a negative own price elasticity would result for each cell. Furthermore, it is likely that each cell has a different cross-price elasticity with the Priority Mail subclass (or even a different cross-price elasticity with each cell of Priority Mail) and it is probably a computationally intense task to compute these elasticity values for each cell under observation. However, this does not undo my argument that the proportional distribution method is not appropriate. The conclusions that I arrived at on page 14 simply imply that this method results in empirically restrictive situations that were not supported by the data.

ANSWERS OF OCA WITNESS JOHN H. O'BANNON
TO INTERROGATORIES USPS/OCA-T200-6-11

USPS/OCA-T200-9. Please refer to your response to USPS/OCA-T200-1(h).

(a) In the last sentence, you state that witness Mayes "ignores the cross-price elasticities among the cells in a given category." Please confirm that, as stated on page 7 of your testimony, your analysis assumes ("Assumption 2") that there are no cross-price elasticities among the cells in a given category. If you cannot confirm, please explain fully.

(b) Are you suggesting that witness Mayes "ignores the cross-price elasticities among the cells" and instead relies exclusively on own-price elasticities? Please explain fully.

(c) Would you agree that the use of the "pre-rate change proportions" to distribute an aggregate category forecast can be thought of as implicitly assuming that, for each rate cell, the combined effect on volume of all relevant rate changes (i.e., its own price and all relevant intra-category, inter-category, and intra-subclass price changes, each multiplied by the corresponding own-price or cross-price elasticity) will be the same? If you do not agree, please explain.

(d) Might it not be the case that, rather than "ignor[ing] the cross-price elasticities among the cells in a given category," witness Mayes uses pre-rate case proportions precisely because she lacks the full range of own-price and cross-price elasticity information she would need to properly "take into account the effects of relative changes in rates between the cells in any one category"? Please explain fully.

A. (a) Confirmed. As I stated in USPS/OCA-T200-1(k) I am not sure if cross-price elasticities among all the cells in a given category of Parcel Post are available or easily computable.

(b) No. As has been previously described in detail, Witness Mayes simply took the total volume numbers given to her by Dr. Tolley, who did incorporate cross-price effects among categories of Parcel Post and Priority Mail, and distributed them among the cells in a given category using the historical proportions.

(c) The statement regarding what the Postal Service is implicitly assuming is correct as written. However, the Postal Service cannot concurrently argue both positions. If one takes into account the cross-price effects of Priority Mail on Parcel Post volumes, then one must also take into account the cross-price effects among the various cells of a given category of Parcel Post.

ANSWERS OF OCA WITNESS JOHN H. O'BANNON
TO INTERROGATORIES USPS/OCA-T200-6-11

(d) Witness Mayes may have chosen her volume distribution method because the full range of cross-price elasticities is not readily available. However, the method used should still attempt to take into account the fact that some cells experience decreases in their rates while others experience increases. Her proportional volume distribution ignores the relative price changes among the cells in the DBMC category of Parcel Post.

ANSWERS OF OCA WITNESS JOHN H. O'BANNON
TO INTERROGATORIES USPS/OCA-T200-6-11

13525

USPS/OCA-T200-10. Please refer to your response to USPS/OCA-T200-1(k). To restate your criticism of the proportional distribution method as succinctly as possible, would it be fair to suggest that you are troubled by the fact that in any instance in which rates for some cells in a category move in the opposite direction than rates for most cells (in this instance, rates decline for 2 cells out of 276), the proportional distribution method, all else being held equal, will cause the volume distributed to those cells to move in the same direction as the volume in the rest of the cells, notwithstanding the difference in direction of rate changes? If you do not agree, please explain fully.

A. The statement describing the situation resulting from using the proportional distribution method is correct as written. As described in USPS/OCA-T200-9(d) above, the problem is the ignoring of the relative price changes among the cells in a given category of Parcel Post.

Revised February 24, 1998

ANSWERS OF OCA WITNESS JOHN H. O'BANNON
TO INTERROGATORIES USPS/OCA-T200-6-11

USPS/OCA-T200-11. Please reconcile the statement in your response to USPS/OCA-T200-1, subpart (k), that "[t]he existence of positive own price elasticities is the indicator of the problem" with your confirmation of subpart (g) that, with TYAR DBMC total volumes higher than TYBR volumes despite a rate increase for DBMC from TYBR to TYAR, application of the formula shown on your page 3 would suggest a "positive implicit own price elasticity" for the DBMC category as a whole. Specifically, are you suggesting that there is a "problem" with the forecast of higher total volume for the DBMC category?

A. I am not stating there is a problem with the forecast of higher **total** volume for the DBMC category. In USPS/OCA-T200-1(g) I was merely confirming that the calculation described in the question, using my implicit own price elasticity equation, would result in a positive value for the DBMC category as a whole. The equation I used to compute implicit own price elasticities at the cellular level does not take into account cross-price elasticities, while Dr. Tolley's estimation of total volume for the DBMC category takes into account the cross-price effect with regard to the Priority Mail subclass.

1 CHAIRMAN GLEIMAN: Does any participant have
2 additional written cross-examination for this witness?

3 [No response.]

4 CHAIRMAN GLEIMAN: If not, that brings us to oral
5 cross. Only the Postal Service requested oral
6 cross-examination of this witness.

7 Does anyone else care to cross-examine the
8 witness?

9 [No response.]

10 CHAIRMAN GLEIMAN: If not, Mr. Koetting, you can
11 proceed when you are ready.

12 MR. KOETTING: Thank you, Mr. Chairman.

13 CROSS-EXAMINATION

14 BY MR. KOETTING:

15 Q Good afternoon, Mr. O'Bannon. As the Chairman
16 said, my name is Eric Koetting and I will be asking you some
17 questions on behalf of the Postal Service. I would like to
18 start by referring you to your response to Postal Service
19 Interrogatory No. 8.

20 A All right.

21 Q Do you have that?

22 A Yes. No. 8, right.

23 Q In subparts (b) through (e), we ask you a number
24 of questions along the lines of wouldn't things have been
25 different if, and I see in your response where you answered

1 those questions.

2 However, the question we asked in subpart (a) was
3 a little bit different and I would like to focus your
4 attention on that and ask that question again, which, as
5 stated in the Interrogatory, was -- Please confirm that the
6 results that you present in your Appendix cannot properly be
7 characterized as own price elasticities because while the
8 price changes are restricted to proposed changes in own
9 prices, the forecasted volume changes reflect proposed
10 changes in cross-prices, as well as own prices.

11 Can you respond to that subpart specifically,
12 please?

13 A Yes. The specific numbers that I generated, we
14 termed implicit ^{own}~~on~~ price elasticities, and that was sort of
15 a qualifier to take account of the fact that -- the
16 calculation I was doing in absence of cross-price effects.

17 Q Let me go back.

18 A Okay.

19 Q Are you agreeing that they cannot properly be
20 characterized as --

21 A They cannot be called purely own price
22 elasticities. That's correct.

23 Q And at the time you were preparing your testimony,
24 which obviously was before you got our first interrogatory
25 on this subject, were you aware that the forecasted Parcel

1 Post volumes that you were examining reflected cross-price
2 effects of changes in Priority Mail rates?

3 A No, I was not aware of that when I first wrote my
4 testimony.

5 Q Is it fair to say that your testimony would have
6 looked a lot differently if you had been aware of that?

7 A Not a lot different. The fact is the theoretical
8 work I did, I did in response to the implicit -- positive
9 implicit price elasticity as I saw -- and my result was that
10 Witness Mayes's volume distribution method was not
11 supportable really -- was not theoretically supportable. So
12 it didn't really matter where she got her volume numbers
13 from.

14 COMMISSIONER HALEY: Excuse me, Mr. O'Bannon, if
15 you would please keep your voice up, we could hear.

16 THE WITNESS: Yes.

17 COMMISSIONER HALEY: Thank you.

18 BY MR. KOETTING:

19 Q In your testimony you present -- on page 13 in
20 footnote 12 there you present a value for something you call
21 the SMD quantity; is that correct?

22 A Yes, that's correct. That's the calculation I'm
23 referring to that doesn't survive a theoretical test.

24 Q And would you agree that that number could --
25 would have been very different if you had focused only on

1 the volume changes caused by changes in Parcel Post rates
2 rather than volume changes caused by changes in both Parcel
3 Post and Priority Mail rates?

4 A I don't understand your question's underlying
5 assumption, because she was given her volume figures from
6 Witness Tolley, and he had already incorporated the total --
7 the aggregate effect of the Priority Mail -- Priority Mail's
8 rate change. So he had already -- I'm not ~~quite~~ ^{quite} sure what
9 your question is asking.

10 Q Well, it would have been possible, would it have
11 not, to have correctly calculated implicit own price
12 elasticities taking cognizance of the fact that the forecast
13 you were working with included cross-price effects?

14 A Okay. Now I understand the question. And no, I
15 don't think that's currently possible. In order to fully
16 calculate elasticities, you would need to be aware of
17 cross-price elasticities between every cell in each category
18 of Parcel Post with every cell in Priority Mail. And that's
19 a very -- if you could just imagine, it's a very large
20 matrix of calculations.

21 Q I can certainly agree with you that that is a
22 daunting prospect. However, are you suggesting that Dr.
23 Tolley's forecasting methodology is incapable of producing a
24 forecast in which Parcel Post rates change and Priority Mail
25 rates do not?

1 A No, that's not what he did.

2 Q No, but --

3 A Right. Okay.

4 Q Isn't that something that you could have done,
5 taken his forecast, hold the Priority Mail rates constant to
6 make sure there's no cross-price effects, simply gone with
7 the proposed Parcel Post rate changes --

8 A Oh, okay.

9 Q And come up with a volume forecast that was
10 unaffected by any cross-price effects from Priority Mail?
11 Wouldn't that have been possible?

12 A That would have been possible. One of the
13 pretexts of her work is that she's trying to cover or she's
14 trying to generate a total revenue amount, and she took the
15 volume figures given to her. So it would be pretty
16 meaningless for me to generate new volume figures unless I
17 were to completely reconstruct her entire testimony.

18 Q But had you done that, you would have come up with
19 some very different implicit elasticities that would more
20 properly be characterized as own price elasticities;
21 correct?

22 A No. In that case -- how are you suggesting I
23 would do this? I would --

24 Q Well, let's look at your formula on page 3 of your
25 testimony. I believe it's on page 3.

1 A Yes.

2 Q The own price elasticity formula -- you're looking
3 at volumes and in this instance we are talking about Parcel
4 Post volumes, DBMC, inter, intra, whatever --

5 A Okay.

6 Q You're looking at volume changes and rate changes
7 and Dr. Tolley can produce a volume forecast for DBMC. In
8 fact, he does --

9 A That's correct.

10 Q -- which is of interest to us, a function of the
11 proposed Parcel Post changes and the proposed Priority Mail
12 rate changes.

13 You could see what volume forecasts he came up
14 with just considering, isolating the effects of a Parcel
15 Post rate increase, and that would give you -- taking the
16 volumes that resulted from that exercise, you could apply
17 this formula and come up with values that were more properly
18 characterized as own price elasticities, correct?

19 A I'm not positive that it is separable in that way.
20 I am not positive of that.

21 Q If we can proceed on the assumption that it is,
22 would you agree that you would get very different numbers
23 than the numbers that you got?

24 A Maybe the term "very" is subjective, but different
25 numbers, yes. They would differ.

1 Q Well, isn't it -- Dr. Tolley has taken account of
2 an increase in DBMC rates and let's just talk about the DBMC
3 category for purposes of simplicity, since that is where the
4 action is, more or less, would you agree?

5 A Yes.

6 Q He is talking about an increase in DBMC rates and
7 according to economic theory and his elasticities, the
8 increase in DBMC rates causes a forecasted decline in DBMC
9 volumes.

10 Does that comport with your understanding?

11 A Yes, my understanding.

12 Q And he is also taking account of a much larger
13 percentage increase in priority mail rates, which according
14 to economic theory is going to have a positive cross-price
15 effect, as it is a substitute good and therefore the price
16 increase for Priority Mail multiplied by the positive
17 cross-price elasticity yields a forecasted volume increase
18 for DBMC volumes, correct?

19 A That is correct in the overall sense, ^{but} ~~and~~ that was
20 not the purpose of my testimony.

21 The purpose of my testimony was what occurs on the
22 individual cell levels and Witness Mays's distribution of
23 volume into the individual cells.

24 Q But my point is it was the fact that the cross
25 price effect was larger which caused Dr. Tolley's overall

1 DBMC forecast to decline -- I'm sorry, caused his overall
2 forecast to increase despite the own price increase that
3 leads to the computation by you of a large number of
4 positive own price elasticities, positive elasticities which
5 you treated as own price elasticities in your appendices, is
6 that correct?

7 A Okay -- that's true, but the fact is the empirical
8 test that I generated could have been supported had she
9 distributed the volume differently, had she put -- she
10 ignored the relative rate changes between the cells, so
11 there are two cells in which rates decline in DBMC, and she
12 distributed the entire roughly 1 million new units of Parcel
13 Post and DBMC -- she distributed that according to the
14 historical proportions.

15 She would have been better off putting a larger
16 proportion into the cells into which the rates decreased and
17 a lesser proportion into the cells in which rates increased.

18 That would have been a more appropriate method,
19 and as I showed, her method fails a theoretically generated
20 test.

21 Q And when you say she fails that test, you are
22 specifically referring to that value in --

23 A -- in Footnote 12 on page 13.

24 Q -- which has a positive value, correct?

25 A Yes.

1 Q And if that value were negative, she would have
2 passed the test?

3 A Yes.

4 Q And if you had done the exercise in which Priority
5 Mail cross-effects had been precluded, and the only thing
6 driving the forecast was the increase in DBMC rates, which
7 would have led the overall DBMC category volume to decline,
8 wouldn't that value have been negative, just like the other
9 categories because as in those other categories the overall
10 volume would now be declining?

11 A If the overall volume declined, those values would
12 be negative, yes.

13 Q And she then would have passed the test?

14 A Yes.

15 Q And then your testimony would have been very
16 different?

17 A Yes.

18 Q If we could look at your response to Postal
19 Service Interrogatory Number 3 --

20 A Okay.

21 Q -- specifically -- I guess there is only one
22 answer. We are asking you, are we not, in this question
23 about something called drop shipping?

24 A Yes.

25 Q That is one of them, right?

1 A Yes.

2 Q And the last sentence of your answer indicates
3 that you are suggesting that you don't have or you are not
4 aware of any data necessary beyond spurious opinion or
5 anecdotal evidence to address whether or not drop shipping
6 occurs?

7 A Yes -- I am not aware of that.

8 Q Okay.

9 A No one has informed me of that.

10 Q But there might be --

11 A There might be --

12 Q -- testimony by other witnesses like Mr. Zwieg --

13 A Yes.

14 Q -- who just got off the stand that there is some
15 of this going on in the marketplace, correct?

16 A Yes. Well, he hasn't started working yet, but --

17 Q He hasn't but perhaps others have?

18 A Yes.

19 Q You wouldn't be suggesting that that testimony is
20 in any way spurious or anecdotal, would you?

21 A No, that is not what the sentence says.

22 Q Okay. Let's look at your response to Postal
23 Service Interrogatory Number 5(b), "b" as in "boy" -- and in
24 the last sentence of that, your response, you state that "if
25 the empirical fact is that mailers are looking only at the

1 aggregate price of their total mailing then cross-price
2 elasticities among cells are immaterial."

3 I would like to explore that a bit.

4 We are talking here about looking for the demand
5 on a cell by cell basis for Parcel Post, correct?

6 A I don't think so. Your question refers to the
7 mailers make their decisions based on the price of their
8 total mailing, and I answered, you know, if it were
9 empirically that way, then setting their cross-price
10 elasticities would be meaningless.

11 Q Okay. Why don't we -- your -- the focus of your
12 testimony is on the volume and price for each cell, correct?

13 A The what? I'm sorry.

14 Q The focus of your testimony, the analysis you
15 undertake in your testimony, the formula for example that we
16 went through on page 3, you apply that on a cell by cell
17 basis, correct?

18 A Yes.

19 Q Okay -- and the own price then if we were looking
20 at volume at that level of aggregation, the own price is the
21 price for that cell, correct?

22 A Yes.

23 Q And let's think of the price for every other cell
24 in that category. Let's think of a composite good, which
25 is all the other Parcel Post cells in that category -- do

1 you understand what I mean by a composite good?

2 A Okay -- one of each or -- let's say --

3 Q Well, for the DBMC category, if I am looking at a
4 particular cell, there is a composite good which is every
5 other cell in DBMC.

6 A Okay.

7 Q Now if we think of mailers who make their decision
8 how they are going to mail their package on the basis of the
9 price or the change in the price in the particular cell,
10 then we'll pick up the response of those mailers when we try
11 to estimate the own price elasticity, correct?

12 A Yes.

13 Q And if there are other mailers out there who are
14 looking at the aggregate rate change in DBMC rates, wouldn't
15 we pick up the response of those mailers by including the
16 aggregate price of the composite good that we just
17 hypothesized as a cross-price variable?

18 A I am not sure how that would work.

19 Q Okay. Well, let's say that I am a business mailer
20 that ships a lot of parcels of varying weights to
21 destinations all over the country and I prefer to do
22 business with just one shipper. If Parcel Post rates are
23 changed, I look at the aggregate rate increase and see
24 whether it is still in my interest to continue to mail
25 Parcel Post, assuming I am a current Parcel Post mailer.

1 If the aggregate rate increase is too great, I
2 might shift all of my business out of Parcel Post and in
3 that case volume would fall in whatever individual cells I
4 would otherwise mail my parcels, is that correct?

5 A That is true, but this -- I see where you are
6 going and I think this is outside of -- this goes back to
7 the earlier interrogatory where I have no knowledge of what
8 proportion of shippers, you know, are interested in the
9 rates in individual cells versus the aggregate rate.

10 Q I guess my point is that going back to your
11 sentence in Interrogatory Number 5, if the empirical fact is
12 that mailers are looking only at the aggregate price of
13 their total mailing then cross-price elasticities among
14 cells are immaterial.

15 A Perhaps -- I should have perhaps put, "if the
16 empirical fact is that all mailers are looking only at the
17 aggregate price."

18 Q Well, either way my question is that the aggregate
19 price has to be a cross-price, doesn't it, if your unit of
20 analysis is the cell? I mean it can't be the own price, can
21 it?

22 A Perhaps you need to be more specific.

23 Q I'm just trying to come to grips with the
24 statement that if -- your analysis is predicated on the
25 notion that volume in each cell is a function of the rate

1 charge for that cell. That's what your formula goes to;
2 correct?

3 A Yes, and elsewhere I mention that I'm not aware if
4 the cross-price elasticities are available, and I also point
5 out that Witness Mayes didn't make use of them either.
6 Witness Tolley only made use of the aggregate cross-price
7 elasticities.

8 Q Well, I mean, you go more than -- you do more than
9 say they're unavailable. Your analysis assumes that there
10 are no cross-price effects, right? On page 7, lines 12
11 through 14, the next basic assumption applied is that each
12 Postal Service's good cell within a category represents a
13 good that is unrelated to every other cell in that category.
14 That's an assumption in your analysis; correct?

15 A That was challenged on an earlier interrogatory.
16 That was challenged on an interrogatory as well. Here it
17 is, Interrogatory -- no that's -- right, I do make that
18 assumption for my theoretical analysis.

19 Q And if in fact the volume in individual cells is
20 being driven by aggregate rate changes, then that assumption
21 is violated, is it not?

22 A I'm not sure. Maybe I don't understand your
23 statement.

24 Q Well, to step back from the math a little bit, I
25 think what you're -- the assumption of your analysis is that

1 the volume for a particular cell of Parcel Post is a
2 function of the rate for that cell, and a mailer is going to
3 react for the change for that particular cell. That's sort
4 of the predicate for your analysis; isn't that correct?

5 A That's what an implicit -- that's what the
6 implicit own price elasticities would say.

7 Q Right. And mathematically this assumption on page
8 7 is what gives effect to the notion that it's the own price
9 that drives the volume in that cell and nothing else;
10 correct?

11 A According to my assumption; yes.

12 Q And my point is if your assumption is incorrect
13 and that volume is driven primarily by an aggregate price
14 increase and all boats rise with the tide so to speak or
15 drop with the tide, that's a cross-price effect that
16 violates your assumption; correct?

17 A But the point is that the exactly proportional
18 increase in volume doesn't make economic sense. That was
19 the issue I was examining, that the cells in which the rates
20 decline should have had greater relative increases than the
21 cells in which the rates increase in volume. Even if --
22 even if the total volume is increasing. That was the -- the
23 problem is the distribution method of its aggregate volume
24 into the individual cells.

25 Q So it's your view that -- well, I think you've

1 just restated your assumption that volume in a cell has to
2 move in the same direction as the rate change for that cell.

3 A No, previously I've stated she should have put
4 more of the volume increase into the cells in which the
5 rates declined, but she could have still had some volume
6 increase in the cells in which the rates increased. She
7 just needed to examine the relative rate changes or the
8 cross-price elasticities between the cells. She did not
9 take that into account.

10 Q And you're stating that this is a problem because
11 for those two cells, and this goes back I think to our
12 Interrogatory No. 10, for those two cells you've got rate
13 changes moving in one direction for 270 cells and rate
14 changes moving in the other direction for two cells; is that
15 correct?

16 A That's true. It was -- yes.

17 Q And your problem is is that the proportional
18 method assumes that the overall change -- whatever direction
19 the overall change is going in, every cell is going to move
20 in that direction regardless of whether the fact that there
21 are some that are moving in the other direction. That's
22 what creates the problem. Correct?

23 A What direction the -- I'm sorry, could you --

24 Q Well, the overall -- for example, her DBMC volumes
25 are increasing, and as we talked about earlier, what's

1 really driving that is the cross-price effect with Priority
2 Mail, but that's pretty much irrelevant to our discussion at
3 this point. It's moving in a particular direction. In this
4 case it's increasing.

5 And for the -- whatever rate changes in Parcel
6 Post are consistent with that, there's some other ones in
7 this case too that aren't consistent with that. They're
8 moving in the opposite direction, and that's going to cause
9 the implicit price elasticities to be of the wrong sign.

10 A I don't know what you mean by consistent.

11 Q Okay.

12 A Okay.

13 MR. KOETTING: I have no further questions, Mr.
14 Chairman.

15 CHAIRMAN GLEIMAN: Is there any follow-up?
16 Questions from the bench?

17 [No response.]

18 CHAIRMAN GLEIMAN: Ms. Dreifuss, would you like
19 some time for redirect?

20 MS. DREIFUSS: I think just two or three minutes
21 will be enough, Mr. Chairman.

22 CHAIRMAN GLEIMAN: Sure.

23 [Recess.]

24 CHAIRMAN GLEIMAN: Ms. Dreifuss.

25 MS. DREIFUSS: OCA has no redirect examination,

1 Mr. Chairman.

2 CHAIRMAN GLEIMAN: There is no redirect. If there
3 is no redirect, then, Mr. O'Bannon, we appreciate your
4 appearance here today and your contributions to the record.
5 And if there is nothing further, you are excused.

6 THE WITNESS: Thank you.

7 [Witness excused.]

