

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

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

RESPONSES OF POSTAL SERVICE WITNESS TANG
TO INTERROGATORIES OF THE MCGRAW-HILL COMPANIES, INC.
(MH/USPS-T35-6-15)

The United States Postal Service hereby files the responses of Witness Tang to the above listed interrogatories, filed on July 12, 2006.

Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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RESPONSE OF POSTAL SERVICE WITNESS TANG
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MH/USPS-T35-6. With respect to proposed advertising pound dropship discounts, editorial pound dropship discounts, and per-piece dropship discounts for Outside-County Periodicals mail:

(a) Please confirm that the “Cost Avoided” for “Pound Rate Dropship Discounts” in cells C47, C48 and C49 of worksheet “Pound Data_Adv” are the same as the “Nontransportation Handling Costs Avoided” in cells D10, D11 and D12 of worksheet “Discounts.” If you do not confirm, please explain fully.

(b) Please explain fully (showing calculations) why each “Final Discount” for “Pound Rate Dropship Discounts” in cells E47, E48 and E49 of worksheet “Pound Data_Adv” differs from the rate differentials reflected in cells E56 through E59 (and cells D78 through D81) of that worksheet.

(c) Please confirm that the proposed editorial pound dropship discounts are based on the same cost savings as the proposed advertising pound dropship discounts, and differ from the latter only in that (i) the former are benchmarked from the proposed \$0.232 unzoned editorial pound charge while the latter are benchmarked from the proposed \$0.279 zone 1&2 charge, and (ii) the former reflect a 40% passthrough of cost savings while the latter reflect a 50% passthrough. If you do not confirm, please explain fully.

(d) With reference to your worksheet “Discounts”, lines 10-12, and your worksheet “Piece Discounts 2”, lines 17-19 and 34-36, please confirm that the proposed per-piece dropship discounts are based on the same nontransportation handling cost savings as the proposed per-pound dropship discounts, and differ from the latter only in that (i) the per-piece discounts reflect higher passthroughs of cost savings but (ii) otherwise reflect only 45.4% of the nontransportation savings reflected in the per-pound discounts, based on an average weight per piece of 0.454 pounds, and (iii) do not reflect any transportation savings. If you do not confirm, please explain fully.

(e) Please confirm that the dropship discounts based on nontransportation handling cost savings are first calculated on a per-piece basis, and then converted into per pound discounts based on the average weight per piece (or average pieces per pound). If you do not conform, please explain fully.

RESPONSE:

(a) Confirmed.

(b) Cells E47, E48 and E49 of worksheet “Pound Data_Adv” are calculated from the handling cost savings. Cells E56 through E59 are derived from a combination of distance-related and non-distance related costs. As applied in previous rate cases,

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distance-related cost is applied to the ADC level and above (zones 1&2 through zone 8), while non-distance related cost is applied to all zones except DDU.

(c) Confirmed.

(d) Confirmed that the unit cost savings in worksheet "Piece Discounts 2", lines 17-19, use the avoided handling costs in worksheet "Discounts", lines 10-12.

In worksheet "Piece Discounts 2", the numbers in lines 34-36 are derived by applying corresponding passthroughs to the cost savings numbers in lines 17-19, and then rounding the results to three digits after the decimal point.

I understand that the aforementioned avoided handling costs do not reflect transportation savings. Please also see my response to part (e).

(e) I understand that the per-piece and per-pound handling cost savings use the same measure of avoided costs. They are just stated in different terms.

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MH/USPS-T35-7. Please refer to your testimony at page 6 line 22 through page 7 line 3: “I propose a 37 – 63 split between revenue to be raised by pounds and pieces. This slight deviation from the traditional 40 – 60 split is moving towards the long-observed trend that the piece side contributes more than 60 percent of mail processing and delivery costs. See R2000-1, USPS-T-28 [witness Daniel], pages 18 -19b. The Postal Service believes that this design better reflects actual cost incurrence.”

Please refer also to your testimony at page 11, lines 17-22: “The non-transportation related (handling) cost savings form the basis of the per piece dropship discounts. . . . In this docket I propose to continue splitting the non-transportation costs equally between pieces and pounds.”

