

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

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 VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.
(VP/USPS-T2-1-7)

The United States Postal Service hereby provides the responses of witness Plunkett to the following interrogatories of Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc.: VP/USPS-T2-1-7, filed on November 15, 2002.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T2-1.

Your testimony (at p. 1, l. 4) states that "Capital One's use of the mail creates unique opportunities," and you refer to "opportunities that arise from Capital One's unique and innovative use of First-Class Mail in its business model" (at p. 2, ll. 3-5).

- a. Do you consider the fact that Capital One heavily uses First-Class Mail for solicitations instead of Standard Mail to be a factor in its unique and innovative use of First-Class Mail? Please explain.
- b. Do you consider the fact that Capital One would be willing to have its nonforwardable solicitation First-Class Mail destroyed if Address Change Service ("ACS") notification would be free to be a factor in Capital One's unique and innovative use of First-Class Mail? Please explain.
- c. Do you consider the fact that the proportion of Capital One's solicitation First-Class Mail that is undeliverable as addressed and cannot be forwarded is about eight times the national average to be a factor in Capital One's unique and innovative use of First-Class Mail? Please explain.
- d. Please explain the extent to which you believe Capital One's capability and willingness to accept and use computerized ACS notices to be unique and innovative.
- e. Do you believe Capital One's preference for physical returns, instead of the Postal Service's computerized ACS, to be unique and innovative? Please explain.
- f. Please list any other characteristics of Capital One's use of First-Class Mail that you consider unique and innovative. If it is some particular combination of characteristics that makes it unique, please specify the characteristics and their interaction that make them unique.

VP/USPS-T2-1 Response:

- a. Yes.
- b. No. Presumably many companies would convert to Address Change Service if it were made available for free, all other things being equal.
- c. I have not studied other companies to the extent necessary to determine whether there are many, or some, or few that have proportions of returned mail comparable to Capital One. I would also maintain that the amount or proportion of return mail that Capital One generates is more a byproduct of its use of the mail, than a characteristic of the same.
- d. See response to part b.

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- e. No. As the number of subscribers to computerized ACS is less than the total number of First-Class Mail users, Capital One's election of the same alternative could hardly be called unique.
- f. In addition to my response in part a, see witness Jean's testimony (COS-T1, pp. 2-3).

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VP/USPS-T2-2.

Your testimony (at p. 3, ll. 5-7) states: "The proposed agreement would allow Capital One access to declining block rates for First-Class Mail in exchange for the receipt of address change information electronically, rather than the physical return of the mail piece."

- a. Do you consider the absolute size of Capital One's First-Class Mail volume to be a factor in concluding that Capital One's use of the mail is unique and warrants a Negotiated Service Agreement ("NSA")? Please explain the role of size in your deliberations, being sure to distinguish between absolute size per se and size relative to other mailers of the same subclass. For example, would the top three users of a subclass be unique or would it be only the largest user in each subclass?
- b. Is the above statement from your testimony intended to mean that you consider the receipt of address change information electronically to be an essential condition for any other mailer to have access to declining block rates in First-Class Mail? Please explain fully any answer that is not an unqualified affirmative.
- c. Is it your testimony that declining block discounts for First-Class Mail should be linked to electronic receipt of address change information? Please explain all reasons why the Postal Service believes the two should be linked.

VP/USPS-T2-2 Response:

- a. I do not consider size to be a factor in determining "uniqueness". However, in this case, Capital One's size is a relevant factor in determining the appropriate form of the Agreement. For example, I consider the thresholds embedded in the declining block discount structure to be appropriate given Capital One's size. Those same thresholds might not be appropriate for the next largest customer in the same subclass.
- b. No. The Postal Service considers Capital One's willingness to receive address information electronically to be an essential element of the Agreement, but it is not necessarily a prerequisite for other agreements.
- c. No. In another agreement, linking the two may not be appropriate and depends on the circumstances of a given mailer.

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VP/USPS-T2-3.

Your testimony (at p. 4, ll. 20-23) discusses the size of the Capital One discounts relative to their total postage bill. You say: "Because of Capital One's size, discounts that are large at the margin ... are relatively small when considered relative to Capital One's total First-Class Mail revenue."

