

UNITED STATES OF AMERICA
Before The
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

Postal Rate and Fee Changes)

Docket No. R2000-1

ANSWERS OF THE OFFICE OF THE CONSUMER ADVOCATE
TO INTERROGATORIES OF THE DIRECT MARKETING ASSOCIATION
WITNESS: JAMES F. CALLOW (DMA/OCA-T6-1-9)
(June 16, 2000)

The Office of the Consumer Advocate hereby submits the answers of James F. Callow to interrogatories DMA/OCA-T6-1-9, dated June 2, 2000. As submitted by DMA, there are two interrogatories numbered, DMA/OCA-T6-3. By agreement with counsel for DMA, the second interrogatory numbered DMA/OCA-T6-3 has been renumbered and is identified as DMA/OCA-T6-9. Each interrogatory, as renumbered, is stated verbatim and is followed by the response.

Respectfully submitted,



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ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES DMA/OCA-T6-1-9

DMA/OCA-T6-1. Please refer to your testimony at page 22, where you compute an "average mark-up index" for First Class Letters in the amount of 1.263. Please also refer to your testimony on page 23 at lines 5-7, where you discuss the annual contribution of First-Class letter mail to USPS institutional costs ". . . intended by the Commission, based upon the average First-Class Letters mark-up index benchmark."

- a. Would you agree that the expressions of intent by the Postal Rate Commission concerning institutional cost contribution of any class of mail, including First-Class Letter mail, are limited to the respective proceeding in question; are based upon the evidence in each respective proceeding; and are limited to the test year utilized in the respective proceeding? Please explain fully any answer other than an unqualified "yes."
- b. Please identify, with as much specificity as possible, any and all expressions of Commission intent with respect to contributions to institutional costs by specific classes or subclasses of mail in years other than the test years utilized in each respective proceeding.
- c. In your opinion, has the Commission ever expressed an intent concerning contribution to institutional costs with reference to averages based upon multi-year periods? If so, please identify all such expressions with as much specificity as possible.

RESPONSE TO DMA/OCA-T6-1.

(a) No. For purposes of my analysis, I interpret the test year as a period that is intended to be typical or representative of (i.e., an average for) the period that recommended rates are in effect. Thus, the contribution recommended by the Commission for the test year should equal the average contribution per year during the period in which the rates are in effect.

(b) - (c) See my response to part (a), above.

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DMA/OCA-T6-2. Please refer to your testimony on page 23, line 1, where you state, "This excess contribution has accelerated in recent years."

- a. Please confirm that the First-Class Letters mark-up index reflected in the Commission's recommendations in the two most recent omnibus rate proceedings, as shown in your Table 10 (1.310 and 1.308, respectively) are both in excess of your computed "average mark-up index" of 1.263. If you do not confirm, please explain fully.
- b. Would you agree that the "acceleration" in the purported "excess contribution" is a direct result of express PRC choices that were made in Dockets R94-1 and R97-1, and that were based on the evidence of record in those proceedings? Please explain fully any answer other than an unqualified "yes."
- c. Please refer to your Table 11. If the annual contributions to institutional costs made by First-Class Letter mail are a result of specific Commission recommendations, is it not erroneous to consider these contributions, especially those in the years 1997 through 2001, to be "excess?" Please explain fully any answer other than an unqualified "yes."

RESPONSE TO DMA/OCA-T6-2.

(a) Confirmed.

