

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

POSTAL RATE AND FEE CHANGES
PURSUANT TO PUBLIC LAW 108-18

Docket No. R2005-1

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS KIEFER
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.,
(VP/USPS-T36-1 and 2(a)-(c), (e)-(h) and (j)-(m))

The United States Postal Service hereby files the responses of witness Kiefer to above-listed interrogatories, filed on May 16, 2006 and amended on May 23, 2006.

Interrogatory subparts VP/USPS-T36-2(d) and (i) has been redirected to witness Talmo (USPS-T-27).

The interrogatories, as amended, are stated verbatim and are followed by the responses.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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

VP/USPS-T36-1.

Please refer to the following portions of your testimony USPS-T-36:

- Page 12, beginning on line 26, where you say: "I have developed a rate design methodology that differs from the 'formula' approach in use (with modifications) since Docket No. R90-1." (USPS-T-36, p. 12, l. 26 to p. 13, l. 1.)
- Page 14, beginning on line 3, in your discussion of the development of commercial Regular rates, where you state: "I developed rates for each grouping of letters by selecting rate elements for the least workshared piece and developed other prices to reflect worksharing, point of entry and other relevant factors.⁵ In the case of the machinable letters group (which includes automation letters) the base piece was a Mixed AADC nonautomation letter entered at an origin facility. The piece rate for such a Mixed AADC letter is \$0.140 and the pound rate is \$0.739. For a piece-rated letter (weighing from 0 to 3.3 ounces) these rate elements produce a minimum per piece rate of \$0.292." (USPS-T-36, p. 14, ll. 3-10.)
 - Footnote 5 states: "The starting piece and pound rates for letters ... were originally selected based upon the approximate rate increase required to achieve the cost coverage targets provided to me by witness O'Hara (USPS-T-31). The base piece rate elements were then adjusted iteratively to achieve revenue targets while keeping other rate design goals such as appropriate rate relationships in mind." (USPS-T-36, p. 14, fn. 5.)
- Your workbook file WP-STDREG.xls in USPS-LR-L-36, sheet 'Proposed Rates,' cell H33, containing the following formula: "="+ROUND(\$D\$8+ROUND((\$D\$9-R\$20)*\$D\$6/16,3)-\$F33,3)".
- Page 32, beginning on line 14, on setting commercial ECR rates, which says: "As with letters, I selected piece and pound rates for the base piece (an origin-entered Basic flat) based on current rates and cost information from witnesses Talmo ... and Kelley...." (USPS-T-36, p. 32, ll. 14-16.)
 - a. Please confirm that cell D8, referenced in the above formula, contains the "base piece rate" of \$0.140 to which you refer on page 14. Please explain any failure to confirm.
 - b. Please confirm that cell D9, also referenced in the above formula, contains the pound rate of \$0.739, to which you refer on page 14. Please explain any failure to confirm.
 - c. Please confirm that the above formula is a key step in your "rate design methodology that differs from the 'formula' approach in use (with modifications) since Docket No. R90-1." Please explain any failure to confirm.
 - d. Please confirm that the final minimum per-piece rate that results from your formula is \$0.292. Please explain any failure to confirm.
 - e. As a conceptual matter, please explain how thinking about the "base piece rate" of \$0.140 is helpful to you in leading to the final minimum per-piece rate of \$0.292.

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Response to VP/USPS-T36-1 continued

- f. Borrowing from your statement on page 32 for ECR rates, which suggests that the "base piece rate" of \$0.140 might be based "on current rates and cost information" (p. 32, ll. 14-15), please provide and explain the cost information on which you relied to help you select the "base piece rate" of \$0.140, specifying precisely what that cost information is and explaining how it relates to the piece rate of \$0.140.
- g. Please explain any relationship you see between the cost of the pieces that pay \$0.292 and the "base piece rate" of \$0.140.
- h. Please explain any relationship you see between the cost of the pieces that pay \$0.292 and the rate of \$0.292 paid by those pieces.
- i. Beginning with your "starting" point of "the approximate rate increase required to achieve the cost coverage targets," discussed in footnote 5, please explain the reasoning by which you arrived at your "base piece rate" of \$0.140.
- j. Do you agree that none of the pieces paying the minimum-per-piece rate of \$0.292 pay the pound rate of \$0.739 or the "base piece rate" of \$0.140? Please explain any failure to agree.
- k. At those times when you saw a need to adjust rates "iteratively to achieve revenue targets," please explain how you decided which "base piece rate elements" to change, explaining in detail any role that the cost of these base pieces played in the decision to change the rate.

