

OFFICIAL TRANSCRIPT OF PROCEEDINGS BEFORE THE POSTAL RATE COMMISSION

In the Matter of:)

EXPERIMENTAL RATE AND)
SERVICE CHANGES TO IMPLEMENT)
NEGOTIATED SERVICE AGREEMENT)
WITH CAPITAL ONE SERVICES,)
INC.)

Docket No. MC2002-2

VOLUME #7

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C O N T E N T S

WITNESSES APPEARING:

J. EDWARD SMITH

JAMES F. CALLOW

<u>WITNESSES:</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>	<u>VOIR DIRE</u>
J. Edward Smith					
by Mr. Costich	1235				
by Mr. May	--	1302	--	--	--
		1346			
by Ms. McKenzie	--	1327	--	--	--
James F. Callow					
by Mr. Costich	1351	--	--	--	--
by Mr. Luby	--	1498	--	--	--
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E X H I B I T S

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P R O C E E D I N G S

(9:37 a.m.)

CHAIRMAN OMAS: Good morning, ladies and gentlemen. Before we get started this morning, we have someone of a problem again with Dr. Penzer. Well, it's really not a problem. The weather is the problem.

We have so many unknowns about the snow tomorrow. We're hearing that there's going to be a dusting, and then there's going to be four to six inches, and then you hear three to five. You know, if you total them all up you've got a foot of snow. As you all know, our weather people, who are quite good, are not always right. The last time we were to have a dusting I think we had four inches.

The problem with Mr. Penzer is because he's due to leave on Saturday to go to New Mexico for a conference, so he's also concerned. I think at this point unless something changes this morning or we hear differently, we're going to cancel the hearing tomorrow and postpone it until the 21st of February.

The only problem with that is it looks like it could postpone us two weeks. I had hoped to get the decision out sometime in April. This means that it would probably be the middle of May.

1 I'm not quite happy with that, but at this
2 point if anyone has any suggestions maybe at the
3 mid-morning break you can sort of talk to counsel and
4 to me because I really don't know what way to go, but
5 I think that the best is to just sort of postpone it
6 tomorrow, and we'll end up with a dusting, and you'll
7 all say, you know, I panicked, but I don't really know
8 what to do. If you would all think about it, and
9 maybe we'll come back to this sometime this morning or
10 at the morning break.

11 Having said that, I'd like to say good
12 morning to everybody and welcome. Today we continue
13 hearing testimony filed in response to the direct case
14 presented in support of the proposed negotiated
15 service agreement between the Postal Service and
16 Capital One Services, Inc. This morning we will hear
17 from witnesses sponsored by the Office of Consumer
18 Advocate.

19 Yesterday the Postal Service submitted a
20 revised response to Interrogatory APWU/USPS-7. The
21 initial answer to that interrogatory was quite brief,
22 but the Service indicated its intention to submit a
23 more complete response. The initial response was
24 designated and appears at Transcript Volume 5, page
25 882.

1 Unless any participant requests an alternate
2 procedure, I would like the revised response to be
3 added to the record. Assuming the Postal Service
4 submits rebuttal testimony, this response can be
5 included in the transcript when the rebuttal testimony
6 is received.

7 Does anyone have any procedural matter to
8 deal with before we begin to hear testimony?

9 MR. MAY: Yes.

10 CHAIRMAN OMAS: Mr. May?

11 MR. MAY: Yes, Mr. Chairman. Capital One
12 had designated a response, an institutional response
13 from the OCA. That is Capital One/OCA-T-1-4
14 redirected from Witness Smith and answered by the OCA
15 institutionally. I would ask that that be printed in
16 the record and admitted into evidence.

17 CHAIRMAN OMAS: Without objection, the OCA
18 response will be received into evidence and
19 transcribed.

20 MR. MAY: And transcribed. I have two
21 copies here for the reporter, but I think they're
22 already up there.

23 CHAIRMAN OMAS: Okay. Thank you.

24 //

25 //

1 (The document referred to was
2 marked for identification as
3 Exhibit No. COS/OCA-T-1-4 and
4 was received in evidence.)
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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
OF OFFICE OF THE CONSUMER ADVOCATE

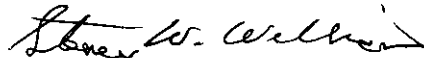
Party

Capital One Services, Inc.