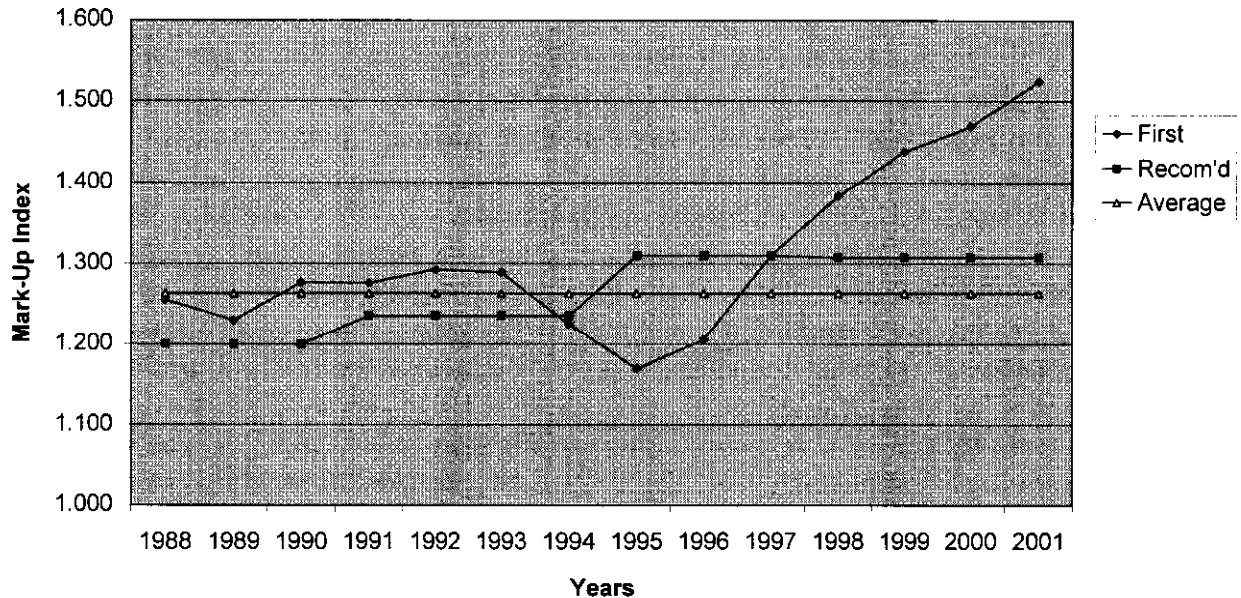
(b) No. The notion that the "'acceleration' in the purported 'excess contribution' is a direct result of express PRC choices" is not borne out by an analysis of actual revenue and cost data. Below, I have reproduced Figure 4 from my testimony, OCA-T-6, Part I, at 13, with one change. That change calculates the First-Class Letters mark-up index using the R97-1 rates for FY 2001.

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Table 4
COMPARISON OF FIRST-CLASS LETTER MARK-UP INDEX TO RECOMMENDED AND AVERAGE MARK-UP INDICES

Mark-Up Index	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
First	1.256	1.230	1.277	1.276	1.293	1.289	1.226	1.169	1.206	1.311	1.384	1.439	1.469	1.524
Recom'd	1.200	1.200	1.200	1.235	1.235	1.235	1.235	1.310	1.310	1.310	1.308	1.308	1.308	1.308
Average	1.263	1.263	1.263	1.263	1.263	1.263	1.263	1.263	1.263	1.263	1.263	1.263	1.263	1.263

Figure 4: Comparison of First-Class Letter Mark-Up Index to Recommended and Average



Source: For FY 2001, Exhibit USPS-32A (revised 4-21-00) at 1.

Beginning in FY 1995, the actual markup index for First-Class Letters rises rapidly through FY 1999. Moreover, using R97-1 rates, the estimated mark-up index continues rising through FY 2001, to 1.524 $((16,631.177 / 24,627.081) / (18,459.138 / 41,647.946))$. During this same period, the Commission-recommended index is essentially constant at about 0.05 above the four-rate-case average. If one calculates the excess First-Class Letter Mail contribution relative to the recommended contribution over the two most recent rate cases, one finds a smaller excess. But the

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annual excess increases every year. Thus, the acceleration in the amount of the excess in recent years remains even after accounting for the Commission's recent higher recommended mark-up indexes.

(c) No. The table below is an excerpt from Table 11 showing the period FY 1995 through FY 2001. This excerpt displays the excess contribution made by First-Class Letter Mail calculated using the Commission's recommended mark-up indexes—1.310 for FY 1995 through FY 1997, and 1.308 for FY 1998 through FY 2001. The excess rises rapidly.

EXCERPT FROM TABLE 11 IN OCA-T-6

1995	1996	1997	1998	1999	2000	2001
(\$1,221)	(\$841)	\$117	\$1,312	\$1,505	\$2,229	\$1,210

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DMA/OCA-T6-3. Please refer to your testimony at page 27, line 3 through page 28, line 5. In this passage you refer to the first pricing criterion of section 3622(b) ("fairness and equity") and state that "Simple fairness suggests that the institutional cost burden for First-Class Letter Mail be mitigated." Please refer also to your testimony on page 28, lines 18-19, where you state, "The trend of a higher institutional cost burden borne by First-Class Letter Mail in excess of that intended by the Commission, on balance, requires mitigation."

- a. Please confirm that, with the exception of a brief reference to pricing criterion 9 ("which permits the Commission to consider such other factors as it deems appropriate.") (page 28, lines 22-23), your testimony omits reference to any other of the pricing criteria set forth in section 3622(b) of the Postal Reorganization Act.
- b. Please explain in as much detail as possible the extent to which you considered pricing criteria 2 through 8 in connection with your recommendation to maintain the single-piece First-Class rate at 33 cents.
- c. Please present an analysis of the evidence of record in this case relevant to pricing criteria 2 through 8 and describe the extent to which this testimony supports or undermines your proposal.