8 CHAIRMAN GLEIMAN: I think we will break for lunch
9 now, and come back at 2:00 o'clock. And at that time, we
10 will take up our next witness, who will be UPS Witness
11 Henderson.

12 [Whereupon, at 12:41 p.m., the hearing was
13 recessed, to reconvene at 2:00 p.m., this same day.]

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AFTERNOON SESSION

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[2:01 p.m.]

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CHAIRMAN GLEIMAN: Mr. McKeever, if you could identify your witness so that I can swear him in.

5

6

MR. McKEEVER: United Parcel Service calls Dr. J. Stephen Henderson to the stand.

7

Whereupon,

8

J. STEPHEN HENDERSON,

9

a witness, was called for examination by counsel for United Parcel Service and, having been first duly sworn, was examined and testified as follows:

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DIRECT EXAMINATION

13

BY MR. McKEEVER:

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Q Dr. Henderson, I'm handing you a copy of a document entitled Direct Testimony of J. Stephen Henderson on Behalf of United Parcel Service and marked UPS-T-3, which includes an appendix and exhibits marked as 3A, 3B and 3C. Was that document, including the appendix and the exhibits, prepared by you or under your supervision?

20

A Yes, it was.

21

22

Q And if you were to testify here orally today, would your testimony be as set forth in that document?

23

A Yes, it would.

24

25

MR. McKEEVER: Mr. Chairman, with that, I move that the document entitled Direct Testimony of J. Stephen

1 Henderson on Behalf of United Parcel Service and designated
2 UPS-T-3, including the appendix and Exhibits 3A, 3B and 3C,
3 be admitted into evidence and transcribed into the record.

4 CHAIRMAN GLEIMAN: Are there any objections?

5 [No response.]

6 CHAIRMAN GLEIMAN: Hearing none, Dr. Henderson's
7 testimony and exhibits are received into evidence and I
8 direct that they be transcribed into the record at this
9 point.

10 [Direct Testimony and Exhibits of
11 J. Stephen Henderson, UPS-T-3, was
12 received into evidence and
13 transcribed into the record.]

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UPS-T-3

BEFORE THE
POSTAL RATE COMMISSION

POSTAL RATE AND FEE CHANGES, 1997

:
:
:
DOCKET NO. R97-1

DIRECT TESTIMONY OF
J. STEPHEN HENDERSON
ON BEHALF OF
UNITED PARCEL SERVICE

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
PURPOSE OF TESTIMONY	3
POSTAL RATEMAKING POLICY	3
A. Postal Pricing Objectives	3
B. The Commission's Pricing Approach	7
C. Attributable Costs	9
D. Ramsey Pricing	13
A PRICING MODEL BASED ON THE COMMISSION'S APPROACH	14
PRICING RECOMMENDATIONS FOR EXPRESS MAIL, PRIORITY MAIL, AND PARCEL POST	18
A. Express Mail	19
B. Priority Mail	20
C. Parcel Post	22
CONCLUSIONS	25

LIST OF TABLES

Table 1 -- Overall Revenue Requirement	17
Table 2 -- Average Rates and Cost Coverages	19

BEFORE THE
POSTAL RATE COMMISSION

POSTAL RATE AND FEE CHANGES, 1997

DOCKET NO. R97-1

DIRECT TESTIMONY OF
J. STEPHEN HENDERSON
ON BEHALF OF
UNITED PARCEL SERVICE

INTRODUCTION

1

2

My name is J. Stephen Henderson. I am an economist and a principal of Putnam, Hayes & Bartlett, Inc. ("PHB"). PHB is an economic and management consulting firm with offices in various cities in the United States. PHB also has a New Zealand subsidiary, an Australian subsidiary, and an affiliate in England. My place of business is in PHB's Washington D.C. office, 1776 Eye Street, N.W., Washington, D.C. 20006.

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I joined PHB in 1996. Prior to that time and beginning in February 1989, I held various positions in the Office of Economic Policy ("OEP") of the Federal Energy Regulatory Commission ("FERC"). From the Summer of 1993 to October 1996, I was the Associate Director of OEP. The Office supported the Commission's consideration of individual cases, such as merger applications, power pooling arrangements, transmission pricing applications, and requests for

1 market-based pricing authority, and also was responsible for the development of
2 industry-wide policy matters. I was responsible for supervising and coordinating a
3 staff of about 12 senior economists who conducted economic and policy studies,
4 especially of the electricity industry. During my tenure, I helped to coordinate a
5 major policy initiative that has opened the industry to competition at the wholesale
6 level. This was FERC's open transmission access policy as embodied in its recent
7 Orders 888 and 889 that have fostered significant restructuring activity in the
8 industry and have promoted competitive initiatives at the retail level in several
9 states.

10 Since joining PHB, my professional activities have continued to center
11 on competitive issues. My assignments on electric power industry matters have
12 involved the definition of relevant markets and the measurement of market power,
13 the restructuring of electric power markets, and the development of Independent
14 System Operators.

15 From 1981 to 1989, I was a senior institute economist at the National
16 Regulatory Research Institute ("NRRI") in Columbus, Ohio. NRRI is sponsored by
17 the National Association of Regulatory Utility Commissioners ("NARUC"). NRRI
18 provides a broad program of research into regulatory matters for the regulatory
19 agencies that belong to NARUC, particularly for state public utility commissions. At
20 NRRI I wrote extensively on the economics of regulation.

21 I have been an assistant professor of economics at the Ohio State
22 University and an instructor at the Air Force Institute of Technology. The courses I

1 have taught include public finance, microeconomics, macroeconomics, managerial
2 economics, and mathematics for economists.

3 I received a B.S. in international affairs from the Air Force Academy
4 and an M.A. in economics from Georgetown University. I hold a Ph.D. in
5 economics from the University of Wisconsin.

6 **PURPOSE OF TESTIMONY**

7 I have been asked to review the Postal Service's pricing methodology
8 in this case. My testimony discusses the statutory framework for postal pricing
9 decisions and addresses the role of economic theory within that framework. As a
10 result of my review, I recommend rate levels for Express Mail, Priority Mail, and
11 Parcel Post that are different from those proposed by the Postal Service.

12 **POSTAL RATEMAKING POLICY**

13 **A. Postal Pricing Objectives**

14 The Postal Reorganization Act contains nine factors or policy
15 objectives that govern postal rate determination:

16 **Objective (1): Fair and Equitable Rates.** Section 3622(b)(1) states
17 that postal rates should be "fair and equitable." From a regulatory policy
18 perspective, the use of this phrase to articulate Congress' first pricing objective is
19 significant. Statutes regulating electricity, natural gas, transportation, and other
20 public utilities typically require regulators to set "just and reasonable" rates. The

1 phrase "just and reasonable" has come to be identified with regulatory approaches
2 designed to provide consumers with efficient rates.¹ In recent years, a "just and
3 reasonable" price has been interpreted by some regulatory agencies as the price
4 that would result where the seller does not have market power.²

5 In contrast, the phrase "fair and equitable" implies a broader
6 regulatory concept involving social objectives that go beyond those encompassed
7 by the "just and reasonable" terminology. In appropriate circumstances, a "fair"
8 postal rate could be a market-driven rate; however, the "equitable" terminology
9 clearly suggests that the Commission should balance various social objectives,
10 including those spelled out in the other eight parts of Section 3622(b). That is,
11 Objective (1) calls for a reasoned regulatory balancing of the various social and
12 economic objectives listed in the Act.

13 Objective (2): Value of Mail Service. The Act allows postal rates to
14 reflect the value of the service rendered to particular mailers and recipients of mail.
15 The Commission has developed a judgmental approach to reflecting the value of
16 mail service objective in postal rates, taking into account demand elasticities and
17 the intrinsic value of the service provided.

18 Objective (3): Cost Recovery. Section 3622(b)(3) requires that each
19 class of mail pay its attributable costs plus a reasonable portion of all other costs.
20 It is the only objective that is a requirement and not merely regulatory guidance.

-
1. Permian Basin Area Rate Cases, 390 U.S. 747, 767 (1968); Farmers Union Cent. Exchange v. FERC, 734 F.2d 1486, 1501 (1984).
 2. See Bernard Tenenbaum and J. Stephen Henderson, "Market-Based Pricing of Wholesale Electricity Service," 4 The Electricity Journal 30 (Dec. 1991).

1 Congress clearly wanted each class of mail to pay for the costs caused by
2 providing service to the class.

3 There is no dispute in this case about the desirability of each class of
4 mail paying rates that cover the costs it imposes upon the Postal Service. There is,
5 however, considerable debate about how to define and measure the costs caused
6 by a class of mail and how to reflect those costs in rates. These issues are
7 discussed later in my testimony.

8 Objective (4): Effect of Rate Increases. This objective allows the
9 Commission to mitigate price increases that would cause "rate shock." Conversely,
10 any rates that would unfairly disadvantage competitors may be set higher. The key
11 consideration in the competitor protection aspect of Objective (4) is that the
12 competitive subclasses be assigned a reasonable share of institutional costs.

13 Objective (5): Available Alternatives. The availability of alternatives
14 as discussed in this objective is distinct from that addressed in Objective (2), which
15 deals with demand conditions and service quality. Objective (5) effectively is a two-
16 part instruction to the Commission. First, in assigning institutional costs the
17 Commission should protect mailers with few or no choices from excessively high
18 prices, especially if the mailers' lack of alternatives results from the Private Express
19 Statutes. Conversely, the Commission need not be as concerned about a high cost
20 coverage when mailers have readily available alternatives. In these circumstances,
21 the Commission should protect competitors from excessively low postal prices. Put
22 simply, Congress expects the Postal Service to be a fair supplier of monopoly
23 services and a fair competitor in the provision of competitive services.

1 Objective (6): Preparation Costs. This objective is a more specific
2 aspect of the general objective that postal rates should reflect the cost impact of
3 mail preparation on the Postal Service. It is both fair and economically desirable
4 that postal rates reflect actual cost savings to the Postal Service resulting from
5 mailer worksharing.

6 Objective (7) Simplicity. A goal of ratemaking, particularly rate
7 design, should be logical relationships within and among the various subclasses of
8 mail.

9 Objective (8): Educational, Cultural, Scientific and Informational
10 Value. The Act specifies special consideration for certain classes of mail deemed
11 to have educational, cultural, scientific, or informational value.

12 Objective (9): Other Considerations. The Commission has the
13 authority to take into account other considerations not mentioned in the first eight
14 factors.

15 The clear conclusion is that the Act requires rates for each subclass
16 to be based on the costs caused by that subclass plus an additional assignment to
17 each subclass of other costs. The additional assignment must be based on the
18 balancing of several specified social objectives. Economic efficiency is a valid
19 consideration, but it is not the primary objective of postal pricing.

1 prevailing and presumptively reasonable relationships. It follows that a markup
2 index should be used to adjust for inter-rate case differences in system-wide cost
3 coverages.

4 The third step is to examine whether there have been any material
5 changes in conditions since the last omnibus rate case that, in accordance with the
6 Section 3622(b) factors, would require a change to these adjusted markups. If so,
7 appropriate changes should be made.

8 The Postal Service has not put forward any major changes in its
9 policy objectives in this case.⁵ Moreover, Postal Service witness O'Hara's
10 discussion of his specific rate proposals does not indicate any change in
11 circumstances since Docket No. R94-1 that would require a change in the
12 previously approved markup relationships. I conclude that the Postal Service
13 perceives no major change in the economic, social, political, or any other feature of
14 postal markets, or of its role in those markets, that warrants a major revision in
15 markup relationships. As a consequence, the appropriate policy under the
16 Commission's approach is to base average subclass rates on the previously
17 approved markup pattern.

18 The Postal Service has not followed this three-step approach. As a
19 result, the Postal Service's proposals for the major package classes -- Express
20 Mail, Priority Mail, and Parcel Post -- do not accord with the Commission's

5. Docket No. R97-1, Trial Brief of the United States Postal Service, pp. 10-12 (Sept. 29, 1997).

1 ratemaking policies. I later propose different rate levels for those subclasses that
2 comport with the Commission's approach.

3 C. Attributable Costs

4 The Commission's implementation of Section 3622(b)(3) of the statute
5 has been straightforward. In particular, the Commission has first determined the
6 attributable costs of each subclass of mail. The Commission then has applied a
7 markup to attributable costs to reflect the appropriate contribution of each subclass
8 to the Postal Service's institutional costs. The attributable costs of a subclass are
9 those costs that are caused by the provision of service to the subclass.
10 Historically, volume variable costs and specific fixed costs have together comprised
11 attributable costs.⁶

12 For the first time, the Commission now has in the record an estimate
13 of the incremental cost for each of the various subclasses of mail. As Postal
14 Service witnesses Panzar and Takis agree, incremental costs are caused by
15 providing service to a subclass.⁷ As such, the incremental costs of a subclass are
16 attributable to the subclass.

17 In this case, the Postal Service proposes to depart from the
18 Commission's well-established practice of marking up attributable costs. It
19 proposes instead to determine the rates for each subclass by marking up only the
20 volume variable costs of the subclass. The Postal Service interprets volume

6. See USPS-T-30, p. 11.

7. USPS-T-11, pp. 8-9; USPS-T-41, p. 3.

1 variable costs to be short-run marginal costs. On the basis that marginal cost
2 pricing is economically efficient, the Postal Service concludes that volume variable
3 costs should be the starting point for determining economically efficient postal
4 rates. The Postal Service proposes to use its incremental cost estimates solely as
5 a check against cross-subsidy.

6 The Postal Service's approach represents a significant departure from
7 prior practice and is contrary to the Commission's prior application of the statute.
8 Dr. Panzar's economic logic notwithstanding, the Commission has interpreted the
9 third pricing factor in the statute, Section 3622(b)(3), to require postal rates to
10 include all attributed costs plus a portion of the "other," remaining costs.⁸ The
11 Commission has determined that attributable costs include incremental costs and that
12 Congress expected an attributable cost "floor to be constructed for each class [with] the
13 rate built upon it."⁹ Consequently, incremental costs should be the basis for markups.

14 Moreover, there is a good practical reason not to use incremental costs
15 solely as a check against cross-subsidy. Without some markup over incremental cost,
16 measurement error could lead to prices for some services that are below their actual
17 incremental costs. Such a situation would create two types of risk for inefficient entry.
18 First, the price for some subclass or subclasses would be lower than incremental cost
19 because of measurement error. Entry into the market for the provision of such services
20 would be inefficiently deterred because of the low Postal Service price. Second, the

8. Opinion and Recommended Decision, Docket No. R90-1, p. IV-3.

9. Opinion and Recommended Decision, Docket No. R87-1, p. 103 (¶ 3009);
see also id., p. 101 (¶ 3007).

1 price for some other subclass or subclasses would be too high because of the need for
2 all subclasses in the aggregate to cover the revenue requirement. Entry into the
3 market for the provision of these services would be inefficiently encouraged because of
4 the excessively high prices. The inefficiencies associated with this dynamic market
5 entry process are not taken into account in Dr. Panzar's theory, but they are real world
6 considerations that can lead to real world inefficiencies.

7 There is another sound economic reason to mark up incremental costs.
8 The short-run marginal cost of providing postal services for a particular subclass of mail
9 changes frequently as a result of changes in volumes, usage mixes, overtime rates,
10 input costs, organizational changes, productivity improvements, general inflation, and
11 other factors. If the primary aim is to achieve economic efficiency, postal prices based
12 on marginal costs necessarily would have to change frequently in order to achieve that
13 goal. Short-run marginal cost pricing may be appropriate if prices could change in a
14 short time period, such as an hour, a day, a month, or a season.¹⁰ When prices do not
15 change in this manner, however, the relevant cost basis for pricing decisions should
16 correspond to the time period during which the rates will be in effect.¹¹

10. Such pricing behavior is often observed in competitive markets. For example, wholesale electric power prices change hourly in response to supply and demand conditions. Under those conditions, price can equal short-run marginal cost, defined as the additional resources required to meet small changes in demand in a short time period.

11. Dr. Panzar has correctly stated the general principle: "The particular version of short-run marginal cost which should be used depends upon a determination of which of the firm's productive inputs can and cannot be varied over the time period *during which the rates are to be in effect.*" Tr. 9/4636 (emphasis added).

1 The postal rates that emerge from this case are likely to remain in place
2 for two to four years. Accordingly, the relevant costs for pricing purposes are longer
3 run, not short run, costs.¹² Most (if not all) of the specific fixed costs identified by the
4 Postal Service are avoidable in the time span between postal rate cases. For example,
5 advertising expenses are not volume variable, but they can be adjusted within such a
6 time frame. The relevant costing concept for economically efficient pricing should
7 capture such resource adjustments. Unfortunately, the Postal Service's proposed rates
8 are based solely on costs that vary over a much shorter time period.

9 The long-run incremental cost concept includes the longer run resource
10 adjustments discussed above. Thus, long-run incremental cost (rather than the Postal
11 Service's volume variable costs) is the appropriate basis for postal pricing markups.
12 While not perfect, the Postal Service's estimates of incremental costs are based on this
13 concept.¹³ Therefore, the Postal Service's incremental cost estimates should be used
14 as the basis for economically efficient markups.

15 For the remainder of my testimony, I use the term "attributable cost" as
16 equivalent to incremental costs.

12. The short run is generally defined as any period shorter than the time it would take to vary all of a firm's productive inputs. The long run, on the other hand, permits all productive inputs to be varied.

13. Better estimates are likely to yield substantially higher incremental costs. See Dianne C. Christensen, Laurits R. Christensen, Charles E. Guy, and Donald J. O'Hara, "U.S. Postal Service Productivity: Measurements and Performance," in Regulation and the Nature of Postal and Delivery Services 237, at p. 249, Michael A. Crew and Paul R. Kleindorfer, eds. (1993), for a method that estimates that attributed cost is about 80 percent of total postal costs, as compared to the Postal Service's estimate of 56 percent in this case.

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D. Ramsey Pricing

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The Postal Service provides an elaborate study estimating Ramsey prices.¹⁴ However, the Postal Service's pricing witness, Dr. O'Hara, did not rely on such prices for his recommended rates. As a result, a debate over the theoretical virtues of Ramsey Prices in promoting economic efficiency is simply irrelevant.

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Moreover, practical considerations limit the usefulness of Ramsey Pricing theory. The data available to the Commission are inadequate to meet the stringent demands of Ramsey Pricing.¹⁵ Furthermore, statutory restrictions, not market forces, result in certain postal customers having relatively inelastic demands and poor

14. See the Direct Testimony of Postal Service witness Bernstein, USPS-T-31.

15. Professor Baumol and Mr. Sidak have explained that

. . . to use the full Ramsey analysis to calculate second-best optimal prices, one needs information on the marginal cost of, and the own-price elasticity of demand for, each of the products in question. One probably needs to know the full set of cross-price elasticities as well.

This data requirement is one reason why most regulators and consulting economists have rejected the use of the Ramsey formulas even to provide approximations for the prices that the regulated firm should be permitted to charge for its products. Marginal-cost figures are difficult enough to come by, although reasonably defensible approximations have been provided by firms to regulatory bodies. But up-to-date estimates of the full set of pertinent elasticities and cross-elasticities are virtually impossible to calculate, particularly in markets where demand conditions change frequently and substantially. As a result, *an attempt to provide the regulator with an extensive set of Ramsey prices is likely to be beset by inaccuracies, by obsolete demand data, and by delays that will prevent the firm from responding promptly and appropriately to evolving market conditions.*

William J. Baumol and J. Gregory Sidak, Toward Competition in Local Telephony, pp. 38-39 (MIT Press & American Enterprise Institute, 1994) (emphasis added).

1 alternatives. Ramsey Pricing would therefore place an inequitably high burden of cost
 2 recovery on customers who lack good alternatives because of regulation that requires
 3 them to buy from a monopolist.

4 Finally, as discussed above, the Postal Reorganization Act was not
 5 intended to elevate economic efficiency to a predominant role in postal ratemaking. In
 6 Docket No. R87-1, the Commission summed up the situation very well when it stated,

7 . . . we find it inappropriate to rely on the second best
 8 pricing [Ramsey Pricing] efforts presented in this case as a
 9 representation of economically efficient rates. Those
 10 efforts utilize insufficiently reliable price elasticity
 11 estimates, are lacking essential cross elasticity data, and
 12 do not compensate in any way for Congressional actions
 13 which are intended to achieve goals other than the
 14 economically efficient allocation of society's resources.¹⁶

15 A PRICING MODEL BASED ON THE
 16 COMMISSION'S APPROACH

17 Relative markups reflect the Commission's judgment about how various
 18 subclasses should contribute to the recovery of institutional costs. Changes in
 19 attributable cost estimates are not by themselves a reason for the Commission to
 20 modify its view about the appropriate relative responsibility of each subclass of mail for
 21 the recovery of institutional costs.

22 Dr. O'Hara correctly points out that using prior relative markups when
 23 underlying costs have changed will result in changes in relative prices.¹⁷ That is as it

16. Opinion and Recommended Decision, Docket No. R87-1, p. 377, ¶ 4058.

17. USPS-T-30, pp. 17-19.

1 should be. Prices should follow costs, and, as a general rule, cost changes should not
2 be negated by changes in the relative responsibility of a class of mail toward the
3 recovery of institutional costs. Therefore, I have used the Commission's relative
4 markups from Docket No. R94-1 to determine the appropriate contribution of the
5 subclasses to the recovery of institutional costs.¹⁸ In so doing, I have included in the
6 cost floor the volume variable costs presented by UPS witness Sellick, under which
7 mail processing labor costs are 100 percent volume variable.¹⁹

8 The model I use to determine the rates for all subclasses is described in
9 the Appendix to my testimony. It incorporates all of the major features of the Postal
10 Service's case aggregated at the subclass level, including information that allows the
11 Commission to estimate how volumes in the various subclasses can be expected to
12 change in response to changes in prices. The model does this by incorporating for
13 each of 16 subclasses a demand curve that reflects the demand elasticities estimated
14 by Postal Service witnesses Tolley and Musgrave.²⁰

18. To the extent that the use of relative markups from the previous rate case would result in excessive rate increases, it might be appropriate to consider objective 4 in Section 3622(b) -- the impact of rate increases on mailers -- as a mitigating factor.

19. UPS-T-2, p. 17 (Table 4).

20. For simplicity, the prices and volumes for the remaining subclasses (those associated with mailgrams, international mail, and special services) are assumed to remain constant; these services provide only about six percent of the Postal Service's total revenue requirement. See UPS-Henderson-WP-1, Table 1a.

1 The model also incorporates marginal cost curves which reflect the cost
2 variabilities shown in Exhibit UPS-T-3A.²¹ Each such cost curve reflects the scope
3 economies discussed by Postal Service witnesses Panzar and O'Hara. In particular,
4 the cost structure aggregated at the subclass level is represented by a formula that has
5 two main features: it has a constant cost variability, and it has a simplified form of
6 scope economies depicted as the sum of two volumes -- those of the particular
7 subclass in question, and a parameter representing those of all other subclasses. The
8 difference between volume variable cost and incremental cost permits the estimation of
9 this economies of scope parameter which improves the ability of the aggregated model
10 to track closely the rates that would be produced by the Postal Service's more detailed
11 costing framework.²²

12 The results of applying my recommended approach and the Postal
13 Service's approach are presented in Exhibits UPS-T-3B and UPS-T-3C. The overall

21. The subclass cost variabilities are aggregated from the Postal Service's Cost Segments and Components Report as revised by Mr. Sellick in his testimony.