Interrogatories

COS/OCA-T1-4 redirected to OCA

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Steven W. Williams".

Steven W. Williams
Secretary

INTERROGATORY RESPONSES OF
OFFICE OF THE CONSUMER ADVOCATE
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory

COS/OCA-T1-4 redirected to OCA

Designating Parties

Capital One

ANSWER OF THE OCA TO INTERROGATORY
COS/OCA-T1-4 REDIRECTED FROM WITNESS SMITH

COS/OCA-T1-4. Please refer to page 3 of your testimony where you discuss the volume threshold.

- (a) Please confirm that, in general, worksharing discounts pass through a portion of Postal Service cost savings from the worksharing and that these discounts are not contingent on the mailer increasing its Test Year mail volume. If not confirmed, please explain fully.
- (b) Please confirm that the only discounts that Capital One is being offered in this case are volume discounts. If not confirmed, please explain fully.
- (c) Please confirm that if the threshold volume is set exactly equal to Test Year before-rates First-Class Mail volume, then Capital One will only receive a discount if it increases its volume in response to the volume discounts.
- (d) Is it your opinion that Capital One should not receive any discount from reducing Postal Service return costs unless Capital One also grows mail volume? Please describe your response in detail.

RESPONSE TO COS/OCA-T1-4.

- (a) If the word "portion" is changed to "percentage," then confirmed.
- (b) Confirmed.
- (c) Not Confirmed. Capital One's "Test Year before-rates First-Class Mail volume" is unknown and unknowable. Thus, it is not possible to know, after the fact, whether a higher volume represents a before-rates-volume estimation error or new volume in response to a discount.
- (d) The OCA has not developed a position on this issue.

1 CHAIRMAN OMAS: Mr. Costich, we come to you
2 now. Would you please introduce your first witness?

3 MR. COSTICH: Thank you, Mr. Chairman. The
4 OCA calls J. Edward Smith.

5 CHAIRMAN OMAS: Mr. Smith, would you stand,
6 please?

7 Whereupon,

8 J. EDWARD SMITH

9 having been duly sworn, was called as a
10 witness and was examined and testified as follows:

11 (The document referred to was
12 marked for identification as
13 Exhibit No. OCA-T-1.)

14 DIRECT EXAMINATION

15 BY MR. COSTICH:

16 Q Mr. Smith, you have before you two copies of
17 a document marked for identification as OCA-T-1. Are
18 you familiar with that document?

19 A Yes, I am.

20 CHAIRMAN OMAS: Mr. Smith, would you just
21 pull it closer to you so you don't have to --

22 THE WITNESS: Yes, sir.

23 CHAIRMAN OMAS: That's good. Thank you.

24 BY MR. COSTICH:

25 Q Was this document prepared by you or under

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(202) 628-4888

1 your supervision?

2 A It was.

3 Q If you were to testify orally today, would
4 this be your testimony?

5 A Yes.

6 MR. COSTICH: Mr. Chairman, I will hand two
7 copies of Mr. Smith's testimony to the reporter and
8 ask that it be admitted into evidence.

9 CHAIRMAN OMAS: Is there any objection?

10 (No response.)

11 CHAIRMAN OMAS: Hearing none, I will direct
12 counsel to provide the reporter with two copies of the
13 corrected direct testimony of J. Edward Smith. That
14 testimony is received and will be transcribed into
15 evidence.

16 (The document referred to,
17 previously identified as
18 Exhibit No. OCA-T-1, was
19 received in evidence.)

