

ADVO, INC. INTERROGATORIES TO VAL PAK WITNESS MITCHELL (VP-T-1)

ADVO/VP-T1-1. On pages 42ff, you discuss economic efficiency and the recognition of value in ratemaking. On page 44 (lines 13 ff), you state that: “The concept of value, as developed to a high level of agreement through economic writings beginning as early as 1850, is central to explaining and understanding the decisions made by consumers, whether individuals or firms.”

- (a) Please explain whether the term “value” as you use it could also be called “utility.”
- (b) Please explain whether the term “[consumer] surplus” (e.g., page 46, line 19) can also be termed as total utility minus total consumer cost at a particular price point.

ADVO/VP-T1-2. On pages 73 ff, you discuss “value of the mail service actually provided each class or type of mail service”

- (a) Please confirm that at a particular price point, the marginal utility of the mail to a mailer determines price sensitivity at that price point. If you cannot, please explain your response.
- (b) Please confirm that, at a particular price point, demand (marginal utility) determines that mailer’s price sensitivity at that price point. If you cannot, please explain your response.
- (c) Please confirm that the greater the price sensitivity of the mailer at a particular price point (*ceterus paribus*), the more consumer total utility and surplus (total utility minus total cost) increase as price decreases. If you cannot, please explain your response.
- (d) Please confirm that, the lower the price sensitivity of a mailer at a particular price point (*ceterus paribus*), the less consumer utility and surplus (total utility minus total cost) decline as price increases. If you cannot, please explain your response.

ADVO/VP-T1-3. On pages 59-60, you discuss private delivery alternatives and describe the large number of free community newspapers that are delivered privately now and the number of private carriers that you have spoken with. On page 82 (lines 22-26), you state: “Much of the mail that is candidate for being handled by alternative carriers weighs more than 3.3 ounces, and therefore pays the pound rates of either ECR or Regular. Private carriers have less difficulty competing for relatively heavy mail than for relatively light mail.” On pages 84-

85, you discuss the types of Standard mail that may be carried by private competitors: merchandise, pieces over 24 pages, and saturation pieces whose addresses can be removed.

- (a) Based on your experience, please describe the extent to which the free papers are letter-shaped (as opposed to flat-shaped).
- (b) Based on your experience, please describe the extent to which private carriers deliver individual letter-shaped pieces (as opposed to flat-shaped pieces or letter-shaped pieces within a flat-shaped piece).
- (c) Please confirm that the private delivery exception for pieces over 24 pages applies to “books and catalogs consisting of 24 or more bound pages” (See 39 C.F.R. §310.1(a)(7)(v)).
- (d) Based on your experience, please describe the extent to which books and catalogs with 24 or more bound pages are letter-shaped (as opposed to flat-shaped), and the extent to which any such letter-shaped books and catalogs are delivered privately.

ADVO/VP-T1-4. Please explain the difference between the TYBR attributable ECR/NECR cost of \$3,189,042,000 in cell E8 of sheet “Inputs” of VP-RWM-Workpaper-8 and the USPS witness Waterbury D report (TYBR PRC Version) of \$3,189,157,000 in ECR/NECR costs.

ADVO/VP-T1-5. On page 118, you state that: “. . .the difference between them [letters and flats within the same subclass] is not a matter of worksharing. The default recognition for a cost difference under these conditions is the subclass cost coverage, but certainly at least 100 percent.” On pages 183-184 (lines 20 ff), you assert that the ECR letter-flat rate differential should be based on a passthrough of the full letter-flat cost differential (adjusted to reflect origin entry) multiplied by the subclass cost coverage. On Page 178 (lines 13-14), you state: “This [100% passthrough of the Basic letter-flat origin cost difference] is far less than a passthrough equal to the subclass cost coverage, which, in theory, I see no reason should not be the default prescription for letters and flats, which are for all practical purposes separate products.”

- (a) Please confirm that your concept is that 100% of the total origin cost difference between different “products” (within the same subclass) multiplied by subclass cost coverage should be the basis for the rate difference between the two “products.” If this is incorrect, please provide the correct explanation.

- (b) Please explain why the product markup is based on total *origin* cost when the subclass markup is based on total *actual* cost, and origin cost is a non-existent cost for a majority of the pieces in each of the “products?”
- (c) Under your theoretical design of rates for separate “products” within a subclass, is there a cost coverage objective for each product individually, relative to the cost coverage for the entire subclass? Please explain fully.
- (d) Please provide all economic documentation you have that supports your above-cited concept (“theory”) of the appropriate way to develop rate differences between two “products” within the same subclass.

ADVO/VP-T1-6. On page 118 (lines 5-8), you state that: “Letters and flats tend to be separate products with separate processing streams . . . the difference between them is not a matter of worksharing.” On page 178 (lines 13-16), you state that ECR letters and flats “... are for all practical purposes separate products.”

