# OFFICIAL TRANSCRIPT OF PROCEEDINGS
# BEFORE THE
# POSTAL RATE COMMISSION

In the Matter of: )
)
EXPERIMENTAL RATE AND SERVICE ) Docket No. MC2002-2
CHANGES TO IMPLEMENT )
NEGOTIATED SERVICE AGREEMENT )
WITH CAPITAL ONE SERVICES, )
INC. )

RECEIVED
FEB 3 4 20 PM '03
POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

Volume 5

Designated Institutional Responses of
United States Postal Service and
Additional Designated Written
Cross-Examination of Postal Service
Witnesses Crum and Plunkett

Pages: 854 through 966

Place: Washington, D.C.

Date: January 31, 2003


**HERITAGE REPORTING CORPORATION**
*Official Reporters*
1220 L Street, N.W., Suite 600
Washington, D.C. 20005-4018
(202) 628-4888
hrc@concentric.net


ORIGINAL

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Experimental Rate and Service Changes
To Implement Negotiated Service Agreement
with Capital One Services, Inc.

Docket No. MC2002-2

DESIGNATION OF WRITTEN CROSS-EXAMINATION

| Party | Interrogatories |
|---|---|
| **United States Postal Service** | |
| **Charles L. Crum (USPS-T-3)** | |
| Newspaper Association of America | POIR No. 3, Questions 1 & 2 |
| **Michael K. Plunkett (USPS-T-2)** | |
| Office of the Consumer Advocate | OCA/USPS-T3-30c redirected to T2 |
| **Institutional** | |
| American Postal Workers Union, AFL-CIO | APWU/USPS-1-2, 4-8<br><br>APWU/USPS-T2-9, 11 redirected to USPS<br>APWU/USPS-T4-13-14 redirected to USPS<br>NAA/USPS-4, 6, 9<br>OCA/USPS-3, 5, 9<br>OCA/USPS-T2-19 redirected to USPS<br>OCA/USPS-T3-14, 17a redirected to USPS<br>OCA/USPS-T4-11, 14, 19e redirected to USPS<br>POIR-4, Question 1<br>Response to Request of Chairman Omas at Tr. 2/342<br>Response to Request of Commissioner Goldway at Tr. 2/396-97 |
| Capital One Services, Inc. | APWU/USPS-2<br>APWU/USPS-T2-9, 11 redirected to USPS<br>APWU/USPS-T4-13-15 redirected to USPS<br>NAA/USPS-T4-13 redirected to USPS<br>OCA/USPS-1-4, 6-9<br>OCA/USPS-T2-19 redirected to USPS<br>OCA/USPS-T3-17a redirected to USPS<br>OCA/USPS-T4-11, 14, 19, 19e redirected to |

| Party | Interrogatories |
| --- | --- |
| Newspaper Association of America | NAA/USPS-4-5, 7-10<br>NAA/USPS-T4-13 redirected to USPS<br>OCA/USPS-T3-28b, d redirected to USPS<br>OCA/USPS-T4-19a-d, f-g redirected to USPS |
| Office of the Consumer Advocate | NAA/USPS-2, 7-8<br>OCA/USPS-10<br>OCA/USPS-T3-28b, d redirected to USPS |

Respectfully submitted,

Steven W. Williams

Steven W. Williams
Secretary

INTERROGATORY RESPONSES
DESIGNATED AS WRITTEN CROSS-EXAMINATION

| Interrogatory | Designating Parties |
|---|---|
| **United States Postal Service** | |
| **Charles L. Crum (USPS-T-3)** | |
| POIR No. 3, Questions 1 & 2 | NAA |
| **Michael K. Plunkett (USPS-T-2)** | |
| OCA/USPS-T3-30c redirected to T2 | OCA |
| **Institutional** | |
| APWU/USPS-1 | APWU |
| APWU/USPS-2 | APWU, Capital One |
| APWU/USPS-4 | APWU |
| APWU/USPS-5 | APWU |
| APWU/USPS-6 | APWU |
| APWU/USPS-7 | APWU |
| APWU/USPS-8 | APWU |
| APWU/USPS-T2-9 redirected to USPS | APWU, Capital One |
| APWU/USPS-T2-11 redirected to USPS | APWU, Capital One |
| APWU/USPS-T4-13 redirected to USPS | APWU, Capital One |
| APWU/USPS-T4-14 redirected to USPS | APWU, Capital One |
| APWU/USPS-T4-15 redirected to USPS | Capital One |
| NAA/USPS-2 | OCA |
| NAA/USPS-4 | APWU, NAA |
| NAA/USPS-5 | NAA |
| NAA/USPS-6 | APWU |
| NAA/USPS-7 | NAA, OCA |
| NAA/USPS-8 | NAA, OCA |
| NAA/USPS-9 | APWU, NAA |
| NAA/USPS-10 | NAA |
| NAA/USPS-T4-13 redirected to USPS | Capital One, NAA |
| OCA/USPS-1 | Capital One |
| OCA/USPS-2 | Capital One |
| OCA/USPS-3 | APWU, Capital One |
| OCA/USPS-4 | Capital One |

| Interrogatory | Designating Parties |
|---|---|
| OCA/USPS-5 | APWU |
| OCA/USPS-6 | Capital One |
| OCA/USPS-7 | Capital One |
| OCA/USPS-8 | Capital One |
| OCA/USPS-9 | APWU, Capital One |
| OCA/USPS-10 | OCA |
| OCA/USPS-T2-19 redirected to USPS | APWU, Capital One |
| OCA/USPS-T3-14 redirected to USPS | APWU |
| OCA/USPS-T3-17a redirected to USPS | APWU, Capital One |
| OCA/USPS-T3-28b redirected to USPS | NAA, OCA |
| OCA/USPS-T3-28d redirected to USPS | NAA, OCA |
| OCA/USPS-T4-11 redirected to USPS | APWU, Capital One |
| OCA/USPS-T4-14 redirected to USPS | APWU, Capital One |
| OCA/USPS-T4-19 redirected to USPS | Capital One |
| OCA/USPS-T4-19a redirected to USPS | NAA |
| OCA/USPS-T4-19b redirected to USPS | NAA |
| OCA/USPS-T4-19c redirected to USPS | NAA |
| OCA/USPS-T4-19d redirected to USPS | NAA |
| OCA/USPS-T4-19e redirected to USPS | APWU, Capital One |
| OCA/USPS-T4-19f redirected to USPS | NAA |
| OCA/USPS-T4-19g redirected to USPS | NAA |
| POIR-4, Question 1 | APWU |
| Response to Request of Chairman Omas at Tr. 2/342 | APWU |
| Response to Request of Commissioner Goldway at Tr. 2/396-97 | APWU |

**Charles L. Crum**
**USPS-T-3**

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS CRUM TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3

**POIR-3, Question 1:** In the response to APWU/USPS-T3-4 (d), witness Crum states that he assumes that Capital One's First-Class Mail is forwarded at or below the average rate for the class as a whole. In part (e) of the response, he goes on to explain that the (1.96 percent) average forwarding rate for all First-Class Mail is derived from USPS-LR-J-69 by allocating the First-Class Mail UAA percentage (3.197 percent) in Table 4.2 by the proportion of First-Class forwarded mail (61.34 percent) in Table 4.3.3.

(a) The 9.6 percent return rate of Capital One's First-Class solicitations dictates that the UAA percentage for Capital One's solicitations must be at least 9.6 percent. Please explain why it is reasonable to use a UAA percentage (3.197 percent) that is demonstrably below Capital One's First-Class solicitation UAA percentage as an element of the estimated forwarding rate of Capital One's First-Class solicitations.

(b) Applying the average forwarding rate for First-Class mail to Capital One's First-Class solicitation volume would suggest a TYBR estimate of 15.1 million forwarded pieces. Viewed in combination with an estimated 73.7 million TYBR returns (9.6 percent of 768 million), this would imply that Capital One's First-Class solicitation UAA mail is roughly 17 percent forwarded and 83 percent returned to sender. In contrast, Table 4.3.3 shows the average First-Class UAA disposition as roughly 61 percent forwarded and 39 percent returned to sender. Please explain any factors that might cause the disposition of Capital One's First-Class solicitation UAA mail to differ from the average for First-Class UAA mail by such a wide margin.

**RESPONSE:**

This question and its subparts seek to understand the relationship, if any, between the return rate and forwarding rate for Capital One's First-Class Mail that is undeliverable-as-addressed (UAA). Specifically, the questions ask how Capital One could have the class-wide average forwarding rate when its return rate is considerably higher than the average. The current questions appear to be based on the premise that if return volumes are high – as they most certainly are for Capital One's solicitation mail – then so must Capital One's forwarding volumes be high. The appeal of this premise appears to lie with an additional assumption: that all UAA mail, which consists of those pieces that are returned and those that are forwarded, is inherently similar. Examination of the respective causes for forwards and returns, and the factual record

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS CRUM TO
PRESIDING OFFICER'S INFORMATION REQUEST NO. 3

regarding Capital One, however, show that a high return rate for solicitation mail does not also imply a high forwarding rate.

While Capital One's use of First-Class Mail for solicitations generates higher levels of returns, there is no reason to believe that it also generates higher levels of forwards. My understanding, in fact, is that the two are generally quite independent of one another such that one can find mailers whose return and forwarding rates are both higher than average, both lower than average, or high for one and low for the other.

The primary cause for returns relates to a deficiency in the address. The reasons include that the addressee is not known at the address, the address itself is lacking key information for delivery, such as an apartment number; the address itself does not exist; or perhaps there is no mail receptacle available for delivery. The other reasons for returns could include that the piece was refused, the address is vacant, the addressee is deceased or the forwarding time has expired. A high rate of return for solicitation mail is understandable given that Capital One does not have a prior existing relationship with the addressees. By comparison, for its customer mail where Capital One has established a relationship with an addressee, the return rate is very close to the First-Class Mail average. See my testimony, USPS-T-3, Attachment A, p 2.

Unlike returns, which can occur for any number of reasons, forwarding happens for only one reason: an addressee has moved within the previous 12 months and the Postal Service has been notified of the new address. What drives the forwarding volume for an address list is how many addressees have recently moved, not the quality of the addresses themselves. A high return rate, which reflects the quality of the addresses, does not correspond to a high forwarding rate, which reflects the mobility of the addressees on the list.

Even if there were some reason to expect a higher than average inherent forwarding rate (and a higher than average return rate is not necessarily such a reason), Capital One's address management practices should significantly reduce its forwarding rate by ensuring that its list reflects the most current change-of-address information. Capital One processes its lists through the National Change of Address database (NCOA) every 30 days for customer mail and 60 days for solicitation mail. This occurs far more frequently than most mailers who process lists every 180 days, the minimum specified by postal regulation. However, NCOA processing, no matter how frequent, would not resolve the primary cause of return to sender mail—deficient addresses.

Witness Wilson's estimate that Capital One's forwarding rate is no more than the average for First-Class Mail is a reasonable one. See his response to APWU/USPS-T2-8, Tr. 3/552. Witness Wilson's statement is not based upon actual knowledge of Capital One's forwarding rate. *Id.* Instead, it is based upon his knowledge of Capital One's address management practices. Because Capital One processes its addresses through NCOA and at a rate far more frequent than most mailers, Wilson estimated that Capital One rate is at or below the average. *Id.* Since the Postal Service does not track an individual mailer's forwarding volume, it is theoretically possible that Capital One's forwarding rate is higher than the average. However, given the basis for witness Wilson's opinion, I decided it was reasonable to rely on his estimate. See my response to APWU/USPS-T3-4(d), Tr. 2/268.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS CRUM TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3

I have also learned another fact about Capital One that supports witness Wilson's estimate that its forwarding rate is no more than average. When Capital One processes its address lists against NCOA, approximately 4 percent of its address are updated. This rate, called a match rate, is close to the average for all mailers that use NCOA. This match rate indicates that Capital One's address lists are about as current as other mailers who use NCOA. If Capital One's match rate had been higher than average, it would indicate that the list had more stale or old addresses and would therefore require more forwarding.

As a final point, the Postal Service did not include in its direct case any attempt to quantify savings associated with avoided mail forwarding precisely because no suitable quantified foundation for estimating such savings could be determined. There are simply too many unknown factors, such as Capital One's forwarding rate. When the Presiding Officer nonetheless requested such a calculation in Presiding Officer Information Request No. 2, Question 7, one was provided that rested on a series of assumptions, which were conservative in the direction of avoiding an overestimate of increased contribution (avoidance of costs). The conclusion of that analysis was that under no circumstances would avoidance of return costs or costs of electronic address correction notices have a negative impact upon the net financial value of the NSA to the Postal Service. If, as the instant question queries, the forwarding rate is more than average, I note that the cost savings from the avoided forwarding costs would only increase.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS CRUM TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3

**POIR-3, Question 2:** In the response to POIR 2, question 7, witness Crum calculates that the estimated 12,794,880 Capital One solicitations that would have been forwarded in the test year would go to 2,293,782 delivery points. This calculation assumes that, in the absence of the NSA, a piece requiring forwarding would be sent to each of these delivery points 5.6 times in the test year. Please explain how the effects of Capital One's practice of processing its solicitation mail addresses through the National Change of Address (NCOA) database every 60 days is reflected in the assumption that a piece requiring forwarding would be sent to the same address 5.6 times without the address being corrected.

**RESPONSE:**

Running NCOA at least every 60 days decreases the forwarding rate of Capital One solicitations and is the key reason for witness Wilson's estimate that Capital One has an average to below average forwarding rate. See his response to APWU-T2-8, Tr. 3/552. Running NCOA does not, however, eliminate all repeat forwards. Witness Wilson estimates that NCOA may capture only about 25 percent of potential changes of addresses. Tr. 3/638-39, 651-52. See also his response to APWU-T2-8 (Tr. 3/552) and Tr. 3/644-645. Thus, when NCOA fails to identify an address in Capital One's database as one with a forwarding order, it will not correct the database. For such addresses, the ACS notices will enable Capital One to update its database and save the Postal Service the cost of forwarding the piece from the old to the new address.

I also note that the impact of NCOA has already been considered and included in the range analysis presented in response to POIR 2, question 7, Tr. 2/318-22. To conduct the analysis, I used witness Wilson's estimate that Capital One's forwarding rate is no more than the average for First-Class Mail. Since his estimate is based upon Capital One's NCOA practices, the impact of NCOA implicitly became a part of the range analysis. Finally, just to clarify, the response to POIR 2, Q7 did not present the 12,794,880 figure referenced above as an estimate of forwarded Capital One

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS CRUM TO
PRESIDING OFFICER'S INFORMATION REQUEST NO. 3

solicitations. It was described as the "theoretical maximum number of pieces forwarded through CFS units" based on the available assumptions.

**Michael K. Plunkett**
**USPS-T-2**

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE
REDIRECTED FROM WITNESS CRUM

OCA/USPS-T3-30. Please refer to your response to POIR No. 2, question 7. Your estimate of costs avoided appears to assume the avoidance of between 10.5 million (12,794,880 – 2,293,782 = 10,501,098) and 2,223,782 million forwards.

c. Is Capital One required under the NSA to continue to correct its solicitation addresses every 60 days using NCOA? If not, what are Capital One's obligations under the NSA with respect to correcting its solicitation addresses on a periodic basis?

**RESPONSE:**

c. See the Agreement section IIC. Capital One agrees to continue updating its address lists, although they are not bound specifically to the use of NCOA.

# Institutional
# USPS

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

APWU/USPS-1. You provided a preliminary FY2003 Integrated Financial Plan as a response to OCA/USPS-5 with a promise to follow-up with a by-AP spread after the audit was complete. Given the changes in Postal Services' financial outlook based on the revised CSRS findings, please provide a revised Integrated Financial Plan and AP spread based on changed pension funding assumptions.

**RESPONSE:**

The FY 2002 audit has not yet been completed. Because legislative change is required to revise funding of pension costs, it is premature to modify FY 2003 financial projections.

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

APWU/USPS-2. The proposed experimental Negotiated Service Agreement between the USPS and Capital One Services, Inc. is expected to last for three years. The proposed rates in the agreement may not be static over that time period. Under certain conditions, there are different discounts proposed for years 2 and 3 depending on mail volume in year 1. In addition, the Postal Service will be implementing new automation capabilities during this time period that USPS witnesses have indicated will decrease the Postal Services' costs of processing Undeliverable as Addressed mail. Since a reduction in those costs is one of the primary reasons that the Postal Service is willing to enter in to this NSA, it is not possible to adequately analyze this agreement without having a complete revenue and cost analysis for the full three years of this experiment.

(a) Please provide an extended cost and revenue analysis, in the same detail as that already provided by witness Crum, that covers the full three years of this agreement.
(b) Please include reasonable assumptions about the upcoming changes in the costs of handling UAA mail due to the implementation of the PARS system and provide all information that will support those assumptions.
(c) If Capital One Services, Inc. is unable to provide volume assumptions for this time period, please make reasonable assumptions and provide documentation on how those assumptions were arrived at.
(d) Please provide an analysis as to how the revenue and cost numbers would change if the circumstances were to occur that would trigger the discounts listed in III. F. of the agreement.

**RESPONSE:**

The Postal Service does not agree with the assertion within this question that adequate analysis of the proposal is not possible without a complete revenue and cost analysis for the full three years of the agreement. Recommended rates which last beyond the test year, into periods in which subsequent developments may cause potentially material changes in postal volumes, operations, and costs, are not only common in postal ratemaking, but are virtually universal. Nonetheless, the single period test year is established by the Commission's rules as the appropriate basis for analysis by the Commission when such changes in rates are proposed. The circumstances in this instance are really no different than those present in the overwhelming majority of Commission proceedings.

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

If the Postal Service had available all of the information necessary to construct the requested analysis by the same means as which the test year analysis was developed, debate as to whether it was necessary to present that information on the record might be fruitful. In fact, however, such information does not exist. In contrast with the FY 2003 information originally submitted in Docket No. R2001-1 and reused as the basis for the test year in this proceeding, no cost rollforward has been developed to generate cost estimates that would be applicable to the second and third years of this proposal. Similarly, no attempt to extend the forecast of Capital One's volumes to those years has been made, and no realistic foundation for any such extension exists.

In an attempt to be responsive to the request for some indication of how the proposal might play out in the later years of the agreement, however, the Postal Service has developed the following analysis.

a.-c. These subparts seek an extended analysis that corresponds to that initially provided by witness Crum, assessing the financial impact of the proposal in the test year. Witness Crum examined three types of impacts from the agreement – increased contribution from new mail, ACS return costs savings, and revenue leakage from the declining block discounts. Considering all three factors, witness Crum estimated that the net effect in the test year would be net increase in contribution to institutional costs of $8.205 million. In response to this question, the Postal Service has sought to show the potential effects on the results presented by witness Crum under a series of hypothetical assumptions regarding the movement of costs and volumes during the second and third years of the agreement. Simply stated, those assumptions, in the absence of any more definitive information, are that the cost and volume factors which

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

drive witness Crum's results could plausibly rise or fall by 5 percent in the second year of the agreement, and an additional 5 percent in the third year. The purpose of this exercise is not to establish that movements of that magnitude represent the totality of possible post-test year developments, but rather to illustrate quantitatively what the effects would be of plausible variations in costs and volumes moving forward in time.