20 //

21 //

22 //

23 //

24 //

25 //

OCA-T-1
Docket No. MC2002-2

DIRECT TESTIMONY

OF

J. EDWARD SMITH

ON BEHALF OF

THE OFFICE OF CONSUMER ADVOCATE

December 20, 2002

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**DIRECT TESTIMONY
OF
J. EDWARD SMITH**

1 **I. STATEMENT OF QUALIFICATIONS**

2 My name is J. Edward Smith, and I am an econometrician in the Office of the
3 Consumer Advocate of the Postal Rate Commission. I have worked as an economist in
4 a variety of business, academic, consulting, and governmental positions. My
5 experience has been focused on the modeling of costs and revenues; analyses related
6 to forecasting, pricing, and marketing; and utility regulation. My economics degrees are
7 from Hamilton College, A.B., and Purdue University, M.S., and Ph.D. I have previously
8 testified before this Commission, in Docket No. R97-1 and Docket No. R2000-1. I have
9 also testified before state regulatory commissions in Virginia, Maryland, and the District
10 of Columbia.

11 **II. PURPOSE AND SCOPE OF TESTIMONY**

12 I first examine Capital One's volume forecast of 1.4 billion pieces of mail for
13 2002. I conclude that the forecasting method is inadequate. Furthermore, the level of
14 the forecasted volume appears to be at the lower bound of plausibility. I also find that
15 a projected level of 1.6 billion pieces for 2003 appears to be plausible. Assuming that
16 the Commission accepts the 1.4 billion piece estimate, I conclude that the volume
17 threshold for the per piece discounts should, accordingly, begin at 1.4 billion pieces, not
18 the lower 1.225 billion pieces advocated by the Postal Service, in order to avoid a free-
19 rider problem.

1 Using Capital One as an example, I examine the appropriate procedures for the
2 estimation of mail volume for an individual company. I find that a regression analysis is
3 inadequate, being hampered by the lack of access to private, unverifiable information. I
4 conclude that the previous year's mail volume adjusted by previous levels of growth can
5 serve as an estimator of the next year's level of mail volume. Such a number may be
6 deficient, as is the case for Capital One, apparently due to changes in marketing
7 approaches. However, such an estimate uses prior management behavior, rather than
8 opinions, as the basis for forecasting.

9 III. THE BASIS FOR THE PROPOSED NEGOTIATED SERVICE AGREEMENT IS
10 INADEQUATE: ADDITIONAL INFORMATION IS NEEDED

11 A. The Postal Service and Capital One have not Provided Credible
12 Substantiation for their Estimates of Projected Mail Volumes

13 Capital One has provided an estimate of 1.4 billion pieces of mail absent the
14 implementation of the Negotiated Services Agreement (NSA).¹ Based on witness
15 Elliott's application of a Postal Service elasticity study for work-shared First-Class Mail,
16 the estimated mail volume with implementation of the NSA was projected to increase by
17 15,458,969 pieces.² The forecast lacks credibility. In addition to the absence of a
18 verifiable quantitative analysis for the base-case projection of 1.4 billion pieces, witness
19 Elliott used an irrelevant elasticity study for the projection of increased volume. The
20 elasticity for workshared First-Class letters applies to mail from all types of customers; it
21 is not specific to Capital One. In fact, Capital One's Solicitation mail may be quite

¹ Direct Testimony of Donald Jean, Docket No. MC2002-2. COS-T-1, at 4, line 19.

² Direct Testimony of Stuart Elliott, Docket No. MC2002-2, COS-T-2, at 5.

1 different from other workshared First-Class mail. Workshared mail could contain billing,
2 customer communication, and possibly other types of mail in addition to solicitation mail;
3 such is not, however, the case for Capital One's Solicitation mail. In addition, Capital
4 One is a large mass mailer of advertising material. The market drivers underlying the
5 demand for advertising mail by Capital One would logically be expected to be a function
6 of mailing list quality and cost, the persuasiveness of advertising copy in eliciting
7 response rates, market penetration and competition by competing firms, and a variety of
8 other factors. The drivers for other types of workshared mail may be quite different from
9 those of Capital One's Solicitation mail. Finally, the Capital One forecasts are proposed
10 for mail levels as low as 1.025 billion pieces under certain circumstances.³ Apparently
11 there is a substantial doubt about forecast accuracy. A forecast of 1.025 billion pieces
12 is only 73 percent of the original forecast of 1.4 billion pieces.