22. Because the model is aggregated at the subclass level, small discrepancies will arise from two sources. First, because subclass costs are represented by a single formula that responds only to the volumes of the subclass itself -- the parameter representing scope economy volumes is a constant and does not change as the subclass rates or volumes change -- some inaccuracy may occur if the mix of underlying costs changes in response to a subclass rate change. Second, the model does not account for cross-elasticities of demand. Thus, the model does not include any cross effects between or among subclasses (changes in either the volume demanded or in the costs associated with one subclass in response to changes in the volumes of another subclass). Both simplifications should result in only a small loss of accuracy.

1 revenue requirement of the Postal Service under my recommendation compared to that
2 under the Postal Service's proposal is summarized in Table 1.

3 **Table 1**
4 **Overall Revenue Requirement**
5 **(\$ millions)**

	Postal Service Proposal	Recommendation
6 Total Revenue Requirement	\$61,616	\$61,386
7 Attributed Cost	34,486 ^(A)	39,215 ^(B)
8 Non-Attributed Cost	27,130	22,171
9 Percent Attributed	56.0%	63.9%

11 (A) Volume Variable Cost

12 (B) Incremental Cost

13 Sources: USPS-30B; UPS-Henderson-WP-I, Table 1a.

14 There are three differences between the Postal Service's proposal and
15 my recommendation. First, replacing Dr. Bradley's estimates of mail processing labor
16 cost variabilities with 100 percent volume variability adds about \$3.5 billion to
17 attributable costs and subtracts a like amount from non-attributed costs. Second, using
18 incremental costs rather than volume variable costs as the measure of attributable
19 costs increases attributable costs by about \$1.4 billion. Third, there is a minor change
20 in the revenue requirement, which decreases attributable costs by about \$0.2 billion.
21 The shift in volume variable costs among the subclasses from one approach to the
22 other accounts for this small difference. For example, if subclasses with higher costs
23 as a result of the cost shift tend to have higher demand elasticities than those

1 subclasses with lower costs, the overall revenue requirement will tend to decrease
2 because of an overall reduction in volume variable costs. That is, the volume
3 reductions associated with the higher elasticity subclasses would dominate and lead to
4 an overall cost reduction. This accounts for the small reduction in the revenue
5 requirement resulting from my recommendation.

6 The average rates resulting from my model are shown in Exhibit UPS-T-
7 3B. For comparison purposes, Exhibit UPS-T-3C contains the average rates proposed
8 by the Postal Service.

9 For First Class letter mail, my approach yields an average rate of 34.7
10 cents per piece. The Postal Service's approach results in an average rate of 35.2
11 cents per piece. Both round to an average price of 35 cents per piece. In the case of
12 Standard (A) Commercial Regular mail -- the second largest of the Postal Service's
13 products -- my model results in an average rate of 20.3 cents per piece, whereas the
14 Postal Service proposes a somewhat higher average rate of 21.3 cents per piece.

15 I have not examined these rates in light of the pricing factors of the
16 statute. In the following section of my testimony, I examine the Express Mail, Priority
17 Mail, and Parcel Post rates resulting from my model in light of those pricing factors.

18 **PRICING RECOMMENDATIONS FOR EXPRESS MAIL,**
19 **PRIORITY MAIL, AND PARCEL POST**

20 In arriving at my rate recommendations for Express Mail, Priority Mail,
21 and Parcel Post, I have followed the Commission's instruction that existing markup
22 relationships should be maintained unless there is a principled reason for change

1 based on the nine statutory objectives. As explained below, my analysis of the
 2 statutory factors as they pertain to Express Mail, Priority Mail, and Parcel Post indicates
 3 that there is no reason to change the established markup relationships. My rate
 4 recommendations and the Postal Service's proposals are set forth in Table 2.

5 **Table 2**
 6 **Average Rates and Cost Coverages**

	Postal Service Proposal		Recommendation	
	Average Rate	Cost Coverage	Average Rate	Cost Coverage
7 Priority Mail	\$3.78	192.1%	\$4.66	193.1%
8 Express Mail	\$13.41	204.9%	\$13.51	118.1%
9 Parcel Post	\$3.34	103.9%	\$3.90	107.1%

10 Sources: Postal Service Proposal – USPS-T-30, WP II, and USPS-30B.
 11 Recommendation – UPS-Henderson-WP-I, Table 1a.

12 **A. Express Mail**

13 My recommended average rate for Express Mail is \$13.51 with a cost
 14 coverage of 118 percent. This compares to the Postal Service's average rate of
 15 \$13.41.

16 Dr. O'Hara does not point to any aspect of this subclass that has
 17 changed significantly since the last general rate case. Dr. Musgrave concludes that
 18 Express Mail is a dynamic service that has changed throughout the 1980's and 1990's

1 and will likely change in the future.²³ This dynamic character is nothing new. As
2 explained by Dr. Musgrave, this has been an aspect of Express Mail since its
3 inception.²⁴

4 Thus, nothing suggests that the balance of Section 3622(b) pricing
5 objectives which the Commission established in the last omnibus rate case should be
6 changed. Therefore, I find no need to modify the results of applying the markup index
7 to Express Mail.

8 B. Priority Mail

9 My recommended average rate for Priority Mail is \$4.66 with a cost
10 coverage of 193 percent. This compares to the Postal Service's proposed average
11 rate of \$3.78. My recommended rate represents a 32 percent increase. This increase
12 is driven by a 31 percent increase in attributed cost per piece for Priority Mail since
13 Docket No. R94-1.²⁵

14 Apart from cost changes, several additional factors should be considered
15 in arriving at appropriate Priority Mail rates. The higher service standards of Priority
16 Mail support a higher markup than for First Class Letters. Dr. O'Hara points out that
17 Priority Mail "enjoys the same priority of delivery as First-Class letters, receives even

23. USPS-T-8, p. 29.

24. Id.

25. This 31 percent cost increase represents an increase from the attributable cost per piece of \$1.84 found by the Commission in Docket No. R94-1 (Opinion, Appendix G, Schedule 1) to the test year attributable cost per piece of \$2.41. UPS-Henderson-WP-1, Table 7a.

1 greater use of air transportation in view of the two-day service standard between most
2 metropolitan areas, and enjoys the convenience of the collection system for the
3 unzoned two-pound rate packages that constitute a large share of its volume.²⁶ The
4 Postal Service is also proposing to offer Priority Mail users a delivery confirmation
5 service, thereby making Priority Mail an even more attractive product relative to First
6 Class Mail.

7 In the last three years, Priority Mail has experienced substantial
8 increases in volume. These increases represent a continuation of Priority Mail's
9 explosive growth rates since the early 1970's. For example, Dr. Musgrave reports that
10 Priority Mail volume has grown about 11 percent annually, on average, in the
11 nineties.²⁷ Because of its popularity and high growth rates, Priority Mail has become a
12 major offering of the Postal Service. This high growth rate is another indication that
13 Priority Mail is a high value service.

14 A higher markup for Priority Mail relative to First Class letters is
15 consistent with the Commission's guidance in previous cases.²⁸ This markup
16 relationship is preserved under my recommendation, which has a markup of 93
17 percent for Priority Mail compared to 71 percent for First Class Letters. In contrast, the
18 Postal Service proposes to reverse this relationship and would establish a markup for
19 Priority Mail that is lower than the markup for First Class Mail.

26. USPS-T-30, p. 27.

27. USPS-T-8, p. 12.

28. See Opinion and Recommended Decision, Docket No. R94-1, Appendix G, Schedule 3, p. 1.

1 The only aspect of Priority Mail that Dr. O'Hara believes is less favorable
2 than First Class letters is Priority Mail's higher elasticity of demand. However, in light of
3 Priority Mail's growth rate, this difference does not seem significant.

4 My proposed rate increase is not excessive because it is primarily cost
5 driven. In addition, Priority Mail is a competitive service of high value. The ready
6 availability of alternatives to Priority Mail means that the Commission need not be as
7 concerned about a higher-than-average rate increase, as it should be for a monopoly
8 service. Accordingly, I find no reason to suggest that the rate derived from applying the
9 established markup for Priority Mail should be modified.

10

C. Parcel Post

11 My recommended average rate for Parcel Post is \$3.90, with a cost
12 coverage of 107 percent. This compares to the Postal Service's proposal of \$3.34. My
13 recommended rate represents a 28 percent increase.

14 This increase results from a number of factors. First, the average rate for
15 Parcel Post is already substantially below cost.²⁹ A 19.4 percent increase is needed
16 just to cover that cost shortfall and reach the Commission's Docket No. R94-1 cost
17 coverage of 107 percent. Second, attributable costs per piece in the test year will be
18 7.2 percent higher than the attributable costs estimated by the Commission in Docket

29. USPS-T-37, p. 24.

1 No. R94-1.³⁰ Thus, to cover costs in the test year and maintain a cost coverage of 107
2 percent, the average rate must increase by 28 percent.

3 My recommended rate for Parcel Post is determined, in part, by my
4 adoption of the Postal Service's attribution of 100 percent of Alaska Air costs. The cost
5 causality requirement of the statute indicates that all of these costs should be
6 attributed.

7 Dr. O'Hara points to only one new pricing factor with respect to Parcel
8 Post -- the lack of access to the collection system due to security concerns.³¹ Dr.
9 Tolley discusses two features of the market for packages in which Parcel Post
10 competes. One is competition from various private firms.³² I am not aware of any
11 major difference in the intensity or nature of this competition since the last rate case.
12 The other feature discussed by Dr. Tolley is the growth in home shopping and
13 electronic commerce.³³ The package market is expanding as a consequence of this
14 change, which would support a more robust markup for Parcel Post.

15 The Parcel Post markup proposed by the Postal Service is extremely
16 low. Economically efficient pricing requires Parcel Post rates to exceed attributable
17 costs in every year, not just in the test year. With a low markup such as that proposed

30. This 7.2 percent cost increase represents an increase from the attributable cost per piece of \$3.40 found by the Commission in Docket No. R94-1 (Opinion, Appendix G, Schedule 1) to the test year attributable cost per piece of \$3.64. UPS-Henderson-WP-I, Table 7a.

31. USPS-T-30, p. 37.

32. USPS-T-6, p. 155.

33. USPS-T-6, p. 156.

1 by the Postal Service, Parcel Post rates will likely be below attributable cost for much of
2 the time the rates established in this proceeding will be in effect.

3 Moreover, the Postal Service's proposed one percent contingency
4 allowance is quite small by historical standards. Mr. Tayman explains that the level of
5 the contingency allowance was set in order "to keep rate increases as low as possible
6 and below the level of growth in general inflation."³⁴ The risk resulting from an
7 inadequate contingency allowance should be reflected in cost coverage decisions, at
8 least for classes (such as Parcel Post) with relatively low cost coverages. The small
9 contingency allowance provides further support for maintaining Parcel Post's cost
10 coverage at the level established by the Commission in Docket No. R94-1.

11 My proposed rate increase for Parcel Post is not excessive given that it is
12 based on increases in its cost. Concern about the size of a rate increase cannot be
13 allowed to become a shield against the adoption of appropriate cost causation
14 principles. Moreover, Parcel Post is a competitive service with readily available
15 alternatives. Finally, the one percent contingency allowance and the need to ensure
16 that Parcel Post rates exceed attributable costs after the test year requires, at a
17 minimum, that the Commission's established relative markup for Parcel Post be
18 maintained.

34. USPS-T-9, p. 38.

UPS-T-3

APPENDIXOverview

1
2 The purpose of the pricing model is to determine what the prices of
3 the subclasses would be by following the Postal Rate Commission's (PRC) pricing
4 procedure. In addition to my calculations based on the PRC procedure, I have run
5 the model using the Postal Service's proposal for comparison purposes.

6 The basis for my prices is the markups from the PRC's decision in the
7 R94-1 case, where it indicated cost coverages, and hence cost markups, for the
8 various subclasses (PRC Opinion and Recommended Decision, Appendix G,
9 Schedule 1). I keep the relative size of these markups the same, and scale the
10 markups to solve the model. The cost base is the incremental cost of a subclass,
11 and the markup is applied to the incremental cost per unit to determine the price.

12 A change in price will lead to a change in volume, and a change in
13 volume will lead to a change in cost. To capture such effects, each subclass in the
14 model has a demand function and a cost function. The demand function relates
15 how volume changes as the price of that subclass changes, and the cost function
16 shows how the variable cost of a subclass changes as the volume changes.

17 For the sake of simplicity, the model includes only sixteen subclasses.
18 This means that the supply and demand curves are considered to be "active" for
19 these 16 subclasses, so that volume, prices, and costs are adjusted to reflect the
20 Commission's R94-1 markups. The remaining subclasses (Mailgrams,

1 International Mail, and all Special Services) are "inactive," so that the volumes,
2 prices, and costs are the same as that proposed by the Postal Service. These
3 inactive subclasses collectively account for about six percent of total revenue.
4 Furthermore, Free Mail has a price of zero by definition, so it is not in the model.

5 Initial Point

6 The model's initial point is based on numerical values taken from
7 testimony, or from modifications to testimony. These values include the volume
8 variable cost, incremental cost, volume, revenue, price, and specific fixed cost for
9 each subclass, as well as total revenue, total cost, and other revenues and costs
10 for the Postal Service as a whole. The demand function, the cost function, and the
11 incremental cost function are all calibrated so as to pass through an initial point.
12 The initial point for the demand function is the Postal Service's Test Year After
13 Rates case (subclass volume and subclass average rate). The initial point for the
14 cost curves is based on TYAR subclass volume and TYAR cost as adjusted by
15 UPS witness Sellick (UPS-T-2). The initial cost point differs from that of the Postal
16 Service proposal because of Mr. Sellick's adjustments to volume variable costs and
17 specific fixed costs. As discussed in Mr. Sellick's testimony, the most significant
18 adjustment is to use 100 percent variability for Cost Segment 3.1

Demand Function

1
2 The demand function for each subclass is the relationship between
3 price and volume for a particular subclass. For a given price, one can determine
4 what the volume of mail will be. On the other hand, for a given volume, one can
5 determine what the price must be to cause that much volume. The demand
6 function I use has the constant elasticity functional form:

$$7 \qquad v = Ap^{-B} \qquad (1)$$

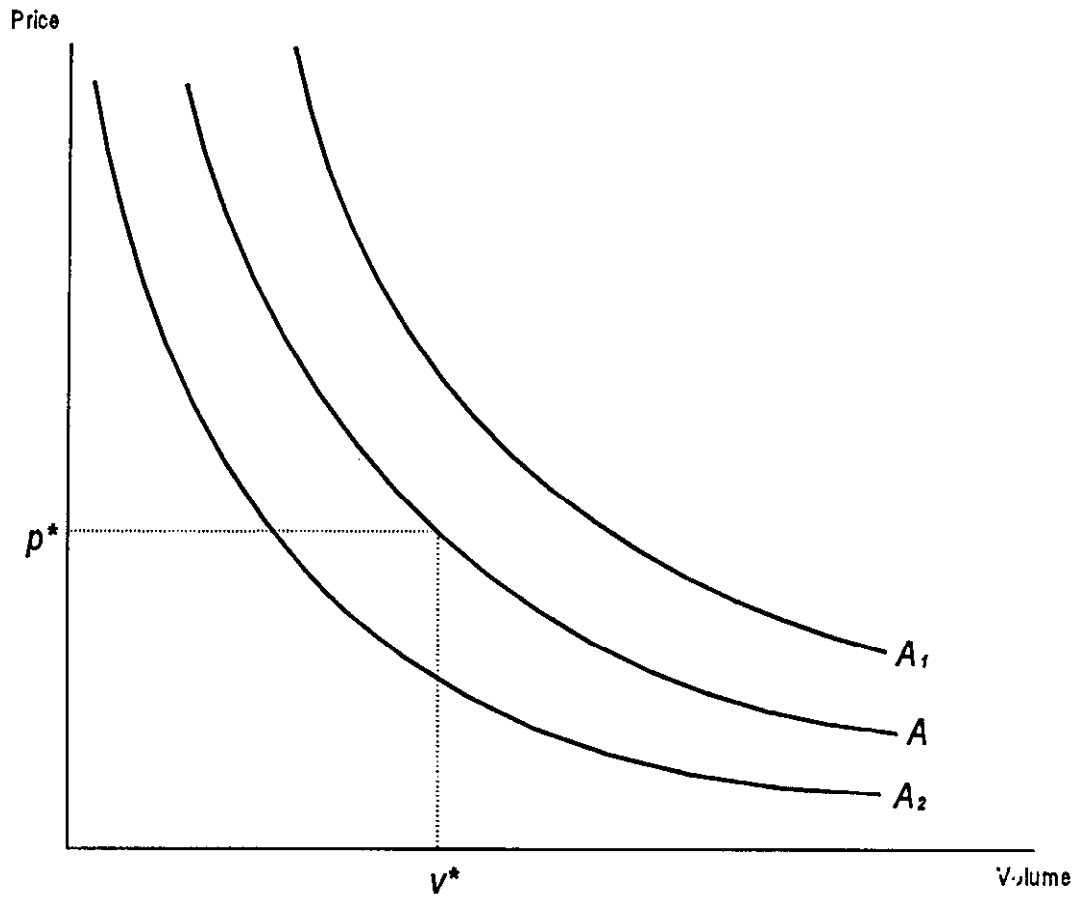
8 This functional form has the property that no matter what the volume,
9 the elasticity remains the same. The volume of mail for a subclass is v , the price
10 per unit for that subclass is p , and A and B are parameters that remain constant.

11 The parameter B is the price elasticity of demand for a subclass.
12 Estimates of this parameter are provided by witness Musgrave (USPS-T-8) for
13 Priority Mail and Express Mail, and witness Tolley (USPS-T-6) for all other
14 subclasses.

15 The parameter A is a scale factor that allows the demand curve to
16 pass through the initial volume and price combination. The diagram below
17 illustrates this idea. At a price of p^* , we know from witness O'Hara's testimony that
18 the volume will be v^* . The curve corresponding to A_1 has a volume that is too large
19 at p^* , and the curve corresponding to A_2 has a volume that is too small at p^* . The
20 curve corresponding to A has the correct volume at p^* . Selection of the parameter

- 1 A, then, ensures that the subclass demand curve passes through the Postal
- 2 Service's TYAR volume and price point.

Figure 1
Demand Function



3

1 Dr. O'Hara's testimony (USPS-T-30) includes revenue and volume
2 information on the After Rates case, which implies a price. Given the price,
3 volume, and B , it is a simple matter to compute A .

4 Total Variable Cost Function

5 The total variable cost function is the relationship between total
6 variable cost and volume for a particular subclass. The function determines the
7 total variable cost of handling a volume of mail. Total variable costs do not include
8 specific fixed costs. The cost function I use has the constant elasticity functional
9 form:

$$10 \quad t.v.c. = a(z + v)^b \quad (2)$$

11 This functional form has the property that no matter what the volume,
12 the elasticity is always the same. The constant elasticity functional form is common
13 in the Postal Service's proposals. In the equation above, the $t.v.c.$ is the total
14 variable cost for a subclass, v is volume of the subclass, and a , b , and z are
15 parameters that remain constant for a given subclass. Note that the lower case
16 parameters a and b in the total variable cost function are not the same as the upper
17 case parameters A and B in the demand function.

18 The parameter b is the cost elasticity. It is the percentage change in
19 total variable cost for a one percent change in volume. The cost elasticity is
20 calculated at the initial point, and does not change as the numbers in the model

1 change. It is a weighted average of the cost elasticities of the Cost Components.

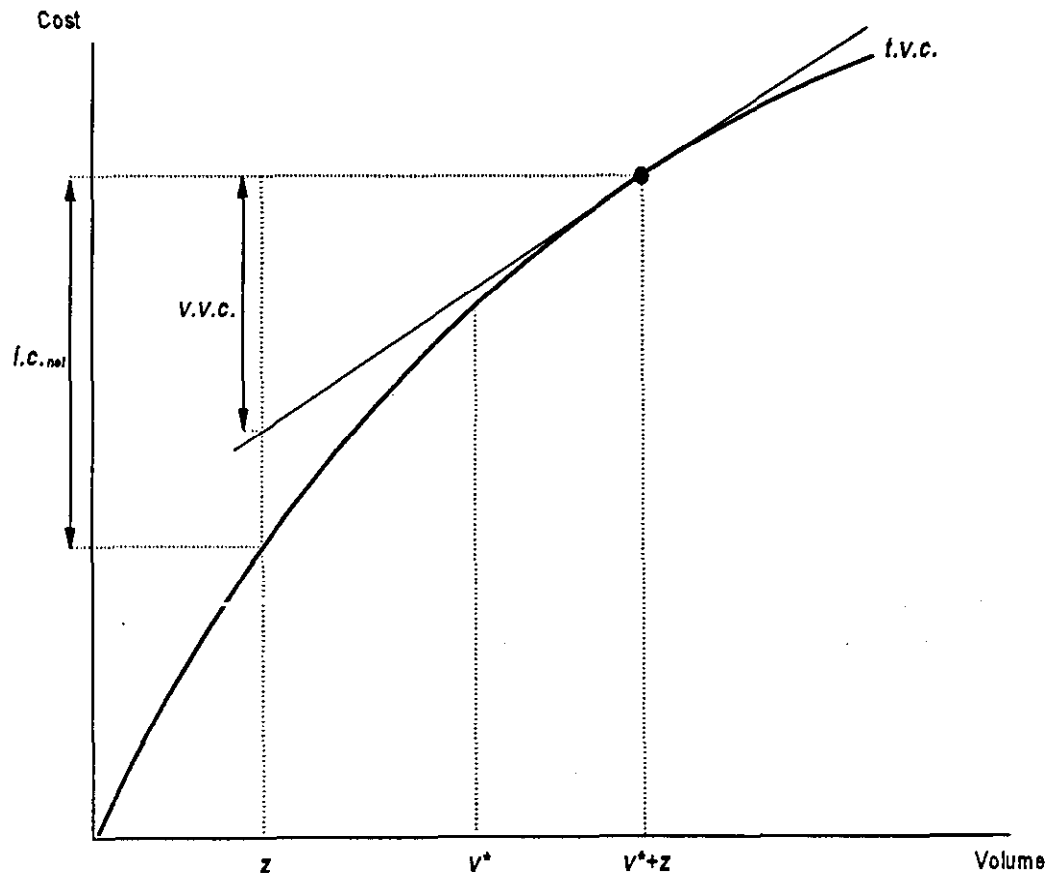
2 The calculation of the cost elasticity is described fully in Workpaper II.

3 The parameters a and z are determined jointly. Parameter a is a
4 scale factor for the cost curve and z is the volume so that two things are true: 1) the
5 difference between the total variable cost for v^*+z and the total variable cost for z
6 equals the net incremental cost (incremental cost net of specific fixed costs) at the
7 initial point (*i.c.* $^*_{net}$), and 2) the marginal cost times the volume at the initial point
8 (v^*) equals the volume variable cost at the initial point.

9 Figure 2 illustrates volume variable cost and net incremental cost.

10 The exact derivation of a and z is discussed in my Workpaper I.

Figure 2
Cost Function



- 1 Three other cost functions that are related to the total variable cost function and
- 2 are used in the calculation of the model are the marginal cost function, the volume
- 3 variable cost function, and the net incremental cost function.