The results are shown on the first attached spreadsheet, labeled "Baseline Test Year." This spreadsheet shows the effect, on each of the three factors, and then on net, of movements in costs and volumes. To put the components of the spreadsheet in context, it may be useful to have Pages 1-4 of witness Crum's Attachment B available for comparison. The calculations are done so that separate results are obtained if costs and volumes move in the same direction, and if costs and volumes move in opposite directions. In each relevant instance, therefore, the results show what happens in each of four scenarios -- if volumes and costs both go up (V+,C+), if volumes go up but costs go down (V+,C-), if volumes go down but costs go up (V-,C+), and if both volumes and costs go down (V-,C-).

The first display in the spreadsheet is Volumes, which starts by presenting the TYAR and TYBR volume forecasts already on the record. Continuing, the spreadsheet shows for Year 2 of the agreement the volumes that would result if BR and AR volumes both increase or decrease 5 percent from their test year levels, and for Year 3, the volumes that would result if BR and AR volumes both increase or decrease 10 percent from their test year levels.

Using these volumes, the next display shows the first of witness Crum's factors, Increased Contribution from New Mail Volume. Increased contribution is the new

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

volume (i.e., the volume resulting from the agreement, or, in each year, AR volume minus BR volume), multiplied by the applicable unit contribution. The unit contribution calculation takes witness Crum's unit revenue of $.2910 as a given, and subtracts the applicable unit cost, and the applicable discount. For each year, therefore, a unit cost that increases or decreases 5 or 10 percent must be applied. These are shown as, for example, Y2UC+, which signifies a unit cost in Year 2 which is 5 percent higher than the unit cost used by witness Crum for the test year ($0.1266), or Y3UC-, which signifies a unit cost in Year 3 which is 10 percent lower than the test year unit cost. (Throughout the spreadsheet, all Y2 numbers represent a change of 5 percent, and all Y3 numbers represent a change of 10 percent.) Note that this methodology does not presuppose any particular reason why unit costs would go up or down by any particular amount. It merely reflects what the results would be if the totality of factors that could affect unit costs result in a net change of the indicated amount. The last element of the calculation, the applicable discount, must be calibrated to the volume interval or intervals in which the new volume would fall, starting at BR levels and proceeding to the AR levels.

For the test year, witness Crum estimated an Increased Contribution amount of $1.846 million. The attached spreadsheet shows that moderate cost and volume movements in years 2 and 3 would still yield results for those years similar to witness Crum's test year estimate. The cumulative and/or offsetting effects of changing discounts and changing unit costs produce results ranging from a high of $2.076 million in Year 3 with a 10 percent increase in volumes and unit costs, and a low of $1.645 million in Year 3 with a 10 percent increase in volumes and a 10 percent decrease in

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

unit costs. As noted, these results bunch fairly tightly around the original test year estimate.

The next display shows the second of witness Crum's factors, the ACS Return Costs Savings. Those savings are a function of the before-rates volume (a higher portion of which, without the agreement, would have been returned), and the unit cost difference associated with the reduction in returns. Witness Crum used a test year cost difference of $.0093, and for purposes of this exercise, that figure has been adjusted as, for example, Y2CD-, which shows a cost difference for Year 2 of $.0088, which is 5 percent less than $.0093. Once again, no attempt is made to identify why the cost difference might change. One possible reason, for example, might be the introduction of the early phases of PARS. Additional information about PARS will be provided in response to APWU/USPS-T4-13, but while none of that information is amenable to explicit incorporation into this exercise, it bears noting at this point that the potential effects of PARS implementation could implicitly be encompassed in the change factors which are incorporated.

Another point to note about the cost difference figure is that, as derived by witness Crum, it is sensitive to the composition of the before-rates volume between customer mail and solicitation mail, because of the different return rates applicable to those two types of mail. If our hypothetically assumed exogenous 5 and 10 percent changes in Capital One's volume were evenly spread between customer mail and solicitation mail, it would have no effect on the cost difference figure utilized in these calculations. If the volume changes were more concentrated on solicitation mail,

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

however, the effect would be that increases in volume would increase the cost difference amount, and declines in volume would decrease the cost difference amount.

In witness Crum's attachments, the test year effect of the ACS Return Cost Savings was estimated at $13.094 million. The results of our exercise once again show a fairly moderate range of variation around that figure, albeit a bit more variation than shown in the New Contribution Analysis. The high figure is $15.844 million in savings, in Year 3 if both volumes and the cost difference go up by 10 percent, and the low figure is $10.607 million in savings, also in Year 3, if both volumes and the cost difference go down by 10 percent.

The next display shows the third of the factors, Discount Leakage. Because the discount leakage is solely a function of the volume level, any variations in cost would have no effect on this factor, and the analysis is therefore simplified to two scenarios. The attachment shows the cumulative level of discounts at the respective before-rates volume levels. The spreadsheet calculates those amounts as the sum of the cumulative total of all discount intervals below the interval in which the last units of volume fall, plus the last applicable discount level times the number of pieces in that interval.

Witness Crum showed a test year Discount Leakage at forecast test year volume levels of $6.735 million. At the assumed volume changes for Years 2 and 3, material changes in the discount leakage become apparent. The high figure is $13.684 million with the volume increase in Year 3, and the low figure is $1.266 million in Year 3 with a volume decrease.

The last display shows the combined effects of each of the three factors in each of our four scenarios for both Years 2 and 3. Witness Crum's estimate of the test year

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

summary impact was $8.205 million. Our Year 2 results range from a high of $11.042 million to a low of $4.976 million. Our Year 3 results range from a high of $13.361 million to a low of $1.355 million. Quite importantly, therefore, this exercise suggests a positive financial impact in each year of the agreement under any of the four scenarios. Once again, the point here is not that we can guarantee a favorable impact, either in any given year, or cumulatively over the duration of the agreement. Instead, this exercise suggests that even a more comprehensive modeling exercise, that would (of necessity) be based on mechanistic application of fairly standard and relatively moderate assumptions, of the approximate magnitude incorporated into this exercise, would seem to be highly unlikely to change the conclusion that the combined impact of this agreement is likely to be positive. In other words, while there might be risks associated with this proposal relating to a variety of potential unforeseen circumstances, there is virtually no risk that the perceived test year benefits would inevitably (or even likely) be eroded in the later years of the experiment by the more mundane fluctuations in costs and volumes that typically are experienced broadly over time.

d. This part of the questions solicits an analysis that addresses the potential consequences of a decline in Capital One's volume in the test year (relative to the estimates provided in this case) that was so severe as to trigger the availability in Years 2 and 3 of the lower tier discounts set forth in section III.F. of the agreement. The second attachment to this answer, labeled "Alternate (Declining) Test Year," provides such an analysis, based on the same format as the analysis provided above. Initially, it may be useful to recall that, contrary to what perhaps may be implied in the question, low volumes in the first year of the agreement do not trigger "different" discounts, so

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

much as they would trigger additional discount tiers. The new tiers would be for volumes below 1.225 billion pieces, but the discounts for volumes above 1.225 billion pieces (which are in effect in the first year, and in each successive year regardless of first year volume) would remain unchanged. As shown below, however, even if triggered by declining first year volumes, the maximum cumulative value of the lower-tier discounts (as measured by Discount Leakage) would be insufficient to offset the inherent cost savings.

The first step in our hypothetical exercise is to assume test year volume levels that trigger the lower tier discounts. Selected for that purpose is a test year volume of 1 billion pieces, slightly below the 1.025 billion level that acts as the trigger. Note that TYBR and TYAR volumes are the same, as no discounts operate to expand demand. Next, we assume the changes in Year 2 and Year 3 before-rates volumes as assumed in our earlier exercise, 5 and 10 percent respectively. Because the lower discounts tiers are in effect under those scenarios in which volume increases, there is a price effect, and the after rates volumes are therefore projected using the same methodology employed by witness Elliott. (In Year 2, the before-rates volume is within the 1-cent discount tier, which represents a 3.44 percent price reduction, eliciting with the workshare elasticity a volume increase of 0.24 percent, or 2.52 million pieces. Similarly, in Year 3, the applicable discount is 1.5 cents, the price reduction is 5.15 percent, and the volume response is 0.37 percent, or 4.07 million pieces.) In those scenarios in which Year 2 and Year 3 volumes decline, there are no operative discounts, and before-rates and after-rates volumes are the same.

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

With these volumes, we can once again evaluate the three factors. For two of the factors, Increased Contribution and Discount Leakage, with assumed volume declines, there are no operative discounts, no discount-induced changes in volume, and therefore no financial effects for the volume-decline scenarios. For the volume-increase scenarios, there are the small discount-induced volume changes explained above, and therefore small amounts of Increased Contribution and Discount Leakage, in all instances in amounts less than $1 million. The only truly material financial impact comes from the third factor, ACS Return Cost Savings, with savings ranging from $7.5 million to $11.3 million. Consequently, looking across all three factors, the range of summary outcomes closely parallels the Return Cost Savings, with the same low of $7.5 million and the high of $10.9 million.

It may be noted that, as mentioned above, the Return Cost Saving results are sensitive to relative changes in proportions of customer mail and solicitation mail, and lower volumes are likely to be associated with relatively lower portions of solicitation mail. Therefore, as all the volume levels in this alternative analysis are well below the baseline TYAR figure of 1.408 billion, the Return Cost Savings results may be viewed as perhaps somewhat overstated. Even if the Return Cost Savings were substantially overstated, however, it is obvious that they would still easily surpass the Discount Leakage. Recall that the absolute maximum amount of Discount Leakage associated in any year with the lower tier discounts would be $3.5 million. (That is to say, if the lower tier discounts were triggered by test year volumes below 1.025 billion, but in a later year volume were to exceed 1.225 billion, the cumulative value of the 1.0-2.5 cent discounts for the volume between 1.025 and 1.225 billion pieces would be $3.5 million.) The

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

lowest generated figure for ACS Return Cost Savings, $7.5 million, is more than twice that amount. Those figures, moreover, relate to volume levels well below 1.225 million pieces, and if the volume levels were to approach 1.225 billion in order to approach the maximum Discount Leakage of $3.5 million, the ACS Return Cost Savings would rise correspondingly.

To summarize, if circumstances in the test year were such that the lower-tier discounts were operable in the later years, the predominant effect of the agreement would be the benefit of whatever ACS Return Savings accrued to the Postal Service, while the offset resulting from Discount Leakage would most likely be either none or minimal.

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

**APWU/USPS-4.** In reference to the USPS response to Oral Request of Chairma n Omas at Tr. 2/342, filed December 9, 2002, please refer to the following statement on page 4:

> "Based on the available information, it is the Postal Service's best estimate that in FY2002 slightly less than half of return to sender pieces received a verified POSTNET barcode and were possibly processed on automation."

Would this also be the percentage of returned mail that received a verified POSTNET barcode in FY2000, the year that this response indicates is the basis for the cost estimates?

**RESPONSE:**

The Postal Service does not expect the FY 2000 numbers to be any different from the FY 2002 numbers. It will provide the FY 2000 information when it becomes available.

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

**APWU/USPS-5.** In reference to the USPS response to Oral Request of Chairman Omas at Tr. 2/342, filed December 9, 2002, please refer to the following statement on page 4: "Thus returns are frequently handled manually throughout the system and, if so, the processing costs are very high."

a) Please confirm that if the piece does not receive a verified POSTNET barcode in the return to sender processing, then it will be handled "manually throughout the system."
b) Please describe what is involved in handling returns "manually throughout the system."
c) Will any mail that receives a verified POSTNET barcode during the return to sender process be handled "manually throughout the system"? If so why?

**RESPONSE:**

a) Confirmed that is generally the case.

b) The testimonies of witnesses Kingsley and Miller in Docket No. R2001-1 describe the manual processing of letters.

c) Local operating decisions may result in some barcoded mail receiving some manual handling.

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

**APWU/USPS-6**. In reference to the USPS response to Oral Request of Chairman Omas at Tr. 2/342, filed December 9, 2002, please refer to and clarify the descriptions on page 5:

a) What is considered to be the "standard processing" for returned mail? Is “standard processing” the steps listed by witness Wilson in his response to OCA/USPS-T4-20 or is it something else? The "special procedures" listed seem to be what witness Wilson describes.
b) If “standard processing” is not as witness Wilson described in OCA/USPS-T4-20, please describe the steps in standard processing.
c) Does the Postal Service specify to its managers the expected handling procedures for returned mail or does each manager determine that for his or her plant?
d) Are there any circumstances under which pieces of returned mail going to one address would be consolidated and returned in one package as opposed to each piece being handled separately?

**RESPONSE:**

a) This statement merely meant to explain that Postal Service operations are generally set up to deliver mail from origin to destination and not to return it from destination back to origin.

b) “Standard processing” was meant to refer to the processing of mail from origin to destination.

c) Final plant operating decisions are made at the local level.

d) Yes. It is possible that returned mail could be consolidated in some way.

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

**APWU/USPS-7.** In reference to the USPS response to Oral Request of Chairman Omas at Tr. 2/342, filed December 9, 2002:

a) Please describe, in detail, which procedures for returned mail are expected to change with the implementation of PARS, Phase I.

b) Please estimate for the three years of this proposed Negotiated Service Agreement, the percentage of returned mail that will be handled with automation equipment versus handled manually throughout the system, given the implementation of PARS Phase I.

**RESPONSE:**

a-b) The main goal of PARS as listed in the Decision Analysis Report (DAR) filed under protective conditions is to improve the handling of forwarded pieces. The Postal Service is developing a more complete answer and will supply it shortly.

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

**APWU/USPS-8.** In reference to the USPS response to the Oral Request of Commissioner Goldway at Tr. 2/396-7 filed on December 6, 2002, please explain how the results of this analysis change if the alternative growth assumptions begin in the Test Year rather than in year two?

**RESPONSE:**

Intuitively, the short answer to the question is that as more extreme hypotheticals are considered, more extreme results are obtained. Thus, in the third year, if 20 and 30 percent assumptions of volume growth produced a negative financial impact for that year in the previous response, assumption of even higher volume growth would produce even more negative financial impacts for that year. Plus, under the stipulated hypothetical, the current test year projection of an approximate financial benefit of $8.2 million would be replaced with the lower positive amounts shown in the previous response for Year 2 under assumptions of 10 and 15 percent volume growth. Of course, those amounts for Year 2 would likewise be replaced by the negative figures shown in the earlier response for Year 3 at assumed growth rates of 20 and 30 percent. Therefore, even without actually doing the calculations, it is fairly evident that the cumulative three-year impact under both an assumed 10/20/30 growth scenario and an assumed 15/30/45 growth scenario would be negative. On the other hand, under similar volume decline scenarios, the impact figure for each year would still be positive, and the cumulative three-year impact would still be considerable.

These results are hardly surprising. Whether one confines analysis to a single test year (as is customary in postal ratemaking and as the Commission requires under its rules), or extends the analysis over a longer time period (e.g., the expected length of the rate cycle, or the specified length of an NSA), it is always possible to find

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

assumptions extreme enough to suggest a negative financial result. The relevant question is how realistic are the operative assumptions? The Postal Service's response to the previous question explained why it believes that volume changes of the magnitude specified therein are far less likely than more modest volume changes. By extension, the more extreme volume swings postulated in this question are even less likely. If one embraces as a necessary component of the hypothetical that that the sky will fall, consequent analysis will tend to do little more than confirm that the sky has fallen.

RESPONSE OF THE UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION, AFL-CIO,
REDIRECTED FROM WITNESS PLUNKETT

**APWU/USPS-T2-9.** How will the costs of making the programming and regulation changes necessary to implement CSR Option 2 by February 1, 2003 be accounted for in the Postal Services' accounting system? Will they be considered an institutional cost? Will they be attributed to specific mail class? If they will be attributed to a specific mail class, how will they be attributed?

**RESPONSE:**

The addressing systems that support ACS, much like most of the Postal Service's longstanding data systems, undergo periodic improvements and builds. The programming changes necessary to implement CSR, Option 2, will occur regardless of what happens in this docket, and would have occurred even if the Capital One NSA had never been signed. Hence, these costs have not been analyzed for this docket. In general, however, they appear in the accounting systems within the costs of the Other Miscellaneous Supplies and Services subcomponent of Component 16.3 (Other Supplies and Services), and therefore would be expected to receive the same treatment as the other costs of that subcomponent. For a detailed description of the treatment of the costs within that subcomponent , please see Library Reference USPS-LR-J-1 in Docket No. R2001-1, the Summary Description of USPS Development of Costs by Segments and Components, FY 2000, and refer to Cost Segment 16.

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION, AFL-CIO, REDIRECTED FROM WITNESS PLUNKETT

**APWU/USPS-T2-11.** On page 12 of your testimony, you discuss data collection issues.

(a) Will the data collection system for this proposed Negotiated Service Agreement be able to identify how many pieces and what proportion of Capital One's First Class mail are forwarded?

(b) Will the data collection system for this proposed Negotiated Service Agreement be able to identify how many pieces and what proportion of Capital One's First Class mail are destroyed?

(c) Will the data collection system for this proposed Negotiated Service Agreement be able to identify how many pieces and what proportion of Capital One's First Class mail are returned as undeliverable as addressed?

(d) If the data collection system is able to identify the number and/or proportion of pieces forwarded, destroyed or returned of Capital One's First Class mail, how will that information be reported and maintained?

(e) If the data collection system is not able to identify the number and/or proportion of pieces forwarded, destroyed or returned of Capital One's First Class mail, will any other methods be developed or used to obtain this information?

(f) Will data be collected for other First Class mailers during the period of the proposed Negotiated Services Agreement, showing the number of pieces and or the proportion of pieces forwarded, destroyed or returned as undeliverable as addressed?

(g) If data is collected for other First Class mailers during the period of the proposed Negotiated Services Agreement, showing the number of pieces and or the proportion of pieces forwarded, destroyed or returned as undeliverable as addressed, how will this information be reported and maintained?