13 B. An Objective Estimate of Projected Mail Volumes is Needed in Order to
14 Avoid a Free-Rider Problem

15 Proposing a threshold volume for the payment of incentives at a lower than
16 forecasted volume (i.e., at levels lower than 1.4 billion pieces in this case) creates a
17 significant free-rider problem. The free-rider problem is the payment of an incentive
18 where none is necessary, i.e., for pieces which would have been sent absent an
19 incentive. The Postal Service needs a benchmark estimate of projected mail volume
20 that is tied to an objective, verifiable estimate of the mailer's projected mail volume. The
21 incentive should encourage additional mailings beyond the threshold level that would

³ Request of the United States Postal Service for a Recommended Decision on Experimental Changes to Implement Capital One NSA, Docket No. MC2002-2, Attachment B, Rate Schedule 610B.

1 have been achieved absent the incentive, or retain mail levels in the event of a
2 projected decline in mail.

3 C. Accurate Determination of a Forecasted Mail Level is Important: the Level
4 can have Substantial Financial Impacts

5 Table 1 presents a spreadsheet model of the proposed discount schedule and its
6 benefits at various levels of projected mail, ranging from 1.275 billion pieces to
7 1.600 billion pieces. Based on the data presented in the case, there are two types of
8 cost and revenue impacts:

- 9 • Changes in margins: revenue from the additional 15.5 million pieces of mail,
10 offset by the amounts paid as incentives, has a negative \$4.9 million (Table 1,
11 Col. G, line 17) impact on Postal Service finances. Although additional margins
12 are generated by the increased volume of mail, the discounts begin at 1.225
13 billion pieces and increase with volume. Accordingly, discounts totaling \$7.4
14 million (Table 1, Col. G, line 8) will have been paid by the time total mail volume
15 has increased by 15.5 million pieces.
- 16 • Savings from ending the return of UAA First-Class Mail to the mailer, offset by
17 the cost of electronic notification: This represents a fundamental change in
18 operating procedures — i.e., the disposal, rather than the physical return, of
19 First-Class Mail — producing savings caused by decreased mail handling. The
20 savings to the Postal Service are projected to be \$13.3 million (Table 1, Col. G,
21 line 22) based on attaining the Capital One level of 1.423 billion pieces.

22 The actual financial impact of the NSA is, however, unknown. The Capital One
23 volume forecast is not substantiated with a formal study. Although the forecasted level
24 of mailings approaches plausibility, apparently there is substantial uncertainty over the
25 actual level of projected mailings. In fact, a later section of this testimony develops a
26 forecasted level of mail close to 1.6 billion pieces.