1 The marginal cost (unit volume variable cost) is the derivative of the
2 total variable cost function:

$$3 \qquad m.c. = ab (z+v)^{b-1} \qquad (3)$$

4 The volume variable cost is the marginal cost times the volume:

$$5 \qquad v.v.c. = abv (z+v)^{b-1} \qquad (4)$$

6 The net incremental cost is the difference between the total variable
7 cost of the subclass with v , and the total variable cost without v .

$$8 \qquad i.c._{net} = a (z + v)^b - az^b \qquad (5)$$

9 Incremental Cost

10 Because the Base Year volume variable costs in my recommended
11 approach differ from those in the Postal Service's proposal, the incremental costs
12 differ also. I have recalculated incremental cost for the Base Year using witness
13 Takis's linked electronic spreadsheets, found in Library References H-297 and H-
14 198. The results of the Base Year calculations were rolled forward to the Test Year
15 using witness Takis's method. A full description of my incremental cost calculation
16 is found in my Workpaper III.

1

Solving the Model

2

The model finds a price equilibrium (an "After Rates" case in which volumes are adjusted for price effects) by scaling the Commission's R94-1 markups so as to cover the Postal Service's revenue requirement.

3

4

It does this by changing two types of numbers. The first is a single number, called the cost markup scaling factor. The second is a set of numbers comprising the volumes of the 16 individual subclasses discussed above.

5

6

Cost Markup Scaling Factor: If the Postal Service simply adopted the markups from the R94-1 decision and applied them to 1998 costs, revenue would not necessarily cover costs. Conversely, revenue might also be greater than costs. Because the Postal Service must meet the break-even requirement, the markups must change so that cost exactly equals revenue. To preserve the relative size of the markups, I have multiplied each markup by the same number. This number is called the cost markup scaling factor.

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For example, if the markup for subclass A was .8 in the R94-1 decision, and the markup for subclass B was .2 in the R94-1 decision, and the cost markup scaling factor is 1.5, then the new markups are 1.2 for subclass A and .3 for subclass B. Since both markups were multiplied by the same scaling factor, the ratio of A to B is 4 in both cases.

17

18

19

1 Volume: The model adjusts the volume of each of the 16 subclasses
2 independently of the volume of any other subclass. This adjustment allows the
3 model to change the markup for each subclass (by changing the distance between
4 the demand and supply functions at a given volume) so as to correspond to the
5 relative R94-1 markup. The model iterates between volumes and the cost markup
6 scaling factor until it finds a solution. The model is set up so that the volume of
7 each subclass affects the subclass price in two ways -- one from the demand
8 function, and the other from the cost function. The demand function establishes a
9 unique price for every volume. Independently, the cost function is marked up,
10 which provides a second view of the price. The volume of a subclass is adjusted
11 until the price computed each way is the same.

12 Workpaper I contains a complete description of how the model is
13 solved.

**Exhibit UPS-T-3A
Cost Variability by Subclass**

	Recommended Approach (1)	Postal Service Proposal (2)
First Class Mail		
Total Letters	0.703	0.630
Total Cards	0.665	0.603
Priority Mail	0.552	0.500
Express Mail	0.543	0.484
Periodicals		
In County	0.508	0.477
Nonprofit	0.609	0.562
Classroom	0.693	0.616
Regular-Rate	0.659	0.599
Standard Mail A		
Commercial Regular	0.681	0.612
Commercial ECR	0.529	0.501
Nonprofit	0.700	0.629
Nonprofit ECR	0.594	0.554
Standard Mail B		
Parcel Post	0.621	0.570
Bound Printed Matter	0.473	0.429
Special Rate	0.571	0.512
Library Rate	0.566	0.502

Sources:

[1] UPS-Henderson-WP-1, Table 3

[2] UPS-Henderson-WP-1, Table 3

**Exhibit UPS-T-3B
Alternative Markups
Recommended Approach**

	Price (\$) (1)	Volume (millions) (2)	Revenue (\$ millions) (3)	Volume Variable Cost (\$ millions) (4)	Incremental Cost (\$ millions) (5)	Markup (%) (6)	Price Increase from 1998 BR (%) (7)
First Class Mail							
Total Letters	0.347	95,862	33,256	18,536	19,406	71.4	1.8
Total Cards	0.162	6,550	1,060	763	784	35.2	-13.1
Priority Mail	4.660	980	4,568	2,213	2,365	93.1	31.6
Express Mail	13.509	62	838	485	710	18.1	4.4
Periodicals							
In County	0.100	866	87	83	85	2.6	10.6
Nonprofit	0.175	2,113	370	351	356	3.9	14.2
Classroom	0.335	29	10	9	9	6.5	62.1
Regular-Rate	0.285	6,959	1,981	1,698	1,714	15.6	25.1
Standard Mail A							
Commercial Regular	0.203	38,335	7,784	5,898	5,956	30.7	-3.0
Commercial ECR	0.146	29,211	4,252	2,025	2,110	101.5	-0.1
Nonprofit	0.122	10,620	1,297	1,224	1,238	4.8	6.1
Nonprofit ECR	0.073	2,594	191	136	136	39.8	-12.1
Standard Mail B							
Parcel Post	3.898	202	787	733	735	7.1	27.6
Bound Printed Matter	0.915	574	525	388	389	35.1	5.3
Special Rate	1.550	210	325	311	312	4.4	-12.2
Library Rate	2.024	27	54	54	54	0.8	26.8
TOTAL*		197,974	61,300	37,786	39,215	56.3	

Sources:

- [1] UPS-Henderson-WP-I, Table 1a
- [2] UPS-Henderson-WP-I, Table 1a
- [3] UPS-Henderson-WP-I, Table 1a
- [4] UPS-Henderson-WP-I, Table 1a
- [5] UPS-Henderson-WP-I, Table 1a
- [6] UPS-Henderson-WP-I, Table 1a
- [7] UPS-Henderson-WP-I, Table 1a

* Includes all Subclasses

**Exhibit UPS-T-3C
Postal Service's Proposal**

	Price (\$) [1]	Volume (millions) [2]	Revenue (\$ millions) [3]	Volume Variable Cost (\$ millions) [4]	Incremental Cost (\$ millions) [5]	Markup (%) [6]	Price Increase from 1998 BR (%) [7]
First Class Mail							
Total Letters	0.352	95,551	33,615	16,806	18,284	100.0	3.3
Total Cards	0.197	5,523	1,089	592	608	83.8	5.9
Priority Mail	3.777	1,152	4,353	2,266	2,682	92.1	6.7
Express Mail	13.412	63	841	411	705	104.9	3.6
Periodicals							
In County	0.093	902	84	81	83	2.8	2.4
Nonprofit	0.159	2,161	343	331	336	3.4	3.5
Classroom	0.222	47	11	13	13	-17.4	7.5
Regular-Rate	0.236	7,148	1,689	1,578	1,600	7.0	3.8
Standard Mail A							
Commercial Regular	0.213	37,628	8,022	5,192	5,303	54.5	1.8
Commercial ECR	0.150	28,686	4,304	1,885	1,969	128.3	3.0
Nonprofit	0.128	10,551	1,351	1,107	1,123	22.1	11.3
Nonprofit ECR	0.078	2,571	201	125	126	61.0	-6.3
Standard Mail B							
Parcel Post	3.336	235	783	753	761	3.9	9.2
Bound Printed Matter	0.913	575	525	346	347	51.6	5.1
Special Rate	1.757	201	352	257	258	37.2	-0.4
Library Rate	1.825	29	52	49	49	6.8	14.4
TOTAL*		195,801	61,530	34,486	37,043	78.4	

Sources:

- [1] UPS-Henderson-WP-1, Table 2a
- [2] UPS-Henderson-WP-1, Table 2a
- [3] UPS-Henderson-WP-1, Table 2a
- [4] UPS-Henderson-WP-1, Table 2a
- [5] UPS-Henderson-WP-1, Table 2a
- [6] UPS-Henderson-WP-1, Table 2a
- [7] UPS-Henderson-WP-1, Table 2a

* Includes all Subclasses

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes, 1997

Docket No. R97-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED PARCEL SERVICE
WITNESS J. STEPHEN HENDERSON
(UPS-T3)

<u>Party</u>	<u>Interrogatories</u>
Advo, Inc.	ADVO/UPS-T3-1-5
Direct Marketing Association, Inc.	ADVO/UPS-T3-1-2 DMA/UPS-T3-1-2 USPS/UPS-T3-1, 4
Nashua Photo Inc., District Photo Inc., Mystic Color Lab, and Seattle Filmworks, Inc.	NDMS/UPS-T3-1-9
Newspaper Association of America	ADVO/UPS-T3-1, 3-5 NDMS/UPS-T3-2-3 PSA/UPS-T3-2-3, 6 USPS/UPS-T3-2, 4
Office of the Consumer Advocate	AAP/UPS-T3-1 ADVO/UPS-T3-1-6 DMA/UPS-T3-1-2 NDMS/UPS-T3-1-9 PSA/UPS-T3-1-9 USPS/UPS-T3-1-5
Parcel Shippers Association	PSA/UPS-T3-1-6, 8-9
United States Postal Service	ADVO/UPS-T3-1-5 NDMS/UPS-T3-3, 6-9 PSA/UPS-T3-4, 8 USPS/UPS-T3-1-3

Party

Interrogatories

United States Postal Service

ADVO/UPS-T3-1-5
NDMS/UPS-T3-3, 6-9
PSA/UPS-T3-4, 8
USPS/UPS-T3-1-3

Respectfully submitted,



Margaret P. Crenshaw
Secretary

INTERROGATORY RESPONSES OF
UNITED PARCEL SERVICE
WITNESS J. STEPHEN HENDERSON (T3)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory:

AAP/UPS-T3-1
ADVO/UPS-T3-1
ADVO/UPS-T3-2
ADVO/UPS-T3-3
ADVO/UPS-T3-4
ADVO/UPS-T3-5
ADVO/UPS-T3-6
DMA/UPS-T3-1
DMA/UPS-T3-2
NDMS/UPS-T3-1
NDMS/UPS-T3-2
NDMS/UPS-T3-3
NDMS/UPS-T3-4
NDMS/UPS-T3-5
NDMS/UPS-T3-6
NDMS/UPS-T3-7
NDMS/UPS-T3-8
NDMS/UPS-T3-9
PSA/UPS-T3-1
PSA/UPS-T3-2
PSA/UPS-T3-3
PSA/UPS-T3-4
PSA/UPS-T3-5
PSA/UPS-T3-6
PSA/UPS-T3-7
PSA/UPS-T3-8

Designating Parties:

OCA
ADVO, DMA, NAA, OCA, USPS
ADVO, DMA, OCA, USPS
ADVO, NAA, OCA, USPS
ADVO, NAA, OCA, USPS
ADVO, NAA, OCA, USPS
OCA
DMA, OCA
DMA, OCA
NDMS, OCA
NAA, NDMS, OCA
NAA, NDMS, OCA, USPS
NDMS, OCA
NDMS, OCA
NDMS, OCA, USPS
NDMS, OCA, USPS
NDMS, OCA, USPS
NDMS, OCA, USPS
OCA, PSA
NAA, OCA, PSA
NAA, OCA, PSA
OCA, PSA, USPS
OCA, PSA
NAA, OCA, PSA
OCA
OCA, PSA, USPS

Interrogatory:

PSA/UPS-T3-9
USPS/UPS-T3-1
USPS/UPS-T3-2
USPS/UPS-T3-3
USPS/UPS-T3-4
USPS/UPS-T3-5

Designating Parties:

OCA, PSA
DMA, OCA, USPS
NAA, OCA, USPS
OCA, USPS
DMA, NAA, OCA
OCA

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

AAP/UPS-T3-1. Exhibit UPS-T-3C to your testimony identifies the Postal Service's proposed volume variable cost for Standard B Mail, Bound Printed Matter, to be 346,000,000 with a markup of 51%. Exhibit UPS-T-3B to your testimony identifies the volume variable cost for Standard B Mail, Bound Printed Matter, to be \$388,000,000 with a markup of 35.1%.

a. Please explain and justify, in detail, the differences between the volume variable costs for Standard B Mail Bound Printed Matter as set forth in each exhibit.

b. Please explain and justify, in detail, the differences between the markup for Standard B Mail Bound Printed Matter as set forth in each exhibit.

Response to USPS/UPS-T3-1. (a) The volume variable costs are different because my recommendation incorporates the assumption that mail processing costs are 100 percent volume variable, while the model that reflects the Postal Service's proposal assumes the mail processing variabilities described in the testimony of Postal Service witness Bradley. Accordingly, I have used \$389 million as the TYAR volume variable costs for Standard Mail (B) Bound Printed Matter, as developed by UPS witness Sellick.

(b) Two differences between my recommendation and the Postal Service's proposal account for the differences between the markups. First, the markup in my recommendation is based on the Commission's decision in Docket No. R94-1, appropriately scaled to account for the break-even requirement, while the markup for the Postal Service's proposal is based on the testimony of Postal Service witness O'Hara in Exhibit USPS-30B. Second, the markup in my recommendation is computed by dividing revenue by incremental cost and subtracting one, while the markup in the Postal Service's proposal is computed by dividing revenue by volume variable cost and subtracting one.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
ADVO, INC.**

ADVO/UPS-T3-1. On page 10, you state,

... there is a good practical reason not to use incremental costs solely as a check against cross-subsidy. Without some markup over incremental cost, measurement error could lead to prices for some services that are below their actual incremental costs . . .

(a) Please confirm that you do not propose just "some markup" over incremental cost, but a specific markup index that is related to historic markups that were applied to attributable costs that did not include incremental costs.

(b) In your opinion, how much of a mark-up above incremental cost would be required in order to provide reasonable assurance that service prices are above their actual incremental costs (e.g., 5 percent, 20 percent, 100 percent)? Please explain your response.

(c) Please explain why the Commission must "mark up" incremental costs in order to ensure that service prices are above their incremental costs.

(d) Please explain why the Commission cannot account for both (1) possible measurement error and (2) incremental cost when it marks up volume-variable costs to generate a subclass price level?

Response to ADVO/UPS-T3-1.

(a) I confirm that I am proposing specific markups. These proposed markups are based on the markups recommended by the Commission in its R94-1 Opinion and Recommended Decision.

(b) It would depend on the reliability of the incremental cost estimate for each subclass. In this regard, independent work noted in my testimony on page 12, footnote 13, suggests that true attributable costs may be substantially higher than the volume

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
ADVO, INC.**

variable costs identified by the Postal Service in this proceeding. While I do not have specific estimates of the uncertainty, I suggest it is a factor to be considered in setting postal rates.

(c) The goal is to insure that service prices are greater than *actual* incremental costs. However, the Commission recommends markups over *estimated* incremental costs. If estimated incremental costs are less than actual incremental costs and the Commission recommended no markup, then prices could be lower than actual incremental cost.

(d) Aside from legal considerations, my testimony is not that the Commission cannot do this but rather provides reasons for not doing so. These reasons include measurement uncertainty, inefficiencies associated with entry that may be encouraged over a range of postal prices as opposed to a precise (but inaccurate) point estimate of incremental costs, and legal precedent for marking up attributable costs (acknowledged by the Postal Service to include incremental costs).

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
ADVO, INC.**

ADVO/UPS-T3-2. Please confirm that a measurement error which understated incremental cost would not, alone, cause pricing below incremental cost. It would have to be combined with a service price level that was below the true value of incremental cost. If you cannot, please explain why not.

Response to ADVO/UPS-T3-2. Confirmed.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
ADVO, INC.**

ADVO/UPS-T3-3. Please refer to your discussion on the bottom of page 11 and top of page 12. In part, you state:

There is another sound economic reason to mark up incremental costs. The short-run marginal cost of providing postal services for a particular subclass of mail changes frequently as a result of changes in volumes, usage mixes, overtime rates, input costs, organizational changes. . . . Short-run marginal cost pricing may be appropriate if prices could change in a short time period, such as an hour, a day, a month, or a season. When prices do not change in this manner, however, the relevant cost basis for pricing decisions should correspond to the time period during which the rates will be in effect.

The postal rates that emerge from this case are likely to remain in place for two to four years. Accordingly, the relevant costs for pricing purposes are longer run, not short run, costs. . . . Unfortunately, the Postal Service's proposed rates are based solely on costs that vary over a much shorter time period.

. . . Therefore, the Postal Service's incremental cost estimates should be used as the basis for economically efficient markups.

(a) If the USPS's rates were to remain in place for only one year (mid-1998 to mid-1999) and all USPS marginal costs were adjusted to recognize the changes in volumes, usage mixes, overtime rates, input costs, organizational changes, etc. for that time period, would you still recommend marking up incremental costs? Please explain.

(b) If long-run marginal rather than short-run marginal costs were estimated in this case (and you were satisfied that they were correctly estimated and involved an acceptably small measurement error), would you still recommend marking up incremental costs? Please explain.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
ADVO, INC.**

(c) Are you suggesting that the USPS estimate of incremental cost is a proxy for long-run marginal cost? Please explain, including an explanation of the differences between incremental costs and long-run marginal costs.

(d) Please explain your definition of the term "economically efficient."

Response to ADVO/UPS-T3-3.

(a) Yes. If postal prices remain in effect for a year without change, I would recommend marking up a longer run concept of marginal cost, such as the incremental cost estimates developed in this case. If postal prices varied from day to day (e.g., Saturday delivery has a higher price) or seasonally, then a short run marginal cost concept might be appropriate as an economic efficiency matter.

(b) This hypothetical question cannot be answered in the abstract without making additional assumptions, e.g., do the long run marginal cost estimates indicate constant returns to scale or large increasing returns to scale such as those estimated by the Postal Service? If the answer is closer to constant returns, then economic efficiency could be served by marking up long run marginal costs with appropriate checks against the incremental cost floor. But if the two costing concepts were substantially different, the Commission might prefer to continue marking up attributed costs (incremental costs), since changing to a new costing framework would require substantial rebalancing of the judgments that comprise its relative markup index.

(c) Yes, especially in regard to specific fixed costs as that term is used by the Postal Service. These are appropriately included as a part of both cost concepts. In contrast, scale economies could cause long run incremental cost to exceed long run marginal cost.

(d) The way I use the term "economically efficient" is well defined by William J. Baumol and Alan S. Blinder in the text *Economics: Principles and Policy* (Dryden

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
ADVO, INC.**

Press, Sixth edition, 1994, page 67), where they write, "Economists define efficiency as the absence of waste. An efficient economy utilizes all of its available resources and produces the maximum amount of output that its technology permits."

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
ADVO, INC.**

ADVO/UPS-T3-4. On page 12, you state:

"... the relevant costs for pricing purposes are longer run, not short run, costs. Most (if not all) of the specific fixed costs identified by the Postal Service are avoidable in the time span between postal rate cases. . . . The longer-run incremental cost concept includes the longer run resource adjustments discussed above. Thus, long-run incremental cost (rather than the Postal Service's volume variable costs) is the appropriate basis for postal markups. While not perfect, the Postal Service's estimates of incremental costs are based on this concept."

When you use the term "long-run incremental cost," do you mean the full system costs that could be avoided, assuming longer-run resource adjustments, if a particular subclass were eliminated from the system? If not, please explain your meaning.

Response to ADVO/UPS-T3-4. I used the term "long-run incremental cost" so as to include the longer term resource adjustments that would result in changes to the Postal Service's version of specific fixed costs.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
ADVO, INC.**

ADVO/UPS-T3-5. With respect to your statement on page 12, USPS witness Takis admits that he does not estimate the incremental costs that could be identified if remaining operations within the Postal Service are "re-optimized" or "reconfigured" as a result of eliminating a particular class or subclass (USPS-T-41, page 10). He assumes that the postal system does not change as a result of elimination of an entire class or subclass because such a reconfiguration could alter service characteristics. However, assume that if First Class Mail were eliminated, the postal system could be reconfigured to eliminate additional costs beyond those estimated by Takis. Under this assumption, would incremental cost estimates that ignore certain longer-run resource adjustments (i.e., system reconfiguration) still be considered longer-run incremental costs? Please explain.

Response to ADVO/UPS-T3-5. In my view, it is not important to be doctrinaire about this issue. If it were possible to estimate long run incremental cost or long run marginal cost for an optimally reconfigured postal system, such estimates would be improvements over estimates that accept the existing system "as is" with no such reoptimization. In practice, the effects of such reoptimization cannot be estimated reliably. I would use the best estimates available.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
ADVO, INC.**

ADVO/UPS-T3-6. In Exhibit UPS-T-3B, you present a table showing the results by subclass of your pricing proposals. Please provide a table in the same format showing the results by subclass assuming the rates proposed by the Postal Service.

Response to ADVO/UPS-T3-6. These results can be found in Exhibit UPS-T-3C.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
THE DIRECT MARKETING ASSOCIATION, INC.**

DMA/UPS-T3-1. Please provide an electronic copy of all spreadsheets shown in UPS-T-3, Workpapers I-III.

Response to DMA/UPS-T3-1. The requested material has been filed as Library Reference UPS-LR-1 and has been separately sent to DMA.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
THE DIRECT MARKETING ASSOCIATION, INC.**

DMA/UPS-T3-2. Please provide an electronic copy of all spreadsheets used to develop the numbers shown in UPS-T-3, Workpapers I-III.

Response to DMA/UPS-T3-2. The requested material has been filed as Library Reference UPS-LR-1 and has been separately sent to DMA.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, AND SEATTLE FILMWORKS, INC.**

NDMS/UPS-T3-1. Please refer to page 25, line 9 of your testimony, where you show your proposed average Priority Mail rate (\$4.66), percent increase over current rates (32 percent), and cost coverage for Priority Mail (193.1 percent). Please confirm that UPS' proposed cost coverage for Priority Mail based on (i) UPS' proposed 32 percent rate increase for Priority Mail, and (ii) the projected test year costs set out in the Postal Service's proposal, would be 227 percent. If you do not confirm, please explain why, what the cost coverage would be, and how you derived it.

Response to NDMS/UPS-T3-1. Not Confirmed. The calculation you suggest results in a cost coverage of 237 percent, not 227 percent. This is calculated by dividing my suggested price by the Postal Service's proposed volume variable cost per piece ($\$4.66 / (2,266 / 1,152) = 237$ percent). However, this calculation is inappropriate because applying the higher price to the Postal Service's proposal would result in lower volume and a different cost per piece.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, AND SEATTLE FILMWORKS, INC.**

NDMS/UPS-T3-2. Please refer to page 20, line 8 through page 22, line 9 of your testimony discussing the 39 U.S.C. § 3622(b) factors to determine your proposed cost coverage for Priority Mail.

a. Please describe how much weight you have given to criterion § 3622(b)(4), specifically regarding the effect of a 32 percent increase in Priority Mail rates on the general public and business mailers.

b. Is it your position that a 32 percent increase in a subclass' rates would not constitute "rate shock" in this docket?

c. What is the largest single rate increase ever imposed by UPS on its customers?