RESPONSE TO DMA/OCA-T6-3.

(a) Confirmed.

(b) - (c) The 33 cent single-piece First-Class rate that I propose is the same rate recommended by the Commission and approved by the Governors in Docket No. R97-1. Consequently, since I propose no change in the lawful current single-piece rate, I did not consider it necessary to analyze any of the criteria in Section 3622(b). Moreover, I am not aware that anyone has contested the consistency of the current single-piece rate with the criteria of Section 3622(b).

My proposal to provide some degree of mitigation of the high and rising institutional cost burden on First-Class Letter Mail can be achieved simply by retaining

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the current single-piece rate, thereby enhancing fairness and equity for individual and smaller mailers.

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DMA/OCA-T6-4. Assuming, arguendo, that the Commission agrees with you that the cost coverage for First-Class letters should be moderated, please provide as complete an explanation as possible as to why the Commission should recommend a cost coverage and mark-up index for First-Class letters at the levels implied in the OCA 33-cent SPFC proposal.

- a. Did you consider during the preparation of your testimony, or can you now suggest, a modification in the USPS proposals that would benefit consumers and small businesses and that would "moderate" First-Class letter cost coverage, but to an extent lesser than that implied by the OCA 33-cent SPFC?
- b. If so, please describe such modification as fully as possible.

RESPONSE TO DMA/OCA-T6-4.

Maintaining the 33 cent single-piece rate would reduce the high institutional cost burden on First-Class Letter Mail in a manner providing the most benefit to consumers. That the First-Class Letter Mail institutional cost burden has become more prominent in recent years, and will remain high through the test year, seems indisputable. See OCA-T-6, Part I, Figures 1 and 2, at 8 and 9, respectively. Moreover, it is clear the institutional cost burden has exceeded that intended by the Commission, on balance, during the years FY 1988 through FY 1999. Similarly, considering only the test year in Docket No. R97-1, the institutional cost burden on First-Class Letter Mail has far exceeded that intended by the Commission, based upon the Commission's recommended mark-up index. See OCA-T-6, Part I, Figure 4, at 13. The conclusion is inescapable that mailers of First-Class Letters are carrying an increasing institutional cost burden of the Postal Service, and to a much greater extent than intended by the Commission, and that simple fairness suggests that this burden be mitigated. For that

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reason, I propose maintaining the 33 cent single-piece rate.

(a) - (b) Yes. Other options for reducing the institutional cost burden on First-Class Letter Mail might include reducing the extra ounce rate, or increasing the “passthroughs” for presort mail. However, these options would be less beneficial for consumers than maintaining the current 33-cent First-Class rate.

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DMA/OCA-T6-5. Please refer to your testimony on page 30, lines 8-17.

- a. Please provide an estimate of the postage costs that would be saved by First-Class mailers in the test year if the OCA 33-cent SPFC proposal were implemented, as compared with the First-Class rates proposed by the Postal Service.
- b. Please provide an estimate of the portion of the estimated savings identified in question 5.a., above, that would be saved by consumers.
- c. Please provide an estimate of the portion of the estimated savings identified in question 5.a., above, that would be saved by business mailers.

RESPONSE TO DMA/OCA-T6-5.

(a) I estimate total postage savings to mailers of First-Class Letters at \$1.076 billion. See my response to PostCom/OCA-T6-4(a).

(b) According to the Postal Service, a reasonable approximation of the volume of First-Class Mail generated by households in 1998 is 14.9 billion. Tr. 12/4766 (OCA/USPS-T33-1(a)). Thus, using this volume figure as a proxy for mail entered by consumers, I estimate consumers would save approximately \$149 million.

(c) I estimate the savings for business mailers to be \$927 million (\$1,076 - \$149).

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DMA/OCA-T6-6. Did you consider the impact of your 33-cent SPFC proposal on overall First-Class Letter rate design, including the size of various work-sharing discounts available to mailers. If so, please explain such considerations in as much detail as possible.

RESPONSE TO DMA/OCA-T6-6.

Yes. In developing my proposal, I considered its effect on workshare discounts for mailers. See my response to Postcom/OCA-T6-4. See also OCA-T-6, Part II, at 42-45. I propose no changes in overall First-Class Letter Mail rate design (other than elimination of the nonstandard surcharge for low aspect ratio letters).