(a) Please confirm that the non-transportation costs that you propose to continue splitting equally between pieces and pounds include those referred to by witness Mayes (USPS-T-25, at page 6 line 20) as the costs of “bulk transfer operations” (such as crossdocking at non-destination facilities), from which the per-piece and (in part) the per-pound dropship discounts are calculated. If you do not confirm, please explain fully.

(b) Please confirm that according to the cited testimony of witness Daniel in R2000-1 (USPS-T-28 at page 18 lines 13-22), non-transportation costs tend to be substantially more piece-related, and less pound-related, than transportation costs. If you do not confirm, please explain fully.

(c) Please explain fully why, in light of the testimony of witness Daniel in R2000-1, and in light of your proposal in this docket to change the overall pound/piece revenue split from 40–60 to 37-63, you nevertheless propose to maintain a 50-50 pound/piece revenue split for the non-transportation costs in question.

(d) Please confirm that to the extent a less than 50-50 pound/piece revenue split were adopted for the non-transportation costs in question, the per-piece dropship discounts would be commensurately larger, and the per-pound dropship discounts would be commensurately smaller, assuming that your rate design approach was otherwise unchanged.

RESPONSE:

(a) Confirmed.

(b) Confirmed.

(c) The non-transportation cost referred to in witness Daniel's testimony is the total cost of Periodicals less the transportation cost. This non-transportation cost includes mail-processing, delivery, and other cost segments, excluding cost segment(s) relating to transportation. The non-transportation or bulk transfer operations cost that is provided

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by witness Mayes is a very small portion of the costs discussed in the testimony of witness Daniel. We maintain that these costs are container related, whereas the Postal Rate Commission deems them to be more pound related than piece related. Please see PRC Op., R2000-1, page 437, paragraph 5684. In Docket No. R2000-1, the Postal Service proposed a 70/30 split of these costs between pieces/pounds for a different reason altogether (please see PRC Op., R2000-1, page 436, paragraph 5681). The Postal Rate Commission rejected that change and maintained the 50/50 split of these costs between pieces and pounds. (Please see PRC Op., R2000-1, page 437, paragraph 5685).

(d) All else being equal, if more than 50 percent of the non-transportation costs were allocated to the piece side, the per-piece dropship discounts would be larger and the per-pound dropship discounts would be smaller.

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MH/USPS-T35-8. Please refer to your worksheet Piece Discounts, lines 3-6:

(a) Please confirm that the piece rate target revenue in cell C4 amounts to 62.5%, rather than the stated 63%, of the required revenue set forth in cell C3 for Outside-County Periodicals mail. If you do not confirm, please explain fully and show your calculations.

(b) Please confirm that the actually derived piece rate revenue in cell C5 amounts to about 62.58% of the required revenue set forth in cell C3 for Outside-County Periodicals mail. If you do not confirm, please explain fully and show your calculations.

(c) Please confirm that the revenue needed from pound rates in cell C6 amounts to \$924,926,363 (cell C3 minus cell C5) (amounting to about 37.42% of the required revenue set forth in cell C3), rather than the stated \$934,355,798 (a difference of \$9,429,435). If you do not confirm, please explain fully and show your calculations.

(d) Please explain fully any significance of the fact that the seeming overstatement of the revenue needed from pound rates in cell C6 amounts to the revenue leakage from the 1.3¢ adjustment to the unzoned editorial pound rate, set forth in cell C47 of worksheet Pound Data_Ed.

(e) Please confirm that if the revenue needed from pound rates in cell C6 of worksheet Piece Discounts is overstated by \$9,429,435, the editorial pound revenue as a percentage of target in cell E42 of worksheet Pound Data_Ed would increase to approximately 96.16%, and the total pound revenue as a percentage of target in cell F101 of worksheet Pound Data_Adv would increase to approximately 98.03% If you do not confirm, please explain fully and show your calculations.

RESPONSE:

(a) Confirmed.

(b) Confirmed.

(c-d) Confirmed that cell C3 minus cell C5 yields a result of \$924,926,364, which shows a difference of \$9,429,434 from the \$934,355,798 in cell C6. As stated in my testimony, in order to mitigate the rate impact on editorial pounds, an adjustment of \$0.013 is applied to the average (non-dropship) editorial pound rate. To recover the revenue leakage caused by this adjustment, this leakage is added back to the total revenue requirement from the pound side and allocated to all pounds.