**RESPONSE:**

Some data sources have been identified and can readily be tapped. However, other procedures have yet to be defined, so that to the extent the term "data collection system" implies the existence of a complete set of established collection procedures, it is a poor descriptor. For example, data on forwarded, destroyed, or returned pieces that flow through CFS units will be comparatively simple to assemble. For those pieces physically returned to Capital One,

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION, AFL-CIO, REDIRECTED FROM WITNESS PLUNKETT

procedures yet need to be worked out between the Postal Service and Capital One. This caveat must be kept in mind for the following responses.

a. Yes. The PERMIT system will allow the collection of Capital One volume, per article III(J) of the Agreement. ACS data will be able to provide the number of most forwarded Capital One pieces. However, this would not include pieces forwarded locally or those forwarded from a destination delivery unit covered by a CFS unit; there is no practical means of counting such pieces.

b. Yes. The PERMIT system will allow the collection of Capital One volume, per article III(J) of the Agreement. ACS data will be able to provide the number of destroyed Capital One pieces.

c. Yes. The PERMIT system will allow the collection of Capital One volume, per article III(J) of the Agreement. Capital One and the Postal Service will work out prior to implementation how to ensure an accurate report of the number of pieces of mail that are returned to Capital One.

d-e. In part because the Commission has yet to issue any recommended decision on the pending NSA Request, these details have not been determined.

f-g. No; this NSA is about Capital One, not other mailers so there is no basis for reporting the behavior of other mailers. That does not mean, however, that the implementation of Change Service Requested, Option 2, will preclude all comparisons of Capital One with system wide measures.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION, AFL-CIO,
REDIRECTED FROM WITNESS WILSON

**APWU/USPS-T4-13.** In your responses to APWU/USPS-T4-1 and APWU/USPS-T4-3, you state that PARS will reduce the Postal Service's costs of handling UAA mail.

(a) Please describe which manual functions for the handling and processing of UAA mail will be automated by PARS or as a result of PARS implementation.

(b) Please describe in detail how PARS will change the handling of mail pieces that will be sent back to the sender. In addition

(1) Will PARS automate the handling of pieces that will be returned to sender?

(2) Will PARS prevent a piece of mail that will ultimately be returned to sender from ever reaching the delivery unit of the address on the mail piece?

(3) Will PARS redirect a piece back to its sender without it going through a CFS unit?

(c) Please describe in detail how PARS will change the handling of mail pieces that will be forwarded. In addition

(1) Will PARS automate the handling of pieces that will be forwarded?

(2) Will PARS prevent a piece of mail that will be forwarded from ever reaching the delivery unit of the address on the mail piece?

(3) Will PARS redirect a forwardable letter without it going through a CFS unit?

(d) Please provide the complete implementation schedule for PARS as currently envisioned.

(e) Please indicate when and where in the network PARS will be implemented.

(f) Please indicate the approximate volume of mail that will be processed through PARS during each year of the proposed Negotiated Service Agreement.

(g) Has the Postal Service produced any estimates of savings expected from the use of PARS in the handling of UAA mail, such as in its Decision Analysis Report for PARS? If so please provide any estimates of such savings for each year for which such estimates are available and show all calculations for deriving those savings estimates. If separate savings estimates have been made for forwarded mail and for return to sender mail please show those separately.

(h) Will PARS result in any changes in how mail is handled by the CFS units? If so please describe.

(i) Will PARS change how much mail is handled by the CFS units? If so please quantify the change in the amount of mail that is handled by the CFS units for each year covered by the proposed Negotiated Service Agreement.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION, AFL-CIO,
REDIRECTED FROM WITNESS WILSON

**APWU/USPS-T4-13.** (continued)

(j) Will PARS have any impact on the generation of electronic Address Correction Service (ACS) notifications? If so, please describe and quantify the impact on the generation of ACS notifications for each year covered by the proposed Negotiated Service Agreement.

**RESPONSE:**

(a) Manual handling functions associated with UAA letter mail that will be automated by PARS include:

(1) Data entry functions typically performed in CFS units to retrieve a customer's new address for forwardable mail.

(2) Data entry functions performed in CFS units to capture ACS participant code and keyline information.

(3) Manual operations performed in CFS units involved with photocopying of UAA mailpieces in production of PS Form 3547 address correction notices.

(4) Manual markings applied to UAA mail pieces by Nixie clerks.

(5) Manual separations made by Nixie clerks of UAA mail pieces participating in the ACS program.

(b) PARS will automate return to sender of letter mail processing by detecting mailpieces that require return to sender handling, reading either the front or back of mailpieces to determine the return address, labeling and

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION, AFL-CIO,
REDIRECTED FROM WITNESS WILSON

barcoding the mailpiece for return handling, capturing ancillary service endorsements or ACS information from the mailpiece and providing the mailer-requested handling. For UAA mail that the DDU identifies as return to sender, PARS will also automate the handling of this mail.

(1) Yes.

(2) Yes, PARS will prevent pieces from reaching the DDUs, depending upon the mail class, presence of ancillary service endorsements, presence of ACS markings, and age of change-of-address order for the delivery address. For example, if PARS detects a First-Class Mail piece with an address where the forwarding order has expired, it will apply a barcoded label to the mailpiece to return it to sender.

(3) Yes.

(c) PARS will automate mail forwarding by detecting forwardable mail pieces in the mailstream when it compares name and address data on mailpieces to the PARS Change-of-Address (PCOA) database. Where matches between mailpiece name and address data and PCOA data occur, PARS will relabel the mailpiece and print the forwarding address and barcode required to direct the mailpiece to the new address. Where ancillary

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION, AFL-CIO,
REDIRECTED FROM WITNESS WILSON

service endorsements or ACS markings are present upon the mailpiece, PARS will provide the requested services.

(1) Yes.

(2) Yes.

(3) Yes.

(d) Phase I of PARS deployment is scheduled to begin in July 2003 and finish in May 2004. Only Phase I has been funded by the Board of Governors. Phase II of PARS deployment is planned to closely follow completion of Phase I, assuming Board of Governor approval, and is scheduled to finish in May 2006.

(e) Phase I of PARS will be deployed in 53 Processing and Distribution Centers throughout the United States from July 2003 through May 2004.

(f) In FY2003, PARS is not expected to process any significant volume of UAA mail. For FY2004, when PARS is being actively deployed, volume is not available. In FY2005, once Phase I is fully implemented, PARS is expected to process about one-third of all UAA machinable letter mail volume. About one quarter of that mail will be intercepted at the plant before it reaches the DDUs. The remaining three-quarters will be

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION, AFL-CIO,
REDIRECTED FROM WITNESS WILSON

identified as UAA mail by the carrier and sent back to the plant for processing on PARS.

(g) Please see the attached chart.

(h) Yes. All machinable letter mail currently worked in the Phase 1 CFS units on mechanized terminals will now be worked through PARS. The only remaining mail volume in the CFS units will be parcels, flats, and non-machinable letters.

(i) Yes. See answer to APWU/USPS-T4-13(f) and (h).

(j) Yes. PARS-affected CFS units will no longer process ACS machinable letter mail. PARS will process the mail and generate the electronic notices instead.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION, AFL-CIO,
REDIRECTED FROM WITNESS WILSON

**APWU/USPS-T4-14.** Do you anticipate that there will be a change in the institutional cost coverage of the address correction service as a result of the implementation of CSR-Option 2? If so, please explain your response and detail any anticipated change.

**RESPONSE:**

The decision to implement CSR-Option 2 was reached independently of this NSA. See response to APWU/USPS-T4-5. The decision was based on an expectation of overall benefits to the Postal Service and its customers, without a specific focus on the discrete costs and revenues of address correction service. The impact on the cost coverage of address correction service was not studied when considering the implementation of CSR-Option 2, and has not been studied since the decision was made.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF AMERICAN POSTAL WORKERS UNION, AFL-CIO,
REDIRECTED FROM WITNESS WILSON

**APWU/USPS-T4-15.** Has the Postal Service done any estimates of the increased volume and/or increased costs of forwarding First Class mail due to a change to CSR-Option 2? Is so, please provide those estimates and all calculations used to generate them and please indicate where these additional costs will appear in the Postal Services' accounting system.

**RESPONSE:**

No. Please see the response to APWU/USPS-T4-14.

# PARS Phase I

## Net Workhour Impact with Labor Distribution Category (LDC) Detail

| Activity/Functional Area | CFS Units | Delivery Units | | | | | | P&DC | REC Sites | Net Total Savings |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Clerk | | | Carriers (In Office) | | | | | |
| | | General UAA Wor | General Delivery | Box Section | City | Rural | HCR | | | |
| | LDC 49 | LDC 48 | LDC 48 | LDC 44 | LDC 21 | LDC 25 | | LDC 11/14/17 | LDC 15 | |
| Processing Change of Address Cards | 509,613 | 194,783 | 401 | 790 | 51,100 | 7,862 | 2,063 | | (161,666) | 614,945 |
| Fulfilling Address Correction Requests | 230,407 | | 34 | 58 | 5,227 | 673 | 177 | | 21,002 | 257,587 |
| Mail Pieces Forwarded | 923,764 | 205,580 | 73 | 144 | 11,137 | 1,433 | 376 | | | 1,142,487 |
| Mail Pieces Returned | 228,382 | 514,437 | 48 | 85 | 7,333 | 944 | 248 | 247,456 | | 998,943 |
| Mail Pieces Treated as Waste | 14,904 | | 52 | 102 | 7,866 | 1,012 | 266 | | | 24,202 |
| Mail Processing | | | | | | | | | | 0 |
| Chain Forwards | 74,807 | | 21 | 41 | 3,206 | 413 | 108 | | | 78,596 |
| PARS Additional Costs | | | | | | | | (167,245) | (128,937) | (296,182) |
| Net Total Operating Savings | 1,981,877 | 914,779 | 629 | 1,240 | 95,869 | 12,336 | 3,238 | 80,211 | (269,601) | 2,820,578 |
| Field Maintenance (LDC 36) | 60,025 | | | | | | | (31,658) | (955) | 27,412 |
| Recurring Training (LDC 91) | (1,376) | | | | | | | (27,594) | (4,820) | (33,790) |
| Net Total Workhour Savings | 2,040,526 | 914,779 | 629 | 1,240 | 95,869 | 12,336 | 3,238 | 20,959 | (275,376) | 2,814,200 |

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF NEWSPAPER ASSOCIATION OF AMERICA

**NAA/USPS-2**: Please provide the Postal Service's calculation of "90% of Capital One's average First-class Mail volume for Postal Service FY2000, FY2001 and FY2002" as referenced in Section II1.D of the NSA submitted as Appendix G of the Request. Please include a showing of the calculation.

**RESPONSE:**

Please see the response of witness Plunkett to OCA/USPS-T2-4.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF NEWSPAPER ASSOCIATION OF AMERICA

**NAA/USPS-4**: Please refer to the preamble of the NSA submitted as Appendix G of the Request, and in particular to the statement that the NSA "will be transferable to other mailers willing to meet the same conditions and terms." Please refer also to the Request, page 4, line 6, at which the Postal Service states: "As proposed, the changes would apply only to one, discretely-positioned mailer." Please clarify whether the NSA is available to other mailers, or if it applies only to one mailer.

**RESPONSE:**

Both. The NSA submitted as Appendix G is a binding agreement between the Postal Service and only one mailer, Capital One. The changes in the DMCS that the Postal Service has requested the Commission to recommend apply by their terms only to implementation of this agreement with this mailer on an experimental basis.

The Capital One NSA indicates that the terms and conditions of the agreement with Capital One would be available to other mailers. This statement is not a term or condition of the Capital One NSA, but, rather, expresses the Postal Service's willingness to enter into the same NSA with another mailer capable of accepting and willing to accept the same terms and conditions.

To the best of the Postal Service's knowledge, no other mailer is situated exactly like Capital One with respect to the terms and conditions embodied in the Capital One NSA. Nevertheless, the Postal Service would be willing to enter into an agreement consisting of the same terms and conditions with another mailer willing to accept them. The mailer would have to demonstrate to the Postal

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF NEWSPAPER ASSOCIATION OF AMERICA

Service that it is similarly situated, and that the Postal Service would derive from the agreement with the new mailer the same or substantially the same benefits resulting from the Capital One NSA.

Any agreement with a new mailer duplicating the terms and conditions embodied in the Capital One NSA would be presented to the Commission as a request for a recommended decision for an experimental change in the DMCS. Unless otherwise determined by the Commission, the Postal Service would expect that DMCS changes implementing the new NSA would be subject to the same review process applied to the changes implementing the Capital One NSA, under Chapter 36 of the Postal Reorganization Act and the Commission's Rules of Practice and Procedure.

As a result of inherent differences among mailers, the Postal Service would expect that any NSA it was considering with other mailers would have terms and conditions different from the Capital One NSA, and would reflect the distinct characteristics of the mailer and its relationship with the Postal Service. The Postal Service is willing to consider new NSAs on those different terms, as negotiated between the mailer and the Postal Service. As with an NSA duplicating the Capital One agreement, furthermore, DMCS changes implementing any new NSA would be submitted to the Commission for review.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF NEWSPAPER ASSOCIATION OF AMERICA

**NAA/USPS-5**: Please refer to the preamble of the NSA submitted as Appendix G of the Request, and in particular to the statement that the NSA "will be transferable to other mailers willing to meet the same conditions and terms." Please indicate where the proposed DMCS language in Attachment A to the Request states that the NSA is available to other mailers willing to meet the same conditions and terms.

**RESPONSE:**

Please see response to NAA/USPS-4.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF NEWSPAPER ASSOCIATION OF AMERICA

**NAA/USPS-6**: Please refer to Section 1V.C of the NSA submitted as Appendix G of the Request, which states that the NSA "is effective on the latest date of signing by both parties." Please state on what date the NSA either did, or will, become effective

**RESPONSE:**

Please see page 11 of the NSA. The NSA became effective under the terms you cite on September 9, 2002, when it was signed by Ms. Bizzotto on behalf of the Postal Service, having previously been signed by Mr. Jean on September 4, 2002. Please see the Notice Of United States Postal Service Regarding Negotiated Service Agreement with Capital One Services, Inc., Filed as Appendix G to the Request in this Docket which was filed on October 22, 2002 and the errata thereto, dated October 23, 2002.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF NEWSPAPER ASSOCIATION OF AMERICA

**NAA/USPS-7**: Please provide the number of First Class mailer production sites that have received certification to date under the Mail Preparation Total Quality Management (MPTQM) program.

**RESPONSE:**

Currently, there are 35 First-Class Mail sites that are MPTQM certified.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF NEWSPAPER ASSOCIATION OF AMERICA

**NAA/USPS-8**: Please provide the number of list mailers to have production sites certified to date under the Mail Preparation Total Quality Management program.

**RESPONSE:**

Currently, there are five production list mailer sites.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF NEWSPAPER ASSOCIATION OF AMERICA

**NAA/USPS-9**: Please confirm that, to the best of the Postal Service's knowledge, other First Class mailers are, or can become, capable of:

a. maintaining MPTQM in their mailing sites;
b. achieving MPTQM certification at additional sites;
c. cleansing address databases for customers not more than 30 days prior to mailings;
d. cleansing solicitation address files no more than 60 days prior to mailing;
e. use Electronic Address Correction Service information in marketing campaigns.

Where it is not possible to confirm, please explain why not.

**RESPONSE:**

a. Confirmed

b. Confirmed

c. Confirmed.

d. Confirmed.

e. Confirmed.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF NEWSPAPER ASSOCIATION OF AMERICA

**NAA/USPS-10**: Please refer to the response provided by the Postal Service to interrogatory NAA/USPS-T4-13, redirected from witness Wilson and filed on November 26, in which the Postal Service states: Capital One's returned mail pieces are routed through the Richmond ADC.

Please explain what is meant by "routed through" as distinct from "routed to" and explain what happens to the returned mail pieces once they arrive at the Richmond ADC, including whether they are routed onward to some other destination.

**Response:**

What was meant by the response to NAA/USPS-T4-13 is that Capital One return mail pieces have ZIP Codes that destinate within the Richmond service area. The type of handling they receive and where they receive it is determined by the Richmond P&DC

The type of handling that Capital One return mail receives could depend on several factors, including their automatability and the extent of intermingling with non-Capital One returns destinating in the Richmond area. This May, when several headquarters personnel visited the area, the Processing and Distribution Center often transported Capital One returns to an annex facility where postal employees would manually riffle the mail to remove pieces that should not be returned to Capital One. Now, apparently, all handling, whether automated or manual, occurs at the Richmond P&DC.

It should be remembered that the actual handling practices were not relied upon to develop cost or savings estimates in this case, so that any changes in operations in this regard have no effect on the cost or savings estimates underlying this case.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF NEWSPAPER ASSOCIATION OF AMERICA,
REDIRECTED FROM WITNESS WILSON

**NAA/USPS-T4-13**: Please describe the processing of Capital One's returned pieces and compare this processing to that received by average returned First-Class mailpieces, focusing specifically on:

(a) the proportion of Capital One's pieces that destinate (and are then picked up by or delivered to Capital One) at an Area Distribution Center;

(b) the proportion of Capital One pieces that receive more than one outgoing sort, given that they may be going to a major Area Distribution Center; and

(c) the proportion of Capital One pieces that receive only one incoming sort due to going to a dedicated sorting bin for a high-volume customer.

**RESPONSE:**

(a) Capital One's returned mail pieces are routed through the Richmond ADC.

(b)&(c) This information is not available.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-1. For Fiscal Years 2000 and 2001, please provide the volume for each permit system mailer of First-Class Mail in rank order. (NOTE: OCA is not asking for the specific identification of any permit system mailers.)

**REPONSE:**

The permit system does not consolidate information by mailer and therefore the information is not available.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-2. For Fiscal Years 2000 and 2001, please provide the return volume for each permit system mailer that receives the physical return of undeliverable-as-addressed First-Class Mail in rank order. (NOTE: OCA is not asking for the specific identification of any permit system mailers.)

**REPONSE:**

The Postal Service does not track the physical return volume of its mailers and therefore the information is not available.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-3. For each of the annual volume ranges below, please provide the number of originators of First-Class Mail for FY 2000 and 2001.

ANNUAL VOLUME RANGES
(billions)

| FROM | UP TO |
|---|---|
| 1.750 | More Than 1.750 |
| 1.500 | 1.750 |
| 1.250 | 1.500 |
| 1.000 | 1.250 |
| 0.750 | 1.000 |
| 0.500 | 0.750 |
| 0.250 | 0.500 |
| Less than 0.250 | |

**RESPONSE:**

ANNUAL VOLUME RANGES
(billions)

| FROM | TO | FY2000 | FY2001 |
|---|---|---|---|
| 1.75 | >1.75 | 0 | 0 |
| 1.50 | 1.75 | 0 | 0 |
| 1.25 | 1.50 | 0 | 0 |
| 1.00 | 1.25 | 1 | 0 |
| 0.75 | 1.00 | 0 | 1 |
| 0.50 | 0.75 | 2 | 2 |
| 0.25 | 0.50 | 19 | 25 |
| < 0.25 | | 65,044 | 65,038 |

The source of these figures is the Corporate Business Customer Information System (CBCIS). CBCIS's automated roll up of volumes is not able to capture all of a particular mailer's volume. One reason for the difference is that letter shops often pay postage from the letter shops' accounts. The letter shops' accounts would not be identified by the CBCIS automated roll-up as relating to the originating mailer, even if the letter shops are using unique permits for the mailer. The CBCIS system has no way of knowing that the permit was directly and solely related to one particular mailer.