Response to NDMS/UPS-T3-2. (a)-(b) By employing the Commission's relative markups from the Docket No. R94-1 case, my procedure embodies the weights the Commission itself has given to the 3622(b) criteria, including 3622(b)(4). As I note on page 20, lines 11 through 13, "This increase is driven by a 31 percent increase in attributed cost per piece for Priority Mail since Docket No. R94-1." A rate increase driven by a corresponding cost increase does not ordinarily constitute rate shock, in my view. The Commission has in the past recommended similarly large rate increases.

(c) I do not know.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, AND SEATTLE FILMWORKS, INC.**

NDMS/UPS-T3-3. On page 22, lines 1 through 3 you state: "The only aspect of Priority Mail that Dr. O'Hara believes is less favorable than First-Class letters is Priority Mail's higher elasticity of demand. However, in light of Priority Mail's growth rate, this difference does not seem significant." Do you believe that, because of Priority Mail's growth rate, it is not relevant to compare Priority Mail's elasticity of demand with that of First-Class Mail? Please explain.

Response to NDMS/UPS-T3-3. No. Both factors are indicators of value. The high demand elasticity of Priority Mail is offset by the high growth rate of the service in the market place.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, AND SEATTLE FILMWORKS, INC.**

NDMS/UPS-T3-4. For purposes of determining coverage levels for both First-Class Mail and Priority Mail, please explain how, for both products, you would compare the following factors:

- a. delivery standards; and
- b. actual performance.

Response to NDMS/UPS-T3-4. I know of no study that compares door-to-door delivery performance of the two services. In any case, I used the Commission's Docket No. R94-1 relative markups, which implicitly contain the Commission's evaluation of the delivery performance for each service.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, AND SEATTLE FILMWORKS, INC.**

NDMS/UPS-T3-5. Please compare and contrast (i) Priority Mail with (ii) UPS Second-Day Air, and with (iii) UPS Three-Day Select, with respect to the following factors:

- a. delivery standards/guaranteed delivery;
- b. actual performance;
- c. tracking/delivery confirmation;
- d. included insurance;
- e. billing and payment options; and
- f. volume discounts and negotiated prices.

Response to NDMS/UPS-T3-5. The Postal Service does not guarantee delivery of Priority Mail within its service standard, whereas UPS does in the case of UPS Second Day Air and 3 Day Select. UPS offers tracking, whereas the Postal Service does not. UPS provides proof of delivery at no extra charge, except there is a charge of \$1.00 for a mailed proof of delivery and \$2.00 for a faxed proof of delivery; the Postal Service is proposing in this proceeding to offer delivery confirmation (at no charge for large Priority Mail users and at a fee below cost for other Priority Mail users). I do not have information on the other factors you mention.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, AND SEATTLE FILMWORKS, INC.**

NDMS/UPS-T3-6. What percentage of (i) UPS Second-Day Air is delivered within two days, and (ii) UPS Three-Day Select is delivered within three days? Please provide data for all available Postal Quarters starting with PQ1, 1995.

Response to NDMS/UPS-T3-6. I do not know.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, AND SEATTLE FILMWORKS, INC.**

NDMS/UPS-T3-7. How much does UPS charge for (i) manual tracking/delivery confirmation and (ii) electronic tracking/delivery confirmation for its Second-Day Air and Three-Day Select products? Please include the effects of volume discounts and negotiated prices in your answer.

Response to NDMS/UPS-T3-7. UPS provides tracking and proof of delivery at no extra charge, except that there is a charge of \$1.00 for a mailed proof of delivery and \$2.00 for a faxed proof of delivery. I have no information on volume discounts and negotiated prices.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, AND SEATTLE FILMWORKS, INC.**

NDMS/UPS-T3-8.

- a. Please provide current published rate schedules (not including negotiated discounts) for (i) UPS Second-Day Air and (ii) UPS Three-Day Select.
- b. Please state the percentage of (i) UPS Second-Day Air and (ii) UPS Three-Day Select for which UPS charges prices below published prices.
- c. Please state the range of discounts from published prices offered to customers of (i) UPS Second-Day Air and (ii) UPS Three-Day Select.
- d. For the most recent Fiscal Year available, please provide the average rate actually paid by customers for each rate cell (including negotiated price and volume discounts) in (i) UPS Second-Day Air and (ii) UPS Three-Day Select.

Response to NDMS/UPS-T3-8. (a) See UPS-LR-7.

(b)-(d) I do not have this information.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
NASHUA PHOTO INC., DISTRICT PHOTO INC.,
MYSTIC COLOR LAB, AND SEATTLE FILMWORKS, INC.**

NDMS/UPS-T3-9. Please identify any shape-based discounts or surcharges, either published or negotiated, in the rates for (i) UPS Second-Day Air and (ii) UPS Three-Day Select.

Response to NDMS/UPS-T3-9. I do not have any such information.

**ANSWER OF UNITED PARCEL SERVICE WITNESS
J. STEPHEN HENDERSON TO INTERROGATORY
OF THE PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T3-1. With reference to your comparison on page 19 of the Postal Service's proposed rates and your recommendations, where you state that the Postal Service has proposed 103.9% cost coverage and your rates would produce 107.1% cost coverage, please confirm the following:

(a) Because the Postal Service's total attributed costs are 56% of total costs and yours are 63.9% of total postal costs, the pool of institutional cost to be recovered through cost coverages is substantially smaller under your proposal.

(b) Average coverage under the Postal Service's proposed attribution of costs equals 178.5%, and average coverage under your proposed attribution of costs is 156.4%.

(c) Since Parcel Post coverage proposed by the Postal Service assumes attributable costs are 56% of total costs, then to have the same equivalent coverage as proposed by USPS under your proposed 63.9% attribution of total costs the coverage for parcel post would have to be 102.87%

(d) Since, at 63.9% attribution of costs, parcel post coverage equivalent to the USPS' proposed coverage would be 102.76%, then your proposed coverage of 107.1% would require parcel post to contribute in percentage terms almost 2-1/2 times as much toward payment of the nonattributed cost pool as under the Postal Service's proposal.

Response to PSA/UPS-T3-1. (a) Confirmed.

(b) Taking into account rounding error in your calculations, confirmed. As shown in UPS-Henderson-WP-I, Tables 1 and 2, average cost coverage is 178.4 percent under the Postal Service's proposal and 156.3 percent under my recommended approach.

**ANSWER OF UNITED PARCEL SERVICE WITNESS
J. STEPHEN HENDERSON TO INTERROGATORY
OF THE PARCEL SHIPPERS ASSOCIATION**

(c) Not confirmed. Your concept of equivalent coverage is not clear. In any case, aggregate coverage ratios cannot be applied to an individual subclass, such as Parcel Post, as you suggest.

(d) Not confirmed. See my answer to (c).

**ANSWER OF UNITED PARCEL SERVICE WITNESS
J. STEPHEN HENDERSON TO INTERROGATORY
OF THE PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T3-2. You state that you began marking up parcel post by starting with the most recently pronounced appropriate cost coverage as found by the Postal Rate Commission, and that was 107% for parcel post in Docket No. R94-1 (p. 19). In order to maintain this 107% cost coverage, you found it necessary to propose overall rate increases for parcel post of 28% (p. 22), whereas the overall average increase required to cover the anticipated cost increases projected into the Test Year experienced by the Postal Service since the last rate case is around 4%. Please provide an explanation of what has happened to parcel post costs, as determined by the Rate Commission in the last case, that has caused the Postal Service to experience such a gigantic increase in the cost of handling parcel post, whereas the other cost increases in handling other classes of mail are such that they do not on average require more than a 4% increase.

Response to PSA/UPS-T3-2. As I state on page 22, line 17, ". . . attributable costs per piece in the test year will be 7.2 percent higher than the attributable costs estimated by the Commission in Docket No. R94-1." I do not consider a 7.2 percent increase to be "a gigantic increase in the cost of handling parcel post."

**ANSWER OF UNITED PARCEL SERVICE WITNESS
J. STEPHEN HENDERSON TO INTERROGATORY
OF THE PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T3-3. On page 5 of your testimony, where you discuss the Postal Reorganization Act Rate Criterion of "available alternatives," you talk about certain services where "mailers have readily available alternatives." Do you believe that mailers have "readily available alternatives" for the ground transportation of parcels to residences, and, if the answer is in the affirmative, please identify each and every "readily available alternative" for a mailer who has a need to distribute parcels to residences on a national bases.

Response to PSA/UPS-T3-3. Yes. The Postal Service and UPS provide ground based delivery of parcels to residences nationwide. FedEx, Airborne, and Emery provide air based delivery of parcels. FedEx had begun to enter the ground market and has recently purchased Caliber (RPS). A multitude of smaller, regional and local firms provide ground, air, or mixed delivery services. These firms provide readily available alternatives for ground transportation of parcels to residences in competition to the integrated nationwide enterprises. It is not necessary that home delivery be provided by a vertically integrated firm for competition to be effective. Contractual arrangements among firms providing various transportation segments can substitute effectively for integrated service. Please see the testimony of Mr. Clark for CTC Distribution Services and that of the witnesses for the Association of Alternative Postal Systems.

**ANSWER OF UNITED PARCEL SERVICE WITNESS
J. STEPHEN HENDERSON TO INTERROGATORY
OF THE PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T3-4. At page 5 of your testimony you discuss the "effect of rate increases" criterion and state that "any rates that would unfairly disadvantage competitors may be set higher." Is it your position that the parcel post rates proposed by the Postal Service in this proceeding would have an injurious impact upon United Parcel Service in its provision of ground parcel transportation? If the answer is in the affirmative, please supply all necessary data to document your response, not limited to, but including,

- (a) detailed information on United Parcel Service's ground transportation volumes;
- (b) a comparison of damaging parcel rates and actual rates charged to UPS customers for the provision of such services;
- (c) a comparison of the actual negotiated contract rates that UPS may have with its major customers with rates proposed by the Postal Service in this proceeding;
- (d) a description of the amount of parcel post volume United Parcel Service believes was diverted away from it to the Postal Service because of parcel post rates;
- (e) an estimation of the amount of parcels United Parcel Service anticipates it will lose to parcel post if the proposed rates are adopted in this proceeding.

If the witness is unable to respond to all or any part of this question, please refer such parts to the appropriate official at United Parcel Service who would be competent to respond.

Response to PSA/UPS-T3-4. I have not investigated the impact that the Parcel Post rates proposed by the Postal Service would have on UPS. My testimony is that unfair Parcel Post rates could injure competitors such as UPS.

**ANSWER OF UNITED PARCEL SERVICE WITNESS
J. STEPHEN HENDERSON TO INTERROGATORY
OF THE PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T3-5. (a) Is it not the case that UPS' parcel post volume has increased far in excess of the increases in parcel post volume since Docket No. R94-1, despite yearly rate increases by UPS, and that, therefore, the Postal Service has not been able to secure its proper share of the increased parcel post market, the lion's share of which has gone to UPS? If the answer is other than affirmative, please supply data to document your response.

(b) If it is the case that the Postal Service has failed to obtain its share of the increased parcel post market, and therefore has less "value of service," one of the criteria to which you advert on page 4 of your testimony, does this not compel a conclusion that parcel post coverage should be the lowest possible in order to enhance its competitive opportunities in the market?

Response to PSA/UPS-T3-5. (a) There is no "proper share of the increased parcel post market" that any particular enterprise deserves. I have not computed market shares as a part of my testimony, and so I cannot confirm the facts on which your question is based.

(b) Not applicable.

**ANSWER OF UNITED PARCEL SERVICE WITNESS
J. STEPHEN HENDERSON TO INTERROGATORY
OF THE PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T3-6. You have recommended, as a model for mark ups, use of the mark ups reflecting the Commission's judgment in the most recent rate case Docket No. R94-1. You state that you have therefore used the Commission's relative mark ups in that case to determine the appropriate contribution in this case to recover institutional costs. Is it not the case that, if the percentage of attributable costs determined in Docket No. R94-1 is less than the percentage of attributable costs that you propose, then a strict application as you propose of the Docket R94-1 cost coverages would produce revenue in excess of that required?

Response to PSA/UPS-T3-6. No. I have scaled the Commission's Docket No. R94-1 markups as described in the Appendix to my testimony, page 9, lines 8-19, to ensure that the model meets the break-even requirement.

**ANSWER OF UNITED PARCEL SERVICE WITNESS
J. STEPHEN HENDERSON TO INTERROGATORY
OF THE PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T3-7. On page 22 of your testimony you state that the average rate for parcel post is already substantially below cost, citing USPS-T-37, at page 24, and stating that a 19.4% increase is needed simply to cover the cost shortfall and reach the Docket No. R94-1 cost coverage of 107%. Please confirm that the average rate for parcel post is, as you say, substantially below cost only because the Postal Service testimony that you cite deviates from established Commission policy and attributes 100% of Alaska air costs to parcel post.

Response to PSA/UPS-T3-7. Not confirmed. While it is true that my rate increase recommendation is based on the attribution of 100 percent of Alaska Air costs to Parcel Post, this is not the only reason why current Parcel Post rates fail to cover costs. The attached exhibit shows the impact of attributing only 20.54 percent of Alaska Air costs to Parcel Post as the Commission recommended in Docket No. R94-1. The attachment shows that removing \$77 million of Alaska Air costs from Parcel Post results in attributed cost per piece of \$3.31. Consequently, Parcel Post's current average rate of \$3.05 (TYBR, O'Hara W/P I, page 3 of 3) is 8.5 percent below costs even if Alaska Air costs are treated as the Commission did in Docket No. R94-1. In this instance, the Parcel Post average rate needed to achieve a cost coverage of 107 percent would be \$3.55, which would constitute a 16.4 percent increase, as opposed to my recommended increase of 27.6 percent.

**ANSWER OF UNITED PARCEL SERVICE WITNESS
J. STEPHEN HENDERSON TO INTERROGATORY
OF THE PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T3-8. On page 23 of your testimony you state that the parcel post mark up, under economically efficient pricing, should require that parcel post rates exceed attributable costs each and every year, not just in the Test Year, and that with a low mark up proposed by the Postal Service rates will likely be below attributable costs for much of the time that they are in effect. Please confirm that, utilizing PRC-approved methodology for the handling of Alaska air costs, parcel post has fully recovered its attributable costs each and every year for which there is data since Docket No. R94-1.

Response to PSA/UPS-T3-8. I have not collected the data needed to answer this question as part of the work supporting my testimony.

**ANSWER OF UNITED PARCEL SERVICE WITNESS
J. STEPHEN HENDERSON TO INTERROGATORY
OF THE PARCEL SHIPPERS ASSOCIATION**

PSA/UPS-T3-9. You state that your proposed overall rate increase for parcel post of 28% ". . . is not excessive given that it is based on increases in its cost." Would you agree that a 28% increase for parcel post would be excessive if it should be that the Commission determines that a 28% increase is not necessary in order to meet 107% coverage of the costs that the Rate Commission, utilizing its methodologies, determines to be properly attributed to parcel post?

Response to PSA/UPS-T3-9. Under your hypothetical question, the Commission is assumed to have determined attributed costs at some unspecified level and adopted its Docket No. R94-1 markup of 7 percent with the result that the rate increase needed to achieve 107 percent cost coverage is smaller than 28 percent. In such circumstances, the rate is cost justified and the rate increase is whatever it is. The 28 percent figure would no longer be relevant. I cannot say whether a 28 percent rate increase would be "excessive" under those circumstances without knowing the rate increase needed to achieve a cost coverage of 107 percent.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T3-1. Please refer to your testimony at page 10. Please confirm that if the price of a postal product or service exceeds its average incremental cost, that product or service will make a "contribution" to joint and common ("institutional") costs. If you do not confirm, please explain fully.

Response to USPS/UPS-T3-1. Confirmed.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T3-2. Please refer to Opinion and Recommended Decision, Docket No. R94-1, paragraph 4010. Please explain how, if at all, employing markups over average incremental cost would determine the "assignment" of the remainder [non-attributable cost] based upon non-cost factors."

Response to USPS/UPS-T3-2. The "assignment" is accomplished by the method outlined in paragraph 4010. The Commission has in past cases attributed costs to the subclasses and then assigned non-attributed costs based on the Section 3622(b) factors by using a markup over attributable costs. I propose that the Commission continue this practice.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T3-3. Please refer to your testimony at page 12. Does your discussion of "the appropriate basis for postal pricing markups" assume that the long-run incremental cost of a postal product or service is greater than the short-run incremental cost of that product or service? Please explain fully.

Response to USPS/UPS-T3-3. On page 12 of my testimony, I note that a long run concept of incremental cost would include costs that are avoidable in a two to four year time frame, such as those costs labeled by the Postal Service as "specific fixed costs" that can be adjusted in such a time frame but that may not be volume variable. As a general matter, in the absence of decreasing returns to scale long run incremental costs will always be at least as great as short run incremental costs. This is true because in the long run, the Postal Service would be able to eliminate more costs than it would be able to eliminate in the short run.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
UNITED STATES POSTAL SERVICE**

USPS/UPS-T3-4. Based on your experience with market-based pricing requests before FERC, please identify and discuss fully the non-cost factors regulators should consider when reviewing or recommending new rates, particularly when the regulated firm is exposed to direct competition by an unregulated firm. Include in your discussion your opinion regarding how often these non-cost factors should be re-examined and reconsidered.

Response to USPS/UPS-T3-4. My experience at the Federal Energy Regulatory Commission leads me to conclude that regulators can employ two broad approaches, not mutually exclusive, to protect the public interest when a regulated firm is subject to competition from an unregulated firm. These are the adoption of structural remedies and the use of traditional cost-based regulation. Structural remedies include vertical separation and the functional unbundling of the business components of the vertically integrated firm, which could involve the separation of monopoly elements from competitive elements, open access to the monopoly portion of the regulated business so that competitors cannot be foreclosed, codes of conduct governing the provision of monopoly services to the regulated firm's competitive functions, and so on. Traditional cost-based regulation includes ensuring that prices cover the relevant costs, providing for transfer pricing standards between business units or affiliates, and so on.

In recent years, FERC has adopted a policy of encouraging or requiring structural measures that allow competitive markets to develop in the non-monopoly sectors of the electricity and natural gas industries. Principally, this has involved rules governing open access to the electricity transmission system and the interstate natural gas pipeline system, i.e., open access to the monopoly sectors. Such structural

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

measures are generally considered to be more effective in protecting the public interest and preventing cross-subsidy than cost of service regulation by itself.

A second lesson from my experience at FERC is that regulation must be governed by the regulator's statutory authority and the requirements of the legislation it administers. I am not a lawyer, but I nonetheless found it necessary to study FERC's enabling statutes in some detail. The Postal Reorganization Act similarly directs and constrains the Commission's regulation of the Postal Service. Because of the differences in the regulatory statutes, postal regulation is different from the regulation administered by FERC. For example, the Postal Rate Commission must be guided by the pricing factors in the Postal Reorganization Act, which differ from the statutory guidance provided to FERC. Moreover, some subclasses of mail are given a preference according to the postal statute. In such circumstances, the Commission's ability to make structural recommendations to the Postal Service may be more limited than FERC's ability to impose structural reform. Nonetheless, the Commission may have opportunities in this regard, although my testimony does not address the issue. To the extent that competitive services can be isolated from the monopoly service of an enterprise in such a way that the monopoly service provides no advantage to the incumbent in competitive areas, the need to rely on cost-based regulation will be reduced and competition can be encouraged.

**ANSWER OF UNITED PARCEL SERVICE
WITNESS HENDERSON TO INTERROGATORY OF
THE UNITED STATES POSTAL SERVICE**

USPS/UPS-T3-5. Please provide a complete list of all books, scholarly publications, studies, or articles which you have authored.

Response to USPS/UPS-T3-5. See Attachment A.

USPS/UPS-T3-4 (Insert question here)

My experience at the Federal Energy Regulatory Commission leads me to conclude that regulators can employ two broad approaches, not mutually exclusive, to protect the public interest and to control for the potential of cross subsidy when a regulated firm is subject to competition from an unregulated firm. These are structural remedies and traditional cost-based regulation. Structural remedies include vertical separation and the functional unbundling of the business components of the vertically integrated firm, which could involve the separation of monopoly elements from competitive elements, open access to the monopoly portion of the regulated business so that competitors cannot be foreclosed, codes of conduct governing the provision of monopoly services to the regulated firm's competitive functions, and so on. Traditional cost regulation includes ensuring that prices cover variable costs or long-run incremental costs depending on the time period of the service offering, providing for transfer price standards between business units or affiliates, and so on.

In recent years, FERC has adopted a policy of encouraging or requiring structural measures that allow competitive markets to develop in the non-monopoly sectors of the electricity and natural gas industries. Principally, this has involved rules governing open access to the electricity transmission system and the interstate natural gas pipeline system, i.e., open access to the monopoly sectors. Such structural measures are generally considered to be more effective in protecting the public interest and preventing cross subsidy than cost regulation by itself.

A second lesson from my experience at FERC is that regulation must be governed by the regulator's statutory authority and the requirements of the legislation it administers. I am not a lawyer, but I nonetheless found it necessary to study the FERC's enabling statutes in some detail. The Postal Reorganization Act similarly directs and constrains the Commission's regulation of the Postal Service. Because of the differences in the regulatory acts, postal regulation is substantially different from the regulation administered by FERC. For example, the Postal Rate Commission must be guided by the pricing factors in the Postal Reorganization Act, which differ from the statutory guidance provided to FERC. Moreover, some subclasses of mail are to be given a preference by the Commission according to its statute. In such circumstances, the Commission's ability to make structural recommendations to the Postal Service may be more limited than FERC's ability to impose structural reform. Nonetheless, the Commission may have opportunities in this regard although my testimony does not address the issue. To the extent that competitive services can be isolated from the monopoly service of an enterprise in such a way that the monopoly service provides no advantage to the incumbent, the need to rely on cost based regulation will be reduced and competition can be encouraged.

USPS/UPS-T3-5 (Insert question here)

ATTACHMENT A

CURRICULUM VITA

February 1998

J. Stephen Henderson

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Education

B.S. International Affairs	1965 U.S. Air Force Academy
M.A. Economics	1966 Georgetown University
M.S. Economics	1971 University of Wisconsin
Ph.D. Economics	1975 University of Wisconsin

Professional Experience

Principal, Putnam, Hayes & Bartlett, Washington, DC, October 1996 - present.

Associate Director for Electricity, Office of Economic Policy, Federal Energy Regulatory Commission, August 1993 - September 1996.

Deputy Associate Director for Electricity (1991 - 1993), Special Assistant (1989 - 1991), Office of Economic Policy, Federal Energy Regulatory Commission.

Senior Institute Economist, National Regulatory Research Institute, 1982 - 1989.

Economist, Office of Economic Policy, Federal Energy Regulatory Commission (On Leave of Absence from NRRI), January 1988 - June 1988.

Assistant Professor of Economics, Ohio State University, 1975-82.

Instructor, Quantitative Studies Department, School of Systems and Logistics, Air Force Institute of Technology, 1971-1975.

Economist, Personnel Analysis Division, Headquarters U.S. Air Force, Pentagon, 1966-1969.

Military Service U.S. Air Force Cadet 1961-1965, Officer 1965-1975

Research Areas The Economics of Public Utility Regulation and Applied Microeconomics

Teaching Areas Public Finance, Microeconomics, Statistics, and Economic Regulation

Papers

"Market-Based Pricing of Wholesale Electric Service," (with Bernard Tenenbaum) *The Electricity Journal*, December 1991.