- (a) Please explain what you mean by “product” and clearly differentiate that term from the traditional postal terms of “subclass” and “rate category.”
- (b) Please provide your understanding of how much difference there must be between two “products” in order to call them “separate” and apply separate cost coverages to their origin costs while keeping them within the same subclass.
- (c) Please provide your understanding of how much difference there must be between two “products” in order to separate them into two separate subclasses.
- (d) Please identify all the separate “products” in the Standard Regular subclass.

ADVO/VP-T1-7. Are all ECR letters one “product” as you define the term?

- (a) If so, is it your belief that the only difference between basic ECR letters (with as few as 10 pieces per carrier route) and saturation letters is the degree of worksharing? Explain the basis for your answer.

- (b) If so, is it your belief that basic ECR letters (with as few as 10 pieces per carrier route) serve the same market and have the same price sensitivity as saturation letters? Explain the basis for your answer.
- (c) If not, please identify the number of separate letter “products” in ECR.

ADVO/VP-T1-8. Are all ECR flats one “product” as you define the term?

- (a) If so, is it your belief that the only difference between basic ECR flats (with as few as 10 pieces per carrier route) and saturation flats is the degree of worksharing? Explain the basis for your answer.
- (b) If so, is it your belief that basic ECR flats (with as few as 10 pieces per carrier route) serve the same market and have the same price sensitivity as saturation flats? Explain the basis for your answer.
- (c) If not, please identify the number of separate flat “products” in ECR.

ADVO/VP-T1-9. Please identify all the rate categories within ECR whose cost differences represent worksharing differences.

ADVO/VP-T1-10. On page 5, lines 4-6, you state that: “The design of rates within subclasses should also be guided by principles, including notions of worksharing, efficient component pricing, cost-based rates, the efficiency of signals sent to mailers, and fairness.” Please refer to the Direct Testimony of John C. Panzar (PB-T-1) where he states that the principles supporting efficient component pricing also apply to basing rate differences – other than worksharing discounts – on cost differences. On page 45, lines 9 ff, he states:

More so than in most markets, mailers have the opportunity to “design their own service.” That is, they can choose many of the intrinsic properties of their mailing: its size (one ounce or several); its shape (letter or flat), the time of day at which it enters the mail stream, the location at which it enters the Postal Service network – any many other of their mail’s characteristics. Two aspects of this flexibility are important for rate-making purposes. First, and most importantly, differences in these characteristics may have important impacts on the costs that the mail imposes on the Postal Service. Second, while mailers may have preferences over these characteristics (e.g., a flat may better serve their purposes than a letter), the relative value of shifting from one alternative to another may be dramatically different than the difference in Postal Service

costs. Just as with traditional worksharing, an effective way to induce changes in mailer behaviour is through rate differences that reflect cost differences.

The basic economic argument in support of cost-based rate differentials is the same as that for avoided cost worksharing discounts. Mailers can act to minimize end-to-end costs only if the difference in rates for mail with differing characteristics reflects differences in the costs incurred by the Postal Service . . .

- (a) Do you agree with Dr. Panzar? If not, please explain fully why not.
- (a) Please identify the ECR rate categories/elements for which you would develop rates on the basis of efficient component pricing.

ADVO/VP-T1-11. On page 116 (lines 5-6), you state that you know of no evidence that the sensitivity of volume to price is much greater for ECR flats than for ECR letters.

- (a) Please provide all evidence you have that the price sensitivities of all the flat and letter “products” in Standard Regular are similar.
- (b) Please provide all evidence you have that the price sensitivities of all the flat and letter “products” in ECR are similar.
- (c) Are there any cross-price sensitivities among the “products” in Standard Regular? If so, please provide any information you may have.
- (d) Are there any cross-price sensitivities among the “products” in ECR? If so, please provide any information you may have.

ADVO/VP-T1-12. On lines 11-13 of page 118, you state: “No theory of which I am aware suggests that two products, even though related, should have the same per-piece markups . . .”

- (a) Please explain what you mean by this statement.
- (b) Please explain what you mean by “related” and specify whether it involves to any extent cross-price sensitivities between the two “relations.”

- (c) Please explain fully your criteria for determining how “related” products must be before they must (or must not) have the same per-piece markups.

ADVO/VP-T1-13. Please refer to your discussion on pages 20 ff on the guidelines for de-averaging existing subclasses into two or more separate subclasses and refer again to your statement on page 118 (lines 5-8) that letters and flats have separate processing streams.

- (a) Do you agree with the Commission that products within subclasses should be homogenous with respect to both cost and market factors? Please explain.
- (b) Is it your opinion that Standard letters and flats no longer have common cost characteristics and that the cost characteristics within Standard are no longer homogenous? Please explain.
- (c) Is it your opinion that ECR letters and flats no longer have common cost characteristics and that the cost characteristics within ECR are no longer homogenous? Please explain.
- (d) Is it your opinion that ECR letters and flats have intrinsic cost differences because of their mail characteristics? Please explain.

ADVO/VP-T1-14. On page 176, you state that: “With the exception discussed above for high-density flats, setting rates in this way honors all of the costs in the tree.”

- (a) Please explain fully what you mean by “honors.”
- (b) Please explain fully how “honoring costs in the tree” comports with your concept of product pricing and economic efficiency.