The volume figures presented in this case for Capital One were obtained directly from the permit system, based on Capital One's specific identification of its permit numbers. Capital One provided the Postal Service with a list of all permits that apply uniquely to its mailings and this was the basis for the volumes presented in witness Crum's testimony.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-4. Please confirm that mailers that enter First-Class presort or automation presort mail are permit system mailers. If you do not confirm, please explain.

RESPONSE:

Confirmed for all but a small amount of such mail.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-5. Please provide the Postal Service's Fiscal Year (FY) 2003 Integrated Financial Plan.

(a) With respect to the FY 2003 Operating Plan, please provide the operating plan by accounting periods for Postal Service operating revenues, appropriations, investment income, expenses and volumes. Please provide your response in the same format as provided in response to OCA/USPS-T6-1(a) in Docket No. R2001-1.

(b) For each of the thirteen accounting periods presented in part "(a)" of this interrogatory, please provide the FY 2003 Operating Plan with operating revenues broken out by mail class and subclass cost categories. Please provide your response in the same format as provided in response to OCA/USPS-T6-1(b) in Docket No. R2001-1.

RESPONSE:

A copy of the FY 2003 Integrated Financial Plan is attached. The accounting period plan spread is currently being finalized and will not be available until after completion of the FY2002 financial audit.

UNITED STATES
POSTAL SERVICE

# INTEGRATED FINANCIAL PLAN
# FISCAL YEAR 2003



# PREFACE

The FY 2003 Integrated Financial Plan is shaped by the unprecedented events of FY 2002, which ends on September 30, 2002. The FY 2002 plan, formulated in August of 2001, was built on an already deteriorating economic outlook that was later acknowledged as a recession. The Postal Service had originally planned for revenues of $68.8 billion, with expenses of $70.2 billion, and a net loss of $1.35 billion for FY 2002.

The economic downturn was quickly exacerbated by the aftermath of the September 11th terrorist attacks. Economic activity in the country virtually ground to a halt. Transportation networks were disrupted for weeks. The Federal Aviation Administration imposed restrictions on mail flown on commercial airlines that continue today. The impact on the mailing industry was immediate. The last three weeks of FY 2001, which ended on September 30, 2001, saw volume declines of approximately 700 million pieces.

The Postal Service responded to the operational problems caused by transportation network disruption as quickly as possible. Nonetheless, service performance was impacted and additional costs were incurred.

In October 2001, the Postal Service found itself responding to yet another terrorist attack when the mail was used as the delivery method for bio-terrorist attacks. Two postal employees died as a result of exposure to Anthrax. By the end of October 2001, major mail processing and mail handling operations in the country's financial and political centers were shut down, or severely hampered. Employees and the public were naturally concerned about the immediate and long-term safety of the mail. Thousands of temporary shutdowns occurred due to hoaxes or legitimate concerns which turned out to be false alarms. The Postal Service responded by initiating widespread testing of facilities and employing irradiation services to sanitize the mail bound for Federal Government entities in Washington, D.C.

It was quickly apparent these events, coupled with a recession, would depress mail volumes for the remainder of FY 2002 causing a dramatic shortfall in revenue. The Postal Service developed a three-pronged response – manage declining workload by reducing work hours and employment through attrition, settle the R2001-1 Rate Case, and obtain funds from the federal government to offset terrorist impacts. Total expenses will be more than $2.5 billion below plan at year-end. Expense growth, estimated to be only 0.3 percent for FY 2002, will be the smallest expense increase in Postal Service history. Work hour reductions for FY 2002 will exceed 70 million, and there will be over 22,000 fewer career employees than at the beginning of the year. The Postal Service and major stakeholders in the pending R2001-1 Rate Case reached a negotiated settlement that enabled the Postal Service to increase prices on June 30, 2002 – three months ahead of the test year. The Postal Service also was appropriated funds to offset the immediate costs of the mail sanitization process, facility clean-up, and employee protection relating to the Anthrax attacks.

Although management expects to end FY 2002 with a smaller net loss than planned, it is estimated that revenues will be about $2.3 billion below plan and mail volume will decline 2.7 percent, or 5.5 billion pieces.

As FY 2003 begins, significant risks cloud the Postal Service's economic environment. Nonetheless, the Transformation Plan, released in April 2002, commits the Postal Service to substantial improvements in efficiency beyond the significant gains achieved over the last three years. These associated cost savings are a critical component of the FY 2003 Integrated Financial Plan. The underlying structural evolution of the American economy and the operational challenges created by the events of FY 2002 are the launch point for the Transformation Plan and the foundation of the FY 2003 Integrated Financial Plan.

# TABLE OF CONTENTS

# INTEGRATED FINANCIAL PLAN

## FISCAL YEAR 2003

## OPERATING PLAN

The FY 2003 Operating Plan was developed under the four phase *CustomerPerfect!$_{sm}$* management cycle. The Establish Phase began in January 2002 followed by the Deploy Phase in March. The Implementation Phase will begin with the new fiscal year and the Review Phase is ongoing.

### FY 2002 BASELINE ESTIMATES

Revenue and volume growth in FY 2002 were adversely affected by the economic slump and the shocks associated with terrorism. Estimated FY 2002 revenue growth is only 1.0 percent. Volume was most severely affected during Quarter I of FY 2002, when it declined nearly 6 percent. Volume for the year will be down 2.7 percent from FY 2001, a decrease of approximately 6 billion pieces of mail. Revenues were enhanced by the carryover impact of postage rate increases implemented in January and July of 2001. However, if the R2001-1 rate increase had not been accelerated pursuant to the settlement agreement and implemented on June 30, 2002, revenues would have declined about $300 million from last.

For FY 2002, total expenses of $67.7 billion will be about $2.5 billion under plan and 0.3 percent more than FY 2001 expenses. Management controlled expense growth in spite of severe operational disruptions and unanticipated mail security and transportation costs. In addition, higher labor costs, increased workers' compensation costs, and rising health benefit costs put upward pressure on expenses. Though mail volume declines of 2.7 percent are expected for FY 2002, 1.6 million more delivery points have been added to the delivery network.

### FY 2003 REVENUE AND VOLUME

Revenue is projected to grow $3.9 billion over FY 2002 revenue. Approximately $3.1 billion of this growth is from the June 30, 2002 rate increase. The remainder, approximately $800 million, is due to forecasted volume growth.

| Volume | FY 2002 Estimate | FY 2003 Plan | Change | % Change |
|---|---|---|---|---|
| First-Class | 101,744 | 102,037 | 293 | 0.3 |
| Priority | 999 | 945 | (44) | (5.4) |
| Express | 62 | 59 | (3) | (4.9) |
| Periodicals | 9,648 | 9,442 | (206) | (2.1) |
| Standard Mail | 87,045 | 90,870 | 3,825 | 4.4 |
| Parcel Post | 367 | 370 | 3 | 0.8 |
| Other Package Svcs. | 709 | 707 | (2) | (0.3) |
| International | 866 | 801 | (65) | (7.4) |
| Other Mail | 483 | 451 | (32) | (6.4) |
| Total Volume | 201,923 | 205,682 | 3,759 | 1.9 |
| *(Pieces in Millions)* | | | | |

The economy appears to be moving out of a relatively short and shallow economic recession. Further, a deeper and longer (18 month) advertising recession also appears to be coming to an end. These positive influences typically would lead to strong volume and revenue rebounds. However, these positive forces are muted by the impacts of the June 30 rate increases and the continued diversion of transactions and correspondence mail to electronic alternatives. The net result is a projected FY 2003 volume growth of 1.9 percent, to 205.7 billion pieces. Virtually all projected volume growth is in Standard Mail. Projected total volume is below the peak volume of 207.9 billion pieces delivered three years earlier, in FY 2000.

The economy may rebound, but the forecast reflects the negative impact of growing Internet use as an alternative to First-Class Mail. Based on that, First-Class Mail, forecasted to grow only 0.3 percent, will lag any economic recovery. Continuing volume declines are projected for Priority Mail and Express Mail, reflecting the impact of price increases on these price sensitive product lines. Standard Mail is projected to rebound with the end of the advertising recession. There will be little change in Package Service volumes. Declines in Periodicals volume and International volume are projected to continue in FY 2003.

*Forecasts and Related Revenue Impacts*

The volume and revenue forecast underlying the plan was built using DRI*WEFA's June 2002 baseline macroeconomic projections. Since June, the tilt in economic forecasting has become more pessimistic. This tilt is reflected in the Federal Reserve policy statement released on August 13, 2002 by the Federal Open Market Committee. It states, "The risks are weighted mainly toward conditions that may generate economic weakness." It is therefore possible that the volume and revenue forecast, which is believed to be based on conservative economic assumptions only a few weeks ago, could be more challenging than anticipated. Should the economy stall, significant negative impacts to postal finances will result.

**Revenue**

| | FY 2002 Estimate | FY 2003 Plan | Change | % Change |
|---|---|---|---|---|
| First-Class | $ 36,287 | $ 38,159 | $1,872 | 5.2 |
| Priority | 4,751 | 4,940 | 189 | 4.0 |
| Express | 927 | 944 | 17 | 1.8 |
| Periodicals | 2,188 | 2,320 | 132 | 6.0 |
| Standard Mail | 15,882 | 17,488 | 1,606 | 9.9 |
| Parcel Post | 1,189 | 1,207 | 18 | 1.6 |
| Other Package Svcs. | 897 | 937 | 40 | 4.5 |
| International | 1,552 | 1,490 | (62) | (4.0) |
| Other Revenue | 2,865 | 2,953 | 88 | 4.8 |
| Total Revenue | $ 66,538 | $ 70,438 | $3,900 | 5.9 |

*($ Millions)*

Overall, revenue is projected to grow $3.9 billion, or5.9 percent. The revenue growth for First-Class Mail, Priority Mail, Express Mail, Periodicals and Package Services primarily reflects the June 30 rate increase. The projected revenue growth for Standard Mail is attributable to the impact of rate increases and volume growth. The projected decrease in International revenue relate to volume losses. The planned increases in Other Revenue are generated by increases in the fees for Special Services and postal box rents.

The Postal Service will employ several initiatives and enlist all employees to build Postal business and generate growth that will exceed this revenue forecast.

## EXPENSE

In FY 2003, total expenses are budgeted at $69.8 billion, which is 3.2 percent more than FY 2002 estimated expenses.

**FY 2003 Expenses**

| | FY 2002 Estimate | FY 2003 Plan | Change | % Change |
|---|---|---|---|---|
| Field | $ 53,711 | $55,529 | $1,818 | 3.4 |
| Corporate Transportation | 3,227 | 3,164 | (63) | (2.0) |
| Corporatewide Activities | 2,361 | 2,417 | 56 | 2.4 |
| Interest | 1,958 | 1,997 | 39 | 2.0 |
| HQ Administrative | 1,307 | 1,307 | (1) | (0.1) |
| OIG and PRC | 124 | 137 | 13 | 10.7 |
| Servicewide | 5,001 | 5,288 | 287 | 5.7 |
| | $ 67,688 | $69,838 | $2,150 | 3.2 |

*($ Millions)*

*Field Expense*

Field expenses will increase by $1.8 billion in FY 2003, with most of the increase due to inflation in salaries and benefits, and the increase in the number of deliveries next year. The growth in field costs will be restrained by $961 million in cost reductions. See "Cost Reduction Programs" on page 6 for specific details. Also, $59 million has been trimmed from administrative work hour expense growth at the Area and District offices.

The total work hours in FY 2003 will be reduced 30 million from the FY 2002 year-end estimate. This will be the fourth consecutive year that the Postal Service has reduced work hours. Work hours were reduced by 12 million in FY 2000, followed by a 23 million reduction in FY 2001, and an estimated reduction in excess of 74 million work hours in FY 2002. The FY 2003 work hour reduction target is equal to over 16,000 full-time equivalent employees.

*Headquarters Expense*
Headquarters expense includes the headquarters organizations and their field support units, and the Postal Inspection Service. Headquarters administrative costs of $1.3 billion represent no growth from the FY 2002 estimate. In FY 2002, inflationary cost pressures were absorbed through staffing reductions, and other cost controls. This will continue in FY 2003 when Headquarters administrative expenses will be below FY 2001 levels.

*Programs and Corporatewide Expense*
Program and Corporatewide activity costs are budgeted at $2.4 billion in FY 2003, which is the same level of spending as FY 2002. Almost three quarters of the program and corporatewide activity budget is devoted to ongoing activities that represent legal or contractual requirements or are needed to support operations. These include: Mail Transportation Equipment Service Centers at $313 million, the purchase of Mail Transportation Equipment at $120 million, Stamp Manufacturing at $138 million, and Point-of-Service (POS) ONE at $93 million. (See the table below for the top ten programs.)

Maintaining the same spending level as FY 2002 in FY 2003 will be achieved by offsetting increased spending for major initiatives with reductions in lower-priority items. This prioritization effort is influenced by Transformation Plan strategies. Major initiatives receiving a boost in spending in FY 2003 include financial recordkeeping and reporting systems ($57 million), upgraded information technology ($28 million), initiation of an ESOP for EEO investigations ($20 million), and the development of *PostalOne!* ($17 million). Although each of these initiatives requires substantial upfront investment, the fact that we are undertaking them during an era of unprecedented fiscal restraint testifies to their importance to our long-term operations.

The FY 2003 total program spending actually represents a decrease of $54 million from what was originally planned for FY 2002. The FY 2002 program spending was reduced or postponed by over $100 million to offset the impact of the revenue shortfall.

**Major Program Spending**
**Top Ten Programs FY 2003**

| Program | FY 2002 Estimate | FY 2003 Plan | Change | % Change |
|---|---|---|---|---|
| Mail Transport Equip Service Ctrs. | $ 308 | $ 313 | $ 5 | 1.6 |
| Stamp Manufacturing | 140 | 138 | (2) | (1.4) |
| Mail Transportation Equipment | 145 | 120 | (25) | (17.2) |
| Corporate Advertising | 137 | 99 | (38) | (27.7) |
| Point-of-Service | 117 | 93 | (24) | (20.5) |
| Expedited Supplies | 110 | 86 | (24) | (21.8) |
| Corporate Contact Management | 90 | 82 | (8) | (8.9) |
| Delivery Confirmation | 75 | 80 | 5 | 6.7 |
| Debit/Credit Card Fees | 72 | 74 | 2 | 2.8 |
| Associate Office Infrastructure | 57 | 70 | 13 | 22.8 |
| | $ 1,251 | $ 1,155 | $ (96) | (7.7) |

*($ Millions)*

*Servicewide Expense*
Servicewide expenses are national-level expenses that cannot be isolated and charged to individual operating units and are outside local management control. These expenses are expected to increase by $287 million in FY 2003. This increase is largely driven by workers' compensation, annuitant health benefits and unemployment compensation.

In FY 2003, benefiting from continued low interest rates, interest expense on debt will be about $385 million, an increase of $22 million over FY 2002. In addition, the current portion of the interest expense on Civil Service Retirement System (CSRS) deferred retirement liabilities is expected to increase by $17 million and total $1.6 billion.

*Expense by Component*

To gain a different perspective on the FY 2003 Operating Plan, expense growth can be examined by component. Personnel expense, including annuitant and workers' compensation costs make up $1,572 million, or 73 percent, of the FY 2003 expense growth. Growth in salaries and benefits is driven by wage inflation and is not a result of growth in work hours which, in fact, are planned to be reduced in FY 2003. Health benefit inflation, which had been relatively stable through the end of FY 1999, rose by double digits (10 percent) again in FY 2002 and is forecasted to rise 14 percent in FY 2003. Health care inflation also contributes to the increase in workers' compensation expense that is expected to continue into FY 2003. Workers' compensation expense rose by over $500 million in FY 2002 and is expected to total approximately $1.6 billion in FY 2003, an increase of approximately 5 percent. The FY 2002 increase resulted from an 8.6 percent increase in the number of paid compensation claims along with an 8.5 percent increase in the average cost per medical claim.

**FY 2003 Expense by Component**

| | FY 2002 Estimate | FY 2003 Plan | Change | % Change |
|---|---|---|---|---|
| Personnel | $ 51,449 | $ 53,021 | $ 1,572 | 3.1 |
| Non-Personnel | 9,091 | 9,623 | 532 | 5.8 |
| Transportation | 5,190 | 5,197 | 7 | 0.1 |
| Interest | 1,958 | 1,997 | 39 | 2.0 |
| Total Expense | $ 67,688 | $ 69,838 | $ 2,150 | 3.2 |

*($ Millions)*

Non-personnel expense growth in FY 2003 is primarily driven by the investments in program initiatives to update and improve financial reporting and information technology capabilities. Other drivers include depreciation and anthrax costs not reimbursed by the federal government. Deploying capital investments that were committed in prior years will increase depreciation expense by $194 million, or 8.3 percent in FY 2003.

National network transportation, which accounts for over 60 percent of total transportation costs, was significantly impacted by the events of September 11th in FY 2002. Priority Mail was diverted from commercial air carriers due to government regulations restricting the carriage of certain types of mail by passenger airlines. This had a negative impact on transportation savings as supplemental private air carriers were used to transport displaced commercial air mail. Later in FY 2002, our agreements with FedEx were amended due to the continued inability to use commercial air transportation for the expedited package business. This action shifted a greater percentage of Priority volume to the FedEx network. Continuing efforts to reduce the cost of the transportation network, by shifting a greater percentage of transportation from air to ground and rationalizing the network, will reduce transportation costs to $3.2 billion which is nearly $60 million below FY 2002 levels. (See "Cost Reduction Programs" below.) Total transportation expenses will be held to nearly FY 2002 levels due to volume decreases in price-sensitive product lines, savings as a result of the FedEx contract, reductions in terminal dues and operational efficiency gains.

## Cost Reduction Programs

The FY 2003 budget includes $961 million in cost reductions that are detailed in the table at right. The benefits are spread across several operational pro-grams and productivity initiatives including Breakthrough Productivity (BPI). Operational program reductions total $192 million and are targeted entirely at the field. Roughly 40 percent of the program savings in FY 2003 will come from automated flat-sorting machines. Operational efficiencies include $673 million in cost reductions targeted at disseminating best practices throughout the field. Finally, actions will be taken to capture $33 million in reduced mail volume workload.