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(e) All else being equal, if this \$934,355,798 in cell E40 of worksheet "Pound Data_Ed" is replaced by \$924,926,364, the value in cell E40 would become \$473,612,879, and the value in cell E42 would increase to 95.23 percent. In worksheet "Pound Data-Adv," all else being equal, if the \$934,355,798 figure in cell F99 is replaced by \$924,926,364, the value in cell F101 would be 98.03 percent.

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MH/USPS-T35-9. Please refer to your response to Presiding Officer's Information Request No. 2, Question No. 8, which states that: "[T]he initial split between pound and piece revenue is 37.5 – 62.5. Although the container rate is neither a pound nor a piece rate, in this case the container revenue was added back to the calculated piece revenue This was done to mitigate the rate impact on the piece side in this particular case, but this approach may not be followed in future cases. Since the additional revenue from the container rate was included in the revenue needed from the piece rates, the proportion of the revenue collected from the piece side actually is reduced."

(a) Please confirm that the container revenue for Outside-County Periodicals mail (\$43,319,140) amounts to about 1.75% of the total revenue required from the pound, piece and container rates (cell C3 of worksheet Piece Discounts). If you do not confirm, please explain fully and show your calculations.

(b) Please confirm that the proposed piece rates actually account for only about 60.83% (62.58 minus 1.75) of the total revenue required from the pound, piece and container rates. If you do not confirm, please explain fully and show your calculations.

(c) Please explain fully why you believed it appropriate to increase the percentage of revenue to be derived from the pound rates (from 37% to 37.42%) (approximately \$10.4 million) in order to mitigate the impact of the piece rates.

(d) Please confirm that if the target revenue for the pound rates were 37% of the total revenue to be derived from the pound and piece rates (cell C3 of worksheet Piece Discounts minus \$43,319,140), the proposed pound rates would more than cover that target. If you do not confirm, please explain fully and show your calculations.

(e) Please confirm that if the target revenue for the pound rates were 37% of the total revenue to be derived from the pound and piece rates, and editorial pounds were required to cover 51.2% of pound revenues (as you propose), the proposed editorial pound rates would cover more than 98% of the target set for them. If you do not confirm, please explain fully and show your calculations.

(f) Please confirm that the actual revenues derived from the proposed piece rates (cell C5 of worksheet Piece Discounts minus \$43,319,140) amounts to only 61.9% of the total revenue to be derived from the pound and piece rates. If you do not confirm, please explain fully and show your calculations.

(g) Please confirm that if the target revenue for the piece rates were 63% of the total revenue to be derived from the pound and piece rates, the proposed piece rates would cover only 98.27% of that target (\$1503.537 million divided by \$1529.9319 million). If you do not confirm, please explain fully and show your calculations.

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RESPONSE:

- (a) Confirmed.
- (b) Confirmed.
- (c) The rate design process usually does not guarantee that the ending percentage necessarily matches perfectly with the initial starting point. (In this instance, the ending 37.42 percent does not exactly match the initial allocation of 37.5 percent.) Please see my response to TW/USPS-T35-3. This variation is unrelated to rate impact mitigation.
- (d) Confirmed.
- (e) Confirmed.
- (f) Confirmed.
- (g) Confirmed.

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MH/USPS-T35-10. With reference to your worksheet "Rev. Adj+Ed. Cont.", cells D59-61 and D66-68, and your worksheet Pound Data_Ed, cells D14-16 and D 28-30

(a) Please confirm that according to the FY 2005 data upon which you rely, approximately 67% of the editorial pounds of Outside-County Periodicals mail is already dropshipped (i.e., entered at the destination ADC, destination SCF, or destination delivery unit). If you do not confirm, please explain fully.

(b) Please confirm that according to the data, only 7.12% of the editorial pounds of Outside-County Periodicals mail is entered in zone 6 or higher. If you do not confirm, please explain fully.