"Natural Gas Prices and Contractual Terms," (with Anand Desai) *Energy Systems and Policy*, December 1989.

"Price Discrimination Limits in Relation to 'Death Spirals'", *The Energy Journal*, July 1986.

"The Effect of Regulation on Nonuniform Electricity Price Schedules in the U.S.," *The Journal of Public Economics*, June 1986.

"Cost Estimation for Vertically Integrated Firms: The Case of Electricity," in Michael Crew (ed) *Analyzing the Impact of Regulatory Change in Public Utilities*, Lexington Books (Lexington, MA: 1984).

"The Economics of Electricity Demand Charges," *The Energy Journal*, Special Electricity Issue, December 1983.

"Costs and Benefits of Residential Time of Use Metering: Comment," *The Energy Journal*, January 1983.

"Bargaining Costs and Regulation Induced Cost Distortions," *The Journal of Public Economics*, February 1982.

"Stochastic Optimal Control of Internal Hierarchical Labor Markets," *Journal of Optimization Theory and Applications*, January 1980.

Papers in Conference Proceedings

"Securing the Reliability and Efficiency of the Bulk Power Grid," Twenty-Fifth Annual Williamsburg Conference, Williamsburg, Va, December 1993.

"Fostering the Transmission Grid Needed for a Competitive Power Market," Twenty-Fourth Annual Williamsburg Conference, Williamsburg, Va, December 1992.

"The Commission's Transmission Pricing and Access Policy," Eighth Biennial Regulatory Information Conference, NRRI, September 1992.

"There Are No Distortions of Short-Term Generation Choices if Electricity Transmission Is Priced Flexibly," Sixth Biennial Regulatory Information Conference, NRRI, December 1988.

"Pricing the Transmission of Electricity," Nineteenth Annual Williamsburg Conference, Williamsburg, VA, December 1987.

"An Economic Perspective about Price Discrimination in Public Utility Regulation," Thirteenth Annual Rate Symposium, St. Louis, MO, February 1987.

"Evaluating Price Discrimination Using a Simple Social Welfare Model," Fifth NARUC Biennial Regulatory Information Conference, NRRI, December 1986.

"Estimating Short Term Cost Functions for Electric Utilities," Fourth NARUC Biennial Regulatory Information Conference, NRRI, December 1984.

"Electric System Load Patterns and Demand Charges", in *The Economic Impact of Energy Conservation*, Volume III, U.S. House of Representatives Committee on Science and Technology, U.S. Government Printing Office, December 1978.

Reports

The Transmission Task Force's Report to the Commission -- Electricity Transmission: Realities, Theory and Policy Alternatives, (with W. Booth and J.S. Herod) Federal Energy Regulatory Commission, October 1989.

An Economic and Legal Analysis of Undue Price Discrimination, (with Robert Burns) National Regulatory Research Institute Report 89-12, August 1989.

Natural Gas Producer-Distributor Contracts: State Regulatory Issues and Approaches, (with J.M. Goldman, et al.) National Regulatory Research Institute Report 87-12, February 1988.

Some Economic Principles for Pricing Wheeled Power, (with Kevin Kelly) National Regulatory Research Institute Report 87-7, August 1987.

Natural Gas Industry Restructuring Issues (editor), National Regulatory Research Institute Report 86-8, September 1986.

Time-of-Use Electricity Pricing in Ohio, (with Robert Burns, et al.) Final Draft Report to the Public Utilities Commission of Ohio, September 1986.

An Economic Analysis of Block Billing for Natural Gas, National Regulatory Research Institute Report 86-5, March 1986.

Natural Gas Rate Design and Transportation Policy Under Deregulation and Market Uncertainty, (with J.M. Goldman, et al.) National Regulatory Research Institute Report 85-15, January 1986.

Regulating Electric Utilities with Subsidiaries, (with Robert Burns, et al.) National Regulatory Research Institute Report 85-16, January 1986.

A Decision Support System for Utility Performance Evaluation, (with Luc Anselin) National Regulatory Research Institute Report 84-15, April 1985.

Cost-of-Service for Intrastate Jurisdictional Telephone Service, (with William Pollard) National Regulatory Research Institute Report 84-13, April 1985.

Commission Regulation of Small Water Utilities: Outside Resources and Their Effective Uses, (with Vivian Davis, et al.) National Regulatory Research Institute Report 84-7, August 1984.

State Regulatory Options for Dealing with Natural Gas Wellhead Price Deregulation, (with Kevin Kelly, et al.) National Regulatory Research Institute Report 83-7, August 1983.

Funding Nuclear Power Plant Decommissioning, (with Robert Burns, et al.) National Regulatory Research Institute Report 82-3, October 1982.

The Need For Natural Gas Storage in Ohio, (with Daniel Czamanski) Report to the Federal Energy Administration, September 1977.

Electricity Pricing Policies for Ohio, (with Daniel Czamanski) Report to the Public Utilities Commission of Ohio, September 1976.

Current Practices and Economic Principles of Regulated Pricing, (with Kevin Kelly) Report to the Public Utilities Commission of Ohio, June 1976.

Optimal Control of a Manpower Hierarchy with Demand Uncertainty, Ph.D. Dissertation, University of Wisconsin, 1975.

1 CHAIRMAN GLEIMAN: Does any participant have
2 additional written cross examination for Witness Henderson?

3 [No response.]

4 CHAIRMAN GLEIMAN: If not, we'll move along to
5 oral cross examination. Four parties -- CTC Distribution
6 Services; Nashua District, Mystic, Seattle; Parcel Shippers
7 Association; and United States Postal Service -- have
8 indicated they want to cross this witness. Does anyone else
9 wish to cross examine this witness?

10 [No response.]

11 CHAIRMAN GLEIMAN: If not, then Mr. Olson, CTC.

12 MR. OLSON: Mr. Chairman, we have no questions of
13 this witness.

14 CHAIRMAN GLEIMAN: Mr. Callender?

15 MR. CALLENDER: Yes, sir.

16 CHAIRMAN GLEIMAN: Of Nashua District, Mystic,
17 Seattle?

18 MR. CALLENDER: Yes.

19 CROSS-EXAMINATION

20 BY MR. CALLENDER:

21 Q Dr. Henderson, my name is Jack Callender and I
22 have some questions on behalf of Nashua, District, Mystic and
23 Seattle.

24 I would like to begin by asking you to refer to
25 your response to NDMS-UPS-T3-5. Do you have a copy of that?

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1 A Yes. Just let me turn to it. T3-5, is that
2 right?

3 Q Yes.

4 A I have it.

5 Q Okay. We asked you to compare priority mail with
6 UPS second-day air and with UPS three-day select with
7 respect to six different factors; is that right?

8 A That's right.

9 Q And in your answer, you compared two of them.

10 A That's right.

11 Q First you said that UPS does guarantee delivery
12 while priority mail doesn't have any guaranteed delivery or
13 money-back refund if the service standard isn't met; is that
14 right?

15 A That's right.

16 Q Now, with respect to just that one factor, is it
17 fair to say that UPS second-day air is better than priority
18 mail?

19 A Certainly a delivery guarantee is of some value,
20 yes.

21 Q And how about for three-day select? Is three-day
22 select better than priority mail?

23 A Once again, the delivery guarantee would be of
24 value, yes.

25 Q Okay. Now, you also talked about delivery

1 confirmation and track and trace in your answer, and I
2 believe you said that tracking is not available for priority
3 mail, while UPS, you can -- there's a way to find out where
4 in the system your package is? Is that --

5 A That's right.

6 Q So with respect to that factor, is it also fair to
7 say that UPS second-day air and three-day select are better
8 than priority mail?

9 A Yes, that's true.

10 Q Okay. And for the rest of the factors we listed,
11 you said that you didn't have enough information; is that
12 right?

13 A That's right.

14 Q Now, first of all, was it priority mail or UPS
15 that you didn't know about, that you didn't have enough
16 information about to answer the question?

17 A I think it's both in most cases. I guess we would
18 have to enumerate each one that you asked about. On volume
19 discounts, I don't know that for either --

20 Q Well, can we talk about each one?

21 A Sure.

22 Q Let's start with delivery performance, by which I
23 mean on-time performance, percent delivered on time. Have
24 you had a chance to review Dr. Haldi's testimony. He's our
25 witness, NDMS-T-2?

1 A Yes, I've read that.

2 Q On page 65 of NDMS-T-2, Dr. Haldi has a table
3 titled Table 7, Performance of First Class and Priority Mail
4 based on ^{ODIS}~~OTIS~~ Data, Fiscal Year 1995 to Fiscal Year 1997.
5 Do you remember?

6 A I don't remember that specifically. I remember it
7 in general, yes.

8 Q Well, in that table, he lists what percentage of
9 priority mail as well as first class mail, but I'm just
10 asking about priority mail, with various delivery standards
11 met its delivery standard.

12 A Okay.

13 Q And the figures he gave were for an overnight
14 standard, he said 14.4 percent failed to meet its delivery
15 standard, and for a two-day standard, 23.8 percent failed to
16 meet its delivery standard, and for priority mail with a
17 three-day standard, 22.3 percent failed to meet its
18 three-day standard.

19 Now, do you have any reason to disagree or do you
20 have any other information that might suggest that this
21 isn't the level of priority mail's performance?

22 A No, I have no reason to -- I have no separate
23 information that would tend to either confirm or deny that.

24 Q Now, from what you know, do you think that UPS has
25 failure rates in this range?

1 A I'm sorry, I really don't know the answer. I
2 really don't know the answer.

3 Q Okay.

4 A I don't have any factual basis on which to base an
5 answer.

6 Q Okay. Now, we also asked you about insurance for
7 the mail or the package included in the base price. Are you
8 aware of any insurance included in the base price of
9 priority mail?

10 MR. McKEEVER: Mr. Chairman, I'm going to object.
11 Dr. Henderson did answer the question very clearly in
12 response to the interrogatory UPS-T-3-5, and he stated, I do
13 not have information on the other factors you mention.

14 I guess counsel maybe is permitted to confirm, but
15 I think Dr. Henderson's answer is clear.

16 CHAIRMAN GLEIMAN: Well, we're going to let Dr.
17 Henderson answer the questions and confirm the
18 interrogatories if, in fact, that's the case, and if he
19 knows that he has answered those questions previously in an
20 interrogatory, he can make reference thereto.

21 THE WITNESS: Would you care to repeat the
22 question? Sorry.

23 BY MR. CALLENDER:

24 Q Oh, sure. Do you agree that priority mail
25 currently has no insurance included in the base price?

1 A I'm sorry, I really don't know the answer to that.
2 I just haven't looked into whether or not that's the case.

3 Q Okay. And you don't -- do you know if UPS offers
4 --

5 A Once again, I don't.

6 Q -- insurance in the basic price?

7 A I do not.

8 Q Okay. How about billing and payment options. Are
9 you aware that the Postal Service doesn't bill for -- that
10 you have to prepay for Postal Service products; you can't
11 send the mail and then get a bill later?

12 A As a general matter, I think I knew that, but I
13 have not looked at that specifically in regard to this case.
14 I haven't --

15 Q I mean specifically with regard to priority mail.

16 A Once again, I know that is generally true, but as
17 an expert, I'm not in a position to say.

18 Q Do you know if billing and later payment is
19 available for UPS products?

20 A I don't know.

21 Q Just from your personal experience, can you send a
22 package by UPS using a corporate account, for example?

23 A I have not done that. My guess is that my firm
24 does that all the time, but I haven't done it myself, so
25 it's not in my own personal experience. I could probably go

1 back and ask my office manager when I get back and we
2 probably do, in fact, have such a thing, but I just don't
3 know for sure right now.

4 Q Okay. Now, lastly on this, volume discounts and
5 negotiated rates, are you aware that the Postal Service
6 doesn't offer any volume discounts for priority mail?

7 A I knew that as a general matter, yes.

8 Q As a general rule?

9 A That's my understanding. I just haven't quizzed
10 anybody closely to see whether or not there are any
11 exceptions to that, so if, in fact, there was one -- you
12 know, a special arrangement, I just don't have any knowledge
13 of it, but my understanding is that generally, that's right,
14 that there are no discounts.

15 Q And are you aware of any possibility of discounts,
16 either volume discounts or discounts by virtue of membership
17 in a group, which are available to UPS customers?

18 MR. MCKEEVER: Mr. Chairman, may I ask for
19 clarification? Is the question only with respect to
20 priority mail? Excuse me, UPS second-day air?

21 MR. CALLENDER: Yes, only UPS second-day air and
22 three-day select.

23 MR. MCKEEVER: Thank you.

24 THE WITNESS: I don't know. I don't know the
25 answer.

1 BY MR. CALLENDER:

2 Q I'm sorry. Would any other UPS witness know the
3 answers to these questions I have asked you here today and
4 in the Interrogatory?

5 A I --

6 Q Is there someone we should be asking these
7 questions to?

8 MR. McKEEVER: Mr. Chairman, I think that question
9 probably is more appropriately addressed to counsel, but I
10 have no objection to Dr. Henderson answering it if he thinks
11 he can.

12 THE WITNESS: I honestly don't know the answer to
13 the question, but I am sure if you wanted to asked Mr.
14 Luciani that question, he would be prepared to tell you
15 whatever it is he knows about it. He is more familiar with,
16 and has been involved in these cases longer than have, so he
17 may have some other reason for knowing that.

18 BY MR. CALLENDER:

19 Q I would like to turn to your response to
20 NDMS/UPS-T-3, question 2. And also to your testimony --

21 A I'm sorry. T-3, question 2?

22 Q Yes. But also to your testimony on page 5, lines
23 8 through 12.

24 A Which would you like to do first?

25 Q The testimony.

1 A Okay.

2 Q Now, in that section of your testimony, you
3 discuss the components of Section 3622(b)(4) of the Postal
4 Reorganization Act, is that right?

5 A That's right.

6 Q Now, I would like to discuss one of those
7 components, which you state is to mitigate price increases
8 that would cause rate shock. Now, for purposes of that
9 section -- could you discuss, first of all, the components
10 of 3622(b)(4)?

11 A Well, it is as you say, the Commission is to
12 examine the effect that price increases have on mailers and
13 other entities that use the postal services. So it is to
14 examine the impact of price increases on users and other
15 enterprises in the private economy.

16 Q What would the effect on mailers be of a 32
17 percent rate increase?

18 A Well, users of --

19 Q Of Priority Mail.

20 A Users of the service, presumably, would demand
21 less of the service, so, presumably, usage would go down.

22 Q And is it also part of 3622(b)(4), the effect on
23 competition on private entities that compete?

24 A Yes.

25 Q What would the effect of a 32 percent Priority

1 Mail rate increase be on the competition?

2 A Presumably, competitors would -- people would
3 substitute the Postal Service for that of the competitors,
4 presumably, all other things being equal.

5 MR. CALLENDER: Thank you. Nothing further.

6 CHAIRMAN GLEIMAN: Parcel Shippers Association.

7 CROSS-EXAMINATION

8 BY MR. MAY:

9 Q Dr. Henderson, if I could your attention to your
10 answer to Parcel Shippers' question No. 3-1, T-3-1.

11 A Yes.

12 Q In that response, you confirmed that under your
13 proposed cost attribution, the system-wide average cost
14 coverage is 156.3 percent, whereas, under the Postal
15 Service's attributions, it is 178.4 percent, correct?

16 A That's right. Although that is not the way the
17 question was stated, but --

18 Q Well, we were rounding. You agreed with it except
19 for rounding.

20 A Yes.

21 Q But those are your rounded numbers, isn't that --
22 that is what you say --

23 A Yes.

24 Q -- the coverage, relative coverage --

25 A Yes.

1 Q -- requirement is. That simply means that under
2 -- that the Postal Service has attributed fewer costs than
3 you have, so that they need to mark-up those attributable
4 costs more than you need to mark them up in order to get the
5 revenue as effectively, isn't that what that means?

6 A Yes.

7 Q So your average coverage is a smaller percentage
8 of the attributable costs. Now, to be precise, your
9 coverage mark-up is only 71.8 percent of USPS's mark-up, and
10 I derive that simply by taking 71.8 percent of 78.4 percent
11 equals 56.3 percent, your coverage, if you will accept that
12 math?

13 A That seems right. I haven't confirmed it, but
14 that sounds right.

15 Q Now, if the same relative coverages were
16 maintained under the Post Office's proposed coverages, but
17 utilizing your cost attributions rather than their own,
18 would it not be the case that each particular cost coverage
19 would have to be less of its attributable costs than under
20 the Postal Service's original coverage? Assuming that it
21 was desirable to maintain the same relative -- relative
22 coverages, as proposed by the Post Office.

23 A I am not sure what you are asking. It is about
24 the -- each and every subclass?

25 Q No. If it was desired to maintain the same

1 relative coverages as proposed by the Post Office, in other
2 words, First Class has a higher coverage than parcel post,
3 and if it is desirable to maintain the same relative
4 coverages that the Post Office had, but we want to use your
5 attributions, under that set of circumstances, would it not
6 necessarily be the case that, in every instance, the
7 percentage coverage would be less under your proposed
8 attributions than under the Postal Service's?

9 A Yes, I think that has got to be correct.

10 Q Thank you. So let's take parcel post. Rather
11 than have 103.9 percent cost coverage, which is what the
12 Post Office proposed, then would it not be the case that, if
13 you wanted to maintain the same ratios of coverage, that
14 you, under your attributions, would only have 71.8 percent
15 of that 3.9 percent or, if you will accept my math,
16 something -- 2.8 percent. In other words, 78 -- 71.8
17 percent of 3.9 percent is 2.8 percent.

18 A Yes. Assuming that the object of the exercise --

19 Q Yes.

20 A -- were to keep the Postal Service's relative
21 coverages, --

22 Q Thank you.

23 A -- what you say is true.

24 Q Now, would you -- I direct your attention to
25 PSA-T-3-2. Now, in that response you say that the

1 attributable costs per piece in the test year for parcel
2 post will be 7.2 percent higher than the attributable costs
3 estimated by the Commission in Docket R94, is that correct?

4 A That's right.

5 Q Could you explain why, if there is only a 7.2
6 percent increase in the estimated cost of parcel post, whose
7 rates were yielding 107 percent cost coverage in the test
8 year, according to the Rate Commission, why is it necessary
9 then to have a 28 percent rate increase in order to maintain
10 that 107 percent cost coverage, when there has only been a
11 7.2 percent increase in cost? Can you explain that?

12 MR. McKEEVER: Objection, Mr. Chairman. Mr. May
13 stated that the coverage in the test year is 107 percent.
14 That clearly is not the case unless the rates change. He
15 has stated as a fact something that not only is not in
16 evidence but is contrary to the Postal Service's numbers.

17 CHAIRMAN GLEIMAN: Mr. May?

18 MR. MAY: I don't understand the objection. Could
19 counsel restate it?

20 MR. McKEEVER: Yes. My objection is to that part
21 of the question that says that there is a 107 percent cost
22 coverage in the test year.

23 MR. MAY: I believe I said in the R94-1 test year.

24 MR. McKEEVER: That was not what I heard, Mr.
25 Chairman, but I may ask that the question be restated,

1 please.

2 CHAIRMAN GLEIMAN: Mr. May, if you would.

3 MR. MAY: Yes. I'll restate it again.

4 BY MR. MAY:

5 Q You have testified that between the R91 test year
6 -- R94-1 test year, the attributable costs, as found by this
7 Commission in that case, have increased only 7.2 percent
8 between that time and the new test year. You have also said
9 part of your exercise was to begin by keeping the same
10 coverage, that the Commission found 107 percent coverage in
11 R94, and that is what your objective is in this proceeding,
12 is that not correct?

13 A That's right.

14 Q My question is if indeed there has only been a
15 7.2-percent increase over the attributable costs as found by
16 the Commission in R97, why is it necessary to have a
17 28-percent increase to cover 7.2-percent costs to keep the
18 same 107-percent cost coverage?

19 A The principal reason is that the test year before
20 rates, the average rates that are currently in effect, are
21 substantially below all of those benchmarks that we just
22 talked about or that you just talked about. The current
23 average revenue per piece is \$3.05. The R94 cost that the
24 Commission had on attributed costs per piece was \$3.40. So
25 it's already -- it's substantially below that.

1 So it's just -- what's apparently happened perhaps
2 is that the use, since this is revenue per piece, something
3 has happened to the usage within this subclass that has
4 caused the average revenue per piece to drift down
5 substantially.

6 Q In other words, if the revenue had stayed
7 approximately the same, you'd only need a 7.2-percent
8 increase to get the same coverage; is that right?

9 A That's right.

10 Q So there must have been a big decline in the
11 average revenue per piece since R94?

12 A That's right.

13 Q There is no other explanation you can think of.

14 A That's right.

15 Q Would you direct your attention to your response
16 to question 3 of the Parcel Shippers?

17 In that response to what you describe as readily
18 available alternatives for the ground -- and I underline
19 ground -- transportation of parcels to residences, is it
20 correct that you have identified only two national carriers,
21 UPS and USPS?

22 A I believe that that's correct as a nationwide
23 vertically integrated service that goes all the way to the
24 home. I believe that those are the only two there that
25 would fall into that category, and then I go on to say

1 that --

2 Q Yes. Then you also say that there are a multitude
3 of smaller regional and local firms.

4 A Right.

5 Q And you further state, quote, it is not necessary
6 that home delivery be provided by a vertically integrated
7 firm for competition to be effective.

8 Now directing your attention to that claim, do you
9 have the corroboration of that claim by any national user of
10 parcel delivery services to residences, anybody who actually
11 uses it you know of that has corroborated your statement
12 that it's not necessary to have a vertically integrated
13 national carrier?

14 A I believe the testimony by the Avon witness might
15 come -- might be enlightening in that regard. I believe he
16 said that they use something on the order of 30 contractors
17 for final home delivery.

18 Q Well, but he did -- but what did -- what kind of
19 service was he talking about?

20 A I assume that since it's Avon, and I -- but it's
21 going -- it's delivery into a residential neighborhood of
22 a -- probably a packet of material.

23 Q Well, since you speak about it, are you aware that
24 at one time Avon was the single biggest customer of United
25 Parcel Service?

1 A No.

2 Q You didn't know that?

3 A No.

4 Q And in fact you don't know, do you, what kind of
5 service it is that Avon requires, do you?

6 A No. Not really, not in detail.

7 Q You don't know if it is expedited pinpoint
8 service, for example. You don't know whether that is the
9 case or not, do you?

10 A That's right.

11 Q Thank you. Now you did testify in your response
12 that you cited Mr. Clark, who is at CTC Distribution
13 Services and the Association of Alternative Postal Systems.
14 In your answer you gave those as "other possible ways" for
15 delivery to be effected and that there -- as proof that
16 there is other competition.

17 Do you recall that?

18 A Yes.

19 Q Now is it not the case that these two entities are
20 actually not mailers of parcels, are they, as such, but
21 rather in the transportation business themselves?

22 MR. MCKEEVER: Mr. Chairman, may I ask how Mr. May
23 defines the term "mailer" --

24 CHAIRMAN GLEIMAN: Counsel has to understand the
25 question that is being asked.

1 MR. MAY: Sure. No, I understand the question. I
2 think it is important that the witness understand, and by
3 mailer I mean -- I go back to my question before this, which
4 was this.