**FY 2003 Cost Reduction Overview**

| Activity | Savings | Total |
|---|---|---|
| **Capital Investments** | | |
| Advanced Flat Sorting Machine 100 | $ 80 | |
| SAFR - Shared Services / Accounting | 24 | |
| Automated Feeders & OCRS | 19 | |
| Bar Code Sorting | 23 | |
| Recognition Improvement | 12 | |
| Letter Recognition Enhancement | 11 | |
| AFCS Video Facing Modification | 11 | |
| Singulate, Scan, Induction | 10 | |
| Other | 10 | $ 192 |
| **Other** | | |
| Operational Efficiency Gains | $ 673 | |
| Transportation | 63 | 736 |
| **Total Cost Reductions** | | $ 928 |
| Reduced Mail Volume Workload | 33 | |
| **Total Savings** | | $ 961 |

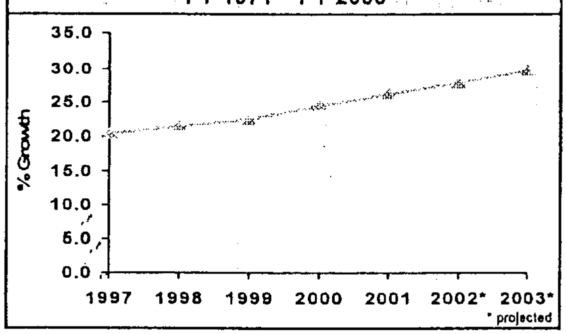
*($ Millions)*

## Productivity

Output Per Work Hour measures the change in the relationship between workload (mail volume and deliveries) and the labor resources used in producing those outputs. Total Factor Productivity (TFP) measures the change in relationship between outputs, or workload, and all resources used in producing those outputs. It is not uncommon for TFP growth to fluctuate from one year to another. During FY 2002, Output Per Work Hour is expected to grow 1.7 percent and TFP is projected to grow 0.6 percent. Projected TFP growth is equivalent to $420 million in expense reductions. FY 2002 marks the third consecutive year of positive TFP growth, with equivalent expense reductions totaling almost $3 billion over this time period. Productivity growth continues to be fueled by substantial restraint on resource usage. FY 2002 will mark the second year of positive TFP growth in the face of declining workload. In

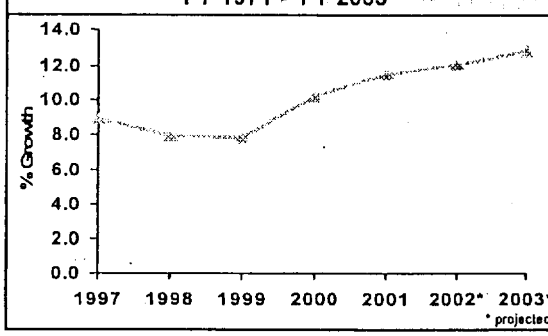
**Output Per Work Hour**

Cumulative Growth
FY 1971 – FY 2003




**Total Factor Productivity**

Cumulative Growth
FY 1971 - FY 2003




earlier years, strong TFP growth was fueled largely by absorbing workload growth. The charts above show the cumulative growth since Postal Reorganization in Output Per Work Hour and Total Factor Productivity for the years 1997 through 2003. Since 1971, Output Per Work Hour and TFP will have grown 29.9 percent and 12.8 percent, respectively.

The FY 2003 financial plan assumes a 1.9 percent increase in Output Per Work Hour and a 0.7 percent TFP growth rate. This is in spite of a small increase in workload (0.2 percent), which is entirely attributed to the expanding delivery network.

## NET INCOME

Total revenue is estimated to grow 5.9 percent, from $66.5 billion to $70.4 billion. Total expense will grow 3.2 percent, from $67.7 billion to $69.8 billion. Net income for FY 2003 is $600 million.

| FY 2003 Operating Budget | | | | |
|---|---|---|---|---|
| | FY 2002 Estimate | FY 2003 Plan | Change | % Change |
| Revenue | $ 66,538 | $70,438 | $3,900 | 5.9 |
| Expense | 67,688 | 69,838 | 2,150 | 3.2 |
| Net Income (Loss) | $ (1,150) | $ 600 | $ 1,750 | |

*($ Millions)*

***Net Income and the Rate Case***

The June 30, 2002 price changes referenced above were a result of the R2001-1 Rate Case approved for filing by the Board of Governors on September 10, 2001. The filing set rates to "breakeven" in the FY 2003 test year, which is the same year addressed in this Integrated Financial Plan. The table below compares the Operating Plan projections and the rate case test year projections produced eleven months ago. The rate case projections covered projected expenses, plus a 3 percent contingency provision and an allowance for the recovery of prior years' losses.

Since the development of the data used in the rate case, filed less than 11 months ago, projected revenue has decreased by $4.4 billion due to the impacts of the national economy, terrorist activities, and mailing industry conditions. This under-run in revenue is double the $2.2 billion provided in the rate case for contingencies. Expenses will be reduced to capture $2.2 billion not covered by the contingency provision. Thus, before the rate case test year has even started, the contingency provision will have been consumed.

Some have questioned the necessity of a rate case contingency provision as large as 3 percent. Recent experience as presented in this table suggests that those questions are not well founded and that a contingency provision is necessary to protect against unforeseen adversities.

| FY 2003 Operating Plan Versus Rate Case | | | |
|---|---|---|---|
| | FY 2003 Plan | Rate Case | Variance |
| Revenue | $ 70,438 | $74,800 | $ (4,362) |
| Expense | 69,838 | 72,000 | (2,162) |
| | $ 600 | $ 2,800 | |
| Contingency | - 0 - | 2,200 | $ 2,200 |
| Net Income | $ 600 | $ 600 | |

*($ Millions)*

# CAPITAL INVESTMENT PLAN

The FY 2001 and FY 2002 plans for capital commitments were significantly reduced to minimize cash outlays. This action was necessitated by the impact of the soft economy on postal revenue and the corresponding declines in cash from operations. Accordingly, the FY 2003 capital commitment plan reflects continued constraint on new capital commitments. The Fiscal Year 2003 capital commitment plan totals $2.5 billion. Capital investments will focus on funding projects that provide a positive return on investment, and address infrastructure necessities.

## FY 2003 CAPITAL COMMITMENTS

The FY 2003 capital commitment plan of $2.5 billion is driven by the strategic focus outlined in the Transformation Plan and those items that can be accommodated within affordability constraints. The capital investment plan supports improved efficiency through automation and mechanization projects that apply to distribution, processing, and delivery systems. Also included are projects that improve the quality of customer interactions. Investments in support equipment will be necessary to accomodate delivery network growth, to repair or replace aging assets, and to provide necessary information and communications technology networks. The current portfolio of capital investment opportunities is expected to produce an overall positive return on investment. As information, the Board of Governors previously approved approximately $335 million of the $2.5 billion commitments. According to their bylaws, the Board of Governors must approve the capital budget each year. This approval represents a general concurrence with the capital investment plan. In addition, following a rigorous and in-depth review by management, each capital investment greater than $10 million is presented to the Board of Governors for review.

**Capital Commitments FY 2003**

| | FY 2002 Estimate | FY 2003 Plan |
|---|---|---|
| Automation/ Mechanization | $ 854 | $ 938 |
| Facilities | 233 | 755 |
| Support Equipment | 247 | 431 |
| Retail Equipment | 12 | 210 |
| Vehicles | 127 | 191 |
| Total | $1,473 | $2,525 |

*($ Millions)*

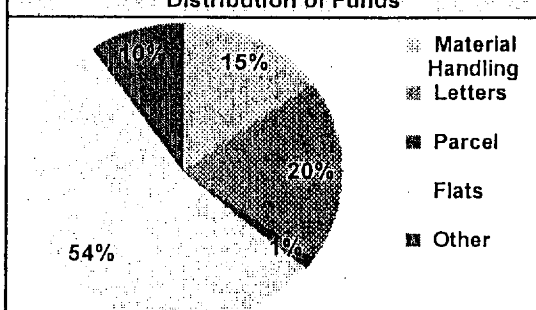
The capital plan major categories are summarized below.

### *Automation and Mechanization*

The FY 2003 capital commitment plan for automation/mechanization equipment is $938 million or 37 percent of the total plan, for programs that generate reduced operating costs. The chart at right reflects the percentage of funds in the plan for automation/mechanization equipment tied to handling equipment or mail types. Automated equipment not only saves work hours and associated indirect costs but also improves efficiency and service quality. Automation provides management with data-gathering capabilities that can be used in future information-based services. In the FY 2003 capital commitment plan, approximately 54 percent of the automation/mechanization equipment portion of the plan is dedicated to flats processing. For example, the Automated Handling System (AHS) is expected to yield savings by eliminating the manual removal, labeling and replacement of flat mail trays on the Automated Flat-Sorting Machine 100 (AFSM100). Other major automation

**Capital Commitments FY 2003**

**Automation and Mechanization Distribution of Funds**



projects directed towards the processing of flat-mail volume include the Flats Optical Character Reader, the Flats Identification Code Sort, and the Flats Feeder Enhancements program.

Letter mail processing equipment represents approximately 20 percent of the automation/mechanization category. The Delivery Bar Code Sorter Input/Output Sub-System (DIOSS) program, which replaces outmoded Multi-line Optical Character Reader Machines, includes benefits such as improved productivity and significant reductions in maintenance costs.

Low cost tray sorters are the primary piece of equipment in the Material Handling segment which represents roughly 15 percent of the automation/mechanization major investment category. Another segment, which is 10 percent of this category, is to support ongoing automation/mechanization programs, which include environmental and energy conservation projects. Finally, the package segment represents roughly 1 percent of the capital commitments for this category. This will involve deployment of the Automated Package Processing System (APPS) and the Bulk Mail Center Singulate, Scan, Induction Unit (SSIU) projects.

***Facilities***

In FY 2003, the planned commitments for facilities projects total $755 million. Consistent with the constraint on new commitments, rather than build new facilities, management will optimize the use of existing space whenever possible and avoid investing in more costly new construction. The customer service facility infrastructure must be maintained to support growth in delivery points.

In the last two years, facility-related investments were limited to those which addressed emergency, safety, and legal issues; modifications to ongoing construction; planning funds for a small number of major projects; and opportunities for revenue generation by selling assets or significant savings. In FY 2003, the criteria are expanded to address high growth areas, facility obsolescence, and necessary maintenance of our real property assets. Projects will be considered on a case-by-case basis. Pending project approval by the Board of Governors, funding is also included for the Philadelphia, Pennsylvania, Processing and Distribution major facility project.

The Postal Service is currently in the process of evaluating the overall network and the results of that evaluation are expected to impact the current infrastructure, including facilities. Therefore, plans beyond FY 2003 will assume the expanded criteria for facility-related investments.

***Support Equipment***

Capital commitments in the support equipment category total $431 million. These investments include communications equipment, network systems, and information technology needs as well as daily operating equipment such as scissor lifts, forklifts, and tow motors. The *PostalOne!* Phase Two implementation project is an example of a support equipment system-related investment. During this phase, full postage statement generation capabilities will be developed that will help protect revenue at acceptance and verification by flagging improperly prepared mail.

The Advanced Computing Environment (ACE) ongoing infrastructure replacement initiative is addressed in the plan and reflects the transition to a more centralized and controlled approach to information technology infrastructure. The General Ledger project is another support system-related investment. It is designed to replace the existing antiquated system, to provide the capacity for cash reporting and to modernize the accounting systems with best business practices.

***Retail***

In FY 2003, $210 million is earmarked for the final phase of Point-of-Service (POS) ONE. When fully deployed, POS ONE will capture detailed sales and customer information at all First-Class post offices. This, when integrated with the technology platform, will assist in reducing workload, integrate debit/credit card functionality, provide inventory management, enable automatic reordering, and provide post office box administration capability.

*Vehicles*
In FY 2003, the planned commitments for vehicles total $191 million. These funds include $163 million for the purchase of cargo vans, which are used for transporting mail between processing mail centers. The remaining funds are for commitments associated with carrier route vans, plus vehicle security and auxiliary equipment.

## FY 2003 CAPITAL CASH OUTLAY PLAN

The FY 2003 plan calls for approximately $2.0 billion in cash outlays. Approximately $1.2 billion of the planned outlays in FY 2003 relate to commitments made in prior years. The remaining $800 million planned cash outlays are attributed to new commitments to be made in FY 2003.

**Capital Cash Outlays FY 2003**

| | FY 2002 Estimate | FY 2003 Plan |
|---|---|---|
| **Automation/ Mechanization** | **$ 881** | **$ 682** |
| **Facilities** | **373** | **574** |
| **Support Equipment** | **244** | **279** |
| **Retail Equipment** | **54** | **204** |
| **Vehicles** | **125** | **244** |
| **Total** | **$1,677** | **$1,983** |

***($ Millions)***

## FINANCING PLAN

The Financing Plan is integrated across fiscal years with the Operating and Capital Plans. With numerous uncertainties facing the Postal Service, a multi-year strategic view of our financing needs is required, especially in light of the statutory limits on our debt. By statute, total debt outstanding cannot exceed $15 billion. In addition, annual increases are limited to $2 billion for capital purposes and $1 billion for operating purposes. The annual change in debt within a fiscal year is driven by the interaction of cash flow from operations, capital cash outlays, and changes in our cash balance. In recent years, cash outlays for capital have been greater than cash flow generated from operations and debt has increased. The FY 2003 plan projects the first reduction in debt since FY 1997.

*FY 2002 Borrowing*

Last August, when the FY 2002 Plan was formulated, management contemplated financing our capital outlays by reducing cash by $400 million and borrowing $1.6 billion. Since then, a number of influences both negative and positive have significantly altered our projected borrowing needs for the year. On the negative side, we had the economic recession coupled with multiple acts of terrorism. However, on the positive side we had offsetting developments that served to increase our cash flows. Positive influences included stringent expense control measures, the early implementation of rates, emergency appropriations, and reduced capital spending. On balance, these positive factors outweighed the negative influences. FY 2002 borrowing needs total approximately $700 million. (See table) Assuming a net loss of $1.2 billion, cash flow from operations will be approximately $600 million. This amount does not include the unspent portion of the emergency appropriations that will be properly set aside until used. The reduced outlays for capital are estimated at $1.7 billion and cash will be reduced by $400 million. Management remains committed to borrowing only amounts necessary to ensure liquidity.

**Financing Plan**

| | FY 2002 | FY 2003 |
|---|---|---|
| **Cash from Ops** | $ 0.6* | $ 2.8 |
| - **Capital Cash Outlays** | 1.7 | 2.0 |
| + **Cash Reduction** | 0.4* | 0.0 |
| = **Borrowing** | 0.7 | (0.8) |
| **Debt Outstanding** | $ 12.0 | $ 11.2 |

*($ Billions)*

**does not include undisbursed emergency appropriations*

*FY 2003 Debt Repayment*

For FY 2003, management projects that cash flow from operations will be $2.8 billion based mainly on net income and (non-cash) depreciation expenses. Capital cash outlays will increase modestly to $2 billion. There are some payments to be made early in the new fiscal year that were accrued in prior years. Additionally, the undisbursed portion of the emergency appropriations should remain part of reported cash balances until disbursed. These factors will prevent debt reduction in the early part of FY 2003. Nevertheless, FY 2003 remains a year whereby meaningful debt reduction of approximately $800 million should be accomplished. In conclusion, management will not seek a Board Resolution authorizing an increase in debt for FY 2003. However, a resolution authorizing management to substitute long-term debt for short-term debt as appropriate to manage liquidity, interest expense, and interest rate risk will be necessary.

On a cautionary note, the cash flow figures can be no more than approximate, since they are based on underlying assumptions and judgments regarding cash versus non-cash expenses and changes in working capital accounts. In addition, risks to the net income plan translate into risks to cash flow from operations that could lessen the amount of debt reduction.

## FINANCIAL SUMMARY

The chart below shows the critical elements of the financial condition for FY 2002 and FY 2003. The first four lines of this chart reflect the generation of cash from operations as outlined in the Operating Plan. Cash flow from operations will total $2.8 billion in FY 2003. The next line in the chart shows anticipated capital cash outlays. The difference between cash flow from operations and capital cash outlay, net of any planned changes to cash on hand, is the amount needed to borrow, or the amount available to repay debt. The remainder of this chart provides additional information on the Postal Service's financial condition. Debt represents the expected outstanding debt at the end of each fiscal year. The capital commitment plan reflects the estimated new capital commitments in each year. The equity amount -- the sum of contributions from the federal government and prior years' losses -- is shown in the last line of this chart.

Board Resolution 95-9, concerning restoration of equity and recovery of prior years' losses, established a policy of planning for net incomes that "equal or exceed the cumulative prior years' loss recovery target" set in the last omnibus rate proceeding. Due to accumulated impacts of earlier net incomes that exceeded annual targets, the Postal Service entered FY 2002 $1.1 billion ahead of the cumulative target. The projected net loss of $1.2 billion in FY 2002 combined with net income of $600 million in FY 2003 will leave the Postal Service nearly on target to achieve this goal.

| Financial Summary FY 2003 | FY 2002 Estimate | FY 2003 Plan |
|---|---|---|
| Net Income | (1.2) | 0.6 |
| Depreciation | 2.3 | 2.5 |
| Adjustments | 0.5 | (0.3) |
| Cash Flow From Operations[1] | 0.6 | 2.8 |
| Capital Cash Outlay | 1.7 | 2.0 |
| Cash Reduction[1] | 0.4 | (0.0) |
| Net Borrowing | 0.7 | (0.8) |
| Debt | 12.0 | 11.2 |
| Capital Commitment Plan | 2.4 | 2.5 |
| Equity | (3.5) | (2.9) |
| Prior Year Losses | (6.6) | (6.0) |

*($ Billions)* [1]Does not include undisbursed emergency appropriations

Because cost levels are expected to continue to rise in FY 2004 and considerable lead time is required to prepare and litigate rate filings, management will be briefing the Board of Governors on options for phasing in rate increases during Fiscal Years 2004 and 2005. These options will be consistent with plans discussed with representatives of the Postal Rate Commission and various stakeholders at the Ratemaking Summit sessions held in May and June of this year.

## RISKS

The FY 2003 Integrated Financial Plan is the product of an extensive development process, during which numerous scenarios were examined. Management has established a solid foundation for achieving the plan. Aggressive actions to manage expenses in response to the declining volume during FY 2002 have been successful. However, the $600 million net income in the FY 2003 represents less than a one percent margin over costs. Therefore, risk factors must be acknowledged.

*Revenue*

New rates were implemented in June 2002, impacting all domestic classes of mail and special services. Historically, mail volume growth has slowed after a rate increase. Other factors, such as a weak economic recovery and migration of mail toward lower-contribution categories could compound the normal post-rate slowdown in growth.

*Economic Risk*

The DRI*WEFA forecast assumes economic growth of 3.0 to 3.5 percent, annually, during the first two years of the new economic expansion and that corporate profits will grow 6 to 7 percent, on average. The DRI*WEFA forecast reflects an assumption that wealth effects from increases in the value of owner-occupied housing have offset the negative equity impacts from stock market declines. If, however, the stock market continues to tumble, consumer confidence may be shaken to the point where a reduction in consumer demand causes the economic recovery to stall. This presents significant dangers and risks to the Postal Service's economic environment for FY 2003.

