

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

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

Docket No. MC2002-2

ANSWERS OF OFFICE OF CONSUMER ADVOCATE  
WITNESS JAMES F. CALLOW TO INTERROGATORIES OF  
CAPITAL ONE SERVICES, INC. (COS/OCA-T2-17-22)  
(February 3, 2003)

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The Office of Consumer Advocate hereby submits the answers of James F. Callow to interrogatory COS/OCA-T2-17, dated January, 22, 2003, and interrogatories COS/OCA-T2-18-22, dated January 23, 2003. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

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ANSWERS OF OCA WITNESS JAMES F. CALLOW  
TO INTERROGATORIES COS/OCA-T2-18-22

COS/OCA-T2-17

Please refer to your response to COS/OCA-T2-8 where you indicate that the Postal Service may not authorize a mailer access to the volume-based declining block rates unless “there is a reasonable expectation that any mailer so authorized will make an additional contribution to institutional costs.” Also, please refer generally to pages 26 to 33 of your testimony and specifically to pages 26 and 27 of your testimony where you state, “I have considered the relevant classification criteria with respect to my development of the proposed classifications for Experimental Automated Address Correction Service and Experimental Volume-Based Declining Block Rates.”

- (a) Do you believe that making an additional contribution to institutional costs is the only criterion that the Commission should consider when evaluating an NSA or experimental classification? If not, do you believe that the Commission should consider all of the criteria listed on pages 26 and 27 of your testimony when evaluating an NSA or niche classification?
- (b) For each criterion that you considered with respect to your proposed classifications for Experimental Automated Address Correction Service and Experimental Volume-Based Declining Block Rates, please indicate whether your discussion of the criterion (on pages 26 to 33 of your testimony) with respect to your proposed classifications also applies to the Capital One NSA. For each criterion for which your discussion does not apply to the Capital One NSA, please explain why it does not apply.

RESPONSE TO COS/OCA-T2-17

(a) No. Yes.

(b) Classification criterion No. 1 requires “the establishment and maintenance of a fair and equitable classification system for all mail.” My discussion of this criterion as it relates my classification proposals do not apply to the Negotiated Service Agreement (NSA) concluded between the Postal Service and Capital One. The Capital One NSA is not fair and equitable. I interpret the term “fair” to mean “free of favoritism or bias” and “impartial.” Similarly, I interpret the term “equity” (or something that is “equitable”) to mean “just, impartial and fair.” As a classification, the Capital One NSA is not fair and equitable because the terms and conditions of the NSA are unique to Capital One.

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No other mailer can meet all of the terms and conditions of the NSA. Unlike the NSA, my proposed classifications offer all potential First-Class mailers willing to meet requirements of general applicability the opportunity to receive electronic address corrections at no charge. Moreover, First-Class mailers that participate in the experimental address correction service can, if interested, have access to the same volume-based rates, including Capital One.

Classification criterion No. 5 concerns “the desirability of special classifications from the point of view of both the user and of the Postal Service.” My discussion of this criterion is applicable in part to the Capital One NSA. The desirability of the NSA to Capital One is clear. The two experimental classifications that I propose would also be desirable to other First-Class mailers seeking access to volume-based rates. From the point of view of the Postal Service, however, the opportunity to reduce costs, generate additional First-Class Mail volume and obtain additional contributions to institutional cost from more mailers is limited because the NSA is limited to Capital One, unlike the experimental classifications.

Pricing criterion No. 1 requires “the establishment and maintenance of a fair and equitable schedule.” My discussion of this pricing criterion is not applicable to the Capital One NSA because the NSA is not fair and equitable. Under the NSA, volume-based declining block rates are not available to all potential First-Class mailers, including competitors. Under the experimental classifications I propose, all authorized First-Class mailers may avoid the address correction fee for undertaking the same requirements and have access to the same volume-based rates on equivalent terms. Thus fairness and equity is enhanced as compared to the NSA. In this manner, mailers

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who view themselves as competitors are placed on an equal footing, at least with respect to postal rates.