5 Do you have the corroboration of any national
6 mailer -- national mailer -- to corroborate your statement
7 that you don't need national delivery systems, and so by
8 "mailer" I mean the originator of the parcel, the person who
9 is actually in the business of selling the product to a
10 consumer.

11 That is what I mean by mailer.

12 MR. McKEEVER: So Mr. May, it does not include the
13 person who actually pays the postage and deposits the mail?

14 MR. MAY: Not in this question.

15 MR. McKEEVER: Thank you.

16 BY MR. MAY:

17 Q So can the -- can you confirm that that is the
18 case, that those two instances you cite are not in fact
19 mailers themselves?

20 A That's right. CTC and the Association would not
21 be mailers in the sense that you just said.

22 Q Now you say that you are familiar with Mr. Clark's
23 testimony. Let me read you his testimony, if I will, from
24 page 10233 of the transcript, and I quote, the question was,
25 "How many have you used during the whole year? -- and so I

1 thought, well, if I ship five packages or 10 packages, that
2 would be one of the 17" -- meaning carriers -- "but on an
3 ongoing basis, we are using seven carriers, and you know,
4 this is a relatively small percentage of our business. I
5 would say less than five, three to five percent."

6 Are you aware of that testimony that was given the
7 other day?

8 A Yes.

9 Q Now is it not the case that Mr. Clark's testimony
10 makes clear that he principally relies upon the Postal
11 Service as the national deliverer of the parcels he
12 consolidates for delivery to customers and not on a
13 multitude of local and regional carriers? -- based on his
14 own testimony.

15 A Well, the lesson that I took from that was that he
16 uses seven other enterprises in his delivery function.

17 Q Yes, but I quoted -- his statement is -- and that
18 in total is three to five percent of the total.

19 Did you hear that?

20 A Yes.

21 MR. McKEEVER: Mr. Chairman, I am not sure Dr.
22 Henderson had finished his answer -- if counsel could --

23 BY MR. MAY:

24 Q Forgive me. Finish then.

25 A I have no way of knowing what the -- you know,

1 other than the statement there, the three to five percent, I
2 don't know, you know, what fraction that they make of the
3 Postal Service.

4 Q Would you have any reason to disbelieve Mr. Clark?

5 A No.

6 Q That these local carriers are in fact seven and
7 not 17 and that its sum total is three to five percent? You
8 have no reason to disbelieve that, do you?

9 A No.

10 MR. McKEEVER: Objection to the indication that
11 the carriers are seven and not 17. I think if Mr. May
12 characterizes what the seven are and the 17 are, I have no
13 problem, but his statement to say that there are only seven
14 carriers and not 17 is contrary to the record.

15 MR. MAY: This is the quote from Mr. Clark --

16 CHAIRMAN GLEIMAN: Could you give us --

17 MR. MCCARREN: "But on an ongoing basis, we are
18 using seven carriers" -- period. That's it, transcript
19 10233.

20 MR. McKEEVER: Well, I am not sure what Mr. May's
21 question is but when he quotes the transcript I have no
22 objection to that.

23 It's when he changes the characterization of what
24 is in the transcript when I have an objection.

25 CHAIRMAN GLEIMAN: Thank you. You don't have an

1 objection to the question that was posited?

2 MR. MCKEEVER: I don't think there is a question
3 pending right now.

4 MR. MAY: No, there is not. No, the witness
5 answered the question.

6 BY MR. MAY:

7 Q Now further, are you familiar at all with the
8 testimony of Mr. Jellison in this proceeding wherein Mr.
9 Jellison's testimony makes the assertion that his members
10 predominantly use either UPS or USPS, and that there is no
11 other reliable deliverer of small parcels to residents?

12 Are you familiar with that testimony?

13 A Yes.

14 Q Do you have any reason to disbelieve Mr. Jellison?

15 A No, I am sure those are his beliefs.

16 Q Thank you. Now if you would direct your attention
17 to your response to PSA-4.

18 A Yes.

19 Q You have in the response been careful to point out
20 that you haven't investigated the impact of the proposed
21 Parcel Post rates on UPS but that you do say that unfair
22 Parcel Post rates could injure competitors such as UPS.

23 Is it not also the case, Dr. Henderson, that fair
24 Parcel Post rates could injure competitors such as UPS?

25 A It certainly could. That's probably true. I mean

1 the --

2 Q And conversely, is it not the case that what --

3 CHAIRMAN GLEIMAN: Mr. May, excuse me. I think
4 that the witness was going add something else. I'm not sure
5 but I thought I heard another word coming out.

6 Let's just slow down a little bit and let him
7 answer.

8 THE WITNESS: At whatever price the Commission
9 decides is a fair price it is probably the case that
10 somewhere in the U.S. economy that there is some competitor
11 someplace that is pretty close to getting on the margin and
12 that price makes just a little bit of a difference to them.

13 That is probably always the case, so that it is
14 possible that competitors could be injured at a price that
15 the Commission would deem to be not fair and also one that
16 it would deem to be fair.

17 BY MR. MAY:

18 Q And since you disclaim any knowledge of the
19 competitive impact on UPS, that could include UPS, could it
20 not?

21 A That's right.

22 Q And conversely, is it not the case that what you
23 describe as, quote, "unfair" Parcel Post rates might not
24 injure UPS?

25 A That's certainly possible. I guess I would have

1 to know a bit more what you have in mind, I guess.

2 Q Well, I am just saying, your testimony is only a
3 conjecture to begin with. You said it could, that unfair
4 rates could injure, and all you are saying now is that
5 unfair rates could also not injure -- that's all I asked
6 you.

7 A That's right.

8 Q Now if you would turn to your response to Question
9 5, there you say that -- I asked you about the increase in
10 Parcel Post volume, UPS compared to Parcel Post, since the
11 last rate case, and you say "I have not computed market
12 shares as part of my testimony so I cannot confirm the
13 facts" -- the facts being that UPS's volume has increased
14 more than UPS.

15 Let me ask you this again. Can you -- is it
16 actually the case that you are unaware that over recent
17 years UPS's Parcel Post type volumes have increased far in
18 excess of the Parcel Post volumes of the Postal Service
19 since Docket Number R94-1.

20 Are you actually unaware that that happened?

21 MR. MCKEEVER: Objection, Mr. Chairman, on two
22 bases.

23 First, Mr. May mischaracterized the interrogatory.
24 The interrogatory went on "and that therefore the Postal
25 Service has not been able to secure its proper share of the

1 increased Parcel Post market."

2 That was the full question, but more importantly,
3 Mr. May doesn't define what he means by Parcel Post type
4 volume, nor does he provide any volume measures of that
5 particular type of volume.

6 MR. MAY: Mr. Chairman, I believe this question is
7 quite simple.

8 I asked this witness is he aware or unaware
9 whether Parcel Post type volumes of the United Parcel
10 Service had increased far in excess of those of the Postal
11 Service since R94.

12 Now this is a perfectly legitimate question. He
13 either is aware or he isn't aware, and also if he doesn't
14 know what Parcel Post is, we can tell him.

15 CHAIRMAN GLEIMAN: The simple question is are you
16 aware or are you not aware that Parcel Post volumes for UPS
17 have increased and garnered a larger market share relative
18 to the Postal Service since R94?

19 Is that a simple restatement or not so simple
20 restatement?

21 MR. McKEEVER: Mr. Chairman, I think you added the
22 phrase "market share" in the question, which was not in Mr.
23 May's question and I think it may make a difference.

24 MR. MAY: I dropped it out of it because he said
25 he didn't study market shares.

1 CHAIRMAN GLEIMAN: All right. Well, then,
2 volumes.

3 MR. MAY: Just volumes, yes.

4 THE WITNESS: I am unaware of -- whatever that
5 increase might have been for UPS I am unaware of it.

6 BY MR. MAY:

7 Q In other words for all you know I mean they may
8 have lost volume compared to the Postal Service?

9 A That's right.

10 Q Well, since that is the case, I am going to ask
11 you to -- I am going to ask you a hypothetical.

12 I am going to ask you to assume that it is the
13 case that UPS's Parcel Post type volumes, i.e., one pound or
14 over, ground transportation, have increased far in excess of
15 the increases in Parcel Post volume since the last case,
16 despite yearly rate increases by UPS, and then ask you to
17 assume that that is the case.

18 Assuming that, is it not -- would it not be the
19 case then that under that hypothesis USPS Parcel Post rates
20 had less value of service, one of the criteria to which you
21 advert on page 4 of your testimony, and would that not under
22 that hypothesis compel a conclusion that Parcel Post
23 coverage should be the lowest possible in order to enhance
24 its competitive opportunities in the market?

25 A That's a big hypothetical. Let me -- if I could

1 just add to it just very briefly. If I were doing that kind
2 of calculations, which I have not done, and were interested
3 in the kind of -- I'll call it a market share that you are
4 talking about, then I think the kind of analysis that I
5 would attempt to do, and I don't know whether one can do it
6 with publicly available data or not, my guess is you can't,
7 but if you could, you would define a relevant product and it
8 is not clear that one pound and over parcels would be a
9 relevant product. You would want to look at all the
10 substitutions that are -- that are possible.

11 If you ended up, and sure enough defined a
12 relevant product to be as you described, a parcel over one
13 pound, and I am by no means certain that that is the case,
14 if that were true, and you also observed at the Postal
15 Service that the parcel post's share was declining, that
16 would certainly indicate a low value of service, yes.

17 Q Thank you. If I could have you look at your
18 answer to PSA-6 again. PSA-6 asks you about your scaling
19 back of -- well, it asks you about your coverage factors
20 again, and in that response, you reference page 9 of your
21 appendix to your testimony and explain that you don't end up
22 with excess revenue by maintaining the same coverages in R94
23 because you have scaled the coverages back, and you
24 reference this appendix, is that correct?

25 A That's right.

1 Q Now, if you would look at that page 9 of your
2 appendix, the appendix is in the back of the witness'
3 testimony.

4 CHAIRMAN GLEIMAN: Thank you.

5 BY MR. MAY:

6 Q Now, on page 9, you state that if the Service
7 simply adopted the mark-ups from the last case and applied
8 them to 1998 costs, revenue could be less than or greater
9 than costs. Do you see that?

10 A Yes.

11 Q In fact, which would it be? Wouldn't it be
12 greater rather than less?

13 A Yes, it would be greater.

14 Q Now, you then provide an example in which you
15 suppose the cost mark-up scaling factor is 1.5. That is not
16 what you used, but that's -- you gave that as an example,
17 did you not?

18 A Yes.

19 Q That that would be the scaling factor, 1.5. Would
20 that mean that all mark-ups would have to be 50 percent
21 greater now than they were in R94, or at least on average?
22 Is that what the 1.5 means?

23 A Yes.

24 Q In fact, it isn't 1.5, the scaling factor would
25 have to be less than 1, would it not, in this case?

1 A Yes. If I might, it turns out in my analysis it
2 is .958, or it is about 4.2 percentage points less than 1,
3 so it is less than 1, as you say.

4 Q And what is the scaling factor used for parcel
5 post then, since you, in your Exhibit 3-B of your testimony,
6 end up with approximately the same exact cost coverage,
7 i.e., 107.1 percent?

8 MR. McKEEVER: Objection, Mr. Chairman. I don't
9 understand how anybody can answer a question that asks if
10 something is approximately exactly the same. I ask that Mr.
11 May make a choice between approximately or exactly so that
12 the question can be answered.

13 BY MR. MAY:

14 Q Well, the Commission approved 107 percent and your
15 -- and change -- and you are recommending 107 percent, are
16 you not?

17 A Yes.

18 Q I believe 107.1 percent.

19 A Yes.

20 Q Which was your objective. Elsewhere in your
21 testimony you say your objective was to start with the exact
22 cost coverage the Commission had in the last case. Now, you
23 seem to have achieved in Exhibit 3-B, do you not?

24 A I used the same mark-ups and I scaled the mark-ups
25 and they are approximately 4 percent smaller in my testimony

1 than they were in the Commission's R94 case, so, yes, it was
2 1.07 or 7.1 and change mark-up in R94 and it is
3 approximately the same, 7.1 percent now. It is, as you say,
4 pre-ordained. That was the object of the exercise.

5 Q Did you use the same scaling factor for every
6 single rate?

7 A Yes.

8 Q And so even though you have -- that your mark-up
9 is only, we went through this before, only 71.8 percent of
10 what the Postal Service proposed, you, nevertheless, are
11 able to achieve the same cost coverages with only a 4
12 percent scaling factor?

13 A That's right. The attributed costs that I used
14 are much closer to what the Commission used in R94.

15 Q I know that.

16 A This is basically the bottom line to your
17 question, I believe.

18 Q Well, but wouldn't that imply that there's only a
19 4 -- roughly a 4 percent deviation in the overall cost
20 coverage in this case, that you propose, than what the
21 Commission found in R94? Since you only -- since you say
22 you only had to reduce the coverages by 4 percent, could you
23 demonstrate -- I don't mean now -- but for the record how
24 you mathematically managed to come up with the same coverage
25 that the Commission did by scaling back all rates by only 4

1 percent -- coverages by only 4 percent?

2 A Well, it's in the testimony. The spreadsheets are
3 right there, and we've provided them electronically also.
4 There's probably only one small, you know, bit of arithmetic
5 that's at all complicated.

6 I did this exercise of scaling for the 16 major
7 subclasses. The remainder, the special services and so on,
8 as I explained in the testimony, they amount to about 5 or 6
9 percent of the total revenue requirement. And just plain
10 for simplicity I did not do this scaling exercise for those.

11 And so I used the Postal Service's proposals in
12 this case and just held those constant, and then the
13 remaining 16 subclasses are all -- the Commission's R94
14 markups are all proportionately adjusted so as to make the
15 revenue requirement come out to what it needs to while
16 marking up the incremental costs, and the arithmetic proof
17 as it were has already been presented.

18 Q Okay. If you would turn to your response to
19 PSA-7.

20 A Yes.

21 Q And that question asked you about your testimony
22 on page 22 where you stated that the average rate for Parcel
23 Post is already substantially below cost. And you were
24 asked to confirm that the rates would not be below cost if
25 the Alaska Air is reduced, and your response was that the

1 pricing model -- that your pricing model excludes the Alaska
2 Air costs in conformance with prior Commission decisions.
3 And you have attached to that answer a cost model which
4 purports to demonstrate that. Is that not the case?

5 MR. MCKEEVER: Objection, Mr. Chairman. The model
6 used by Dr. Henderson he clearly states does not give the
7 Alaska Air costs the treatment the Commission did. What he
8 supplied in response to this answer does, but Mr. May again,
9 I believe, made a misstatement. I have -- if he would ask
10 his question --

11 MR. MAY: No, I said the attached model to the
12 question excludes Alaska Air costs.

13 MR. MCKEEVER: Then I have no objection, and I ask
14 that the question be repeated, please.

15 BY MR. MAY:

16 Q The pricing model attached to your answer excludes
17 Alaska Air, does it not?

18 A That's right.

19 Q Now according to this table this price model shows
20 that volume-variable parcel post costs per piece are \$3.30,
21 which is roughly according to your response 25 cents per
22 piece more than Parcel Post current average rate of \$3.05;
23 is that correct?

24 A That's right.

25 Q Now is it not the case that if the \$77 million

1 Alaska adjustment is reduced from the Postal Service's
2 calculation of volume-variable costs, as you reflect in your
3 Exhibit T-3C, which is the last page of the witness'
4 testimony, in that exhibit, that shows -- your exhibit there
5 shows that the average cost per piece for parcel post is
6 \$2.91, and not the \$3.31 that you show in your table 1 to
7 this interrogatory response? Is that not the case?

8 A I'm sorry, would you -- you said \$2.90?

9 Q \$2.91, which is a simple calculation of
10 subtracting 77 million from the 753 million of
11 volume-variable costs that are shown -- that the Post Office
12 claims and as are shown in your table T-3C. If you subtract
13 the 77 million Alaska costs from the Post Office's
14 attributable costs, I believe you can agree that will give
15 you \$638 million, and there are according to this table,
16 T-3C, there are also 235 million pieces, Parcel Post, which
17 if you divide into 683 million you get \$2.91. It's not that
18 complicated math, but forgive me for putting you to that
19 trouble.

20 A That sounds approximately about right. I
21 certainly can't confirm the exact numbers, but that's
22 certainly the way that you would make the calculation, yes.

23 Q So in other words, if one uses the Postal
24 Service's attributable costs minus the Alaska Air cost,
25 then, with no rate increase at all and using current rates,

1 each piece of parcel post on average has a profit of 14
2 cents, that is, your own testimony is the current rates are
3 \$3.05 on average. If the current cost using the Postal
4 Service's costs are \$2.91, the difference, is it not, is 14
5 cents?

6 MR. MCKEEVER: Mr. Chairman, I have no objection,
7 but it would have been helpful if Mr. May could have
8 supplied these calculations beforehand and then we could
9 have confirmed them. I do think it's difficult to ask a
10 witness to go through even relatively straightforward
11 calculations when there's one on top of the other. But I
12 have no objection to Dr. Henderson answering the question if
13 he feels he can do it here on the stand.

14 MR. MAY: Well, I had no doubt that, indeed, Dr.
15 Henderson would have no difficulty with these calculations,
16 but I should have given concern to the attorneys who are in
17 this case. A lot of us are somewhat derelict.

18 CHAIRMAN GLEIMAN: And the Commissioners were up
19 here with pencil and paper trying to figure this all out,
20 too, so we're a notch down from the attorneys on math, I
21 think.

22 BY MR. MAY:

23 Q But \$3.05 minus \$2.91 is 14 cents, is it not?

24 A Yes.

25 Q And so if one uses the Postal Service's

1 attributions, and you subtract the Alaska Air cost, it is
2 the case, is it not, that today, with no rate increase at
3 all, parcel post rates are producing a profit of 14 cents.

4 MR. McKEEVER: Objection to the term profit.

5 BY MR. MAY:

6 Q Is producing -- whatever word one uses -- is
7 producing a surplus over the volume variable cost of 14
8 cents per piece; is that correct?

9 MR. McKEEVER: No objection.

10 THE WITNESS: Yes, it is producing a 14-cent
11 contribution.

12 MR. MAY: I have no further questions. Thank you,
13 Mr. Chairman.

14 Thank you, Dr. Henderson.

15 CHAIRMAN GLEIMAN: Postal Service? Mr. Cooper?

16 CROSS-EXAMINATION

17 BY MR. COOPER:

18 Q Good afternoon, Dr. Henderson. I am Rick Cooper
19 for the Postal Service. I have a few questions for you. It
20 shouldn't take too long. Principally I'm going to be asking
21 you about Ramsey pricing, which I believe you discuss at
22 page 13 of your testimony or beginning at page 13?

23 A Yes.

24 Q Now, at line 6 of page 1, you refer to limitations
25 in the usefulness of Ramsey pricing theory; isn't that

1 correct?

2 A Yes.

3 Q It is not your position, is it, that Ramsey
4 pricing theory is totally irrelevant to postal rate-making,
5 is it?

6 A No, I wouldn't say that it's totally irrelevant.

7 Q Now, let's assume for the moment that we have
8 sufficient cost and demand information to carry out a full
9 Ramsey analysis. In these circumstances, what role might
10 Ramsey prices play in the Commission's deliberations?

11 A There's certainly information. I'm one who's
12 always in favor of more information and presenting it
13 different ways. I think it has value. The question is what
14 to make of it and how to interpret it.

15 In my view, the Commission or the Postal Service,
16 for that matter, has no choice but to take into account
17 demand elasticities when it's setting prices. Whether it
18 sets those and thinks about it as setting them relative to
19 Ramsey pricing or thinks about it as setting it with mark-up
20 indices that have been determined in accordance with the
21 other pricing factors in the act, no matter how they --
22 either the Commission or the Postal Service thinks about it,
23 you have no choice but to have it in the context of today's
24 market and the demand elasticity in today's market is part
25 and parcel of that.

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1 So the decisionmaking is going to be informed one
2 way or the other by demand elasticity, and I guess it's the
3 question of whether a separate calculation of Ramsey pricing
4 per se adds information content. My guess is that the
5 answer to that has got to be yes because it's another
6 indicator and indicates something; it's just not something
7 that can be relied on to the exclusion of the other pricing
8 factors in the act.

9 Q On page 13, line 6, you refer to practical
10 limitations adversely affecting the usefulness of Ramsey
11 pricing theory. Do you see that?

12 A Yes.

13 Q And specifically, you dismiss the data available
14 to the Commission as inadequate to make any use of Ramsey
15 pricing. Am I understanding you correctly there?

16 A I'm saying the data are poor and probably don't
17 support the use of Ramsey pricing once again to the
18 exclusion of other pricing factors.

19 Q Now, in preparing your testimony, did you review
20 all of the cost data presented by the Postal Service to the
21 Commission?

22 A Probably not all of it. You probably managed to
23 put something on the record that I didn't see.

24 Q With respect to that cost data that you did
25 review, would you consider yourself an expert on their

1 development?

2 A No. No, I do not consider myself to be the
3 costing expert.

4 Q And similarly, did you examine the own-price and
5 cross-price elasticity submitted to the Commission?

6 A Yes, I have seen those.

7 Q And would you consider yourself an expert on their
8 development?

9 A No. I have not actually done any separate
10 investigation into the econometrics that lie behind those
11 estimates. I just accepted them for what they were.

12 Q You do, in fact, rely on elasticities developed by
13 the Postal Service in your testimony.

14 A That's right, I certainly do. Effectively, I
15 adopt the elasticities in the Postal case in adjusting to
16 the Commission's mark-ups in my work.

17 Q So to be clear, it's not your position that the
18 price elasticity and cost data provided to the Commission in
19 this case are so unreliable that they can't form the basis
20 of postal rate adjustments?

21 A I agree with that. I did not indicate that they
22 are so reliable as to be not used at all. What I was
23 indicating was that if the Commission were to attempt to use
24 Ramsey pricing to the exclusion of the other pricing
25 factors, I think that the data requirements and the

1 credibility of those -- of the data would just have to be
2 moved up a notch.

3 Q Now, again at page 13, in the footnote, footnote
4 15, you have a quote from a book by Baumol and Sidak; is
5 that right?

6 A Yes.

7 Q And this quote comes from the book Toward
8 Competition in Local Telephony.

9 A Yes.

10 Q Is that right? Is your quote intended to show
11 that Professors Baumol and Sidak opposed the use of Ramsey
12 information in rate regulation?

13 A The quote is intended to show that they recognized
14 the practical limitations of basing regulated pricing, you
15 know, solely on Ramsey pricing, yes.

16 Q Once again, I assume that -- I haven't talked to
17 either Baumol or Sidak, but as a professional economist, we
18 would all say that demand conditions matter, and no one --
19 no professional economist would tell you that such
20 information is not relevant.

21 Q Okay. Let's look more carefully at the words that
22 they use in the quoted section. At one point, they say that
23 up-to-date estimates of the full set of pertinent
24 elasticities and cross-elasticities are virtually impossible
25 to calculate, particularly in markets where demand

1 conditions change frequently and substantially. Do you see
2 that?

3 A Yes.

4 Q I want to place that in context. The context of
5 this book or this remark is a treatise on telecommunication
6 regulation; isn't that right?

7 A That's right.

8 Q Isn't it fair to say that the demand conditions in
9 the telecommunications market have changed frequently and
10 substantially in recent years?