The uncertain direction of the U.S. economy presents the greatest external risk to achieving the plan. The Commerce Department recently revised its estimates of Gross Domestic Product for 1999 – 2001, indicating that the economy was, in fact, in recession during the first three quarters of calendar year 2001. It also showed that economic growth in the two most recent complete quarters had been weaker than initially believed. Some economists are forecasting that the economy could suffer a "double-dip" recession, although this is a decidedly minority viewpoint. A more likely scenario is that economic growth will continue to be slow and uneven well into 2003. Corporate profits, which are a driver of advertising expenditures, may not materialize if productivities from cost savings cannot be maintained or if global deflation limits price increases. Also, the recent stock market slump, if prolonged, could erode wealth and restrain consumer spending, which in turn will restrain economic growth. Mail, particularly advertising mail, is particularly sensitive to economic conditions. Recovery in mail volume has historically tended to lag improvement in the economy by several months. It is therefore possible that the volume and revenue forecast, which we believed to be based on conservative economic assumptions only a few weeks ago, could be more challenging than we believed. Should the economy stall, significant negative impacts to postal finances will result.

*Inflation*

Inflation has generally been moderate in recent years, except for a spike in fuel costs in FY 2001. Fuel costs, of course, are subject to wide fluctuations due to world-wide political and economic events. Any significant upward movement in fuel costs will adversely affect our financial results. Most of our bargaining employees receive cost-of-living adjustments based on changes in the consumer price index. Since most economists are forecasting low levels of inflation for the foreseeable future, there is a relatively low risk that inflationary pressures will impact labor costs.

*Health Benefits Costs*

After several years of moderate increases, health care inflation returned with a vengeance in 2000. Since then, health benefits premium increases for the Postal Service have been about 11 percent each year. The plan for FY 2003 incorporates an expected increase of 14 percent. The actual will not be known until January 2003.

*Aggressive Work Hour Reductions*

The FY 2003 operating budget calls for a fourth consecutive year of work hour reductions. Since FY 1999, the Postal Service has eliminated over 105 million work hours. It is expected that work hours will be reduced by 30 million more in FY 2003. During this same time period, we have added over five million daily deliveries. Work hour reductions in FY 2003 rely primarily on process improvements, rather than capital investment programs. As the work hour mix becomes more heavily weighted toward deliveries, it becomes more challenging to realize efficiencies.

As always, the potential for the occurrence of unplanned events, such as natural disasters which could adversely impact the Postal Service's finances, must be acknowledged as a risk.

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**OCA/USPS-6.** During its negotiations with Capital One concerning the Negotiated Service Agreement (NSA), did the Postal Service consider proposing, or did it propose, block rates that provided the largest discount for the first volume increment and subsequently smaller discounts for each succeeding volume increment? If so, why was such a block rate structure rejected?

**RESPONSE:**

The discount structure discussed in this interrogatory was not considered during negotiations with Capital One.

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**OCA/USPS-7.** During its negotiations with Capital One concerning the Negotiated Service Agreement (NSA), did the Postal Service consider proposing, or did it propose, block rates that provided the same discount for the first volume increment and each succeeding volume increment? If so, why was such a block rate structure rejected?

**RESPONSE:**

The discount structure discussed in this interrogatory was not considered during negotiations with Capital One.

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**OCA/USPS-8.** Please refer to Attachment G of the Request, the Negotiated Service Agreement at Article II, paragraph C, where it states "Capital One agrees to update its databases within 2 business days and use the information in all future marketing campaigns."

(a) Please confirm that the "2 business days" is determined from the day Capital One downloads electronic Address Change Service (ACS) information from the National Customer Support Center (NCSC). If you do not confirm, please explain.

(b) Please confirm that Capital One has no affirmative obligation imposed upon it (by either the NSA or the proposed DMCS language) to download the electronic ACS information from the NCSC. If you do not confirm, please explain.

(c) Please explain why there is no affirmative obligation on Capital One (in either the NSA or the proposed DMCS language) to require it to download the electronic ACS information from the NCSC.

(d) Please explain why the databases to be updated within 2 business days by Capital One are not specified in the NSA.

**RESPONSE:**

a-b. Not confirmed to the extent that this question implies that Capital One determines the time at which the transmission of information will take place. Address changes are sent automatically, and no intervention on the part of Capital One is necessary to complete the exchange.

c. See the response to (a-b). Under the Agreement, Capital One must use the information in "all future marketing campaigns" and therefore must upload the NCSC data into its database(s) promptly.

d. There was no need to identify the specific databases used internally by Capital One. The Agreement requires Capital One to use the updated address information in "*all* future marketing campaigns." Attempting to name specific databases could have a limiting effect if the list of databases turned out not to be comprehensive, if databases were renamed in the future, or if new databases were created.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORIES OF OFFICE OF THE CONSUMER ADVOCATE

**OCA/USPS-9.** Please provide any data (on an annual or annualized basis) on:
(a) the number of postal delivery points involving a move or change of address;
(b) the number (or percentage) of such delivery points for which a change of address has been submitted either by the mail recipient or the carrier.

If precise figures are unavailable, then please provide ballpark estimates.

**RESPONSE:**

| FY 2002 Postal delivery points with COAs filed | | | |
|---|---|---|---|
| COAs Filed | permanent | temporary | % |
| **Mail Recipient Filed**<br>Forwardable | 21,109,120 | 583,888 | 87.16% |
| **Carrier Filed**<br>Moved Left No Address<br>Box Closed | 2,256,553<br>939,820 | | 12.84% |
| **Total delivery points** | 24,305,493 | 583,888 | |

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-10. OCA submitted interrogatory OCA/USPS-T2-16 to witness Plunkett on October 21, 2002. In that interrogatory OCA questioned witness Plunkett about the Postal Service's NSA agreements with international customers (a fact that he noted in USPS-T-2 at 1, l. 21). In his response to interrogatory 16 (filed October 31, 2002), witness Plunkett states that he has "not studied agreements with international customers" and does not indicate familiarity with such agreements. Please provide an institutional response to the questions posed in interrogatory 16 based upon consultation with officials who are knowledgeable about international mail agreements.

(a) Please confirm that the Postal Service has entered into "customer-specific pricing arrangements" with one or more international mail customers that accomplish one or more of the "three distinct goals" identified at page 1, l. 6-9, of USPS-T-2. Fully explain any negative answer.

(b) Please identify the number of "customer-specific pricing arrangements" concluded between the Postal Service and its international mail customers that accomplish one or more of the "three distinct goals" identified at page 1, lines 6-9, of USPS-T-2, by distinct goal. Fully explain any negative answer.

(c) Please identify the number of "customer-specific pricing arrangements" concluded between the Postal Service and its international mail customers that accomplish all "three distinct goals" identified at page 1, l. 6-9, of USPS-T-2. Fully explain any negative answer.

**RESPONSE:**

Please note that witness Plunkett's testimony draws no connection between the two statements cited in the question. The "three distinct goals" are discussed in the context of the "unique opportunities create[d]" by "Capital One's use of the mail." The international agreements are cited to support the statement that the concept of customer-specific agreements is not new.

(a) Confirmed.

(b) As of November 29, 2002, the Postal Service has concluded 155 "customer-specific-pricing arrangements" that accomplish at least one of the "three distinct goals."

(c) None. As noted above, the three distinct goals relate specifically to the Capital One NSA, including "to maintain and increase the use of First-Class Mail." First-Class Mail is a domestic, not an international, service.

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE OFFICE OF THE CONSUMER ADVOCATE,
REDIRECTED FROM WITNESS PLUNKETT

**OCA/USPS-T2-19.** Please refer to your response to OCA/USPS-T2-9(a), where it states that the agreement "was negotiated between both parties and therefore must be believed by each to benefit its own interests."

(a) Is it fair to conclude that any finalized Negotiated Service Agreement (NSA) between any mailer and the Postal Service is beneficial to the Postal Service?

(b) What incentives are there on the part of any Postal Service negotiator(s) to conclude an NSA that is in the financial interests of the Postal Service?

(c) If the NSA is conclusively beneficial to the Postal Service, what is the purpose of witness Crum's testimony?

**RESPONSE:**

The previous answer was not meant to imply that the successful negotiation of agreement terms for any NSA would, by itself, constitute economic justification for a rate or classification proposal embodied in the agreement. Rather, the answer merely pointed out that the agreement represents an acceptable balance of interests between the NSA partners that benefits both. That balance, furthermore, is founded on a determination by each partner that the NSA meets its financial objectives. For the Postal Service, such objectives include its statutory responsibilities to establish rates that reflect the policies of the Act.

This conclusion does not substitute for an overall evaluation of the financial merits of the NSA when it constitutes the basis for a rate and classification change, but it reinforces other reasoning supporting a favorable recommendation. In this regard, the answer also discusses the overall context in which the proposals should be assessed. That context involves the positive contributions that each element of the agreement makes, including increased

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY
OF THE OFFICE OF THE CONSUMER ADVOCATE,
REDIRECTED FROM WITNESS PLUNKETT

volume, lower costs, increased contribution, and its beneficial effect on the cost burdens of all mailers.

To the extent that this interrogatory was intended to inquire into the process by which the Postal Service negotiates and executes an NSA, and the expectations and beliefs that support an NSA that is presented to the Commission for review in the form of a request for classification changes, those considerations reinforce the overall conclusion. It is fair to state that by executing the NSA, and by obtaining the approval of senior management and the Board of Governors, the Postal Service believes the NSA will prove beneficial in light of the Postal Service's statutory responsibilities, which must be presumed to guide the decisions to adopt the NSA and pursue these proposals. Moreover, the act of seeking a favorable recommended decision from the Commission itself embodies a request for the Commission's concurrence that the NSA comports with the Postal Reorganization Act, and also implicitly that it is good for the Postal Service.

Admittedly, the foregoing assessment is not unqualified. Any determination that the NSA is "conclusively beneficial" to the Postal Service can only constitute an opinion at this time. We do not and can not currently know whether the volume, revenue and behavioral projections will come to pass. For that matter, the Commission has yet to complete the exercise of its statutory obligations, which adds another level of uncertainty to whether current expectations will ultimately mature into an *ex poste* conclusion that the NSA was good for the Postal Service.

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE, REDIRECTED FROM WITNESS CRUM

**OCA/USPS-T3-14**. Please refer to pages 1-2, "Background," of your prefiled testimony. Please explain the relationship, if any, between the NSA's provisions for address correction savings and the NSA's provisions for volume-related discounts. In your response, describe and quantify the rate relationship if any between the NSA's proposed volume discounts and postal cost savings associated with address correction changes.

**RESPONSE:**

There is no quantifiable rate relationship between the address element cost savings of the Capital One NSA and the volume discount element, as the question suggests. However, the linkage of the elements within the NSA makes good economic and business sense for the Postal Service, Capital One, and all mailers.

The current heightened interest in NSA's as a pricing approach arises from a business and economic environment in which the Postal Service faces unprecedented challenges to its ability to maintain levels of volume and revenue from all services for the benefit of all mailers. Particularized arrangements with customers are seen in many industries, not just the Postal Service, as one way to maintain and promote growth during the adverse economic conditions currently faced by all businesses, as well as by their customers.

In this respect, Capital One is, and has been, a high-volume First-Class Mail user that has shown both a willingness and ability to capitalize on the particular advantages of First-Class Mail service for its own business model. In fact, this past fiscal year, Capital One's mail volumes have increased beyond Postal Service expectations. This has occurred at a time when First-Class Mail volume -- as well as mail volume for almost all other classifications -- declined or was stagnant at best. In this context, the Postal Service regards the Capital One NSA as presenting a unique opportunity to

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE, REDIRECTED FROM WITNESS CRUM

**Response continued, page 2**

experiment with measures that could influence increased volume and contribution for the benefit of all mailers. Particularly, the Postal Service cannot take for granted that Capital One will continue to grow at previous rates, or even remain at its historically high volume levels. The Capital One NSA would create conditions favoring volume and revenue growth by meeting Capital One's relatively distinct needs as a user of First-Class Mail, while resulting in reduced costs and more efficient Postal Service operations.

With this as a backdrop, the Postal Service worked to develop an agreement with Capital One that encompassed more than the reduction of physical returns of undeliverable mail, and that created an incentive package encouraging Capital One both to continue its high level of mail usage, and to contribute additional mail volume growth. The proposed rate incentives evolved out of this effort. Perhaps the Postal Service could have proposed providing Capital One some type of fee incentive only for using electronic address correction service, in lieu of physical returns. However, it determined that it could accomplish more by constructing a proposal that would combine addressing and operational advantages to both Capital One and the Postal Service, with volume incentives linked to the successful implementation of the address correction element of the agreement.

The proposed Negotiated Service Agreement thus ties the address-related savings to volume incentives in a way that provides some insurance or offset to the risk that would be presented by the declining block approach to volume discounts, had it been offered independently. In this respect, while there is no quantifiable rate

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE, REDIRECTED FROM WITNESS CRUM

**Response continued, page 3**

relationship between the address correction element of the agreement and the volume discounts, the two are logically related as part of the overall strategy and benefits of the NSA. In other words, unbundling the arrangement into its component parts would eliminate the incentive to maintain or increase volume, and would potentially allow Capital One to use any financial benefits from the proposed NSA, as a result of improving Capital One's operations and business, to fund non-mail activities that might not make an additional contribution to Postal Service institutional costs.

As indicated in the testimony of witness Crum, the Postal Service evaluated the net contribution change from the proposed NSA in its entirety in determining whether to enter into the agreement. The address management terms, including those related to address correction, are intertwined with the declining block discounts in a number of ways and are only available if Capital One complies with the address management terms. For example, the company's use of ACS for its solicitation mail determines whether mail will be counted towards the threshold for the discounts, or if it will be eligible to receive an additional discount.

The Postal Service acknowledges that this agreement does not "fit" the standard worksharing/cost avoidance/discount mold that underlies the more familiar presortation, automation, and dropshipment discounts. However, this agreement does present a customer-responsive approach to postal ratemaking that provides a new opportunity to increase contribution to the institutional costs of the Postal Service. Ignoring these possibilities would limit the Postal Service's ability to be more responsive to its

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE, REDIRECTED FROM WITNESS CRUM

**Response continued, page 4**

customers' needs, and to develop opportunities that could help maintain the Postal Service's financial viability in a rapidly evolving market place.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

**OCA/USPS-T3-17**. Please refer to your response to NAA/USPS-T3-11, and Table 5.2.2 in USPS-LR-J-69 from Docket No. R2001-1.

(a) In the case of "ACS Keying," please describe the features of a mechanized terminal and a non-mechanized terminal.

**RESPONSE:**

The keying is the same for bother terminals. The mechanized terminal handles machinable letters and the non-mechanized terminal handles all other types of mail, such as flats, packages, and non-machinable letters.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE
REDIRECTED FROM WITNESS CRUM

**OCA/USPS-T3-28**. Please refer to your response to POIR No. 2, question 7. You "project[] Capitol One's annual solicitation volume over the number of domestic delivery points . . . ."

b. How many forwarding orders were in effect at any time during the fiscal years 2000, 2001, and 2002?

d. How many forwarding orders were in effect at any time during the fiscal years 2000, 2001, and 2002 for domestic *residential* delivery points?

**RESPONSE:**

| | | |
|---|---|---|
| b, | FY2000 | 43,348,777 |
| | FY2001 | 43,678,997 |
| | FY2002 | 43,486,837 |

| | | |
|---|---|---|
| d. | FY2000 | 35,743,129 |
| | FY2001 | 35,914,749 |
| | FY2002 | 37,806,230 |

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE, REDIRECTED FROM WITNESS WILSON

**OCA/USPS-T4-11**. Please refer to your response to OCA/USPS-T4-2 (c), where you state that in the absence of the Negotiated Service Agreement (NSA), the Postal Service would not offer Change Service Requested, Option 2, to Capital One at no charge. Given that offering Change Service Requested, Option 2, to Capital One at no charge reduces Postal Service costs by $13.1 million, please explain why offering electronic address change service at no charge in the absence of the agreement is not beneficial to the Postal Service. Please provide any relevant cost/benefit analysis that supports your response.

**RESPONSE**:

The prior response of witness Wilson to interrogatory OCA/USPS-T4-2(c) does not state or imply that waiving the address correction fee could not be beneficial. It was a simple statement that acknowledged the fee structure presently in place. However, the Postal Service recognizes that the current address correction fee structure for First-Class Mail will need to be re-evaluated in a context broader than this case.

While the Postal Service is actively engaged in re-evaluating address correction fees, it does not yet have the in-depth cost studies and analysis that would be necessary to support elimination of the fee for First-Class Mail electronic address correction service. Nor has the Postal Service yet been able to incorporate the concept of eliminating the fee into its long-term address management strategy. Eliminating the fee for all First-Class Mail has far more cost variables/inputs and policy implications (such as reducing the incentive to keep address lists accurate) than waiving the fee in the narrow context of the Capital One Negotiated Service Agreement. The Postal Service cannot state whether eliminating the fee would be "beneficial," before it has developed and examined the necessary data, solicited the appropriate input from industry stakeholders, and carefully considered the policy implications.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE
REDIRECTED FROM WITNESS WILSON

**OCA/USPS-T4-14**. Please refer to your response to OCA/USPS-T2-18(a). Please state whether a net savings/loss results to the Postal Service from the following types of handling of UAA First-Class machinable letter mailpieces that cannot be forwarded (and thus must be returned; assume a percentage figure for forwarding equal to the First-Class average):

(a) Change Service Requested, Option 2, offered at no charge to a First-Class mailer that *is currently* an ACS/**CSR** participant, and whose return volumes *exceed* the average percentage of First-Class returns. Please display all calculations and cite all sources to provide this answer.

i. Discuss specifically how the $15 cost for setting up ACS service with a participant (your response to interrogatory OCA/USPS-T4-9.d.) affects the Postal Service's net savings/loss position.

ii. Discuss specifically how the "85 percent" figure presented at page 7, line 4, of your testimony affects the Postal Service's net savings/loss position.

iii. Give a hypothetical example of such a participant, using specific assumed volume and percentage return figures for the hypothetical participant.

(b) Change Service Requested, Option 2, offered at no charge to a First-Class mailer that *is currently* an ACS/**CSR** participant, and whose return volumes are *equal to* the average percentage of First-Class returns. Please display all calculations and cite all sources to provide this answer.

i. Discuss specifically how the $15 cost for setting up ACS service with a participant (your response to interrogatory OCA/USPS-T4-9.d.) affects the Postal Service's net savings/loss position.

ii. Discuss specifically how the "85 percent" figure presented at page 7, line 4, of your testimony affects the Postal Service's net savings/loss position.

iii. Give a hypothetical example of such a participant, using specific assumed volume and percentage return figures for the hypothetical participant.

