

UNITED STATES OF AMERICA
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

ANSWERS OF OFFICE OF CONSUMER ADVOCATE
WITNESS JAMES F. CALLOW TO INTERROGATORIES OF
UNITED STATES POSTAL SERVICE (USPS/OCA-T2-1-19)
(January 21, 2003)

The Office of Consumer Advocate hereby submits the answers of James F. Callow to interrogatories USPS/OCA-T2-1-19, dated January 8, 2003. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

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ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES USPS/OCA-T2-1-19

USPS/OCA-T2-1

Please refer to page 7, lines 14-16 of your testimony where you state “Under OCA’s experimental classification, electronic address correction notices would be provided at no charge to First-Class mailers authorized by the Postal Service that participate in the ACS program.”

- a. Do you propose any minimum required First-Class Mail volume for a customer to be eligible for the waiver of ACS fees? Please explain why or why not.
- b. Do you propose any minimum number of annual returns, forwards or UAA pieces for a customer to be eligible for the waiver of ACS fees? Please explain why or why not.

RESPONSE TO USPS/OCA-T2-1

(a) – (b) No. Each electronic notice reduces costs to the Postal Service by avoiding the physical return of a First-Class mailpiece, or by reducing the number of mailpieces that are repeat forwards. A minimum required First-Class Mail volume or minimum number of undeliverable-as-addressed (UAA) mailpieces could have unduly limited the number of mailers that might be authorized by the Postal Service. Thus, the absence of a minimum requirement is designed to prompt further reductions in Postal Service costs by encouraging as many First-Class mailers as possible to participate in the Experimental Automated Address Correction Service.

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USPS/OCA-T2-2

Refer to page 7, line 16 to page 8, line 2 of your testimony where you state: "The current fee of 20 cents for each electronic notice would be waived, provided mailers correct and update their address databases and take other actions to improve their address databases."

- a. What "other actions" would be required? Please list and describe each such action.
- b. Would it be sufficient for a mailer to only perform these "other actions" and not "update their address data bases" as long as address databases were "improved"? Please explain.
- c. Please describe the mechanism and standards you expect the Postal Service to utilize in determining whether address databases have been corrected, updated or improved.
- d. What is the estimated annual cost of implementing the mechanism you describe in your response to part (c)? Please show all assumptions and calculations used to prepare your estimate.
- e. Will the per customer cost of implementing the monitoring method described in your response to part (c) vary with the size of the customer as measured by
 - i. annual volume of First-Class Mail?
 - ii. volume of ACS notifications?
 - iii. volume of returned, forwarded or UAA mail?
 - iv. number of permits held by the customer? or
 - v. number of locations at which the customer holds permits?

RESPONSE TO USPS/OCA-T2-2

(a) The "other actions" refer to the Postal Service's Move Update program. OCA-T-2 at 9 and 10, lines 15-18, and 1-9, respectively. Under the Experimental Automated Address Correction Service, mailers must comply more frequently with the requirements of the Move Update program by running their address database against

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the National Change of Address (NCOA) database or utilize *FASTforward* within 60 days prior to mailing. See OCA-T2 Attachment A, DMCS § 610.43.

(b) No. Mailers must comply more frequently with the requirements of the Postal Service's Move Update program, in addition to correcting and updating their address databases within two days of receiving electronic notices. See OCA-T2 Attachment A, DMCS § 610.6(a) and (b).

(c) As stated in my response to APWU/OCA-T2-3(b), the proposed DMCS for Experimental Automated Address Correction Service requires that mailers provide the Postal Service with a commitment to "retrieve or receive" address correction information weekly or more often. See OCA-T2 Attachment A, DMCS § 610.42. Mailer receipt of this information can be monitored by the Postal Service and is the starting point for compliance. Ultimately, the Postal Service should determine whether correcting address databases reduces the number of mailpieces that are repeat forwards to the same address—a requirement of my data collection plan. See OCA-T-2, at 13, lines 21-22. Under the experimental classification, monitoring mailer compliance with the Move Update program would involve the same monitoring now used by the Postal Service to assure mailer compliance. In addition, although the Postal Service did not specify the mechanisms it intended to use, whatever procedures the Postal Service contemplated for monitoring Capital One's compliance with the requirements to correct and update address databases can likely be extended to mailers under this experimental classification.

