

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

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POSTAL SERVICE
WASHINGTON, D.C.

EXPERIMENTAL RATE AND SERVICE CHANGES
TO IMPLEMENT NEGOTIATED SERVICE AGREEMENT
WITH CAPITAL ONE SERVICES, INC.

Docket No. MC2002-2

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORIES OF OFFICE OF THE CONSUMER ADVOCATE
(OCA/USPS-T2-1-14)

The United States Postal Service hereby provides the responses of witness
Plunkett to the following interrogatories of Office of the Consumer Advocate:

OCA/USPS-T2-1-14, filed on October 7, 2002.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking



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October 17, 2002

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
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OCA/USPS-T2-1. Please refer to your testimony at page 1, lines 6-9, where you discuss “three distinct goals” accomplished by the Negotiated Service Agreement (NSA) with Capital One. Please confirm that the Postal Service would enter into a NSA with another company that “allows the Postal Service to reduce costs and increase revenue,” provides “an incentive for the company to maintain and increase its use of First-Class Mail,” and “reduces the overall burden on postal ratepayers” by generating additional contribution to institutional costs. If you do not confirm, please explain and identify and describe all other “distinct goals” that would have to be accomplished in order for the Postal Service to conclude a NSA with another company.

RESPONSE:

Confirmed that these goals, and possibly others, would need to be met in order for the Postal Service to consider entering into a Negotiated Service Agreement with another company. Please note another NSA would not necessarily relate to First-Class Mail.

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OCA/USPS-T2-2. Please refer to your testimony at page 1, lines 18-21, where it refers to NSAs between the Postal Service and its international mail customers, and the “three distinct goals” on lines 6-9.

- (a) Please confirm that the Postal Service has entered into NSAs with one or more international mail customers that accomplish one or more of the “three distinct goals” identified on lines 6-9. If you do not confirm, please explain.
- (b) Please identify the number of NSAs concluded between the Postal Service and its international mail customers that accomplish one or more of the “three distinct goals” identified on lines 6-9 by distinct goal.
- (c) Please identify the number of NSAs concluded between the Postal Service and its international mail customers that accomplish all “three distinct goals” identified on lines 6-9.

RESPONSE:

Not confirmed. Please note that my testimony states that “customer-specific pricing arrangements have been used ... by the Postal Service with its international customers.” These are not NSAs, in the sense that that term is being used to refer to an agreement involving domestic mail, the implementation of which requires implementation of changes in rates, fees, and/or classifications through the Postal Rate Commission process. The goals I discuss are based in part on the requirements of that process, which does not apply to international rates.

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OCA/USPS-T2-3. Please refer to your testimony at page 3, lines 7-10. By concluding the NSA with Capital One, does the Postal Service anticipate that Capital One will be able to reduce the volume of First-Class Mail that is physically returned because it is undeliverable-as-addressed (UAA), as well as the number of electronic address correction notifications for UAA mail? Please explain.

RESPONSE:

The Postal Service expects that this agreement will result in fewer pieces having to be returned physically to Capital One. Capital One is not currently receiving electronic notifications for UAA mail.

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OCA/USPS-T2-4. Please refer to your testimony at page 3, lines 12-14.

- (a) Please explain how the volume threshold of “more than 750 million pieces of qualified First-Class Mail annually” was derived. Provide citations to all figures used, and show all calculations.
- (b) Please explain the rationale for the volume threshold of “more than 750 million pieces of qualified First-Class Mail annually.”
- (c) Please confirm that a volume threshold between zero and 750 million pieces of qualified First-Class Mail annually would result in cost savings to the Postal Service. If you do not confirm, please explain.

RESPONSE:

As described in my testimony (p 5, lines 11-13), the thresholds in this agreement represent the outcome of negotiations between the Postal Service and Capital One, and consequently represent a balancing of benefits rather than mathematical derivation.

The agreement is intended, in part, to provide incentives for Capital One to continue to mail very large volumes of First-Class Mail. Balances of benefits at lower volume levels were not considered.

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OCA/USPS-T2-5. Please refer to your testimony at page 4, footnote 1. Please explain how the volume threshold of 1.025 billion pieces was derived. Provide citations to all figures used, and show all calculations.

