Postal Rate Commission
Submitted 2/3/2003 3:15 pm
Filing ID: 36971

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

NOTICE OF THE OFFICE OF CONSUMER ADVOCATE
CONCERNING ERRATA TO THE RESPONSE OF
WITNESS JAMES F. CALLOW TO
USPS/OCA-T2-13(c)
(February 3, 2003)

The Office of the Consumer Advocate hereby gives notice of the filing of revisions to the response of James F. Callow (OCA-T-2) to USPS/OCA-T2-13(c), filed on January 21, 2003. The revisions correct the expressions and calculations in the response resulting from the use of $0.2026, rather than $0.23, as the cost difference between a physical and an electronic return. The changes are listed below.

PAGE	UNNUMBERED LINE	CHANGES
1	21	Insert “$” between “=” and “0.009*x*”
	21	Change “$0.019” to “$0.017”
	22	Change “$0.019” to “$0.017”
2	1	Change “$0.23” to “$0.2026 ($0.5347 - $0.3321)”
	3	Change “$0.019” to “$0.017”
	4	Change “$0.01” to “$0.008”
	6	Change “$0.01” to “$0.008”

	7	Change “$0.01” to “$0.008”
	14	Change $0.1955” to “$0.1722”
	15	Change $0.1955” to “$0.1722”
	16	Change $0.1955” to “$0.1722”
	16	Change “$0.23” to “$0.2026”
3	1	Change $0.1955” to “$0.1722”
	2	Change $0.1955” to “$0.1722”
	3	Change “21.7” to “19.13”
	4	Change “21.7” to “19.13”
	5	Change “21.7” to “19.13”
	5	Change “0.046” to “0.052”
	5	Change “4.6” to “5.2”

The revised pages are attached.

Respectfully submitted,

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

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

Consider a mailer with a volume threshold equal to x and an actual mail volume of $x + a$, where a is positive. The maximum total discounts the mailer could earn would be $\$0.060(0.15x) = \$0.009x$. The total cost savings would be $\$0.017(x + a)$, where \$0.017 is the product of 9.6 percent, representing the proportion of Capital One's mailpieces returned; 85 percent, representing the proportion of electronic returns; and

$0.2026 ($0.5347 - $0.3321), representing the cost difference between a physical and an electronic return. The net increase in contribution to the Postal Service is

$$\$0.017(x + a) - \$0.009x =$$

$$\$0.008(x + a) + \$0.009a,$$

which is always positive. Thus, the minimum additional contribution per piece mailed is greater than $0.008.

The minimum additional contribution per piece of more than $0.008 calculated above is based upon a return rate of 9.6 percent. Not all mailers, however, have a 9.6 percent return rate. If we treat the return rate as a variable, we can see that the contribution per piece is proportional to the return rate. This means that higher return rates generate a larger contribution per piece, and lower return rates generate a smaller contribution per piece.

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

$$\$0.1722r(x + a) - \$0.009x =$$

$$\$0.1722(x + a) - \$0.009x/r,$$

where $0.1722 is the product of 0.85 and $0.2026. This expression becomes smaller as r gets smaller because $0 < r < 1$ and dividing by such a fraction causes the negative portion of the expression to become larger. Is there a value of r for which the net contribution expression equals zero? If so, mailers with an r less than or equal to that r should not be offered volume discounts.

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

0.1722x$ + 0.1722a$ = 0.009x$/$r$

(0.1722x/0.009x) + (0.1722a/0.009x) = 1/r

19.13(1 + a/x) = 1/r

r = 1/[19.13(1 + a/x)]

Since (1 + a/x) is greater than 1, r will always be less than 1/19.13 = 0.052 or 5.2 percent. This "minimum" return rate becomes smaller as the volume of additional or “new” mail volume grows relative to the volume threshold, i.e., the ratio of "new" volume to threshold volume (a/x) increases. Thus, for two mailers with the same threshold, the mailer expected to produce the greater volume in response to discounts can have a smaller return rate and still be profitable for the Postal Service. Conversely, for two mailers expected to generate the same new volume, the one with the smaller threshold can have a smaller return rate.