(d) Since this classification is proposed as an experiment, no mechanisms to monitor mailer compliance have been established. The Postal Service would be in a

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better position to determine such mechanisms. Nevertheless, the cost of determining whether or when a mailer has retrieved or received electronic address correction information should be negligible, and the cost to monitor mailer compliance with the Move Update requirements should not change under the experimental classification. The data collection plan I propose would require the Postal Service to provide “the costs to the Postal Service of monitoring, by mailer, compliance with the requirements of the experimental classification.” OCA-T-2, at 14, lines 9-12. Whatever costs the Postal Service determined would be incurred to monitor Capital One’s compliance with the requirements to correct and update address databases are likely to be similar per mailer under this experimental classification.

(e) For Subparts i. – iii., the cost to collect mailer-specific volume data from automated systems (i.e., the permit system, CFS units, and PARS, when deployed) should not vary with the size of the customer.

For Subparts iv. – v., I don’t know whether the cost will vary with the size of the customer. It should be noted, however, that the Postal Service has the authority to control the number of “unique permit accounts” used by a mailer to enter eligible First-Class Mail. See OCA-T2 Attachment A, DMCS § 610.44. Moreover, with respect to the “number of locations at which the customer holds permits,” the Postal Service may deny authorization to participate in the experimental classification “for any legitimate data collection, administrative or logistical reason.” See OCA-T2 Attachment A, DMCS § 610.41.

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USPS/OCA-T2-3

USPS/OCA-T2-3. Please refer to your testimony at page 12 line 11 through page 14 line 25 where you list data that should be collected under your proposed classifications. Under the rates, fees, and classifications that you propose, please provide your forecast of the annual expected or average:

- a. Number of First-Class Mailers that will choose “to receive electronic address correction notices under the experimental classification.”
- b. Number of “unique permit accounts used by each authorized First-Class mailer to enter presorted First-Class mailpieces.”
- c. “[V]olume of presorted First-Class mailpieces by rate category entered for each unique permit account.”
- d. “[V]olume of presorted First-Class mailpieces that are forwarded, and the mailer’s volume of repeat forwards.”
- e. “[V]olume of presorted First-Class mailpieces physically returned to the mailer.”
- f. “[N]umber of electronic address correction notices provide to each authorized First-Class mailer for forwarded mailpieces, and separately for mailpieces that would otherwise be physically returned.”

Please show all calculations used to prepare these forecasts.

RESPONSE TO USPS/OCA-T2-3

(a) – (f) Parts a. through f. of this interrogatory list items included in my data collection plan for the Experimental Automated Address Correction Service. They are included in my data collection plan because I have proposed an experimental classification for which the data and information listed are not known, and are intended to be collected for analysis and monitoring. Consequently, I have no “forecast of the annual expected or average” for the listed items.

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USPS/OCA-T2-4

Please provide your estimate of the change in Postal Service net income for test year 2003 if your proposed rates, fees, and classifications were implemented. Show the impact of your proposed DMCS sections 610 and 620 separately. Please show all calculations and assumptions used to derive this estimate.

RESPONSE TO USPS/OCA-T2-4

As stated in my response to APWU/OCA-T2-1, what I have tried to do is create classifications that substantially increase the likelihood that the Postal Service will generate an increase in contribution to institutional costs. That said, however, additional information is needed to estimate precise changes in revenue and costs associated with the experimental classifications. For the Experimental Volume-Based Declining Block Rates classification, I would need estimates of mail volume to be provided by, and the Postal Service-established volume threshold for, each mailer to estimate changes in revenues. For the Experimental Automated Address Correction Service, I would need an estimate of undeliverable-as-addressed (UAA) mailpieces to estimate changes in costs.

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USPS/OCA-T2-5

USPS/OCA-T2-5. Please refer to your testimony at page 17, lines 20-21 where you “propose that a unique volume threshold [for the volume-based declining block rates classification] be developed by the Postal Service for each interested First-Class mailer based upon the mailer’s known, historical mail volume.”

- a. Please provide an estimate of the number of “interested First-Class mailer[s]” that you expect to request a calculation of their volume threshold. Please show all calculations used to prepare this estimate.
- b. Please provide an estimate of the percentage of the “interested First-Class mailer[s]” identified in part (a) that would qualify for your proposed volume-based declining block rates classification. Please show all calculations used to prepare this estimate.
- c. Please provide an estimate of the percentage of the “interested First-Class mailer[s]” identified in part (a) that would qualify for your proposed volume-based declining block rates classification. Please show all calculations used to prepare this estimate.
- d. Please provide the average (per customer) cost of calculating the “unique volume threshold” for each “interested First-Class mailer.” Please show all calculations used to prepare this estimate.
- e. Do you expect the average (per customer) cost estimated in part [(d)] to vary depending on
 - i. the customer’s volume of First-Class Mail?
 - ii. the number of permits that the customer holds?
 - iii. the number of locations at which the customer holds permits?