RESPONSE: See my response to OCA/USPS-T2-4.

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OCA/USPS-T2-6. Please refer to your testimony at page 4, lines 3-6. Please explain how the volume threshold of 1.225 billion pieces was derived. Provide citations to all figures used, and show all calculations.

RESPONSE: See my response to OCA/USPS-T2-4.

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OCA/USPS-T2-7. Please refer to your testimony at page 14, Appendix 1, lines 6-18 (volume block/incremental discount table). Please confirm that in the second and third year of the agreement, Capital One will have access to the incremental discounts listed in the table at Appendix 1, lines 6-18, provided Capital One enters qualifying First-Class Mail volume exceeding 1.025 billion pieces. If you do not confirm, please explain.

RESPONSE:

Not confirmed. The discount tiers described in appendix 1 are not activated unless Capital One's volume falls below 1.025 billion pieces in the first year of the agreement.

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OCA/USPS-T2-8. Please refer to your testimony at page 4, lines 7-15. Please confirm that in the first year of the agreement, if Capital One enters qualifying First-Class Mail volume of less than 1.225 billion pieces, Capital One will not have access to any of the discounts contained in Article III, paragraphs E and F of the agreement. If you do not confirm, please explain.

RESPONSE:

Confirmed.

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OCA/USPS-T2-9. Please turn to your testimony at page 6, lines 1-4. In setting the initial threshold at 1.225 billion pieces, when Capital One's projected volume is projected to be in excess of 1.4 billion pieces, you appear to be providing Capital One with an unneeded incentive for pieces that Capital One would mail regardless of the declining block discounts, based on its forecasts. This appears analogous to Capital One's obtaining a consumer surplus from the Postal Service.

- (a) Have you explored the appropriateness of the declining block discount schedule in terms of economic efficiency? Please explain.
- (b) Why would it not be more economically efficient to provide the same level, or possibly even an increased level, of per piece discount for volumes exceeding the projected 1.4 billion pieces? Please explain.

RESPONSE:

- (a) Not directly. The appropriate way to consider the value of the Postal Service's agreement with Capital One, in terms of economic efficiency or anything else, is to consider the effects of the entire agreement as a whole. It would be inappropriate to attempt to isolate a single component of the agreement, such as the declining block discount, for the type of evaluation suggested by this question. Moreover, I view the expected effect on economic efficiency of the overall agreement to be positive, since it was negotiated between both parties and therefore must be believed by each to benefit its own interests, and since it is also projected to increase volume, lower costs, and increase overall contribution from Capital One, and thereby lower the institutional cost burden on all other mailers.
- (b) Any fixed price results in some users capturing consumer surplus, to the extent that that the price is set at a point below the maximum that some customers would have been willing to pay for some or all of the units they consume. As I indicate in my testimony, the thresholds and discounts specified in the instant agreement are negotiation outcomes that reflect many different considerations. Potential further

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gains in economic efficiency are not relevant if the other party to a negotiated agreement is unwilling to accept the terms associated with those potential gains, presumably because of a belief that the overall agreement with such terms would not achieve as much benefit from its perspective as the agreement with the terms to which it has agreed.

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OCA/USPS-T2-10. Please turn to your testimony at page 7, lines 4-7, where you state that "much of the value to the Postal Service of this agreement arises from the avoidance of costs incurred by handling undeliverable-as-addressed (UAA) mail." Please provide a detailed description of all of the operations involved in handling UAA mail. Also, please provide a detailed statement of all of the costs associated with UAA mail, thereby showing all costs per piece for undeliverable mail.

RESPONSE:

These subjects are covered in the testimonies of witnesses Crum and Wilson.

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OCA/USPS-T2-11. Please refer to your testimony at page 7, lines 6-9.

- (a) Please confirm that the offering of Change Service Requested, Option 2, at no charge to any First-Class mailer whose return or forwarding volumes exceeded the average would produce net cost savings to the Postal Service. If you do not confirm, please explain.
- (b) Please confirm that the offering of Change Service Requested, Option 2, at no charge to any First-Class mailer whose return or forwarding volumes are below the average would produce net cost savings to the Postal Service. If you do not confirm, please explain.
- (c) Please confirm that the Postal Service is aware of other First-Class mailers in addition to Capital One whose return or forwarding volumes exceed the average. If you do not confirm, please explain.
- (d) For Fiscal Years 2000 and 2001, please provide the return volume of First-Class permit system mailers whose UAA volumes exceed the average. (NOTE: OCA is not asking for the specific identification of any permit system mailers.)