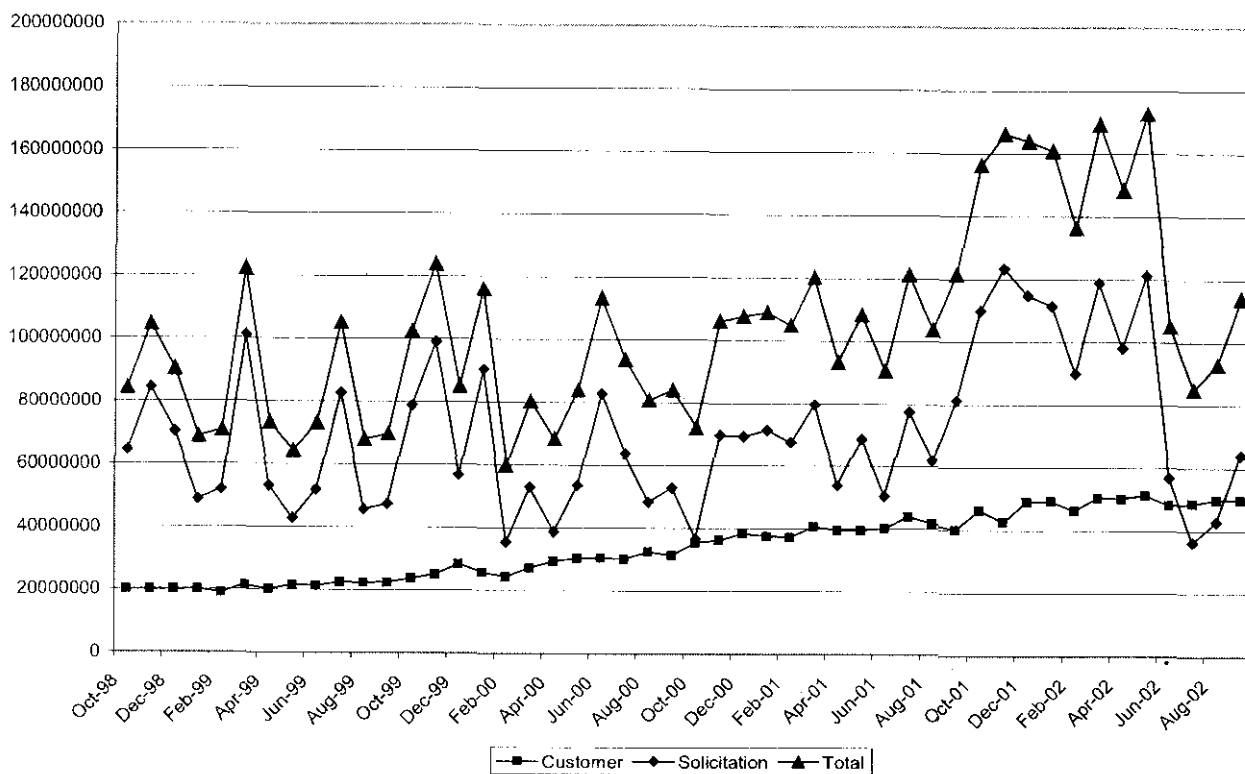
Table 1

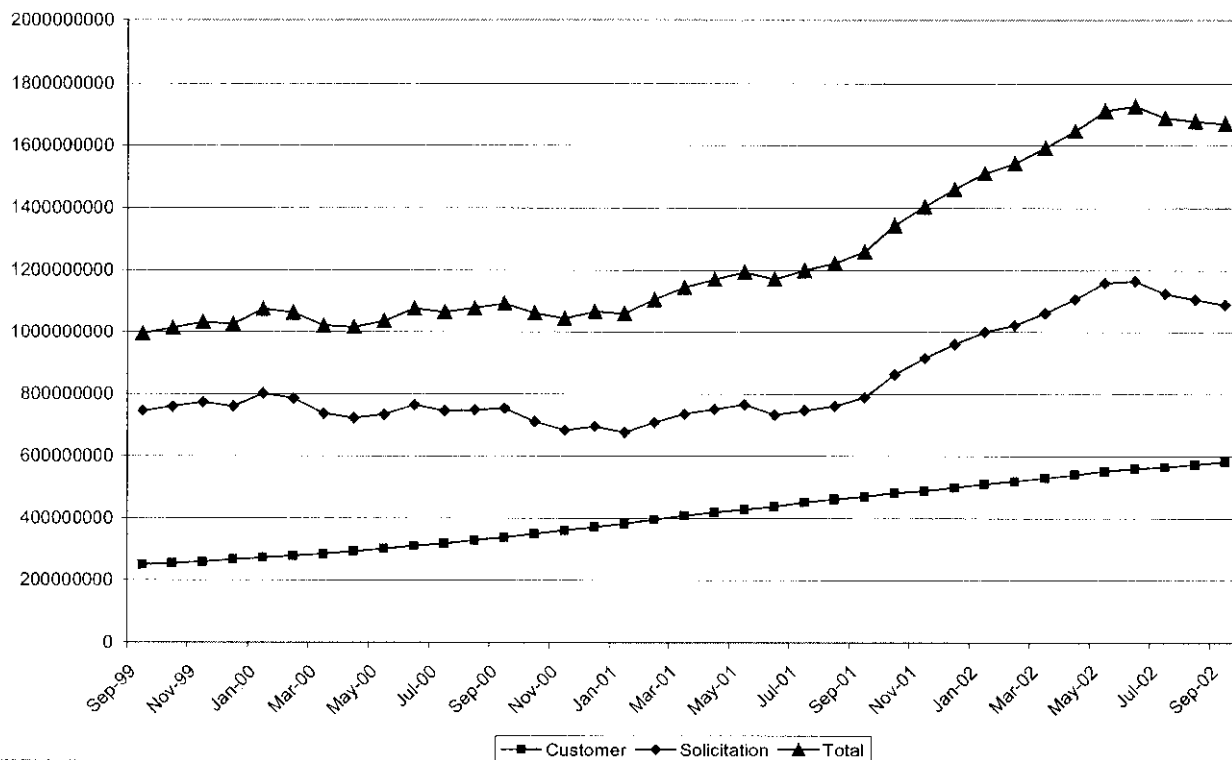
	B	C	D	E	F	G	H	I	J
2	Projected Mail Volume - total	1,275,000,000	1,525,000,000	375,000,000	408,000,000	423,458,999	1,450,000,000	1,525,000,000	1,600,000,000
3	Additional Pieces	50,000,000	50,000,000	50,000,000	33,000,000	5,458,999	25,541,031	75,000,000	75,000,000
4	Customer Mail	640,000,000	640,000,000	640,000,000	640,000,000	640,000,000	640,000,000	640,000,000	640,000,000
5	Solicitation Mail	635,000,000	665,000,000	725,000,000	768,000,000	783,458,999	3,100,000,000	335,000,000	960,000,000
6	Cents per Piece-Discount	0.030	0.035	0.040	0.045	0.046	0.045	0.050	0.055
7	Discount Dollars - Incremental Load	1,500,000	1,750,000	2,000,000	1,485,000	635,654	1,943,346	3,750,000	4,125,000
8	Cumulative Discount Dollars	1,500,000	3,250,000	5,250,000	6,735,000	7,370,654	9,314,000	12,375,000	16,500,000
9	Additional Margin	-	-	-	-	2,540,819	4,352,254.47	12,325,313.98	12,326,313.38
10	Cumulative Additional Margin (plus)	-	-	-	-	2,540,819	6,903,074	13,229,990	31,555,307
11	UAA Mail Returned-Current-Pieces	60,350,000	65,760,000	70,550,000	73,725,000	75,212,001	77,760,000	84,350,000	92,150,000
12	UAA Mail Returned-Projected-Pieces	9,144,000	9,864,000	10,264,000	11,055,000	11,281,000	11,664,000	12,744,000	13,324,000
13	UAA Mail Returned-Current-Dollars	32,535,337	35,163,313	37,725,444	39,425,420	40,216,555	41,579,368	45,423,331	49,273,274
14	UAA Mail Returned-Projected-Dollars	4,333,423	4,724,422	4,855,417	5,135,515	5,132,545	5,235,908	5,314,400	5,391,391
15	UAA Mail Returned-Dollar Savings (plus)	27,735,759	29,888,393	32,070,028	33,509,907	34,184,423	35,343,460	39,314,931	41,337,333
16	Cost/Electronic-UAA Mail (minus)	17,213,443	18,565,535	19,520,749	20,515,150	21,234,136	21,953,479	23,335,209	25,013,333
17	Contribution, New Volume, line 9 - line 7:	(1,500,000)	(3,250,000)	(5,250,000)	(6,735,000)	(4,889,635)	(1,721,926)	5,354,990	15,355,307