Please explain and show all calculations.

RESPONSE TO USPS/OCA-T2-5

(a) – (d) I do not have the requested estimates.

(e) For Subparts i. and iii., the cost to calculate the volume threshold for each interested First-Class mailer should not vary based upon the volume of mail or the number of locations at which the mailer holds permits.

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For Subpart ii., the number of permits that a mailer holds could cause costs to vary by mailer if a larger number of permits is held by one mailer as compared to a smaller number by another mailer. If the Postal Service uses historical volume data in establishing a volume threshold, it would have to verify the mailer's volume entered through the permit accounts.

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USPS/OCA-T2-6

Please refer to your testimony at page 17, lines 20-21 where you “propose that a unique volume threshold [for the volume-based declining block rates classification] be developed by the Postal Service for each interested First-Class mailer based upon the mailer’s known, historical mail volume.” Once a volume threshold has been established:

- a. Would this threshold remain constant over the term of the proposed experimental classification? Please explain.
- b. If not, how and under what circumstances do you propose changing the volume threshold?

RESPONSE TO USPS/OCA-T2-6

(a) Yes. In the absence of a mailer merging with or acquiring another entity, the volume threshold once established for each mailer would be unchanged for the three-year period of the experiment.

(b) Not applicable.

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USPS/OCA-T2-7

For each of the following examples, please provide the volume threshold showing all calculations.

- a. Consider Mailer A, which mailed 100 million pieces of qualified First-Class Mail in Year 1 (and in every prior year), and mailed 100 million pieces of qualified First-Class Mail in Year 2. At the end of Year 2, what would be Mailer A's volume threshold for your proposed classification?
- b. Consider Mailer B, which mailed 100 million pieces of qualified First-Class Mail in Year 1 (and in every prior year), and mailed 110 million pieces of qualified First-Class Mail in Year 2. At the end of Year 2, what would be Mailer B's volume threshold for your proposed classification?
- c. Consider Mailer C, which mailed 100 million pieces of qualified First-Class Mail in Year 1 (and in every prior year), and mailed 90 million pieces of qualified First-Class Mail in Year 2. At the end of Year 2, what would be Mailer C's volume threshold for your proposed classification?
- d. Consider Mailer D, which mailed 100 million pieces of qualified First-Class Mail in Year 1, and mailed 110 million pieces of qualified First-Class Mail in Year 2. In every year prior to Year 1, Mailer D mailed 50 million pieces of qualified First-Class Mail. At the end of Year 2, what would be Mailer D's volume threshold for your proposed classification?
- e. Consider Mailer E, which mailed 100 million pieces of qualified First-Class Mail in Year 1, and mailed 110 million pieces of qualified First-Class Mail in Year 2. In every year prior to Year 1, Mailer E mailed 200 million pieces of qualified First-Class Mail. At the end of Year 2, what would be Mailer E's volume threshold for your proposed classification?

RESPONSE TO USPS/OCA-T2-7

(a) – (e) My proposal does not specify a forecasting model or any other method to be used by the Postal Service in establishing a volume threshold for any mailer. Nor is the Postal Service limited in developing a forecasting model or any other method, other than using its own or publicly available data. As an experiment, however, I expect

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that the Postal Service might contemplate and test several different methods,
depending upon the type, quantity and quality of mailer information available to it.

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USPS/OCA-T2-8

- a. Do you propose a minimum volume threshold for mailers to be eligible for your proposed DMCS section 620? Please explain.
- b. Would a mailer mailing 500 million pieces of qualified First-Class Mail who meets all other requirements be eligible for your proposed DMCS section 620? Please explain.
- c. Would a mailer mailing 500 pieces of qualified First-Class Mail who meets all other requirements be eligible for your proposed DMCS section 620? Please explain.
- d. Under what circumstances would a mailer who previously mailed ONLY single-piece First-Class Mail be eligible for your proposed DMCS section 620? Please explain.

RESPONSE TO USPS/OCA-T2-8

(a) No. Under the Experimental Volume-Based Declining Block Rate classification, I propose that the Postal Service calculate a unique volume threshold for each mailer. The specification of a minimum required volume for mailers would have unduly limited the number of mailers that could be authorized by the Postal Service.

(b) – (c) Whether a mailer offering 500 or 500 million pieces (or any other amount) of eligible First-Class Mail should be authorized access to volume-based declining block rates would be determined by the Postal Service. See OCA-T2 Attachment B, DMCS § 620.41.