Response

- (a) Not confirmed. While the average cost of handling undeliverable-as-addressed pieces physically is greater than the cost of providing returns electronically, it is not necessarily true that waiving fees would – in every case – result in net cost savings, even in the event that a particular customer's percentage of returned pieces exceeds the average rate.
- (b) Not confirmed. See response to part (a).
- (c) Not confirmed. I'm not aware of any study of individual customer returns that would confirm this supposition, however, by definition, it is fair to assume that more than one customer is above average.
- (d) Please see the response of the Postal Service to OCA/USPS-2.

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OCA/USPS-T2-12. Please refer to your testimony at page 7, lines 11-12. Please confirm that Capital One was the largest originator of First-Class Mail in Fiscal Years 2000, 2001 and 2002. If you do not confirm, please explain.

RESPONSE:

Confirmed.

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OCA/USPS-T2-13. Please turn to your testimony at page 11, lines 4-8 and footnote 3, where you state that the First-Class presort elasticity used is not specific to Capital One but, rather, is developed from all First-Class presort mailers. In the case of Capital One, the need to send bills is a function of the number of accounts. Accordingly, for price elasticity to have an effect on volume, it would appear that the elasticity and price change have to cause the introduction of new mail, prompt Standard Mail to migrate to First-Class Mail, or cause electronic other billing options to convert to physical mail. In the case of customer account mail, please explain why elasticity is relevant to the estimate of mail volume. Also, please provide an estimate of the quantity of mail shifted for each of the various alternatives discussed above.

RESPONSE:

To the extent elasticity could be estimated for customer account mail, it would presumably reflect many factors including the cost and availability of alternatives as described above. The instant agreement however, does not assume any new customer account mail, other than through the creation of new accounts at the margin consequent to increased solicitation volumes in response to the declining block discounts. I am not aware of any estimates of the volume shifts described above.

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OCA/USPS-T2-14. Please refer to your testimony at page 6, lines 2-4.

- (a) Please confirm that the initial volume threshold is less than Capital One's projected volume for FY 2003. If you do not confirm, please explain.
- (b) Please confirm that one of the Postal Service's objectives in concluding the NSA with Capital One is to promote the growth of First-Class Mail volume. If you do not confirm, please explain.
- (c) Given that Capital One's estimate of the growth in volume ranges from 15-53 million pieces, with a total projected volume of 1,423,458,969 pieces in FY 2003, why does the declining block discount schedule establish a volume threshold at less than 1.4 billion—the quantity Capital One would have produced absent the discounted rates?
- (d) Why should access to the declining block discounts for volume of less than 1.4 billion pieces cause Capital One to mail more pieces of mail if, in fact, Capital One's projected mail volume is based on factors other than the proposed declining block discounts?
- (e) What factors would cause Capital One to mail fewer than 1.4 billion pieces in FY 2003?

RESPONSE:

- (a) Confirmed
- (b) Confirmed
- (c) See response to OCA/USPS-T2-4.
- (d) My understanding is that Capital One's volume is based on many variables including postage costs. It is not unreasonable to conclude that lower postage rates would – all other things being equal – result in increased volumes.
- (e) I have no information that would allow me to answer this question specifically. As I stated in response to part (d), my understanding is that Capital One's volume is based on many variables, of which postage is only one.

DECLARATION

I, Michael K. Plunkett, declare under penalty of perjury that the foregoing answers are true and correct, to the best of my knowledge, information, and belief.

A handwritten signature in black ink, appearing to read "Michael K. Plunkett". The signature is written in a cursive style with a long horizontal stroke at the end.

Dated: 10/17/02

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.

A handwritten signature in cursive script, appearing to read "Scott L. Reiter", is written above a horizontal line.

Scott L. Reiter

475 L'Enfant Plaza West, S.W.
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