(c) Change Service Requested, Option 2, offered at no charge to a First-Class mailer that *is currently* an ACS/**CSR** participant, and whose return volumes *are below* the average percentage of First-Class returns. Please display all calculations and cite all sources to provide this answer.

i. Discuss specifically how the $15 cost for setting up ACS service with a participant (your response to interrogatory OCA/USPS-T4-9.d.) affects the Postal Service's net savings/loss position.

ii. Discuss specifically how the "85 percent" figure presented at page 7, line 4, of your testimony affects the Postal Service's net savings/loss position.

iii. Give a hypothetical example of such a participant, using specific assumed volume and percentage return figures for the hypothetical participant.

(d) Change Service Requested, Option 2, offered at no charge to a First-Class mailer that is *not* currently an ACS/**CSR** participant but subsequently could become such a participant, and whose return volumes *exceed* the average percentage of First-Class returns. Please display all calculations and cite all sources to provide this answer.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE
REDIRECTED FROM WITNESS WILSON

i. Discuss specifically how the $15 cost for setting up ACS service with a participant (your response to interrogatory OCA/USPS-T4-9.d.) affects the Postal Service's net savings/loss position.

ii. Discuss specifically how the "85 percent" figure presented at page 7, line 4, of your testimony affects the Postal Service's net savings/loss position.

iii. Give a hypothetical example of such a participant, using specific assumed volume and percentage return figures for the hypothetical participant.

(e) Change Service Requested, Option 2, offered at no charge to a First-Class mailer that is *not* currently an ACS/**CSR** participant but subsequently could become such a participant, and whose return volumes are *equal to* the average percentage of First-Class returns. Please display all calculations and cite all sources to provide this answer.

i. Discuss specifically how the $15 cost for setting up ACS service with a participant (your response to interrogatory OCA/USPS-T4-9.d.) affects the Postal Service's net savings/loss position.

ii. Discuss specifically how the "85 percent" figure presented at page 7, line 4, of your testimony affects the Postal Service's net savings/loss position.

iii. Give a hypothetical example of such a participant, using specific assumed volume and percentage return figures for the hypothetical participant.

(f) Change Service Requested, Option 2, offered at no charge to a First-Class mailer that is currently an ACS/**CSR** participant but subsequently could become such a participant, and whose return volumes *are below* the average percentage of First-Class returns. Please display all calculations and cite all sources to provide this answer.

i. Discuss specifically how the $15 cost for setting up ACS service with a participant (your response to interrogatory OCA/USPS-T4-9.d.) affects the Postal Service's net savings/loss position.

ii. Discuss specifically how the "85 percent" figure presented at page 7, line 4, of your testimony affects the Postal Service's net savings/loss position.

iii. Give a hypothetical example of such a participant, using specific assumed volume and percentage return figures for the hypothetical participant.

**RESPONSE:**

The attempt of this interrogatory to quantify the effect of eliminating the address correction service fee for pieces bearing the Change Service Requested (CSR) endorsement is not without merit. The question endeavors to isolate the impact of important variables such as a mailer's return rate and whether the mailer is a current or prospective participant. However, the net impact of eliminating the fee cannot be determined as the question suggests because of the unknown impact from additional

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE
REDIRECTED FROM WITNESS WILSON

key variables. In particular, the Postal Service does not know the effect on mailers' address hygiene practices of the hypothetical waiver of the fee. Therefore, a precise net contribution analysis is not possible, although the Postal Service will provide a qualitative analysis.

**Current ACS Participant**

For a current ACS participant, as posited in parts (a)-(c) of this interrogatory, the address correction fee creates an economic incentive for a mailer to update its address database so that it does not mail to the UAA address again, lest it be charged for a subsequent notice. If the fee is waived and, as a result, there is a degradation of the address hygiene practices, then the mailer's amount of UAA mail would increase, both in the amount of mail that is forwarded as well as in the amount of mail that is physically returned. This would raise the overall cost of handling the mailer's mail. For example, if the amount of UAA mail were to double, then the Postal Service would not only lose the current revenue from the address correction fees, it would also experience higher UAA costs from that mailer. Thus a net loss for the Postal Service would result.

The $15 cost to activate a participant and the 85 percent figure (i.e., that 85 percent of UAA mail would receive an electronic notice) mentioned in the interrogatory would have no effect on the analysis, for a current ACS participant. The Postal Service would have already incurred the activation cost before the fee waiver. The 85 percent figure is already part of a current ACS mailer's UAA costs. Thus, if the amount of UAA mail doubled, then the UAA costs would likely double as well.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE
REDIRECTED FROM WITNESS WILSON

**Prospective ACS Mailer**

For a prospective ACS mailer, as posited in interrogatory parts (d)-(f), the elimination of the address correction fee for CSR-endorsed mail may not only result in failure to update as described above, but may also drive mailer behavior away from more productive address management practices. ACS is one of the ways mailers can comply with the Move Update requirement for First-Class Mail automation letters. Other options for Move Update compliance include pre-mailing address hygiene through NCOA or FastForward processing, which often cost tens of thousands of dollars a year. By eliminating the fee for providing electronic notices for CSR-endorsed mail, a mailer may well have an incentive to shift from premailing to post mailing address hygiene, resulting in a sharp increase of UAA costs.

If the fee is eliminated and, as a result, a mailer stops processing its addresses through NCOA or FastForward, and instead opts for ACS, then the mailer's amount of move-related UAA mail would increase, both in the amount of mail that is forwarded as well as in the amount of mail that is physically returned because the forwarding order has expired. If the mailer then did not update its address database with the move-related and non-move-related address correction information, UAA costs would increase even further. Accordingly, if the fee were eliminated for a prospective ACS user and the amount of UAA mail triples, the Postal Service would experience substantially higher UAA costs from that mailer.

These higher UAA costs result even though the conversion to ACS would save UAA costs on the amount of return-to-sender UAA mail that existed before the fee elimination. See witness Crum's testimony, USPS-T-3 at 4-5. The much higher costs

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE
REDIRECTED FROM WITNESS WILSON

arise on the additional UAA volume caused by the deterioration of address hygiene practices. For the pieces that must be forwarded, the Postal Service incurs a cost of a cost of 30.5 cents per piece plus 6.6 cents per piece to send an electronic notice. Table 5.1.1 of USPS-LR-J-69/R2001-1 and Response to NAA/USPS-T3-11. For pieces that cannot be forwarded and would in the absence of ACS be returned-to-sender, the costs for such UAA mail identified by witness Crum in his testimony would apply. Id. The "85 percent figure" noted in the interrogatory is relevant here because 85 percent of the additional UAA volume would incur a cost of 33.2 cents per piece when an electronic notice is given, and the remaining 15 percent would incur a cost of 53.5 cents per piece. See T-3, Attachment A, p. 2. Thus, a net loss for the Postal Service would result.

The $15 cost for activating a prospective ACS would have little or no effect on the analysis. The $15 cost would be insignificant as compared to the higher UAA costs.

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE
REDIRECTED FROM WITNESS WILSON

**OCA/USPS-T4-19.** Please refer to your testimony at page 5, lines 2-4, where it refers to the "CFS processing center."

(a) How many CFS processing centers does the Postal Service operate?

(b) What types of postal employees (i.e., craft, full-time, part-time, temporary, etc.) staff the postal-operated CFS processing centers?

(c) How many CFS processing centers do contractors of the Postal Service operate?

(d) What types of employees (i.e., unionized or non-unionized, full-time, part-time, temporary, etc.) staff the contractor-operated CFS processing centers? see

(e) Please provide the locations of the CFS processing centers identified in parts (a) and (c) of this interrogatory.

(f) Please confirm that every carrier delivery unit sends its undeliverable-as addressed (UAA) CSR-endorsed First-Class Mail to a CFS processing center. If you do not confirm, please explain, and provide an estimate of the number of carrier delivery units that do not send UAA CSR-endorsed First-Class Mail to a CFS processing center and the number of delivery points affected. Also, please provide the reasons that UAA CSR-endorsed First-Class Mail may not be sent to a CFS processing center

(g) Please confirm that every carrier delivery unit sends its UAA ASR-endorsed First-Class Mail to a CFS processing center. If you do not confirm, please explain, and provide an estimate of the number of carrier delivery units that do not send UAA ASR-endorsed First-Class Mail to a CFS processing center and the number of delivery points affected. Also, please provide the reasons that UAA ASR-endorsed First-Class Mail may not be sent to a CFS processing center.

.) Please confirm that every carrier delivery unit sends its UAA First-Class Mail without any endorsement to a CFS processing center. If you do not confirm, please explain, and provide an estimate of the number of carrier delivery units that do not send UAA First-Class Mail without any endorsement to a CFS processing center and the number of delivery points affected. Also, please provide the reasons that UAA First-Class Mail without any endorsement may not be sent to a CFS processing center.

**RESPONSE:**

(a) There are 219 CFS centers.

(b) At the CFS centers, the craft employees can be full-time, part-time, casual or transitional employees. Each center has a supervisor and some also have a manager.

(c) – (d) There are no contractors operating the CFS centers.

(e) This information will be provided shortly.

(f) Confirmed. Every Delivery Destination Unit with a carrier delivery unit sends its ACS/CSR endorsed mail to a CFS center. If the DDU does not have a carrier delivery

RESPONSE OF UNITED STATES POSTAL SERVICE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE
REDIRECTED FROM WITNESS WILSON

unit, then it does not send its mail to the CFS center. Also, see response to OCA/USPS-T4-17(e).

(g) Confirmed in part. The only UAA mail with the ASR endorsement that a carrier delivery unit sends to a CFS center is move-related mail. All carrier delivery units send such mail to CFS center. The non-move related mail is placed back in the mail stream. If a destination delivery unit does not have a carrier delivery unit, then ASR endorsed UAA mail is not sent to the CFS center. Also, see response to OCA/USPS-T4-17(e).

(h) Confirmed in part. For mail without an endorsement, only move-related mail is sent to the CFS center. Otherwise the UAA mail is marked with the reason for non-delivery and placed back in the mail stream to be returned to sender. See USPS-T4, at pp. 1-2.

**RESPONSE OF UNITED STATES POSTAL SERVICE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 4**

1. During the December 4, 2002 cross-examination of Postal Service witness Bizzotto, Vice Chairman Covington raised a question regarding what recourse a potential Negotiated Service Agreement candidate has if the candidate is unable to successfully negotiate a Negotiated Service Agreement with the Postal Service, or otherwise feels that it was treated unfairly. Tr. 3/518. Witness Bizzotto stated that she had not contemplated the issue before, but that there is a "fairly well-established process for customers who feel that there is an issue with how they've been treated by the Postal Service." Id. Please provide the following information on how the Postal Service intends to resolve a customer grievance related to a Negotiated Service Agreement.

(a) Describe the existing processes that the Postal Service utilizes to provide review to "customers who feel that there is an issue with how they've been treated by the Postal Service." Include a description of all mechanisms available to a customer to appeal a previous decision of the Postal Service in any stage of these processes.

(b) Describe what processes, if any, will be available to accommodate a grievance related to a Negotiated Service Agreement. Please consider whether the same process would be available to (a) a mailer that is denied a Negotiated Service Agreement by the Postal Service, and (b) the competitor of a mailer that has a Negotiated Service Agreement with the Postal Service.

(c) Compare the role played by the Postal Service's Law Department in negotiating a Negotiated Service Agreement, to the role played by the Postal Service's Law Department in resolving a grievance related to a Negotiated Service Agreement using the Postal Service's internal adjudication process.

(d) Describe the Postal Service's position on the availability of judicial review of the Postal Service's final decision regarding a Negotiated Service Agreement grievance. Comment on any claim of immunity provided by § 410(a). Include references to any supporting case law, if applicable.

(e) During the cross-examination of Witness Bizzotto, the possibility was raised that a Complaint may be filed with the Commission to resolve a Negotiated Service Agreement grievance. Tr. 3/528-29. Describe the Postal Service's position on the role that the Commission should have in resolving Negotiated Service Agreement grievances, and what action will be required of the Postal Service in response to a decision of the Commission.

**RESPONSE OF UNITED STATES POSTAL SERVICE TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 4**

**RESPONSE:**

(a) Domestic Mail Manual section G020.3.0 sets forth the current process for appeals of classification decisions.

(b) The process for determining whether to develop an NSA with a particular customer can be compared to the general process of developing changes in rates, fees, and classifications. Suggestions regarding such changes may be received from mailers at any time, and the Postal Service discusses its own potential proposals with mailers on a continuing basis. Of course, not all of these ideas end up being proposed. Similarly, not all potential NSAs will come to fruition.

Whenever a request for changes is filed, parties who believe the classifications or rates should be defined differently raise those issues during the litigation. If the Postal Service chooses not to propose a particular change, a mailer who believes that situation results in its paying rates that are not consistent with the statute may file a complaint with the Commission.

Similarly, as witness Bizzotto indicated during her appearance, if the existence of an NSA with mailer A leads mailer B, who was not successful in negotiating a NSA, to believe that the rates it is paying are not lawful, that mailer has the right to file a complaint with the Commission under section 3662. See Tr. 3/528. Undoubtedly, if there were a mailer or mailers who felt they could qualify for the terms of the NSA currently before the Commission, but had been unsuccessful in negotiating an NSA with the Postal Service, the Commission would have heard from those parties in the current docket.

The DMM process for review of decisions applying existing classifications is not viewed as applicable to decisions on whether or not to file an NSA proposal, just as it is not applicable to decisions on whether or not to file any other rate, fee, or classification proposal.

The process for Capital One to appeal decisions regarding implementation of its NSA is set forth in the paragraph IV.B. of the NSA.

**RESPONSE OF UNITED STATES POSTAL SERVICE TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 4**

(c) The Law Department is available to advise its clients in the development of all rate, fee, and classification proposals, including NSAs. The Law Department represents the Postal Service in all litigation before the Commission, including defending rate complaints. The Law Department also may provide advice to its clients regarding review of classification decisions. As noted above, that process is not viewed as applicable to potential NSAs. The Law Department would also be available to advise its clients regarding appeals under the NSA with Capital One.

(d) This question is not applicable, since that process is not viewed as applicable to NSAs.

(e) As noted above, the Postal Service believes that the section 3662 complaint process is available to parties who believe the existence of an NSA to which they are not a party results in their paying rates they believe to be unlawful.

RESPONSE OF UNITED STATES POSTAL SERVICE TO ORAL REQUEST OF CHAIRMAN OMAS AT TR. 2/342

**REQUEST:** At this point in the transcript, Chairman Omas asked Postal Service counsel if a response could be prepared to APWU's counsel's question about comparing the cost components of mail that is forwarded to mail that is returned to sender as presented in witness Crum's testimony and USPS/LR-J-69. The response was also to include the operational explanation of the cost components of forwarding and return costs. Tr. 2/342.

**RESPONSE:**

Attached is a spreadsheet comparing the major cost items identical to both forwarded and returned pieces. The data is taken directly from USPS/LR-J-69, but has been adjusted to match the information in witness Crum's LR-1 which excludes Postage Due and Accountable mail. Most simply, the 23 cent cost difference between forwarding and returns is comprised of the additional mail stream processing, clerk handling, and carrier preparation costs of returns, offset partially by the higher CFS processing costs for forwards.

Regarding the mail stream processing, another issue was raised during the hearings questioning the source of that data in USPS/LR-J-69 and witness Crum's testimony. Tr. 3/633-634. The footnote in Table 5.2.4.1 of USPS/LR-J-69 lists the source of the costs as FY 98 IOCS (In-Office Cost System) tallies. This led to a question regarding the processing that existed in 1998. However, the footnote is incorrect. The source of the cost data is FY 2000 IOCS tallies and the unit cost numbers come directly from those dollar-weighted tallies divided by the volumes in FY 2000. This means that the referenced return costs as presented in USPS/LR-J-69 and witness Crum's testimony are based on the operational reality as it existed during fiscal year 2000 and, therefore, reflect the mix of manual and automation processing of UAA mail. Witness Wilson described the types of manual and automated processing that existed in 2000. See Tr. 3/605-607.

RESPONSE OF UNITED STATES POSTAL SERVICE TO ORAL REQUEST
OF CHAIRMAN OMAS AT TR. 2/342

The detailed operational explanation of return and forwarding costs follows:

**Forwarding**

The process begins when a customer submits a COA (change of address) form to the Postal Service through the mail, in person, or through the Internet. The new COA form is sent to the carrier at the facility that serves the old address. After recording this information, the carrier sends the COA form onto the CFS (Computerized Forwarding System) site serving that delivery unit. The CFS clerk engages in activities such as validating the old and new address against the AMS (Address Management System) directory and submitting an update to the NCOA (National Change of Address) database. After this, the COA card is returned to the delivery unit where it remains as long as necessary before destruction.

Generally UAA mail (forwards and returns) makes it all the way to the carrier responsible for delivery to the address on the mail piece before being determined to be UAA. While sorting mail into a delivery case, the carrier sets aside mail pieces that are not to be delivered. While on the route, the carrier may find additional pieces as he/she attempts to deliver mail from pre-sequenced bundles such as those from DPS (delivery point sequencing). Regardless of the means of catching the UAA piece, the carrier deposits it at a designated location (throwback case) within the delivery unit for further processing. Mail for which there is a valid forwarding order is usually sent to the CFS unit serving that address. A clerk consolidates the various pieces to be forwarded and prepares them for delivery to the CFS site.

The primary responsibility of the CFS unit is to handle forwarded mail. For each piece of UAA mail that has been sent to the CFS unit by a letter carrier, the terminal

RESPONSE OF UNITED STATES POSTAL SERVICE TO ORAL REQUEST
OF CHAIRMAN OMAS AT TR. 2/342

operator keys data from the address, class, and endorsement on the mail piece. The terminal operator interacts with the COA database, retrieves the new address, and generates a yellow forwarding label. The letters version of this terminal automatically applies the label to the mail piece. The flats and parcels version of the terminal presents the adhesive label in a window. The CFS unit sends the pieces with yellow forwarding labels to the nearest P&DC (Processing and Distribution Center). Mail carrying yellow forwarding labels can often be processed on the Postal Service's sortation equipment as the labels can contain POSTNET barcodes and machine-readable text. An additional activity adding costs to the system is "chain forwards". Some customers move frequently creating a continuing series of yellow forwarding labels that are themselves caught by downstream carriers and sent back to CFS sites to receive new forwarding labels. Chain forwards add many additional processing steps.

**Returns**

As discussed above, mail to be processed as returned to sender is generally caught by the carrier either in the office or while delivering on the route. Return-to-sender pieces are handled at the delivery unit. Delivery unit employees separate the mail by one of 22 reasons for nondelivery and may bundle and endorse the pieces. Once the pieces are identified and endorsed, they need to be "marked up" by the method used in that area. Usually either a label or a hand stamp is used to apply the "Return to Sender" mark along with a reason, or a list of reasons. Delivery units then send their consolidated return-to-sender pieces to the P&DC that handles their mail. If it has not already been applied, "Return to Sender" and one of many possible endorsements (such as no such number, no such street, attempted – not known,

RESPONSE OF UNITED STATES POSTAL SERVICE TO ORAL REQUEST OF CHAIRMAN OMAS AT TR. 2/342

insufficient address, etc.) are placed on the face of the mail piece. This can be done either manually or it may be applied during automated processing on the AFCS (Advanced Facer/Canceler System) or DBCS/OSS (Delivery Bar Code Sorter – Output Subsystem). The return-to-sender mail is often then run through a LMLM (Letter Mail Labeling Machine) which puts a blank label over any postal barcode that may be present.