(d) This question posits the situation of a mailer “who previously mailed ONLY single-piece First-Class Mail.” The specific requirements that any mailer must satisfy are found in OCA-T2 Attachments A and B. In general terms, however, such a mailer must offer presorted First-Class Mail and be a participant in the Address Change Service (ACS) program. In addition, the mailer must receive authorization from the

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Postal Service to participate in, and comply with the requirements of, the Experimental Automated Address Correction Service. Finally, the mailer must receive authorization from the Postal Service to participate in, and comply with the requirements of, the Experimental Volume-Based Declining Block Rate classification.

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USPS/OCA-T2-9

In his testimony, witness Plunkett stated that the terms and conditions of the Capital One NSA were based on negotiation between Capital One and the Postal Service (see for example, Tr. 4/781 lines 15-18).

- a. In the process of the negotiations, do you believe it to be reasonable that trade-offs were made between the level of various rate and fee terms (e.g., thresholds, size of incremental volume blocks) and the size of the discount offered? Please explain.
- b. In the process of the negotiations, do you believe it to be reasonable that trade-offs were made between the level of various rate and fee terms (e.g., thresholds, size of incremental volume blocks) and the other non-rate and fee elements (e.g., compliance provisions, term length) of the agreement? Please explain.
- c. In the process of the negotiations, do you believe it to be reasonable that trade-offs were made between the size of the discount offered and the other non-rate and fee elements (e.g., compliance provisions, term length) of the agreement? Please explain.
- d. Please refer to your testimony at page 19, line 11 through page 20, line 5. If your response to any of parts (a), (b), and (c) above is affirmative, please explain if (and how) the existence of these trade-offs was recognized in your proposed DMCS section 620 classification.

RESPONSE TO USPS/OCA-T2-9

(a) – (c) Yes. The negotiations between Capital One and the Postal Service were presumably undertaken for the purpose of reaching a mutually acceptable agreement, which could not be achieved without compromise (i.e., trade-offs) on these and other issues raised during the negotiations.

(d) I did not explicitly account for these trade-offs in my proposal since I was not attempting to conclude an agreement with another party. Rather, I have proposed two classifications of general applicability. That said, the proposed classifications are closely modeled after the Negotiated Service Agreement (NSA) between the Postal

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Service and Capital One. In this way “trade-offs” are reflected in the proposed classifications. My primary goal in developing these classifications was to provide the Postal Service with an opportunity to obtain additional contributions to institutional costs while minimizing financial risks to the Postal Service associated with volume-based declining block rates.

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USPS/OCA-T2-10

Assume that the volume threshold for Mailer A has been established at 100 million eligible First-Class Mail pieces annually and that all conditions for eligibility under your proposed DMCS section 620 classification are met. For each of the following examples, please calculate the postage discount under your proposed Rate Schedule 620A. Please show the calculation by incremental volume block as illustrated, for example, in USPS-T-3, Attachment B at 3.

- a. Mailer A's annual volume of eligible First-Class Mail pieces is 90 million
- b. Mailer A's annual volume of eligible First-Class Mail pieces is 100 million.
- c. Mailer A's annual volume of eligible First-Class Mail pieces is 115 million.
- d. Mailer A's annual volume of eligible First-Class Mail pieces is 120 million.
- e. Mailer A's annual volume of eligible First-Class Mail pieces is 130 million.
- f. Mailer A's annual volume of eligible First-Class Mail pieces is 150 million.

RESPONSE TO USPS/OCA-T2-10

(a) Mailer A would not receive any discounts because its annual volume of 90 million pieces of eligible First-Class Mail is less than its volume threshold of 100 million.

(b) Mailer A would not receive any discounts because its annual volume of 100 million pieces of eligible First-Class Mail is equal to its volume threshold of 100 million.

(c) \$555,000. See the table below.

Amount Mailed =	115,000,000					
Volume Limit =	15,000,000					
Discount Threshold =	100,000,000					
[1]	[2]	[3]	[4]	[5]	[6]	[7]
<u>Incremental Volume Blocks</u>		<u>% Change</u>	<u>Difference</u>	<u>Discount Volume</u>	<u>Discount</u>	<u>Revenue</u>
100,000,001	104,000,000	4.0%	3,999,999	3,999,999	\$0.030	\$120,000
104,000,001	108,000,000	8.0%	3,999,999	3,999,999	\$0.035	\$140,000
108,000,001	112,000,000	12.0%	3,999,999	3,999,999	\$0.040	\$160,000
112,000,001	115,000,000		2,999,999	2,999,999	\$0.045	\$135,000
TOTAL				14,999,996		\$555,000

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(d) \$635,000. See the table below.