(c) Please state whether, in proposing to establish editorial-pound dropship discounts from the longstanding flat editorial pound charge, the primary goal of the Postal Service is to encourage additional dropshipping or to reward those mailers who are already dropshipping two thirds of all editorial pounds, and explain fully the goals of the Postal Service in this regard and the reasoning underlying those goals.

(d) Please confirm that in developing the proposed rates, you assumed that no additional editorial pounds would be dropshipped in FY 2008. If you do not confirm, please explain fully, with references to the record.

(e) Please confirm that according to your worksheets (Rev. Adj+Ed Cont., cell C60; Pound Data_Ed., cell D29; RR TYAR, cells B18 and B36; NP TYAR, cell B18; CR TYAR, cell B18), even if the proposed editorial pound dropship discounts are implemented, the number of editorial pounds dropshipped by Outside-County Periodicals mailers to a destination SCF in FY 2008 will decline by some 732.3 million pounds, by comparison with FY 2005. If you do not confirm, please explain fully, with references to the record, and showing calculations. If you do confirm a substantial decline, please explain fully the reasons for the decline

(f) For each proposed dropship (destination entry) rate category for editorial pounds of Outside-County Periodicals mail, please provide your best estimate of the number of editorial pounds of Outside-County Periodicals mail that are not presently being dropshipped, but that would be dropshipped in TY 2008 under the proposed editorial pound dropship discounts, and explain the basis for your estimates.

(g) Assuming that the proposed editorial pound dropship discounts were to be implemented, please provide your best estimate of the net savings (not passed through to mailers) that would accrue to the Postal Service in TY 2008 as a result of dropshipping that would not occur absent editorial pound dropship discounts, and explain the basis for your estimate.

RESPONSE:

(a) Confirmed.

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- (b) Confirmed.
- (c) The goal here is to offer price signals to change the behavior of those not dropshipping. At the same time, the Postal Service is not proposing to discounts to those that are already reducing the Postal Service costs by dropshipping.
- (d) Confirmed.
- (e) Not confirmed. My calculation shows a decrease of 39.0 million pounds. By adding up "RR TYAR" cells B18 and B36, "NP TYAR" cell B18, and "CR TYAR" cell B18, I get a total of 1,151,553,834 editorial pounds at the SCF level for the Test Year. Subtracting this 1,151,553,834 from the 1,188,878,877 figure in "Pound Data_Ed." cell D29 yields 37,325,043, which shows the differential between the number of editorial pounds dropshipped by Outside-County Periodicals mailers to a destination SCF in FY 2008 and the Base Year, FY 2005. Since no separate projection or estimate has been made regarding the dropshipped editorial pounds, this volume decrease reflects the volume forecast for Outside County Periodicals, which shows a ratio of 96.9 percent between TYAR and the base year.
- (f-g) Please see my response to parts (d-e).

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MH/USPS-T35-11. Please refer to your testimony at page 8 lines 20-22 and page 9 lines 7-19:

In order to make sure that the ECSI value from editorial pounds is recognized and reflected in rate design, an adjustment of \$0.013 is applied to the average editorial pound rate. . . .

. . . This balanced approach would provide incentives for Periodicals mail to be dropshipped closer to the destination. Meanwhile, it also would mitigate the impact of rate increases on those who are not able to take advantage of these incentives. Finally, in addition to the aforementioned \$0.013 adjustment to the editorial pound rates to mitigate the impact, I propose to raise the 50 percent passthrough to 80 percent for the rate differentials derived for the advertising pound rates. The flat editorial pound rate increases by 14.29 percent, less than three percentage points above the average increase. Through this rate design, the Postal Service believes that mailers, both large and small, would have the potential to move significant volume of mail to destinating facilities.

(a) Please confirm that by proposing an above-average 14.3% increase in the unzoned editorial pound rate, in conjunction with creating editorial pound dropship discounts, the Postal Service did not intend to penalize relatively small, high-editorial publications that are distributed nationally, and for whom copalletization and dropshipping may not be feasible options. If you do not confirm, please explain fully.

(b) Please confirm that the unzoned editorial pound charge has traditionally been set at 75% of the zone 1&2 advertising pound charge (which would amount to \$0.209 per pound under the proposed rates), but is proposed to be set in this case at 83.2% of the proposed zone 1&2 advertising pound charge (amounting to \$0.232 per pound). If you do not confirm, please explain fully. In either event, please explain your use (at page 8 lines 21-22) of the term "average" editorial pound rate.