RESPONSE

- a. Confirmed.
- b. Confirmed.
- c. This formula is a way to implement part of my rate design methodology. In that sense, it could be considered a "key step."
- d. Confirmed that the proposed rate for the non-drop-shipped Mixed AADC Nonautomation machinable letter rate (the rate for the "base piece") is \$0.292.
- e. Generally, by establishing piece and pound rates and applying these to both piece-rated pieces and piece-and-pound-rated pieces, consistency at the break point can be easily achieved. While letter-shaped pieces having weights greater than the break point do not pay piece and pound rates in the way nonletter-shaped pieces

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Response to VP/USPS-T36-1 continued
do, the parallel rate element structure used to develop the letter rates is useful in
facilitating comparison between the proposed rates for letters and those for
nonletter-shaped pieces.

- f. Cost information was available from witnesses Miller and Kelley on the unit mail processing and delivery costs for the "base piece." These are shown separately in the Inputs worksheet of my workbook WP-STDREG.XLS, and are summed for machinable letters in cell D7 of the Proposed Rates worksheet. This sum served as a reference point when I chose both the piece and pound rate elements shown in cells D8 and D9. Other factors also contributed to the choice of these elements.
- g. Please see the response to subpart (f). The choice of the base piece rate was not intended to reflect a precise mathematical formulaic relation to the cost information presented in cell D7. It should be noted that the cost information in D7 serves as a reference point for the piece and pound rate elements to ensure, for example, that the proposed rates do not fall below the summed unit cost data in D7.
- h. Please see my response to subpart (g).
- i. The starting point rate elements, including the base piece rate elements mentioned in the question, were adjusted up or down over the course of numerous iterations as needed to produce prices that covered costs, met subclass revenue targets, resulted in acceptable and reasonable rate increases, and bore acceptable and reasonable rate relationships to other proposed rates. The base piece rate cited in the question was a mechanism to arrive at appropriate pricing for letters and was not seen as an end or outcome of the process in itself.

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Response to VP/USPS-T36-1 continued

- j. All minimum-per-piece-rated pieces, of whatever shape, pay a single rate per piece and do not calculate or pay separate piece and pound rates, regardless of the mechanism I used to arrive at those rates. The rates I propose for minimum-per-piece-rated pieces of all shapes are shown on my Proposed Rates spreadsheets as single per-piece prices. They are also presented as single per-piece prices in the proposed Rate Schedules filed by the Postal Service in this docket.
- k. When rate adjustment was deemed necessary, it was seldom the case that a single base piece rate element was the only rate element to be changed. For example, if the rates produced revenues that exceeded the target, several rate elements would likely be lowered together to maintain appropriate rate relationships. Similarly, if rate change mitigation were deemed necessary for one rate category, various rate elements in other rate categories might be simultaneously raised to offset the revenue shortfall. The costs of base pieces did not usually trigger a decision to change a rate, although they served as reference points during the rate change process.

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VP/USPS-T36.2.

In Regular Standard, please refer to the rates proposed at the minimum per-piece level for mixed ADC flats of 43.1 cents (per piece) and for mixed ADC letters of 29.2 cents, both machinable. (See, e.g., Request, Attachment A, pp.11-12, Rate Schedule 321A.)

- a. Please confirm that the mail processing cost for these mixed ADC letters, shown in USPS-LR-L-48, is 5.546 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 question, as appropriate.
- b. Please confirm that the carrier cost for these mixed ADC letters, shown in USPS-LR-L-67, is 3.596 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 question, as appropriate.
- c. Please confirm that the attributable mail processing plus carrier costs of these letters is 9.142 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 question, as appropriate.
- d. Please confirm that USPS-LR-K-119, Docket No. R2005-1, showed the cost for all Regular Standard letters, exclusive of mail processing and carrier costs, to be 0.6417 cents, and that Postal Service witness Yorgey, in Docket No. MC2005-3, USPS-T-2 (see, e.g., p. 4 of Appendix A), used the figure of 0.6417 cents as the cost of letters beyond mail processing and carrier costs. If you do not confirm, please provide alternative add-on costs, identifying their source. Also, please update the cost of 0.6417 cents to the instant docket and FY 2008.
- e. Please confirm that, based on these costs, the per-piece contribution of these letters is 19.42 cents, implying a cost coverage of 298.46 percent. If you believe these figures are wrong, please provide alternative figures, explaining their derivation.
- f. Please confirm that the mail processing costs for mixed ADC flats, shown in USPS-LR-L-43, is 23.522 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 question, as appropriate, explaining its derivation.
- g. Please confirm that the carrier costs for these mixed ADC flats, shown in USPS-LR-L-67, is 9.413 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 question, as appropriate, explaining its derivation.
- h. Please confirm that the attributable mail processing plus carrier costs for mixed ADC flats is 32.935 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 question, as appropriate, explaining its derivation.
- i. Please confirm that USPS-LR-K-119, Docket No. R2005-1, showed the costs for flats, exclusive of mail processing and carrier costs, to be 2.6155 cents, and that Postal Service witness Yorgey, in Docket No. MC2005-3,