Amount Mailed =	120,000,000						
Volume Limit =	15,000,000						
Discount Threshold =	100,000,000						
	[1]	[2]	[3]	[4]	[5]	[6]	[7]
					Discount		
	<u>Incremental Volume Blocks</u>		<u>% Change</u>	<u>Difference</u>	<u>Volume</u>	<u>Discount</u>	<u>Revenue</u>
	100,000,001	104,000,000	4.0%	3,999,999		\$0.030	
	104,000,001	108,000,000	8.0%	3,999,999	3,000,003	\$0.035	\$105,000
	108,000,001	112,000,000	12.0%	3,999,999	3,999,999	\$0.040	\$160,000
	112,000,001	118,000,000	18.0%	5,999,999	5,999,999	\$0.045	\$270,000
	118,000,001	120,000,000		1,999,999	1,999,999	\$0.050	\$100,000
TOTAL					15,000,000		\$635,000

(e) \$765,000. See the table below.

Amount Mailed =	130,000,000						
Volume Limit =	15,000,000						
Discount Threshold =	100,000,000						
	[1]	[2]	[3]	[4]	[5]	[6]	[7]
					Discount		
	<u>Incremental Volume Blocks</u>		<u>% Change</u>	<u>Difference</u>	<u>Volume</u>	<u>Discount</u>	<u>Revenue</u>
	100,000,001	104,000,000	4.0%	3,999,999		\$0.030	
	104,000,001	108,000,000	8.0%	3,999,999		\$0.035	
	108,000,001	112,000,000	12.0%	3,999,999		\$0.040	
	112,000,001	118,000,000	18.0%	5,999,999	3,000,002	\$0.045	\$135,000
	118,000,001	124,000,000	24.0%	5,999,999	5,999,999	\$0.050	\$300,000
	124,000,001	130,000,000	30.0%	5,999,999	5,999,999	\$0.055	\$330,000
TOTAL					15,000,000		\$765,000

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(f) \$900,000. See the table below.

Amount Mailed =	150,000,000					
Volume Limit =	15,000,000					
Discount Threshold =	100,000,000					
[1]	[2]	[3]	[4]	[5]	[6]	[7]
				Discount		
<u>Incremental Volume Blocks</u>		<u>% Change</u>	<u>Difference</u>	<u>Volume</u>	<u>Discount</u>	<u>Revenue</u>
100,000,001	104,000,000	4.0%	3,999,999		\$0.030	
104,000,001	108,000,000	8.0%	3,999,999		\$0.035	
108,000,001	112,000,000	12.0%	3,999,999		\$0.040	
112,000,001	118,000,000	18.0%	5,999,999		\$0.045	
118,000,001	124,000,000	24.0%	5,999,999		\$0.050	
124,000,001	130,000,000	30.0%	5,999,999		\$0.055	
130,000,001	150,000,000		19,999,999	15,000,000	\$0.060	\$900,000
TOTAL				15,000,000		\$900,000

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USPS/OCA-T2-11

Please explain why a volume cap of 15 percent (as opposed to 10 or 30 percent or some other number) is imposed in your proposed DMCS 620 classification? In the absence of the Cap One NSA agreement, please explain what volume cap, if any, you would have proposed?

RESPONSE TO USPS/OCA-T2-11

The purpose of the volume limit is to provide some protection to the Postal Service from the financial risks associated with volume-based declining block rates. The volume limit of 15 percent represents the percentage difference between Capital One's projected volume of 1.408 billion and its volume threshold of 1.225 billion. See OCA-T-2 at 20, lines 10-14. This volume limit is more than 10 times the volume that witness Elliot estimates Capital One will mail in response to the availability of volume-based declining block rates, based upon the price elasticity of -0.071 for First-Class workshared letters. Tr. 2/211 (COS-T-2, Exhibit 6.) Even in the absence of the volume estimates provided in conjunction with the Capital One NSA, I would have proposed a volume limit to protect the Postal Service from financial risks, and a 15 percent volume limit would be reasonable.

Establishing a volume threshold is best achieved by determining each mailer's demand. That said, no mailer is likely to provide, and the Postal Service is unlikely (or unable) to calculate, each mailer's price elasticity. In the absence of such information, use of the price elasticity for First-Class workshared letters of -0.071 becomes the next best alternative—recognizing that the group of mailers likely to seek access to volume-based rates will have a price elasticity different from the average. The 15 percent volume limit would not constrain, for an example, the volume on which Capital One

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could claim discounts even if Capital One's price elasticity were 10 times the price elasticity for First-Class workshared letters. That is, if Capital One's price elasticity is – 0.71 instead of –0.071, Capital One would mail 154,589,691 new mailpieces, as shown in the modifications to Exhibit 6 of witness Elliot's testimony (COS-T-2). This volume of new mailpieces is less than Capital One's volume limit of 183,750,000 (1.225 billion * 0.015).