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DMA/OCA-T6-7. Please refer to your testimony at page 37, lines 9-12, where you state that “. . . rates for First Class Letters . . . would be set without regard to the ‘integer constraint.’” You continue by stating, “*The rate actually paid by households, by contrast, would be set at a whole cent.*”

- a. Is it your proposal that the SPFC “integer rate” would not be available to business mailers? If so, how do you propose that the Postal Service enforce the requirement that business mailers pay a rate other than the integer rate?
- b. Are you proposing that there would be a difference in the SPFC rate depending upon whether a stamp, a postage meter or some other method of paying postage were used? Please explain fully.
- c. Do you have any data or estimates on the number of household mailers that have access to means of paying postage other than by applying stamps? If so, please provide such data and/or estimates in as much detail as possible.

RESPONSE TO DMA/OCA-T6-7.

(a) - (b) No. Under SPFC rate stability proposal, any mailer, business or otherwise, entering single-piece First-Class letter mail, e.g., mail other than presorted or prebarcoded, would pay the single-piece First-Class rate, and could benefit from the longer period of stable rates intended by this proposal.

(c) No.

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DMA/OCA-T6-8. Please refer to your testimony at page 37, line 20 through page 38, line 5.

- a. Would the 33-cent SPFC stamp you propose produce a "positive balance" in the "SPFC Reserve Account" that you propose, in the test year?
- b. If so, how large do you estimate the reserve would be at the end of test year?
- c. On pages 21 through 23 of your testimony, you argue that First-Class letter mail has contributed an excess of revenues over the past twelve years. Is it your testimony that, in effect, there is already a "positive balance" to the "credit" of SPFC mail that should cause the Commission to recommend SPFC rate stability in this proceeding by maintaining the 33-cent rate recommended in R97-1?
- d. Have you made an analysis as to whether similar "excess contributions" have been made by other classes or subclasses of mail that should be used to maintain rate stability for those classes, as well? If so, please describe such analyses in detail.

RESPONSE TO DMA/OCA-T6-1-8

(a) - (b). In this proceeding, if the Commission maintains the current First-Class rate at 33 cent, rate stability will effectively be provided through two rate case periods, Docket Nos. R97-1 and R2000-1. Under these circumstances, I would not expect the Commission to recommend my rate stability proposal in this proceeding; it would be more appropriate to recommend this proposal in the next rate proceeding. Please note that to illustrate the operation of my proposal, I assumed a 34 cent SPFC rate and a "calculated" non-integer single-piece rate of 33 cents, the rate from which workshare discounts are set. Under these illustrative assumptions, which could be recommended by the Commission in this proceeding, I estimate that the SPFC Reserve Account would accumulate \$517 million in the test year. See OCA-T-6, part II, Table 13, at 40.

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(c) No. I consider my proposal to mitigate the high institutional cost burden on First-Class Letter Mail by maintaining the current 33 cent First-Class rate, discussed in Part I of my testimony, separate from the SPFC rate stability proposal, discussed in Part II of my testimony. The high institutional cost burden on First-Class Letter Mail should be reduced whether or not the Commission decides to recommend the SPFC rate stability proposal. Similarly, the Commission could recommend a “calculated” non-integer single-piece rate that results in the same cost coverage as proposed by the Postal Service, and then set the SPFC rate to fund the SPFC Reserve Account.

(d) No. However, an analysis of the institutional cost contribution of Standard (A) Regular mail reveals not “excess contributions,” but contributions less than intended by the Commission, based upon the Commission’s recommended mark-up index for Standard (A) Regular. See OCA-T-6, Part I, Figure 8, at 19.

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DMA/OCA-T6-9. What are the cost coverage and mark-up index for First-Class letters implied by the OCA 33-cent SPFC proposal in the Test Year both (1) using Test Year costs proposed by the Postal Service and (2) using Test Year costs as estimated by OCA witness Thompson. See OCA-T-9.

RESPONSE TO DMA/OCA-T6-1-9

With respect to (1) Test Year costs proposed by the Postal Service, the cost coverage and mark-up index for a 33 cent single-piece First-Class rate would be 190.1 percent and 1.369, respectively.

With respect to (2) Test Year costs estimated by OCA witness Thompson, the cost coverage and mark-up index for a 33 cent single-piece First-Class rate would be 180.4 percent and 1.353, respectively.

DECLARATION

I, James F. Callow, declare under penalty of perjury that the answers to interrogatories DMA/OCA-T6-1-9 of the Direct Marketing Association are true and correct, to the best of my knowledge, information and belief.

Executed 6-16-00

James F Callow

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the rules of practice.


JENNIE D. WALLACE

Washington, DC 20268-0001
June 16, 2000