My discussion of pricing criterion No. 2, which concerns “the value of the mail service actually provided,” is applicable to the Capital One NSA. Capital One must become an Address Change Service (ACS) participant under the NSA, and so must First-Class mailers under the experimental address correction service, in order to obtain free electronic address correction information. Both Capital One and First-Class mailers that provide additional volumes would receive existing mail services at lower rates.

My discussion of pricing criterion No. 3 is applicable to the Capital One NSA. According to the Postal Service, the Capital One NSA will make an additional contribution to institutional costs. Similarly, the experimental classifications I propose are designed to make an additional contribution to institutional cost.

Pricing criterion No. 4 concerns “the effect of rate increases upon . . . business mail users.” My discussion of this pricing criterion is applicable in part to the Capital One NSA. Under the NSA and the experimental classifications, no First-Class mailers will experience an increase in published rates. However, because the NSA is unique to Capital One, no other First-Class mailers can receive free electronic address correction information or access volume-based rates, including competitors. Such mailers, especially competitors, will experience relatively higher rates than Capital One under the NSA.

My discussion of pricing criterion No. 6 is applicable to the Capital One NSA. Both the Capital One NSA and the experimental address correction service will reduce

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the number of First-Class mailpieces physically returned and may reduce the number of mailpieces that are repeat forwards, thereby reducing costs to the Postal Service. (See *also* my response to COS/OCA-T2-22).

My discussion of pricing criterion No. 7 is applicable to the Capital One NSA. The Capital One NSA and the experimental classifications will add a modest degree of complexity to the rate schedule while maintaining an identifiable relationship between mail volumes and rates.

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COS/OCA-T2-18

Please refer to your response to COS/OCA-T2-13(c) where you state, "Thus, any information that can be made public, such as posted on the Commission's website, without violating any contractual or copyright provisions would be included within the meaning of 'publicly available'" Please confirm that, your definition of publicly available data includes statements made in testimony that is posted on the Commission's website and therefore statements made in testimony that is posted on the Commission's website can be used by the Postal Service to determine the volume threshold. If not confirmed, please explain fully.

RESPONSE TO COS/OCA-T2-18

To facilitate providing a thorough response to compound questions, the relevant portion of each question addressed is quoted verbatim, followed by the response.

"Please confirm that, your definition of publicly available data includes statements made in testimony that is posted on the Commission's website . . ."

Confirmed.

"Please confirm that . . . statements made in testimony that is posted on the Commission's website can be used by the Postal Service to determine the volume threshold. "

Not confirmed. By definition, statements made "in public," such as testimony posted on the Commission's website, are publicly available. However, such testimony is not necessarily independently verifiable. Publicly available information that is independently verifiable provides an objective basis for establishing a volume threshold.

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COS/OCA-T2-19

Please refer to your response to COS/OCA-T2-14(a) where you state, "Under either method, establishment of the 'correct' volume threshold for any mailer is unknowable."

- (a) Please define fully "unknowable" as used in your response to COS/OCA-T2-14(a).
- (b) Based upon the definition provided in your response to subpart (a) of this interrogatory, are the Test Year Before Rates volume forecasts by subclass that are used in rate cases "unknowable"? Please explain fully.

RESPONSE TO COS/OCA-T2-19

(a) By the word "unknowable," I mean that a volume threshold cannot be checked or back-tested after the test year to determine the additional contribution generated for the Postal Service. According to the Postal Service, "Once discounts intended to influence mailer behavior are established, it is not possible to 'observe' what mailer behavior would have been without such discounts." Tr. 4/767. This follows from the fact that It is not possible to separately identify "existing" volume, or volume the mailer would have entered in the absence of discounts, from "new" volume. Id. Consequently, it's not possible to know whether more contribution was generated than would have been generated in the absence of the volume-based rates.

(b) In a general rate case, the Postal Service can check after-the-fact whether total revenues exceed total costs, both in total and by subclass. General rate cases, to date, have not involved test year before rates forecasts for volume-based rates. If volume-based rates were proposed in a general rate case, the same problem of "unknowability" would arise with respect to forecasted mail volumes.

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COS/OCA-T2-20

Please refer to your response to COS/OCA-T2-14(a) where you state, "Consequently, the requirement that the Postal Service use its own or publicly available data is one of several means of reducing financial risks to the Postal Service associated with establishing a volume threshold. The others are linking access to volume-based discounts to reducing the number of physical returns so as to reduce Postal Service costs, and limiting the amount of discounts available to any one mailer."