It can be difficult to process return-to-sender mail via automation for many reasons. For example, the return of address may be on the back of the piece or various graphics or types of mail piece design make application of a new address barcode very difficult. Also, when the POSTNET barcode for the original delivery address is contained in the address block, the Postal Service cannot use the LMLM to cover the POSTNET. In that case, the Postal Service may use a grease pencil to manually block out the original POSTNET. This is not particularly effective since part of the delivery address may be blocked, the original POSTNET code may still be visible or there may still be a duplicate POSTNET imprinted on the piece that needs to be run on the LMLM. Moreover, if the piece has a florescent ID tag on the back, the original delivery address is stored in the Postal Service's data systems. If the equipment processing return to sender mail cannot detect a barcode on the front of the piece, it will process the piece according to the ID tag and may send the piece back to the original delivery address. Thus returns are frequently handled manually throughout the system and, if so, the processing costs are very high.

Based on the available information, it is the Postal Service's best estimate that in FY2002 slightly less than half of return to sender pieces received a verified POSTNET

RESPONSE OF UNITED STATES POSTAL SERVICE TO ORAL REQUEST
OF CHAIRMAN OMAS AT TR. 2/342

barcode and were possibly processed on automation. While plants are generally focused on the standard processing of mail, some institute special procedures which attempt to get return-to-sender pieces into the automation mail stream. OCRs (Optical Character Readers) may be used to look for the return address and attempt to apply a new barcode. More often, when the OCR has trouble locating or reading the return address, it sends the mail piece image to a REC (Remote Encoding) site where a manual keyer attempts to extract the necessary data. Those mail pieces whose images went to the REC site are loaded into a DBCS/OSS which is configured to match the mail pieces with information coming from the REC to apply a new barcode. Returning mail can be a very extensive process. Compared to correctly addressed mail, return-to-sender mail pieces often get at least three to four extra handlings.

Attachment to Oral Request of Chairman Omas at Tr. 2/342

| | **Forwarded Mail** | | | **Returned Mail** | | | |
|---|---|---|---|---|---|---|---|
| | Cost | % | Total | Cost | % | Total | Difference |
| Carrier Preparation | $ 0.0314 | 100.0% | $ 0.0314 | $ 0.0545 | 100% | $ 0.0545 | $ 0.023 |
| Clerk Handling | $ 0.2711 | 9.2% | $ 0.0250 | $ 0.2711 | 49% | $ 0.1328 | $ 0.108 |
| CFS Processing | $ 0.1386 | 90.8% | $ 0.1258 | $ 0.1386 | 35% | $ 0.0485 | $ (0.077) |
| Mailstream Processing | $ 0.1223 | 100.0% | $ 0.1223 | $ 0.2995 | 100% | $ 0.2995 | $ 0.177 |
| Sum | | | **$ 0.305** | | | **$ 0.535** | **$ 0.231** |

RESPONSE OF UNITED STATES POSTAL SERVICE TO ORAL REQUEST OF COMMISSIONER GOLDWAY AT TR. 2/396–97
(page 1)

**REQUEST:** At this point in the transcript, Commission Goldway referred to an earlier discussion (Tr. 2/392-94) of the Postal Service's response to APWU/USPS-2, and requested that, in lieu of the assumed annual 5 percent rate of change in Capital One's First-Class volume used in that response, a similar additional analysis be provided focused instead on assumed 10 and 15 percent annual rates of change in volume.

**RESPONSE:**

The additional analysis making the requested adjustments to the analysis presented in response to APWU/USPS-2 is attached. It shows that, even under scenarios in which volume is assumed to change at annual rates of 10 and 15 percent, the Postal Service would be expected to receive cumulative net benefits over the full three years of the agreement under every scenario. In that sense, the attached analysis is consistent with that provided in response to APWU/USPS-2, which likewise indicated positive financial results under each scenario.

Before describing the analysis, however, it is necessary to explain why the Postal Service believes the annual volume changes (particularly volume increases) of the 10 to 15 percent range it assumes are far less likely than the 5 percent annual changes assumed in the earlier analysis. As Dr. Elliott testified (COF-T-2 at 4), Capital One has announced a corporate strategy involving a reduced level of asset and account growth relative to the growth of the last two years. These announcements, moreover, are not statements made by the company specifically to justify the terms of the proposed agreement, but are much broader statements made in widely-circulated financial statements to which close attention is paid by both potential investors and government regulators. Dr. Elliott testified that the level of solicitation mailing implicit in the volume projections utilized in this case is consistent with the announced corporate strategy. On the other hand, the level of solicitation mailing implicit in assumed annual volume

RESPONSE OF UNITED STATES POSTAL SERVICE TO ORAL REQUEST
OF COMMISSIONER GOLDWAY AT TR. 2/396–97
(page 2)

growth rates of 10 and 15 percent could possibly raise questions regarding the company's adherence to its the corporate strategy announced in its securities filings. Given the current environment, expectation of such growth rates would not appear realistic. Moving into the future, while growth rates of that magnitude cannot be categorically excluded, they simply are far less likely than the more modest volume changes assumed in the earlier analysis.

Nevertheless, the requested analysis focusing on 10 and 15 percent annual volume changes is attached. Attachment One shows results assuming an annual volume change of 10 percent, and Attachment Two shows results assuming 15 percent. Each of these closely parallels the earlier analysis, in that each starts with new assumed volumes, and then shows the implications of those volumes on increased contribution from new mail volume, ACS return cost savings, and discount leakage. There is, however, one additional display in the new analysis. In the earlier analysis provided in response to APWU/USPS-2, the financial impact in each year under each scenario was positive, so that it was manifestly evident that the cumulative impact across all three years was likewise positive. With larger assumed before-rate volume growth, however, the financial impact in the last year of the agreement can become negative, and it is therefore necessary to aggregate the figures for all three years of the agreement before reaching a conclusion regarding the ultimate financial impact under each hypothetical scenario. That result is shown in an additional display labeled

RESPONSE OF UNITED STATES POSTAL SERVICE TO ORAL REQUEST
OF COMMISSIONER GOLDWAY AT TR. 2/396–97
(page 3)

"3-Year Cumulative Financial Impact," which adds the derived figures for Years 2 and 3 under each scenario with witness Crum's estimate of the financial benefit of $8.205 million in the Test Year.

Beyond that, the only other wrinkle is that, with the large assumed volume changes, it is necessary to refine the ACS return cost savings calculations. As noted in the response to APWU/USPS-2, those calculations are sensitive to the composition of the before-rates volume between customer mail and solicitation mail, because of the different return rates applicable to those two types of mail. In the earlier response, it was noted that the calculation included for ACS return cost saving was conditioned upon an assumed even spread of new volume between customer and solicitation mail, and that, if the new volume were concentrated in solicitation mail, the cost savings results would be higher. Under the requested assumptions, it is now no longer reasonable to postulate that, for example, a 30 percent volume increase or decrease could realistically be expected to be spread evenly between customer and solicitation mail.

To address this concern, a supplemental analysis has been conducted, which is presented in Attachment Three. This analysis assumes that the new volume is distributed between customer and solicitation volume in the same proportions as shown in Dr. Elliott's Exhibit 7. In that Exhibit, of the total of 53.12 million projected pieces of new volume, Dr. Elliott calculated that 51.2 million pieces, or 96.4 percent, would be solicitation mail, and only 1.92 million pieces, or 3.6 percent, would be customer mail. For each new volume scenario, these proportions have been applied to the new volume

RESPONSE OF UNITED STATES POSTAL SERVICE TO ORAL REQUEST
OF COMMISSIONER GOLDWAY AT TR. 2/396–97
(page 4)

(calculated as the difference between the assumed volume and 1.408 billion pieces used as the Test Year before-rates figure) to break out the new volume into customer and solicitation mail. As shown on Attachment Three, the customer mail projections thusly derived range from a high of 656 million pieces to a low of 625 million pieces, while the solicitation mail ranges from a high of 1194 million pieces to a low of 361 million pieces.

To calculate the applicable cost difference figure to use in the ACS return cost savings calculation for each scenario, the customer and solicitation before-rates volume figures for that scenario were substituted in witness Crum's Attachment A, page 2 spreadsheet for the customer volume (640 million) and solicitation volume (768 million) figures that he used. His spreadsheet, as modified, then produces different "current" and "after-rates" unit cost estimates, and the difference between those two figures has been recorded in Attachment Three in the column labeled "Cost Dif." Compared with witness Crum's original cost difference figure of .93 cents, the new figures range from .62 cents to 1.09 cents. As expected, the higher cost savings figures relate to the higher volume scenarios, in which the increased proportion of solicitation raises the potential for return cost savings. The cost difference figures in Attachment 3 are then plugged into the ACS Cost Savings calculations shown in Attachments One and Two.

Attachment One shows the results for the scenarios in which Year 2 volumes go up or down 10 percent, and Year 3 volumes go up or down 20 percent. In Year 2, the net impact is positive regardless of the direction in which volumes move, but in Year 3, the 20 percent increase in volume yields a negative impact. Across all three years of

RESPONSE OF UNITED STATES POSTAL SERVICE TO ORAL REQUEST
OF COMMISSIONER GOLDWAY AT TR. 2/396–97
(page 5)

the agreement under the volume-increase scenario, however, the cumulative impact is still a positive $9.5 million. The positive gains from the Test Year and Year 2 more than offset the potential loss in Year 3. In comparison, the cumulative impact of the volume-decline scenario is a positive $28 million, reflecting expected gains across all three years of the agreement.

Attachment Two shows the results for the scenarios in which Year 2 volumes go up or down 15 percent, and Year 3 volumes go up or down 30 percent. The pattern of effects is the same as in Attachment One. Year 2 uniformly shows a positive impact, while Year 3 is negative under the volume-growth scenario. Cumulatively, however, both scenarios show a positive impact across all three years, with a gain of $0.7 million if volumes go up by the hypothesized amount, and a gain of $23.9 million if volumes similarly go down.

To summarize, the Postal Service believes that volume swings of the magnitudes assumed for purposes of this response are far less likely than the more modest changes assumed for purposes of the response to APWU/USPS-2. Volume swings of any magnitude, of course, can be either positive or negative. While information about the credit card market in general and Capital One in particular is available and may be useful, the Postal Service has no basis to make a specific prediction of what Capital One's exact First-Class Mail volumes might be in the last two years of the agreement. The analysis provided in response to APWU/USPS-2, however, showed that, within a range of relatively plausible scenarios, the Postal Service still stood to benefit in each year of the agreement. This analysis shows that, even with more extreme (and hence,

RESPONSE OF UNITED STATES POSTAL SERVICE TO ORAL REQUEST OF COMMISSIONER GOLDWAY AT TR. 2/396–97
(page 6)

substantially less likely) assumptions regarding volume swings, the Postal Service stands to benefit in every year if the direction of the volume swing is negative, and still stands to benefit overall if the direction of the volume swing is positive.

**ATTACHMENT ONE**
Q. Tr. 2/396-97

**BASELINE TEST YEAR**, 2ND YEAR VOLUME PLUS/MINUS 10%, 3RD YEAR PLUS/MINUS 20%

VOLUMES

| | |
|---|---|
| TYBR | 1,408,000 |
| TYAR | 1,423,459 |
| Y2BR+ | 1548800 |
| Y2BR- | 1267200 |
| Y2AR+ | 1565805 |
| Y2AR- | 1281113 |
| Y3BR+ | 1689600 |
| Y3BR- | 1126400 |
| Y3AR+ | 1708151 |
| Y3AR- | 1138767 |

INCREASED CONTRIBUTION FROM NEW MAIL VOLUME

Incr.Cont. =( Unit Rev ($.2910) - Unit Cost - Discount) *New Volume

| | | | |
|---|---|---|---|
| TYUC | 0.1266 | | |
| Y2UC | 0.1266 | Y3UC | 0.1266 |

| | Y2 | Y3 |
|---|---|---|
| V+ | 1860.336 | 1936.704 |
| V- | 1839.355 | 0 |

ACS RETURN COST SAVINGS

Savings = Cost Difference * Before-Rates Vol

TY Cost Difference = $.1359-$.1266 = 0.0093

| | | | |
|---|---|---|---|
| Y2CD+ | 0.0099 | Y3CD+ | 0.0105 |
| Y2CD- | 0.0085 | Y3CD- | 0.0075 |

| | Y2 | Y3 |
|---|---|---|
| V+ | 15333.12 | 17740.8 |
| V- | 10771.2 | 8448 |

DISCOUNT LEAKAGE

Leakage = Before-Rates Vol * Applicable Discounts

| | Y2 | Y3 |
|---|---|---|
| V+ | 13684 | 21876 |
| V- | 1266 | 0 |

SUMMARY FINANCIAL IMPACT ($000)

Total = Incr. Cont. + Cost Savings - Leakage

| | Y2 | Y3 |
|---|---|---|
| V+ | 3509.456 | -2198.5 |
| V- | 11344.56 | 8448 |

3-YEAR CUMULATIVE FINANCIAL IMPACT ($000)

| | |
|---|---|
| V+ | 9515.96 |
| V- | 27997.56 |

**ATTACHMENT TWO**
Q. Tr. 2/396-97

**BASELINE TEST YEAR**, 2ND YEAR VOLUME PLUS/MINUS 15%, 3RD YEAR PLUS/MINUS 30%

VOLUMES

| | |
|---|---|
| TYBR | 1,408,000 |
| TYAR | 1,423,459 |
| Y2BR+ | 1619200 |
| Y2BR- | 1196800 |
| Y2AR+ | 1636978 |
| Y2AR- | 1209940 |
| Y3BR+ | 1830400 |
| Y3BR- | 985600 |
| Y3AR+ | 1850497 |
| Y3AR- | 996421.3 |

INCREASED CONTRIBUTION FROM NEW MAIL VOLUME

Incr.Cont. =( Unit Rev ($.2910) - Unit Cost - Discount) *New Volume

| | | | |
|---|---|---|---|
| TYUC | 0.1266 | | |
| Y2UC | 0.1266 | Y3UC | 0.1266 |

| | Y2 | Y3 |
|---|---|---|
| V+ | 1856.008 | 2098.095 |
| V- | 0 | 0 |

ACS RETURN COST SAVINGS

Savings = Cost Difference * Before-Rates Vol

TY Cost Difference = $.1359-$.1266 = 0.0093

| | | | |
|---|---|---|---|
| Y2CD+ | 0.0102 | Y3CD+ | 0.0109 |
| Y2CD- | 0.008 | Y3CD- | 0.0062 |

| | Y2 | Y3 |
|---|---|---|
| V+ | 16515.84 | 19951.36 |
| V- | 9574.4 | 6110.72 |

DISCOUNT LEAKAGE

Leakage = Before-Rates Vol * Applicable Discounts

| | Y2 | Y3 |
|---|---|---|
| V+ | 17652 | 30324 |
| V- | 0 | 0 |

SUMMARY FINANCIAL IMPACT ($000)

Total = Incr. Cont. + Cost Savings - Leakage

| | Y2 | Y3 |
|---|---|---|
| V+ | 719.8475 | -8274.54 |
| V- | 9574.4 | 6110.72 |

3-YEAR CUMULATIVE FINANCIAL IMPACT ($000)

| | |
|---|---|
| V+ | 650.303 |
| V- | 23890.12 |

**Attachment 3**
Q. Tr. 2/396-97

## COST DIFFERENCES AT NEW VOLUME LEVELS USED TO CALCULATE ACS RETURN COST SAVINGS

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 0.963855 **(Note 1)** | | | 768000 | | 640000 | | | |
| 0.036145 **(Note 2)** | TYBR | 1408000 | | | | | | |
| | TYAR | 1423459 | Solicitation **(Note 3)** | | Customer **(Note 4)** | | Cost Dif. **(Note 5)** | |
| 15% / 30% | Y2BR+ | 1619200 | 203566.3 | 971566.3 | 7633.735 | 647633.7 | 0.0102 | |
| | Y2BR- | 1196800 | 203566.3 | 564433.7 | 7633.735 | 632366.3 | 0.008 | |
| | Y2AR+ | 1636978 | 220701.5 | 988701.5 | 8276.308 | 648276.3 | | |
| | Y2AR- | 1209940 | 190901.1 | 577098.9 | 7158.79 | 632841.2 | | |
| | Y3BR+ | 1830400 | 407132.5 | 1175133 | 15267.47 | 655267.5 | 0.0109 | |
| | Y3BR- | 985600 | 407132.5 | 360867.5 | 15267.47 | 624732.5 | 0.0062 | |
| | Y3AR+ | 1850497 | 426502.8 | 1194503 | 15993.86 | 655993.9 | | |
| | Y3AR- | 996421.3 | 396702.4 | 371297.6 | 14876.34 | 625123.7 | | |
| 10% / 20% | Y2BR+ | 1548800 | 135710.8 | 903710.8 | 5089.157 | 645089.2 | 0.0099 | |
| | Y2BR- | 1267200 | 135710.8 | 632289.2 | 5089.157 | 634910.8 | 0.0085 | |
| | Y2AR+ | 1565805 | 152101.1 | 920101.1 | 5703.792 | 645703.8 | | |
| | Y2AR- | 1281113 | 122300.6 | 645699.4 | 4586.273 | 635413.7 | | |
| | Y3BR+ | 1689600 | 271421.7 | 1039422 | 10178.31 | 650178.3 | 0.0105 | |
| | Y3BR- | 1126400 | 271421.7 | 496578.3 | 10178.31 | 629821.7 | 0.0075 | |
| | Y3AR+ | 1708151 | 289302 | 1057302 | 10848.82 | 650848.8 | | |
| | Y3AR- | 1138767 | 259501.5 | 508498.5 | 9731.306 | 630268.7 | | |

**Note 1:** Portion of New Volume that is Solicitation Mail, from Elliott Testimony, Exhibit 7, Line 7/Line 13
**Note 2:** Portion of New Volume that is Customer Mail, from Elliott Testimony, Exhibit 7, Line 12/Line 13
**Note 3:** First Column: Change amount based on solicitation proportion from Note 1and volume change from 1408000
Second Column: New Solicitation Volume = 768000 +/- Change amount from first column
**Note 4:** First Column: Change amount based on customer proportion from Note 2 and volume change from 1408000
Second Column: New Customer Volume = 640000 +/- Change amount from first column
**Note 5:** Cost Difference calculated as position (24) - position (25) when new before-rates customer and solicitation volume are substituted for 640000 and 768000 in positions (4) and (5) in witness Crum's Attachment A, Page 2 spreadsheet