(c) Please confirm that the proposed 14.3% increase in the unzoned editorial pound charge is the only proposed double-digit increase among the pound charges for Outside-County Periodicals mail, and exceeds the proposed percentage increases for all but three of the piece charges for such mail. If you do not confirm, please explain fully.

(d) Please provide the weighted-average percentage increase proposed for (i) the advertising pounds and (ii) the piece charges, respectively, for Outside-County Periodicals mail, and show your calculations.

(e) Please confirm that if as a policy matter the Postal Service wished to do so, it would be feasible for the Postal Service to make a further reduction of up to 2.3¢ in the unzoned editorial pound charge, without necessarily reducing the proposed editorial pound dropship discounts, because both the advertising/editorial revenue split and the

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pound/piece/container revenue split are ultimately guided by rate design objectives, as you appear to recognize at page 9 (lines 1-10) of your testimony and in your response to Presiding Officer's Information Request No. 2, Question 8. If you do not confirm, please explain fully.

(f) Please explain fully: (i) whether the Postal Service considered making any such further reduction in the proposed unzoned editorial pound charge, and if so, specify the reduction that was considered and explain fully why the Postal Service decided against it; and (ii) whether the Postal Service deemed it more important to "mitigate the rate impact on the piece side" (response to Presiding Officer's Information Request No. 2, Question 8), and if so, please explain fully the reasons why.

(g) Please specify the "rate differentials derived for advertising pound rates" for which you "propose to raise the 50 percent passthrough to 80 percent" (page 9 lines 12-13 of your testimony), and specify the costs subject to passthrough and the precise portions of your workpapers where the referenced differentials and passthrough are reflected.

RESPONSE:

(a) Confirmed.

(b) The current unzoned editorial pound rate is \$0.203, about 78 percent of the current Zones 1&2 advertising pound rate of \$0.261. I can confirm that the proposed rate for non-dropshipped editorial pounds is about 83.2 percent of the proposed Zones 1&2 advertising pound rate. The term "average" comes from the Outside County Periodicals rate design workbook, worksheet "Pound Data_Ed.", cell C8. It represents the proposed non-dropshipped editorial pound rate, to which the \$0.013 deduction adjustment ("Pound Data_Ed" cell C45) has been applied.

(c) Not confirmed. On the pound side, other than the 14.3 percent increase for non-dropship editorial pounds, the proposed double-digit rate changes that are more than 14.3 percent include: a 24.1 percent decrease for DDU editorial pounds, a 43.4 percent decrease for DDU Science of Agriculture editorial pounds, a 29.1 percent decrease for DSCF Science of Agriculture editorial pounds, and a 22.7 percent decrease for DADC

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Science of Agriculture editorial pounds. On the piece side, the proposed double-digit rate changes that are more than 14.3 percent include a 16.0 percent increase for Basic Automation Flat, a 17.4 percent increase for Carrier Route High Density, a 37.5 percent increase for the DSCF entry discount, a 50 percent increase for the DADC-entry discount, and an 18.3 percent increase for ride-along pieces.

(d) I sum up the test-year-after-rates revenue and volume in worksheets "RR TYAR", "NP TYAR", and "CR TYAR", and divide the total advertising pound revenue (\$439,864,166) by advertising pounds (1,569,469,593) to derive the weighted-average revenue per advertising pound of \$0.282. The total piece revenue (\$1,452,280,853) divided by total pieces (8,049,954,276) gives the weighted-average revenue per piece of \$0.180. By the same token, in worksheet "Test Year BR with 24pc Adjustm't", the total advertising pound revenue (\$423,122,874) divided by advertising pounds (1,616,749,608) yields the test-year-before-rates revenue per advertising pound of \$0.262; the total piece revenue (\$1,331,944,540) divided by volume (8,332,198,836) yields test-year-before-rates revenue per piece of \$0.160.

(i-ii) Based on the figures above, the weighted-average percentage increase for advertising pounds is 7.6 percent; the weighted-average percentage increase for piece rates is 12.8 percent.