- (a) Please confirm that, everything else equal, if the mailer's return rate is lower, then the Postal Service's financial risk associated with your proposed volume-based discounts will be higher. If not confirmed, please explain fully.
- (b) Please confirm that, everything else equal, Capital One having a higher-than-average return rate reduces the Postal Service's financial risk from the NSA.

RESPONSE TO COS/OCA-T2-20

(a) Confirmed. This question poses the converse situation stated on page 2 of my response to USPS/OCA-T2-13(c) (revised 2-3-03), where  $r$  is the return rate. Thus, the expression,  $\$0.1722(x + a) - \$0.009x/r$ , becomes "larger" as  $r$  gets "larger" because  $0 < r < 1$  and dividing by such a fraction causes the negative portion of the expression to become "smaller."

(b) Confirmed that, everything else equal, because Capital One has a higher-than-average return rate, the financial risk to the Postal Service is reduced as compared to a mailer with the average return rate.



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COS/OCA-T2-21

Please refer to your response to USPS/OCA-T2-16(c) where you state, "The proposed changes to the DMCS simply direct that the Postal Service establish the volume threshold for each mailer using its own or publicly available data. The absence of a specific forecasting model or any other method permits the Postal Service to develop the most appropriate method based upon the type, quantity, and quality of mailer information available to it."

- (a) Based upon the data presented in this case, could the Postal Service set a unique volume threshold of 1.225 billion pieces for Capital One if it participated in your proposed Experimental Volume-Based Declining Block Rate Classification? Please explain your response fully
- (b) In your experimental classifications, would the Postal Service be allowed to set the volume threshold below estimated Test Year Before Rates volumes as long as it believed that contribution would be increased? Please explain your response fully.

RESPONSE TO COS/OCA-T2-21

(a) No. Capital One says it will mail 1.408 billion mailpieces even in the absence of the volume-based rates. Tr. 2/40-41. Under the Experimental Volume-Based Declining Block Rate classification, establishing a volume threshold at 1.225 billion would simply "pay" Capital One to enter mail that it expects to provide in the absence of volume-based rates.

(b) No. For both experimental classifications, the Postal Service must find there is a "reasonable expectation" that an authorized mailer will make an additional contribution to institutional costs. Thus, each mailer, and each classification on its own, is expected to provide an additional contribution. Linking access to volume-based rates to reducing the number of physical returns under the experimental address correction service is one means of reducing financial risks to the Postal Service associated with establishing a volume threshold.

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Where there is a test year before rates volume estimate, establishing a mailer's volume threshold at a lesser amount simply means the Postal Service would "pay" the mailer to enter mail that it expects to provide in the absence of volume-based rates. Under these circumstances, the Postal Service could not legitimately find that there is a "reasonable expectation" that the mailer would make an additional contribution to institutional costs from its participation in the Experimental Volume-Based Declining Block Rate classification.

In developing the Experimental Volume-Based Declining Block Rate classification, I contemplated that the Postal Service would establish the volume threshold as accurately as possible, making its best estimate for any given mailer. I gave no consideration to the possibility that the Postal Service would determine a "best estimate" volume threshold and then establish lower threshold to purposely cause the payment of discounts that would be offset by additional mail volume above its best estimate.

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COS/OCA-T2-22

Please refer to your response to USPS/OCA-T2-1 where you state, "Each electronic notice reduces costs to the Postal Service by avoiding the physical return of a First-Class mailpiece, or by reducing the number of mailpieces that are repeat forwards." Regarding your Experimental Automated Address Correction Service classification, is it your opinion that the cost savings from reducing the number of mailpieces that are repeat forwards will more than offset the cost of providing electronic notices for forwarded mail? Please explain your response fully.

RESPONSE TO COS/OCA-T2-22

I do not know. I have not estimated the cost savings from reducing the number of mailpieces that are repeat forwards or the cost of providing electronic notices for forwarded mail. To answer this question definitively, additional information would be needed, specifically, the number of repeat forwards by, and number of electronic notices provided to, mailers participating in the Experimental Automated Address Correction Service.