18	Savings from not returning First-Class mail	-	-	-	-	-	-	-	-
19	From UAA Mail no longer returned-line 15	27,735,759	29,888,393	32,070,028	33,509,907	34,184,423	35,343,460	39,314,931	41,337,333
20	Cost of Electronic Notification	17,213,443	18,565,535	19,520,749	20,515,150	21,234,136	21,953,479	23,335,209	25,013,333
21	Net Gain-Not Physically Returning Mail	10,433,315	11,322,737	12,149,278	12,694,757	12,950,287	13,389,001	14,525,723	15,333,445
22	Adj for Contingency (1.03)	10,311,235	11,662,431	12,515,757	13,075,555	13,338,796	13,790,671	15,037,585	16,344,439
23									
24	NSA-Net Benefits: lines 17 + 22	9,311,235	8,412,431	7,265,757	6,340,555	8,448,991	12,068,744	21,322,575	31,471,435
Line	Line-by-Line Analysis								
2	Capital One forecast is 1.4 Billion pieces, increments are based on NSA.								
3	Incremental Pieces based on proposed NSA and are included in total pieces in line 1								
4	Customer Mail - Capital One assumption								
5	C2-C4 Total Mail minus Customer Mail								
6	Discount per NSA								
7	C3-C5: This is the discount for the mail increment.								
8	Cumulative determination of discount dollars in terms of increasing volume								
9	Additional Margin generated by additional pieces: (2509561914EE21-1233332333232)*55								
10	Cumulative additional margin summary as volume varies across columns 2 through 5								
11	UAA Mail Returned-Current-Pieces	335*1c5							
12	UAA Mail Returned-Projected-Pieces	15*1c5*5							
13	UAA Mail Returned-Current-Dollars	5347*1c11							
14	UAA Mail Returned-Projected-Dollars	5347*1c12							
15	UAA Mail Returned-Dollar Savings (plus)	15*c13							
16	Dollar Cost/Electronic-UAA Mail (minus)	33*c5*333*55							
17	Contribution, New Volume, line 9-line 7	19-c7							
18	Title								
19	Line 15	15							
20	Cost of Electronic Notification	16							
21	Net Gain-Not Physically Returning Mail	19-c20							
22	Contingency Adjustment	1.03							
23									
24	NSA-Net Benefits: lines 17 + 22	9,311,235							