**Response to USPS/OCA-T2-11, based upon Exhibit 6: SLS
Consulting Projection of First-Class Mail Volume - Method 1**

FY 2003 Capital One Before-Rates Projection

First-Class Mail Solicitation Volume	768,000,000	[1]
First-Class Mail Customer Mail Volume	640,000,000	[2]
Total First-Class Mail	1,408,000,000	[3]

SLS After-Rates Projection Using USPS Price Elasticities - Method 1

Price Elasticity - Workshared First-Class Letters	-0.71	[4]
Marginal Price Discount from NSA (Percent)	-15.5%	[5]
First-Class Mail Volume Increase (Percent)	11.0%	[6]
First-Class Mail Solicitation Volume Increase (Pieces)	84,321,649	[7]
First-Class Mail Customer Mail Volume Increase (Pieces)	70,268,041	[8]
Total First-Class Mail Volume Increase (Pieces)	154,589,691	[9]
After-Rates First-Class Mail Solicitation Volume (Pieces)	852,321,649	[10]
After-Rates First-Class Mail Customer Mail Volume (Pieces)	710,268,041	[11]
Total After-Rates First-Class Mail Volume (Pieces)	1,562,589,691	[12]

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USPS/OCA-T2-12

Please refer to your testimony at page 22 lines 11- page 23 line 16 where you list data that should be collected under your proposed DMCS 620 classification. Under the rates, fees, and classifications that you propose, please provide your forecast of the annual expected or average:

- a. Number of First-Class Mailers that will “receive discounts under the experimental classification.”
- b. “[V]olume threshold” for participating mailers.
- c. “[V]olume of presorted First-Class mailpieces by rate category.”
- d. “[A]mount of discounts paid by rate category for each authorized First-Class mailer.”
- e. Total “amount of discounts paid by rate category”

Please show all calculations used to prepare these forecasts.

RESPONSE TO USPS/OCA-T2-12

(a) – (e) Parts (a) through (e) of this interrogatory list items included in my data collection plan for the Experimental Volume-Based Declining Block Rate classification. They are included in my data collection plan because I have proposed an experimental classification for which the data and information listed are not known, and should be collected for analysis and monitoring. Consequently, I have no “forecast of the annual expected or average” for the listed items.

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USPS/OCA-T2-13

- a. Please confirm that your proposal establishes participation under proposed DMCS section 610 as a prerequisite for access to the discounts under proposed DMCS section 620. If not confirmed, please explain.
- b. Please confirm that your proposal establishes participation under proposed DMCS section 610 as a prerequisite for access to the discounts under proposed DMCS section 620 to ensure that cost savings exist to fund the discounts proposed in DMCS section 620. If not confirmed, please explain.
- c. Please explain how your proposed rates, fees, and classifications ensure that the total cost savings accruing from proposed DMCS section 610 will equal or exceed the total value of the discounts proposed in DMCS section 620 for:
 - i. An individual mailer
 - ii. All participating mailers.

Please show all calculations and assumptions.

RESPONSE TO USPS/OCA-T2-13

(a) Confirmed.

(b) Not confirmed. The reduction in costs resulting from mailer participation in the Experimental Automated Address Correction Service is not designed to fund the discounts available to mailers under the Experimental Volume-Based Declining Block Rate classification. For each classification, the Postal Service must make a finding that there is a reasonable expectation that each mailer will make an additional contribution to institutional costs. Thus, each mailer, and each classification on its own, is expected to provide an additional contribution to institutional costs. The cost reductions from the experimental address correction service are intended to provide some protection to the Postal Service from the financial risks associated with volume-based declining block rates.

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(c) There are no absolute assurances that the reduction in costs resulting from the Experimental Automated Address Correction Service will equal or exceed the total amount of discounts provided to mailers under the Experimental Volume-Based Declining Block Rate classification. However, I have structured the experimental classifications, individually and collectively, to increase the likelihood that they will make additional contributions to institutional costs, while limiting the Postal Service's financial risk. These measures include requiring the Postal Service to make a finding that there is a reasonable expectation that each mailer will make an additional contribution to institutional costs; linking mailer access to volume-based declining block rates to participation in the experimental address correction service that reduces Postal Service costs; and, limiting the total amount of discounts available to any one mailer.