- a. Please explain whether it is your contention that the merits of the proposed Negotiated Service Agreement ("NSA") depend on the absolute size of Capital One's postage bill for First-Class Mail.
- b. According to the testimony of Capital One witness Stuart Elliott, COS-T-2, the before-rates First-Class volume of Capital One is 1.408 billion pieces. You indicate on page 4, line 21, of your testimony that the maximum discount, on a declining block basis, is "just above 20 percent." Witness Elliott pegs the after rates volume at between 1.423 and 1.461 billion pieces. For purposes of this question, assume the after-rates volume is 1.450 billion, which is an increase in volume of approximately 3 percent. If the discounts began at 1.408 billion pieces (instead of 1.225 billion pieces), the total discount amount would equal 1.450 — 1.408 billion times the average per-piece discount. This amount could easily be divided by the total postage bill to obtain what may be called a discount proportion.
 - (1) Please explain any extent to which you disagree that the discount proportion as just defined is a meaningful way to compare the total discount amount to the total postage bill of the mailer.
 - (2) Except for the fact that the proposed discounts take effect below the projected before-rates volume level, please explain the extent to which the discount proportion as just defined is similar in nature to the "one percent" figure you provide on page 5, line 1, of your testimony.
 - (3) Assume a mailer one-tenth the size of Capital One which has a before rates volume of 0.1408 billion pieces (i.e., 140.8 million pieces). Assume this mailer is given declining-block discounts similar to those proposed, and the volume increases to 0.1450 billion pieces. Please explain whether the discount proportion for this mailer would be larger, smaller, or the same size as the "one percent" figure you provide for Capital One.
 - (4) If your response to part (3) above is "the same size," please explain the references in your testimony to the importance of the absolute size of Capital One's postage bill and to the smallness of the discount proportion.

VP/USPS-T2-3 Response:

- a. I don't believe the merits of this proposal depend at all on the total size of Capital One's postage bill.
- b. The hypothetical example presented in this question is conceptually similar to my characterization as referenced, and may be an appropriate basis for

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comparing proposals. If the per piece discounts were identical, then the total discounts would be one tenth the size, and if the postage bills were proportionally similar, then the percentage discounts are the same. As indicated in my response to part a, I do not consider the size of the total postage bill relevant in determining the soundness of the Agreement. Because the Postal Service is proposing discounts that are – when expressed in absolute terms – much larger than typical discounts, I included the instant language for illustrative purposes.

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VP/USPS-T2-4.

Your testimony (p. 8, ll. 17-19) refers to the size of the Capital One discounts relative to overall Postal Service revenue as “barely measurable.”

- a. Please explain the extent to which it is your testimony that the smaller in absolute terms a discount is, the more justifiable it is.
- b. Please explain whether you would agree that since Capital One is such a large mailer, similar discounts for almost any other mailer would be even less measurable than the discounts for Capital One.
- c. If you do not see the absolute size of discounts relative to the overall Postal Service budget to be an important factor in assessing the extent to which a particular NSA is meritorious, please explain why you emphasize such size in your testimony.

VP/USPS-T2-4 Response:

- a. One of the purposes of my testimony is to explain why a proposal that would be considered novel is consistent with the Act. In doing so I thought it appropriate to mention that the possible effects that this agreement would have on other customers. Arguably, agreements that are larger in absolute terms would present larger risks to other customers, and the Commission would no doubt take this into account in making its Recommended Decision.
- b. All other things being equal, smaller discounts would – by definition – have smaller effects.
- c. See my response to part a.

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VP/USPS-T2-5.

Within the framework of a traditional linear-demand curve, of the kind commonly used to think about economic situations, with price on the vertical axis and quantity demanded per unit of time on the horizontal axis, please respond to the following questions.

- a. If a particular price is selected and the demand curve indicates the quantity purchased by the market or by a particular customer at that price, do you agree that the revenue collected by the Postal Service is represented by the two dimensional area of a rectangle with height equal to the price and width equal to the quantity demanded, and that the upper right corner of the rectangle touches the demand curve at one point? If you disagree (or have difficulty with the framework of the question), please so state, and explain your disagreement or difficulty.
- b. If, for a given quantity, the Postal Service were able to perfectly segment the market and extract all of the value that mailers receive from having the mail sent, do you agree that the revenue of the Postal Service would be equal to the entire area under the demand curve up to the given quantity? If you disagree, please explain your disagreement.
- c. If there are a market price and a market quantity, or a price and quantity for a specific customer, do you agree that progressively declining block discounts from the given price could be viewed as a way to extract in revenue a greater part of the area under the curve than could be obtained from a simple rectangle as described in part a above? Please explain any negative answer.
- d. When a firm uses declining block discounts to obtain revenue equal to more of the area under the demand curve (so long as the price is above the firm's marginal cost), do you agree that both the customers and the firm gain and that there are no losers? Please explain any disagreement.
- e. If declining block discounts can be used to obtain additional net revenue as just described, and the welfare of customers can be improved, please explain whether you believe this means that declining block discounts can make economic sense in and of themselves, without being used in combination with other contract features.
- f. If declining block discounts are justified according to the logic suggested in this question, please explain whether you believe that the strength of this justification depends in any way on the absolute volume or the relative volume of the mailer.