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Response to VP/USPS-T36-2 continued

USPS-T-2 (see, e.g., p. 6 of Appendix A), used the figure of 2.6155 cents as the cost of 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 cost of 2.6155 cents to the instant docket and FY 2008.

- j. Please confirm that the revenues on sheet 'Revenues @ TYBR Vols.' and the volumes on sheet 'Reclassified Comm. Pcs. & Lbs.' of your workbook file WPSTDREG.xls in USPS-LR-L-36 can be used to calculate a per-piece revenue for mixed ADC (machinable) flats, origin entered, of 50.08 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.
- k. Referring to the figures in parts a through k, as well as any corrected figures you may provide, please provide an explanation of the appropriateness of the high per-piece contribution for letters (19.42 cents) and the relatively lower per-piece contribution for flats (14.43 cents). Please include in your explanation all reasons why you believe it is appropriate to favor flats to this extent, at the expense of letters, including reasons of policy. For ease of reference, these figures are:

Mixed ADC (machinable)	Rate (cents) Postage/pc.	Cost (cents)	Per-piece Contribution	Implied Cost Coverage
Letters	29.2	9.784	19.42	298.45%
Flats	50.08	35.551	14.43	140.87%

- i. (i) Are these the costs on which you focused when, as suggested in your testimony at page 32, beginning on line 14, you "selected piece and pound rates for the base piece"? (USPS-T-36, p. 32, l. 14.) If they are not, please provide the costs on which you focused.
(ii) Based on these costs summarized in part k as well as on any costs you may provide, please explain how consideration of these costs led you to a "base piece rate" for mixed ADC letters of 14.0 cents.

RESPONSE

- a. Confirmed.
- b. Confirmed.
- c. Confirmed.

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Response to VP/USPS-T36-2 continued

- d. Redirected to witness Talmo (USPS-T-27).
- e. I am unable to confirm this calculation. I have seen no study that provides comparable numbers for the test year and that are consistent with the cost data confirmed in subparts (a) and (b), above. I would also note that there is a potential problem with using an average price estimate for all Standard Mail letters to develop unit costs for a highly de-averaged rate category. I do not know how much the unit costs, exclusive of mail processing and carrier costs, for a non-drop-shipped, minimally presorted letter might vary from the average unit cost, assuming one were available.
- f. Confirmed.
- g. Confirmed.
- h. Confirmed.
- i. Redirected to witness Talmo (USPS-T-27).
- j. I can confirm that the approach and the per-piece revenue calculation are correct for Mixed ADC Nonautomation origin entered flats.
- k. For the reasons cited in my responses to subparts (e) and (j) above, I cannot confirm the accuracy or appropriateness of the total unit cost estimates in this table. Nevertheless, even if one were to accept these data as "ballpark estimates" for the sake of argument, they do not indicate that my proposed pricing for flats and letters is inappropriate or that it "favors" flats over letters. Simply consulting the Percent Rate Changes sheet in my WP-STDREG.XLS workbook will demonstrate this fact. Mixed AADC Presorted (Nonauto) Machinable letter prices are proposed

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to increase from 1.5% to 3.5%, while I have proposed that comparable Mixed ADC flats receive increases in the 18-19% range. One would have to turn the meaning of the word "favor" on its head to claim that a rate proposal that asks flats mailers to pay percentage rate increases that are between five and eleven times the rate increases of comparable letters actually "favors" flats over letters.

- I. (i) No. As indicated in my testimony on page 32 and elsewhere, the cost information I used as reference points when developing my rate elements for base pieces came from witnesses Kelley (delivery cost information for all Standard Mail pieces), Miller (mail processing cost information for Standard Mail Regular nonletters and Standard Mail ECR parcel-shaped pieces), Abdirahman (mail processing cost information for Standard Mail Regular letters), and Talmo (mail processing information for Standard Mail ECR pieces). These cost data are shown in the Inputs spreadsheets in my WP-STDREG.XLS and WP-STDECR.XLS workbooks.
- (ii) Please see my responses to VP/USPS-T36-1, subparts (f), (g), (i) and (j).

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.

Nan K. McKenzie

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May 30, 2006