Nevertheless, based upon available unit cost and revenue data, it is possible to estimate the minimum additional per piece contribution to the Postal Service. Dispensing with the uninteresting cases first, if a mailer provides a quantity of mail less than its volume threshold, the mailer receives no discount—generating a net increase in contribution. If a mailer provides no mail volume, the mailer receives no discounts and there is no cost savings to the Postal Service—a breakeven proposition. The relevant situation is when a mailer provides a quantity of mail in excess of its volume threshold.

Consider a mailer with a volume threshold equal to x and an actual mail volume of $x + a$, where a is positive. The maximum total discounts the mailer could earn would be $\$0.060(0.15x) = 0.009x$. The total cost savings would be $\$0.019(x + a)$, where $\$0.019$ is the product of 9.6 percent, representing the proportion of Capital One's mailpieces returned; 85 percent, representing the proportion of electronic returns; and

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\$0.23, representing the cost difference between a physical and an electronic return.

The net increase in contribution to the Postal Service is

$$\$0.019(x + a) - \$0.009x =$$

$$\$0.01(x + a) + \$0.009a,$$

which is always positive. Thus, the minimum additional contribution per piece mailed is greater than \$0.01.

The minimum additional contribution per piece of more than \$0.01 calculated above is based upon a return rate of 9.6 percent. Not all mailers, however, have a 9.6 percent return rate. If we treat the return rate as a variable, we can see that the contribution per piece is proportional to the return rate. This means that higher return rates generate a larger contribution per piece, and lower return rates generate a smaller contribution per piece.

If we let r be the return rate, then the net contribution expression becomes

$$\$0.1955r(x + a) - \$0.009x =$$

$$\$0.1955(x + a) - \$0.009x/r,$$

where \$0.1955 is the product of 0.85 and \$0.23. This expression becomes smaller as r gets smaller because $0 < r < 1$ and dividing by such a fraction causes the negative portion of the expression to become larger. Is there a value of r for which the net contribution expression equals zero? If so, mailers with an r less than or equal to that r should not be offered volume discounts.

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$$\$0.1955x + \$0.1955a = \$0.009x/r$$

$$(0.1955x/0.009x) + (0.1955a/0.009x) = 1/r$$

$$21.7(1 + a/x) = 1/r$$

$$r = 1/[21.7(1 + a/x)]$$

Since $(1 + a/x)$ is greater than 1, r will always be less than $1/21.7 = 0.046$ or 4.6 percent. This "minimum" return rate becomes smaller as the volume of additional or "new" mail volume grows relative to the volume threshold, i.e., the ratio of "new" volume to threshold volume (a/x) increases. Thus, for two mailers with the same threshold, the mailer expected to produce the greater volume in response to discounts can have a smaller return rate and still be profitable for the Postal Service. Conversely, for two mailers expected to generate the same new volume, the one with the smaller threshold can have a smaller return rate.

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USPS/OCA-T2-14

In proposed DMCS section 610.3, eligible First-Class Mail is defined as

presort First-Class Mail that bears the endorsement specified by the Postal Service” and “does not include Business Reply Mail, Qualified Business Reply Mail, Cards, or Priority Mail.

In proposed DMCS section 620.3, eligible First-Class Mail is defined as

letter-shaped, automation compatible First-Class Mail that bears the endorsement specified by the Postal Service” and “does not include Business Reply Mail, Qualified Business Reply Mail, Cards, or Priority Mail.

Please explain why some First-Class Mail mailpieces (i.e., all non-automation presort and automation flats) would be eligible under DMCS 610 and not eligible under DMCS 620.

RESPONSE TO USPS/OCA-T2-14

With respect to the Experimental Automated Address Correction Service, I defined eligible First-Class Mail as all presort First-Class Mail in order to encourage as many presort mailers as possible to convert their physical returns to “electronic” returns. Encouraging as many mailers as possible to convert presort pieces, such as flats, which are more costly to return physically than the average piece of presorted First-Class Mail, would further reduce costs to the Postal Service.

With respect to the Experimental Volume-Based Declining Block Rate classification, I defined eligible First-Class Mail as letter-shaped, automation compatible First-Class Mail in order to ensure that only mailers offering the least costly mailpieces would have access to volume-based declining block rates.