VP/USPS-T2-5 Response

- a. I agree.
- b. I agree.
- c. I agree.
- d. Not necessarily. In order to agree that all parties gain and no party loses, it is necessary to establish the basis for comparison more precisely. For

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example, if we start at a given price and quantity, with no declining block rates, and then implement declining block rates starting only at quantities in excess of the initial quantity, I agree that both the customers and the firm stand to gain under the conditions specified. On the other hand, if the declining block rates are used by the firm only to obtain more revenue from some of the units that were already being purchased (i.e., the original given price is now the lowest price charged in the declining block structure, rather than the highest), the firm stands to gain, but the customers do not. Under this scenario, the firm would be attempting to “segment” the market (as described above in subpart b.) to obtain more of the area under the demand curve as revenue, purely for its own benefit.

- e. I agree that declining block discounts can make economic sense in and of themselves, just as the venerable maxim “buy low and sell high” makes economic sense. The true hurdle to be overcome in each instance, however, is not in grasping the underlying economic theory, but in applying that theory to the real world. The theoretical framework upon which all of these questions have been premised (e.g., a known demand curve) is a useful analytic construct, but we must not fail to appreciate that our understanding of demand curves (particularly for individual customers) encompasses many of the same volatilities as our understanding of stock markets and stock prices.
- f. While there is a justification for declining block rates in terms of consumer welfare, I’m not prepared to say that justification would hold regardless of

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volume. For instance, declining block rates at significantly lower volume levels may create practical difficulties that would not necessarily be offset by any benefits of the arrangement.

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VP/USPS-T2-6

OCA/USPS-T2-11(a) asked you: 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.

You responded: 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. Please answer the following questions.

- a. Have you assumed that the "at no charge" service being provided is ACS service and that it is provided to all undeliverable-as-addressed (UAA) pieces (as opposed to those that are returned)? Please explain any negative answer.
- b. Please state whether you have made any assumptions about the ratio of UAA pieces that are successfully forwarded, to UAA pieces that are returned, both (i) on average, and (ii) for Capital One, and explain these assumptions.
- c. You state that "the average cost of handling undeliverable-as-addressed pieces physically is greater than the cost of providing returns electronically...." Please state whether this is true for UAA pieces that are forwarded or for UAA pieces that are returned, or both. Please also state whether the cost of handling UAA pieces physically depends on whether the piece is forwarded or returned. Please explain each answer in detail.
- d. Proceeding from the last phrase in the last sentence of your response quoted above, please assume that a particular customer's percentage of returned pieces exceeds the average rate. Under this assumption, if the average cost of returning UAA pieces physically for this customer is greater than the cost of providing returns electronically, please explain how waiving the fees would not result in a net cost savings for the Postal Service.
- e. Proceeding again from the last phrase in the same last sentence, please assume that a particular customer's percentage of returned pieces is equal to the average rate of returned pieces. Under this assumption, if the average cost of returning UAA pieces physically for this customer is greater than the cost of providing returns electronically, please explain how waiving the fees would not result in a net cost savings for the Postal Service.
- f. Proceeding once more from the last phrase in the same last sentence, please assume that a particular customer's percentage of returned pieces is less than the average rate of returned pieces. Under this assumption, if the average cost of returning UAA pieces physically for this customer is greater than the cost of providing returns electronically, please explain how waiving the fees would not result in a net cost savings for the Postal Service.
- g. Please explain how the qualitative relation (greater than, equal, or less than) of a particular customer's returns to the average rate of returns bears on whether waiving the fees would result in a net cost savings for the Postal Service.