(e-f) Using the same methodology, the weighted-average percentage increase for editorial pounds is 2.2 percent (test-year-after-rates revenue per editorial pound of \$0.207 vs. test-year-before-rates revenue per editorial pound of \$0.203). The Postal

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Service believes that the ECSI value has been sufficiently recognized by the proposal and does not plan on making further reduction in the editorial pound rate.

(g) The rate differentials refer to cells C14-C16 in worksheet "Pound Data_Ed." The costs subject to passthroughs are shown in worksheet "Pound Data_Adv." Please see my response to MPA/USPS-T35-22 for the details of how the costs have been applied to develop the advertising pound rates.

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MH/USPS-T35-12. For purposes of gauging the impact of the proposed rate structure on Outside-County Periodicals mailers:

(a) Please provide alternative (non-binding) pound rates designed to recover the same revenue as the proposed pound rates and containing an unzoned editorial pound charge set at 75% of the zone 1&2 advertising rate, but not containing editorial pound dropship discounts.

(b) Please provide alternative (non-binding) pound rates designed to designed to recover 40% (rather than 37% or 37.5%) of the aggregate piece, pound and container revenues for Outside-County Periodicals mail in TY 2008, both (i) under the proposed rate structure and (ii) under the alternative rate structure described in subpart (a) above.

RESPONSE:

(a-b) I cannot provide alternative pound rates as requested. Developing prices involves a balancing of a number of rate design objectives. I cannot develop any hypothetical alternative prices that necessarily would have met those objectives.

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MH/USPS-T35-13. With reference to your testimony at page 9 lines 1-7:

- (a) Please explain fully your reference on line 2 to “increased dropship discounts,” by reference to your workpapers and/or otherwise.
- (b) Please explain fully how allocating fewer (48.8% rather than 50%) of the transportation costs to advertising pounds would increase the rates for farther zones.
- (c) Please explain fully your use of the term “pound allocation” (as opposed to revenue allocation) on line 6 and explain fully the derivation of a 50% allocation of transportation costs to advertising pounds, by reference to your workpapers and/or otherwise.

RESPONSE:

(a-c) I will be filing a revised first paragraph on page 9 of my testimony to clarify this point. The revision will read as follows:

One of the goals of the Postal Service’s proposal is to maintain or increase the current difference between dropship rates (DDU, DSCF & DADC) and the farther zones such as Zones 7 and 8. The allocation of transportation costs between advertising and editorial pounds can be done using the same ratio as the one used for the allocation of revenue, i.e. 48.8 percent advertising and 51.2 percent editorial. However, I have chosen to allocate 50 percent of the transportation costs to advertising pounds because doing so increases the difference between dropship rates and farther zones, and thereby improves the incentives for dropshipping Periodicals mail closer to the destination.

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MH/USPS-T35-14. With reference to your worksheet Piece Discounts 2, please explain fully the 24% passthrough for palletized pieces in cell D20.

RESPONSE:

Please ignore the 24 percent figure, as it is not used in the workbook. This figure would be the passthrough percentage for a pallet discount; however, no such discount is included in the proposal. It is a remnant of previous rate design models that did include such a discount.

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MH/USPS-T35-15. With reference to your worksheet Discounts, please reconcile the 9.795¢ unit mail processing cost for carrier route nonautomation mail in cell C33 with the 4.011¢ unit mail processing cost for basic carrier route mail in cell C59.

RESPONSE:

The two numbers in question are from different sources. The 9.795¢ unit mail processing cost for carrier route nonautomation mail in cell C33 is developed in LR-L-43 for Periodicals, and this number is used to calculate the rate differential between nonautomation 5-digit and Carrier Route Basic pieces. However, no data are developed specifically for Periodicals regarding the mailing processing cost beyond the Carrier Route Basic level, that is, for High Density and Saturation. Consistent with the approach adopted in previous rate cases, for rate design purposes, we use the costs developed for Standard Mail (LR-L-84). The 4.011¢ figure for Carrier Route Basic in cell C59 and the 1.599¢ in cells C60 and C61 all reflect Standard Mail mail processing costs. The differential of mail processing and delivery costs between Carrier Route Basic and High Density is then calculated in cell F61 and used to develop the Carrier Route High Density rate.