

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

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POSTAL RATE AND FEE CHANGES, 2006

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Docket No. R2006-1

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS KIEFER  
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.  
AND VALPAK DEALERS' ASSOCIATION, INC.,  
(VP/USPS-T36-3-5a-b, d-h))

The United States Postal Service hereby files the responses of witness Kiefer to above-listed interrogatories, filed on May 26, 2006. Interrogatory subpart VP/USPS-T36-5(c) has been redirected to witness Talmo.

The interrogatories are stated verbatim and are followed by the responses.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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June 9, 2006

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIEFER TO  
INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC.  
AND VALPAK DEALERS' ASSOCIATION, INC.

**VP/USPS-T36-3.**

Please refer to page 6 of your testimony, USPS-T-36, lines 23-25, where you say: "The Automation Basic rate category [of Standard Mail ECR and Nonprofit ECR letters] will be eliminated. I am assuming that these pieces will migrate to the Regular subclasses and pay the Automation 5-digit letter rates."

Please refer also to your Library Reference, USPS-LR-L-36, workbook WPSTDECR.xls, tab 'TYAR Commercial Pieces & Pounds,' cell I8, which contains the following formula for the TYAR volume of origin-entered basic letters weighing from 3.3 to 3.5 ounces (*i.e.*, heavy letters): "="+Comm. Piece-Pound Dist.-- BY '!I8/SUM('Comm. Piece-Pound Dist.-- BY '!I8:\$L8)\*Inputs!\$D42\*ECR Commercial BDs!\$H\$135/('ECR Commercial BDs!\$H\$23)".

- a. Please confirm that this formula means that (the TYAR volume of basic origin entered heavy letters) is equal to (the BY volume of basic heavy letters at all entry points) \* (the BY proportion of basic heavy letters that are entered at an origin office) \* (the TYAR to BY ratio of basic non-letters, piece rated and pound rates, all entry offices). If you do not confirm, please explain as a function of simple concepts and ratios what this formula means.
- b. Please explain why the growth in basic heavy letters between BY and TYAR should be equal to the corresponding growth in basic non-letters, piece rated and pound rated, all entry points.
- c. Please explain any definitional requirements that will be placed on basic letters in the Test Year, such as a requirement that they be machinable or automation compatible, or any other.
- d. Please reconcile the projection in cell I8 with your statement on page 6, both referenced above, that "these [automation Basic letters] will migrate to the Regular subclasses and pay the Automation 5-digit letter rates."
- e. Please explain how the projection in cell I8, referenced above, relates to the projection for automation Basic letters found in cell D39, tab 'Inputs,' of the same workbook.

**RESPONSE:**

- a. Confirmed.
- b. The model used by witness Thress (USPS-T-7) includes ECR Basic heavy letters with Basic Nonletters for forecasting purposes. I receive a single forecast for commercial ECR Basic Nonletters that I disaggregate to the various shapes (heavy letters, flats, parcels), entry levels (origin, DBMC, DSCF, DDU) and weight categories (piece-rated, pound rated) using base year values from billing determinants data. This means that the projected growth for ECR commercial

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIEFER TO  
INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC.  
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Basic heavy letters will necessarily parallel the forecasted growth for all commercial Basic Nonletters.

- c. I understand that no changes in the mailing requirements for nonautomation ECR Basic letters are being planned at the present time. Nevertheless it should be borne in mind that mailing standards do change from time to time as conditions warrant.
- d. Please see the response to subpart (b). There are only about 4.0 million ECR Basic heavy letters in the test year. For analytical simplicity it was decided to keep these relatively few pieces together in ECR with other mail pieces that are forecasted as part of the same group. I recognize that this decision introduced a difference between the way ECR Basic heavy letters and ECR piece-rated Automation Basic letters (which are forecasted as a separate single group) are treated. In my view, my treatment of ECR Basic heavy letters does not introduce any material problems. For example, had I treated these pieces the same as piece-rated Automation Basic letters and assumed that 100% of heavy letters migrated to Standard Mail Regular 5-digit heavy letters, a rough calculation suggests that my projection of total Standard Mail revenue might have declined by less than \$50,000.
- e. It is not related. Please see my responses to subparts (b) and (d).

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIEFER TO  
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**VP/USPS-T36-4.**

Please refer to your Library Reference, USPS-LR-L-36, workbook WP-STDECR.xls, tab 'TYAR Commercial Pieces & Pounds,' cell D10, which contains the following formula for the TYAR volume of piece-rated saturation letters entered at an origin office: " $=+'Comm. Piece-Pound Dist.-- BY '!D10/SUM('Comm. Piece-Pound Dist.— BY!$D10:$G10)*Inputs!$D41$ ".