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USPS/OCA-T2-15

Please refer to the term “reasonable expectation of additional contribution to institutional costs” in your proposed DMCS 610.41; 610.51(a); 610.71; 620.41; and 620.51(a). Please state whether there is a minimum amount of additional contribution that would necessary before a mailer could be authorized to use the Experimental Address Correction Service or the Experimental Volume Based Declining Block Rates. If there is a minimum, please state what the minimum amount would be and explain how you arrived at that number. If there is no minimum, please explain why not.

RESPONSE TO USPS/OCA-T2-15

The proposed DMCS provisions referenced above do not state, nor do they require the Postal Service to determine, a minimum amount of additional contribution necessary for a mailer to be authorized under the experimental classifications. The Postal Service must make a finding that there is a “reasonable expectation” that each mailer so authorized will make an additional contribution. A specific minimum amount of additional contribution could have unduly limited the number of mailers that might be authorized by the Postal Service to participate in the experimental classifications.

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USPS/OCA-T-2-16

Please refer to Capital One Services, Inc. mailing volume history which is presented through July 2002 in Exhibit 2 to COS witness Elliot's testimony, COS-T-2, Tr. 2/207, and presented for August and September 2002 in the response to OCA/COS-T2-5, Tr. 2/238. Assume that no event occurs that would require an adjustment to the threshold under your proposed DMCS language 620.63.

- a. Under your proposal, what would be COS' unique volume threshold? Please show all calculations and assumptions you use to derive the threshold.
- b. If your answer to part (a) does not give a volume number for the threshold, please discuss why a volume number is not given.
- c. If your answer to part (a) does not give a volume number for the threshold, please discuss how the Postal Service would determine the volume threshold.

RESPONSE TO USPS/OCA-T2-16

(a) – (b) I have not calculated a unique volume threshold for Capital One. My proposal does not specify a forecasting model or any other method to be used by the Postal Service in establishing a volume threshold for any mailer.

(c) The proposed changes to the DMCS simply direct that the Postal Service establish the volume threshold for each mailer using its own or publicly available data. The absence of a specific forecasting model or any other method permits the Postal Service to develop the most appropriate method based upon the type, quantity and quality of mailer information available to it.

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USPS/OCA-T-2-17

Please refer to your proposed DMCS 620.2 where the Experimental Volume-Based Rates are available only to First-Class Mailers that are authorized Experimental Automated Address Correction Service mailers under section 610. If a mailer is authorized as an Experimental Automated Address Correction Service mailer, but does not use the endorsement specified by the Postal Service on its mail, would it still be entitled to have access to the volume-based declining block rates? Why or why not?

RESPONSE TO USPS/OCA-T2-17

No. Under the Experimental Volume-Based Declining Block Rate classification, I expect the Postal Service to specify the endorsement Change Service Request. Thus, any mail entered that lacked the CSR endorsement would not qualify for volume-based rates.

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TO INTERROGATORIES USPS/OCA-T2-1-19

USPS/OCA-T-2-18

Please refer to your proposed DMCS language 620.3, which defines eligible First-Class Mail, and assume for the purposes of this interrogatory that the Postal Service has specified the use of the Change Service Requested endorsement.

Are the volume-based declining block rates available only for mail that uses the Change Service Requested endorsement and complies with the Postal Service rules and regulations associated with that endorsement?

RESPONSE TO USPS/OCA-T2-18

In developing the Experimental Volume-Based Declining Block Rate classification, I contemplated that volume-based declining block rates would be available only to First-Class Mail pieces bearing the Change Service Requested (CSR) endorsement, and complying with the Postal Service's rules and regulations associated with that endorsement. Nevertheless, the Postal Service might be able to justify that it is worthwhile to make First-Class Mail pieces other than those bearing the CSR endorsement available for volume-based declining block rates. The changes to the DMCS that I propose do not preclude this possibility.

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USPS/OCA-T2-19

- a. Please confirm that the Experimental Automated Address Correction Service would not be available for First-Class Mailers who use the current service associated with the "Address Service Requested" endorsement. If you do not confirm, please explain.
- b. If you confirm part (a), please address whether an undue discrimination problem would arise? Why or why not?

RESPONSE TO USPS/OCA-T2-19

(a) Confirmed.

(b) No undue discrimination problem would arise. A mailpiece bearing the endorsement "Address Service Requested" that cannot be forwarded is physically returned to the mailer. Since the cost reductions underlying the experimental classification are based on eliminating physical returns, any mailer seeking to participate in the experimental classification must agree to forgo such physical returns. In many respects, the situation described in Part a. of this interrogatory is similar to the Postal Service offering new presort discounts. Mailers willing to tender mail meeting the requirements that qualify the mail for presort discounts receive discounts; mailers unable or unwilling to do so receive no discounts.