11 A I would think that that's a fair characterization,
12 yes.

13 Q And isn't it also the case that the changes in the
14 telecommunications market have been more dramatic than any
15 such changes in the market for postal services?

16 A I wouldn't know how to characterize that. I think
17 there has been fairly substantial changes in the
18 transportation industry in the United States, and so there's
19 a fair number of changes going on that probably affect the
20 delivery of postal products also, and I -- I see
21 technological change occurring in both. I think it's fair
22 to say that telephone technology and computer technology
23 certainly is affecting telephony more than the basic
24 transportation industry, that's probably true.

25 Q Your quote comes from pages 38 and 39 of the

1 Baumol cited book. I have that book with me and I would
2 like to review it briefly with you. Specifically, I would
3 like to look at pages 38 and 39, copies of which I have made
4 and I have designated these copies as USPS/UPS-T3-EX-1. And
5 I have provided a copy to your counsel beforehand, but I
6 will distribute additional copies now.

7 [Cross-Examination Exhibit
8 USPS/UPS-T3-EX-1 was marked for
9 identification.]

10 BY MR. COOPER:

11 Q Let's look at page 39 of the handout. The portion
12 quoted by you in your footnote ends where the first
13 paragraph on that page ends, isn't that right?

14 A That's right.

15 Q Now, Professors Baumol and Sidak go on to say more
16 positive things about Ramsey pricing than you have quoted.
17 In fact, in the next sentence following your quote, they go
18 on to say, "Rather, regulators have accepted the usefulness
19 of Ramsey theory as a source of general qualitative guidance
20 rather than as a generator of precise and define
21 prescriptions for pricing." Isn't that right?

22 A That's what they say.

23 Q Do you disagree with that statement?

24 A I have no real grounds for disagreeing it. My
25 former -- in a former life, I was on the staff of the

1 National Regulatory Research Institute and did a price
2 discrimination study there and had opportunity to interact
3 with State Commission staff and I would say they had a
4 general opposition to the idea of Ramsey pricing as a
5 general matter. So I am not quite sure what basis Baumol
6 and Sidak have for this. But it is -- I am sure they could
7 support that.

8 Q Well, I am mainly just trying to provide a fuller
9 quote than you have provided. Let me go on to point out
10 that later in the same paragraph, they state, do they not,
11 that Ramsey theory has also been used to reject high
12 mark-ups on costs in the prices of goods where demands are
13 highly elastic and to note that the self-interest of firms
14 will normally lead them to avoid that sort of pricing
15 behavior in the understanding that charging high prices for
16 goods whose demands are elastic is a sure way to lose one's
17 customers. That's there also, isn't it?

18 A Yes.

19 Q And, finally, they conclude by saying that, in
20 sum, Ramsey pricing analysis continues to play a significant
21 role in regulation and one that may become more substantial
22 in the future. Isn't that also there?

23 A Yes.

24 MR. COOPER: Mr. Chairman, I would ask that this
25 cross-examination exhibit not be admitted into evidence, but

1 be transcribed.

2 CHAIRMAN GLEIMAN: Cross-Examination Exhibit
3 USPS/UPS-T3-EX-1, I'll direct that it be transcribed into
4 the record at this point.

5 [Cross-Examination Exhibit
6 USPS/UPS-T3-EX-1 was transcribed
7 into the record.]

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USPS/UPS - T3 - EX-1

AEI STUDIES IN TELECOMMUNICATIONS DEREGULATION
J. Gregory Sidak and Paul W. MacAvoy, series editors

TOWARD COMPETITION IN LOCAL TELEPHONY
William J. Baumol and J. Gregory Sidak

Toward Competition
in
Local Telephony

William J. Baumol
J. Gregory Sidak

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ing deficit. If the model of perfect competition cannot offer the regulator useful guidance on price regulation, it is virtually worthless as a model for an agency charged with regulating prices.

More than that, the model of perfect competition turns regulation and antitrust toward attempts to populate the industry with a multiplicity of smaller enterprises. But where scale economies are present and substantial, such an effort cannot long succeed unless government virtually dictates all operations of the firms. For otherwise, any one firm that happens to expand will reap a competitive advantage through the scale economies that become available to it, and it will thereby be able to expand even further, all at the expense of its smaller rivals. Thus, where scale economies are substantial an equilibrium with many small firms cannot be expected to last. Nor is it in the social interest that such an equilibrium should endure. For in an equilibrium with scale economies, costs will be unnecessarily high if all enterprises are tiny, since the smallness of the firms must prevent them from taking advantage of the cost savings that scale economies offer. With costs unnecessarily high, prices must be correspondingly excessive if the firm is to survive. That is, the small scale of firms, in equilibrium, can be achieved only at the expense of consumers, who must forgo the savings from the scale economies that would be passed along through lower prices. That result is hardly consonant with the goal of economic efficiency.

The Ramsey Solution

One alternative source of guidance for economic regulation is the body of analysis now called "Ramsey theory," the formal structure first laid out for the analysis of tax policy by the young Cambridge philosopher Frank Ramsey, who managed to produce revolutionary contributions to probability theory, combinatorial analysis, geometry, and economics, as well as to his own field, before his death at age twenty-six. Since its formulation, the theory has elicited contributions by such distinguished economists as A.C. Pigou, Paul Samuelson, Marcel Boiteux, John Hicks, Peter Diamond, and John Mirrlees, and

the validity of its arguments seems to command universal acceptance among economists.¹²

Applied to the field of regulation, Ramsey theory undertakes to determine those second-best prices that are Pareto-optimal, subject to the requirement that they yield revenues sufficient to cover the total costs incurred by the supplier of the products in question. That is, recognizing that in the presence of scale economies a firm would lose money if required to set the prices of each of its products equal to the corresponding marginal costs, the theory explores the alternative pricing possibilities. In a multiproduct firm, many combinations of prices will just enable the supplier to cover its total cost. Ramsey analysis undertakes to determine which of these price sets maximizes economic welfare—or, what turns out to be the same thing, which price set is consistent with Pareto optimality, subject to the requirement that the prices yield revenues adequate for the firm to cover all its costs.

Ramsey analysis provides a set of mathematical formulas that can be solved, with the aid of the appropriate cost and demand data, to determine precisely what prices are required to achieve second-best optimality. This calculation would appear to deprive the regulated firm of any vestige of freedom in its pricing decisions. Apparently the regulator simply calculates the Ramsey-optimal prices from the formulas and directs the regulated firm to adopt those prices and no others. Taken in this way, Ramsey theory is hardly to be interpreted as an instrument of deregulation—that is, a means to enhance the freedom of decision making by the management of the regulated firm. Undoubtedly, some regulators have been tempted to interpret the role of Ramsey theory in this way. Generally, however, the analysis has been assigned a more modest role in regulatory practice. To understand the limitedness of the role it has usually been assigned, we must review what the analysis asserts.

12. The original paper is Frank Ramsey, *A Contribution to the Theory of Taxation*, 37 *ECON. J.* 47 (1927). For a review of the subsequent literature, see William J. Baumol, *Ramsey Pricing*, in 4 *THE NEW PALGRAVE DICTIONARY OF ECONOMICS*, *supra* note 1, at 49-51; William J. Baumol & David F. Bradford, *Optimal Departures From Marginal Cost Pricing*, 60 *AM. ECON. REV.* 265 (1970).

First, although Ramsey analysis is invoked most frequently for the case of scale economies, its results apply equally whether there are scale economies, diseconomies, or constant returns to scale. Second, the Ramsey formula most frequently cited—the so-called inverse-elasticity formula—is a special case that is *not* applicable universally. It holds only when the set of products at issue contains no two items that are substitutes (like Coca-Cola and Pepsi-Cola) or complements (like bread and butter) in demand.¹³

The logic of the Ramsey formula is intuitively explainable from the proposition that, if it were feasible financially, economic welfare would be maximized by setting the price of each product equal to its marginal cost. If this set of prices yields revenues insufficient to cover the supplier's total cost, however, the prices must be modified for the goods to continue to be supplied by private enterprise. But every deviation of price from marginal cost creates some inefficiency—first, because it provides an incentive for consumers to switch to those goods whose prices are raised only modestly relative to their true marginal cost, and second, because every rise in price restricts demand by cutting into consumer purchasing power.

The objective, then, is to revise prices in the way that minimizes the need to deviate from marginal costs, while eliciting the requisite increase in total revenue of the firm—that is, raise most the prices of those items that yield the largest revenue contribution, or the most “bang for the buck.” This rule immediately yields the course of action prescribed by Ramsey theory. If good *X* has a large price elasticity of demand—that is, a 1 percent rise in its price severely cuts demand—then a rise in the price of *X* will add little to the firm's revenue. But if the demand for good *Y* is inelastic, then a 1 percent

13. The prices that will emerge under the regulatory rules proposed in this monograph will not necessarily be Ramsey prices. Indeed, in theory these may differ altogether. There is reason to expect, however, that in practice the prices that would have emerged, had competition been fully effective, will tend to approximate the Ramsey prices. Indeed, even in theory, because those competitive prices will be the prices required for economic efficiency if two or more firms are present in the market, they must be the same as the pertinent Ramsey prices. For proofs that these competitive (contestable) market prices must be efficient in multifirm equilibria, see WILLIAM J. BAUMOL, JOHN C. PANZAR & ROBERT D. WILLIG, *CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE*, chaps. 2-5, 11, 12 (Harcourt Brace Jovanovich, rev. ed. 1988).

rise in its price will cut only modestly into the quantity of *Y* demanded, and so will add a comparatively great amount toward eliminating the shortfall in the firm's revenue.

Hence, the damage to welfare is minimized if the shortfall is covered through smaller increases in the prices of the goods whose demands are elastic, and larger increases in the prices of goods whose demands are comparatively inelastic. This pricing rule, in essence, is the logic of the inverse-elasticity formula, which states that, where goods are neither substitutes nor complements, the percentage difference between the price of any good *X* and the marginal cost of *X* should be inversely proportionate to the price elasticity of demand for *X*. A formal derivation of the inverse-elasticity formula appears as Appendix 3-1 to this chapter.

Where some of the firm's products are complements, substitutes, or a mixture of the two, in addition to the own-price elasticities of demand, the cross-price elasticities also become pertinent. That is, the effect of a change in the price of good *X* on the quantity demanded of another good *Y* also matters directly. Where commodity demands are interrelated in such ways, an attempt to increase revenue by raising the price of *X* can either be frustrated by an accompanying fall in the quantity of *Y* demanded, or the price rise can overshoot its mark if the indirect effect on demand goes in the opposite direction. Therefore, to use the full Ramsey analysis to calculate second-best optimal prices, one needs information on the marginal cost of, and the own-price elasticity of demand for, each of the products in question. One probably needs to know the full set of cross-price elasticities as well.

This data requirement is one reason why most regulators and consulting economists have rejected the use of the Ramsey formulas even to provide approximations for the prices that the regulated firm should be permitted to charge for its products.¹⁴ Marginal-cost

14. Another reason why regulators reject a regime of Ramsey pricing is the inelasticity of demand for local telephone service, which means that the price of such service is likely to be increased substantially by the Ramsey rules. It is thought that the resulting reduction in demand, though smaller in relative terms than the reduction in demand for more price-elastic services, would tend to frustrate the universal-service goal in telecommunications regulation.

figures are difficult enough to come by, although reasonably defensible approximations have been provided by firms to regulatory bodies. But up-to-date estimates of the full set of pertinent elasticities and cross-elasticities are virtually impossible to calculate, particularly in markets where demand conditions change frequently and substantially. As a result, an attempt to provide the regulator with an extensive set of Ramsey prices is likely to be beset by inaccuracies, by obsolete demand data, and by delays that will prevent the firm from responding promptly and appropriately to evolving market conditions.

Rather, regulators have accepted the usefulness of Ramsey theory as a source of general qualitative guidance rather than as a generator of precise and definitive prescriptions for pricing. Ramsey theory has, for example, been used to defend the legitimacy in terms of the general welfare of what in the regulatory arena is called "differential pricing"—that is, the use of discriminatory prices, in the economic rather than the legal sense.¹⁵ After all, the Ramsey formula is a prescription for deriving those prices whose deviations from marginal costs will serve the public interest where scale economies are present. But such differentiated price-marginal cost deviations are precisely what economists mean by the term "price discrimination." Ramsey theory has also been used to reject high markups on costs in the prices of goods whose demands are highly elastic, and to note that the self-interest of firms will normally lead them to avoid that sort of pricing behavior, in the understanding that charging high prices for goods whose demands are elastic is a sure way to lose one's customers.¹⁶ In sum, Ramsey-pricing analysis continues to play a significant role in regulation, and one that may become more substantial in the future. But that role is nevertheless circumscribed, and Ramsey analysis is unlikely to determine the actual magnitudes of regulated prices.

15. See, e.g., *National Rural Telecom Ass'n v. FCC*, 988 F.2d 174, 182-83 (D.C. Cir. 1993) (Williams, J.); *Policy and Rules Concerning Rates for Dominant Carriers, Further Notice of Proposed Rulemaking*, CC Dkt. No. 87-313, 3 F.C.C. Rec. 3195, 3257-58 ¶¶ 111-15 (1988).

16. See, e.g., *Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520, 526-27 (1985).

One final aspect of Ramsey analysis merits attention. In a competitive market, the own-price elasticity of demand is considerably smaller for a product than for a firm. If a firm unilaterally raises its price for a product, it will lose customers to other sellers, even if those customers are not lost to the industry. Which of these two elasticity figures should be used in the Ramsey formula? The industry elasticity is often assumed to be the appropriate one, but that is not generally correct. The purpose of the Ramsey calculation is to bring to the firm the addition to total revenue that it needs to cover its costs, and to do so with minimal deviation of prices from marginal costs. The way to do so is to focus upon changes in those prices for which a given percentage increase contributes most to the firm's revenues. But the prices that will accomplish this objective are those for which *the firm's* demand elasticity is lowest, regardless of what the own-price elasticity of demand may be for those products for the entire industry.¹⁷ This observation is important. It means that Ramsey markups on competitive products will be lower, because they are appropriately guided by the firm's elasticity of demand; to compensate for this, Ramsey markups on monopoly products will be higher than they would be if the pertinent demand elasticity for each of the firm's products were that of the industry.

The Endogeneity of the Demand Elasticity for a Regulated Firm

Application of Ramsey analysis to regulation is subject to another important caveat because feasibility of the calculations is likely to require them to take the pertinent demand elasticities as a given. In the language of economics, these elasticities are then treated as exogenous. But regulators considerably influence the firm's demand elasticity by their decisions and policies that affect the firm's actual or potential competitors. Clearly, severe constraint of firms' entry and pricing will somewhat immunize each enterprise from the competitive

17. A review of the simplified derivation of the Ramsey formula in Appendix 3-1 to this chapter confirms that the marginal revenue, and hence the demand elasticities, throughout the mathematical argument are indeed those for the firm, not those for the industry.

1 MR. COOPER: I have no further questions.

2 CHAIRMAN GLEIMAN: Are there follow-up questions?
3 Questions from the bench?

4 I am a little confused here. Maybe you can help
5 me out. Looking back at PSA/UPS-T3-5 --

6 THE WITNESS: Yes.

7 CHAIRMAN GLEIMAN: Question A. Is it not the case
8 that UPS's parcel volume has increased far in excess of
9 increases in parcel post volume since Docket R94-1, despite
10 yearly rate increases by UPS and that, therefore, the Postal
11 Service has not been able to secure its proper share of the
12 increased parcel post market, the lion's share of which has
13 gone to UPS?

14 Your answer to that was there is no proper share
15 of the increased parcel post market that any particular
16 enterprise deserves.

17 You were asked some questions about -- well,
18 before I get on -- just looking at the question, would you
19 conclude from the facts presented in the question about
20 declining market share for the Postal Service, in light of
21 rate increased by UPS, that the Postal Service wasn't a
22 particularly efficient provider?

23 THE WITNESS: If I had all of those facts and was
24 comfortable with them, I think that is the type of
25 conclusion that one would tend to draw, yes. I just -- this

1 wasn't part of my -- assembling those facts wasn't part of
2 my testimony.

3 CHAIRMAN GLEIMAN: Well, I am accepting, you know,
4 that the statement is factual here. If it is factual, then
5 your conclusion would be that the Postal Service apparently
6 is not an efficient provider, otherwise, they would not have
7 lost market share in the face of increasing --

8 THE WITNESS: Or it is not an effective competitor
9 in some -- in some fashion.

10 CHAIRMAN GLEIMAN: With respect to Ramsey pricing,
11 do you have any sense if one were to use pure Ramsey pricing
12 what -- how much of an increase or decrease one might wind
13 up with in Parcel Post rates? Do you think that rates would
14 be substantially higher than those that have been proposed
15 by the Postal Service?

16 THE WITNESS: I'm trying to recall Witness
17 Bernstein's numbers. That would give us some indication of
18 that. As I -- I probably have it here if you'd -- if I
19 could check my facts.

20 CHAIRMAN GLEIMAN: Well, you can take a moment and
21 find it if you think you have it. Yes, it would be helpful.

22 THE WITNESS: I'm trying to recall where it would
23 be.

24 Bernstein came up with a \$4.11 price for -- under
25 Ramsey price for Parcel Post.

1 CHAIRMAN GLEIMAN: Thank you.

2 Commissioner LeBlanc?

3 COMMISSIONER LeBLANC: I've just got one question
4 now, because basically to follow up. That was kind of along
5 the lines I was going to ask Mr. Henderson. But in that
6 same PSA-5 you talk about -- or counsel asked you a question
7 about in order to enhance a competitive opportunity in the
8 market. When you set your rates that you came up with, you
9 looked at more than price. You looked at -- in other words,
10 what did you look at to come up with -- or did you look at
11 anything to come up with competitive opportunities for your
12 client as well as others, or --

13 THE WITNESS: I made no separate --

14 COMMISSIONER LeBLANC: In other words, what focus
15 did you use there?

16 THE WITNESS: Basically the study that I conducted
17 was based on the cost information provided to me by UPS
18 Witness Sellick. I used that as the cost basis. I then
19 used the Commission's prior markups from the R94 case, and
20 then the Postal Service's elasticities from this case. So
21 the competitive condition facing the Postal Service in my
22 view is reflected in large part in those demand
23 elasticities. Those demand elasticities reflect the overall
24 market demand elasticity as well as the supply response that
25 the Postal Service can expect from its competitors when it

1 changes its prices.

2 So it's -- within those demand elasticities there
3 is already information about the market response, both on
4 the demand side and on suppliers other than -- providers of
5 postal services other than the Postal Service itself.

6 So it's -- I made no separate study to -- of
7 competitive conditions and simply accepted the Postal
8 Service's work in that regard.

9 COMMISSIONER LeBLANC: So in other words you
10 weren't trying to get to a market share for --

11 THE WITNESS: No.

12 COMMISSIONER LeBLANC: Any particular person, and
13 obviously then from what you're telling me -- don't let me
14 put words in your mouth here. I don't want to
15 mischaracterize what you said. But you looked at service
16 based on what you answered to the chairman as I understood
17 it. You looked at the pricing, the criteria. You looked at
18 our criteria in other words that we have to deal with as you
19 alluded to in your testimony. So you looked at the ball of
20 wax, if you will, the whole --

21 THE WITNESS: That's right --

22 COMMISSIONER LeBLANC: And then came up with your
23 price.

24 THE WITNESS: What I tried to do was to look at it
25 in the way that I thought the Commission traditionally

1 looked at it, and the major departure from the Postal
2 Service case is that I base my cost study on that of Witness
3 Sellick, and there is a difference between his development
4 of postal costs and the Postal Service's own development of
5 that cost. That's the principal difference.

6 COMMISSIONER LeBLANC: Okay. Fine. That answered
7 my question. Thank you very much.

8 Thank you, Mr. Chairman.

9 CHAIRMAN GLEIMAN: Further questions?
10 Followup to questions from the bench?
11 Mr. May.

12 FURTHER CROSS-EXAMINATION

13 BY MR. MAY:

14 Q Yes. Dr. Henderson, the Chairman's question was
15 would you conclude that if it were the case that Parcel Post
16 share volumes declined compared to UPS's despite UPS's
17 rising prices, whether that would not indicate that the
18 Postal Service was inefficient, and I believe you agreed.

19 Is that simply one explanation for that
20 phenomenon? Inefficiency?

21 A Yes. I believe in answering I said or in some way
22 that the Postal Service is apparently an ineffective
23 competitor.

24 Q Yes, well let me ask you this. Suppose it's the
25 case that despite yearly increases by UPS, the actual prices

1 UPS really charges its customers are overall less than what
2 the Parcel Post charges? Wouldn't that be another
3 explanation for that phenomenon?

4 A If that were true, it certainly would be a factor.

5 Q I know. But the fact is you don't know what is
6 true. You simply had to take the assumptions that were
7 made, and the assumptions -- and based on those assumptions
8 you said inefficiency could be an explanation. Now you've
9 said prices could be an explanation. But you don't know
10 what are the facts, because you haven't studied it. Is that
11 correct?

12 A I have not studied the UPS position in particular
13 in my testimony. My testimony is based upon the Postal
14 Service's costs and the Postal Service's market conditions
15 as a whole, not those of an individual competitor such as
16 UPS.

17 Q Yes. As far as you know, UPS's rates are less
18 than the Post Office. You simply don't know, do you?

19 A I have no way of knowing one way or the other.

20 Q Now Commissioner LeBlanc's question. Is it not
21 the case that you did not carefully go through all of the
22 various criteria and make an independent judgment but rather
23 that you simply subsumed them all in a conclusion that the
24 Commission's judgment in the last case about coverage which
25 reflected those factors was good enough for you, and you

1 would go with that this time?

2 A What I did was to look at the Commission's
3 decision in R94 and then I looked at the record in this case
4 to see whether there were changed circumstances or changed
5 conditions that would warrant a change in those relative
6 markups. You know, being cognizant of the Commission's
7 reasoning in the past.

8 Q And you found nothing to suggest a change?

9 A I found nothing that suggested a major deviation
10 from those markups is needed.

11 Q Thank you, doctor.

12 CHAIRMAN GLEIMAN: Mr. Cooper, any further
13 questions? Redirect?

14 MR. MCKEEVER: If I may have a couple of minute,
15 Mr. Chairman.

16 CHAIRMAN GLEIMAN: Certainly.

17 [Recess.]

18 MR. MCKEEVER: Mr. Chairman, we have no redirect.

19 CHAIRMAN GLEIMAN: If that is the case, then that
20 brings us to the conclusion of our hearings today.

21 Dr. Henderson, I want to thank you for your
22 appearance and for your contributions to the record. And if
23 there is nothing further, you are excused.

24 [Witness excused.]

25 CHAIRMAN GLEIMAN: That concludes today's

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1 hearings. We will reconvene tomorrow, Wednesday, the 25th,
2 at 9:30 to receive testimony from Time-Warner, Witness
3 Stralberg; Magazine Publishers Association, Witness Cohen;
4 United Parcel Service, Witnesses Sellick and Luciani; and
5 Office of Consumer Advocate, Witness Sherman.

6 You all have a good afternoon.

7 [Whereupon, at 3:22 p.m., the hearing was
8 recessed, to reconvene at 9:30 a.m., Wednesday, February 25,
9 1998.]

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