- a. Please confirm that this formula means that (the TYAR volume of piece-rated saturation letters entered at an origin office) is equal to (the TYAR volume of both piece-rated and pound-rated saturation letters entered at all entry points) \* (the ratio for the BY of piece-rated saturation letters entered at an origin office to piece-rated saturation letters entered at all offices). If you do not confirm, please explain as a function of simple concepts and ratios what this formula means.
- b. Please explain why the TYAR volume of origin-entered piece-rated letters should be equal to an origin-entry proportion for piece-rated letters applied to a volume projection for piece-rated and pound-rated letters combined.

**RESPONSE:**

- a. Confirmed.
- b. The model used by witness Thress (USPS-T-7) includes ECR Saturation heavy letters with Saturation Nonletters for forecasting purposes. I receive a single forecast for commercial ECR Saturation Nonletters that I disaggregate to the various shapes (heavy letters, flats, parcels), entry levels (origin, DBMC, DSCF, DDU) and weight categories (piece-rated, pound rated) using base year values from billing determinants data. This means that the projected growth for ECR commercial Saturation heavy letters will necessarily parallel the forecasted growth for all commercial Saturation Nonletters.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIEFER TO  
INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC.  
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**VP/USPS-T36-5.**

In Commercial ECR Standard, please refer to the rates proposed at the minimum perpiece level for saturation **letters** of 17.2 cents (per piece) and for saturation **flats** of 18.2 cents, the former being required to be machinable and automation compatible. (See, e.g., Request, Attachment A, p. 19, Rate Schedule 322.)

- a. Please confirm that the mail processing cost for these saturation letters, shown in workbook LR-L-84.xls in USPS-LR-L-84, is 1.095 cents. If you do not confirm, please correct this cost and substitute your revised estimate in the remaining parts of this interrogatory, as appropriate.
- b. Please confirm that the carrier cost for these saturation letters, shown in workbook UDCModel.USPS.xls in USPS-LR-L-67, is 3.205 cents. If you do not confirm, please correct this cost and substitute your revised estimate in the remaining parts of this interrogatory, as appropriate.
- c. Please confirm that workbook LR-K-119.xls, tab 'Unit Costs,' in USPS-LR-K- 119, Docket No. R2005-1, showed the FY 2006 cost for all ECR letters, exclusive of mail processing and carrier costs, to be 0.2341 cents, and the corresponding cost for flats to be 0.8012 cents, and that Postal Service witness Yorgey, in Docket No. MC2005-3, USPS-T-2 (see, e.g., p. 4 of Appendix A, footnote 9), used the figures of 0.2341 cents and 0.8012 cents as the cost of letters and flats beyond mail processing and carrier costs. If you do not confirm, please provide alternative add-on costs, identifying their source. Also, please update the costs of 0.2341 cents and 0.8012 cents to FY 2008.
- d. Please confirm that the revenues on sheet 'Revenues @ TYBR Vols.' and the volumes on sheet 'TYBR Commercial Pieces & Pounds' of your workbook file WP-STDECR.xls in USPS-LR-L-36 can be used to calculate a per-piece revenue for saturation letters, origin entered, of 17.23 cents and for saturation flats, origin entered, of 19.66 cents. If you do not confirm, please provide a figure that you believe to be correct, and substitute it in the remaining parts of this interrogatory, as appropriate.
- e. Please confirm that the mail processing cost for saturation flats, shown in workbook LR-L-84.xls, tab 'Table 1,' in USPS-LR-L-84, is 1.599 cents. If you do not confirm, please correct this cost, or supply an alternative cost, and substitute your estimate in the following parts of this interrogatory, as appropriate, explaining its derivation.
- f. Please confirm that the carrier cost for saturation flats, shown in USPS-LR-L- 67, is 5.213 cents. If you do not confirm, please correct this cost, or supply an alternative cost, and substitute your estimate in the following parts of this interrogatory, as appropriate, explaining its derivation.
- g. Referring to the figures in parts a through f, as well as any corrected figures you may provide, please provide an explanation of the appropriateness of a per-piece contribution for letters of 12.696 cents and a somewhat smaller per-piece contribution for flats of 12.047 cents. Please include in your explanation all reasons why you believe it is appropriate for the per-piece contribution of saturation letters to be higher than the corresponding contribution of flats, including reasons of policy. For ease of reference, these figures are:

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIEFER TO  
INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC.  
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Saturation	Revenue Per-piece (cents)	Per-piece Cost (cents)	Per-piece Contribution (cents)	Implied Cost Coverage
Letters	17.23	4.534	12.696	380.01%
Flats	19.66	7.613	12.047	258.24%

- h. Please refer to the cost figures and the per-piece contribution figures in part g, or to any corrected figures you provide.
- (i) Please explain the appropriateness of products with substantially different costs having approximately the same per-piece contributions.
  - (ii) Please provide any examples you know of in the competitive private economy where a firm's higher-cost product, in this case 67.9 percent higher, makes the same or lower contribution as the lower-cost product.
  - (iii) Please explain the nature of any competitive conditions that would lead to equilibria with these kinds of cost/contribution relationships.

**RESPONSE:**

- a. Confirmed.
- b. Confirmed.
- c. Redirected to witness Talmo, USPS-T-27.
- d. The sheet titles in the question are believed to be misidentified. If the first sheet is understood to refer to "Revenues @ TYAR Vols." and the second sheet is understood to refer to "TYAR Commercial Pieces & Pounds" the calculations can be confirmed, with the qualification that the flats are pieces that are addressed on the piece and do not use DALs.
- e. Confirmed.
- f. Confirmed.
- g. The allocated costs in the table should be adjusted to reflect the updated cost estimates supplied by witness Talmo (USPS-T-27) in USPS-LR-L-135. With these updated cost allocations the "Per-piece cost" estimate for ECR Saturation origin-entered letters becomes 4.57 cents and the estimate for ECR Saturation origin-entered flats becomes 7.69 cents. Subtracting these values from the average per-

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIEFER TO  
INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC.  
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piece revenue estimates for ECR Saturation origin-entered letters and flats yields estimates for "Per-piece contribution" for this group of letters of 12.66 cents and for this group of flats of 11.97 cents. I do not know whether pieced-together numbers like these can lead to appropriate measures of contribution comparable to the contribution measures developed using CRA data at the subclass level.

Nevertheless, I am willing to use them as reference points in responding to this question. With that caveat in mind, these "per-piece contribution" values do not seem at all inappropriate to me. There are several reasons for my view. First of all, the estimated "contributions" of the two groups of mail are fairly close to each other. Second, the contribution portion of a rate is designed to recover costs that are specifically not volume variable, and that are not attributable to any specific classification of mail. I see no reason why the sole fact that one group's or product's unit volume variable cost is higher than another's should mean that the first product must be required, for that reason alone, to make a higher unit contribution to the Postal Service's institutional costs. Third, the Postal Service has long asserted the obvious point that its customers pay rates, and not cost coverages. In developing these rates the Postal Service took into account, not only cost information, but also the existing rates for Saturation letters and flats, degree of mail preparation, market conditions, as well as historic rate relationships. The rates I am proposing reflect a balancing of these factors to reach what I believe is a fair and appropriate set of rates for ECR Saturation letters and flats. Fourth, and related to the previous point, in the proposed rates the Postal Service has widened the rate difference between what a Saturation letter will pay and what a comparably addressed flat will pay. Fifth, the analysis of "per-piece contribution" that forms the basis of this question is seriously flawed. It is flawed because it overlooks the important fact that my pricing proposals for Saturation flats also

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS KIEFER TO  
INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC.  
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include a 1.5 cent per-piece surcharge for pieces that use detached address labels (DALs). Including the surcharge further widens the differential between what the Postal Service is asking ECR Saturation flats mailers and letter mailers to pay. Depending on what proportion of Saturation flats mailers use DALs, the "Per-piece revenue" and "Per-piece contribution" shown in the table (even as amended) would have to be revised. At some DAL usage level, the "Per-piece contribution" of flats actually exceeds the "Per-piece contribution" shown for letters.

- h. (i) Please see my response to subpart (g). As I stated in that response, pieced-together unit volume variable costs are not, or should not become, the sole driving factor in determining the "per-piece contributions." In MC95-1, the Postal Service and the Postal Rate Commission recognized the common characteristics of saturation-type advertising mail, and its distinctiveness from other mail types, when it established a separate subclass for ECR mail. It should not be surprising, then, that the unit contributions for pieces sharing these common characteristics would have similar "per-piece contributions."
- (ii) I am not privy to detailed per-piece cost data from competitive private sector businesses since this sort of information is considered strictly proprietary and highly confidential, so I am unable to answer this question.
- (iii) Please see my response to (h)(ii).

## **CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

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June 9, 2006