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VP/USPS-T2-6 Response:

- a. Yes.
- b. I did not make any specific assumptions in drafting my response.
- c. In general, my response is true irrespective of whether the pieces being handled physically are returned or forwarded.
- d-f. On average, a net cost savings would result if all users converted to electronic receipt of CSR if one ignores the impact that waiver of the fee has on the mailer's address hygiene practices (see response to OCA/USPS-T4-14). In my response I was making a distinction between this general point, and the extreme notion implied in the interrogatory: that in every case, provision of ACS for free produces a net cost savings
- g. In no way did I intend that an individual customer's proportion of returned mail bears on this issue. I was acknowledging that the costs of handling UAA mail might vary by customer, and that in some cases a net cost savings may not result.

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VP/USPS-T2-7

OCA/USPS-T2-18(b) asked you: Please provide an example of a mailer whose "average cost of handling undeliverable-as-addressed pieces physically is greater than the cost of providing returns electronically" but does not result in net cost savings to the Postal Service.

Your responded:

I am not aware of any specific examples. My response to OCA/USPS-T2-11(a) was based on the fact that the savings estimates employed in the instant filing are based on average per-piece costs. By definition a significant number of returned pieces costs less than the average, and it is therefore plausible that a given mailer's characteristics are such that conversion to CRS Option 2 would not produce a net savings.

Please answer the following questions.

- a. Please state whether you assumed in your answer that the undeliverable-as-addressed (UAA) pieces being handled physically were all being returned instead of being forwarded. Please explain any negative answer.
- b. In your answer you state: "By definition a significant number of returned pieces costs less than the average . . ."
 - (i) Do you have an opinion as to the characteristics of the pieces that, or the nature of the mailers whose pieces, "cost[] less than the average"? If so, what is that opinion?
 - (ii) To what extent would you expect that the return costs for unusually large mailers might be lower than, or otherwise different from, return costs on average? Please explain your answer.
 - (iii) Would you expect the costs for mailers who send predominately lettersize pieces would be lower than the return costs on average? Please explain your answer.
- c. Have you analyzed whether the physical return costs caused by Capital One's First-Class Mail solicitation pieces are below average, and therefore that Capital One might be one of those mailers whose "characteristics are such that conversion to CRS Option 2 would not produce a net savings?" If so, please provide that analysis.
- d. Since the average mail processing cost of physically returning mailpieces is 29.95 cents, would you agree that the plausibility "that a given mailer's characteristics might be such that conversion to CRS Option 2 would not produce a net savings" would depend in large part on the on the dispersion (e.g., standard deviation) of cost around the mean figure of 29.95 cents? Please explain any disagreement.
- e. Since the average cost of ACS is 14.5 cents, would you agree that the plausibility "that a given mailer's characteristics might be such that conversion to CRS Option 2 would not produce a net savings" would depend to some degree on the on the dispersion (e.g., standard deviation) of cost around the mean figure of 14.5 cents? Please explain any disagreement.
- f. Have you seen, or are you aware of, any data that bear on the dispersion of the unit cost of physically returning mailpieces around the mean of 29.95 cents? If so, please explain the full extent of your knowledge, and provide any data of which you are aware that bear on the dispersion of unit costs around the mean.

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- g. Have you seen, or are you aware of, any data that bear on the dispersion of the unit cost of ACS around the mean of 14.5 cents? If so, please explain the full extent of your knowledge, and provide any data of which you are aware that bear on the dispersion of unit costs around the mean.

VP/USPS-T2-7 Response:

- a. I didn't make any such assumptions.
- b. I didn't perform the analysis suggested by this interrogatory. My point was more general; that there are and will be deviations from the average such that some pieces would have characteristics that would cause a net increase in costs if that mailer were to convert to CSR.
- c-g. In witness Crum's testimony, he implicitly assumes that the cost of handling Capital One's undeliverable solicitations are appropriately represented by the average cost. I am not aware of any analysis that would measure the true costs of Capital One's UAA mail or compare such a measurement to an estimated average. I would point out two factors that support the implicit assumption that Capital One's mail is adequately represented by an average. First, Capital One accounts for a significant proportion of return volume. Consequently, their mail determines what average is more than any other mail. Second, Capital One is a national mailer that sends solicitation mail all over the US. As a result, this mail is likely to represent a wide range of local operating conditions, and therefore less likely to reflect unusual conditions.

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.

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