1 IV. CAPITAL ONE MAILING TRENDS SUGGEST THAT A FORECAST OF
2 1.4 BILLION PIECES IS AT A LOWER BOUND

3 A forecast of 1.4 billion pieces for 2003 approaches plausibility but appears to be
4 at the lower range of possible outcomes. Graph 1 presents monthly mailings by Capital
5 One, as delineated by witness Elliott in his testimony.⁴ The underlying data and 12-
6 month moving totals are presented in Appendix 1 of this testimony. Monthly Customer
7 mailings gradually increased during the time period Oct-98 to Sept-02. In comparison,
8 monthly Solicitation mailings fluctuated substantially from month to month during
9 October 1998 through August 2001. Subsequently for October 2001 through May of
10 2002, there was a substantially higher level of Solicitation mailings, again subject to
11 substantial fluctuation. It is difficult to see a meaningful time trend in the Solicitation
12 data in Graph 1. Graph 2 presents 12-month moving totals of Customer, Solicitation,
13 and Total mailings. The key question is the outlook for 2003.

⁴ Direct Testimony of Stuart Elliott, Docket No. MC2002-2, COS-T-2. Exhibit 2.

Graph1: Capital One Monthly Pieces--Customer, Solicitation, Total

Graph 2: Capital One 12-Month Moving Totals, Customer, Solicitation, Total Mail

1 Customer Mail

2 A time trend analysis based on 12-month moving totals indicates that the level of

3 Customer mail is gradually rising. As of September 2002 total Customer mail was at a

4 rate of 582 million pieces per year, having increased since September of 2000 and

5 September of 2001 at rates of 2.29 percent and 1.80 percent per month respectively.

1 Annualized, the growth rates were respectively 31 percent and 24 percent. Witness

2 Jean predicts Customer mail level at 640 million pieces for 2003.⁵

- 3 • An estimate of 640 million pieces of Customer mail for 2003 represents the
- 4 results of an approximately 10 percent growth rate.
- 5 • An estimate of 722 million pieces for 2003 represents the results of a 24 percent
- 6 annual growth rate, the experience during the previous year, Sept 01 — Sept 02.

7 **Solicitation Mail**

8 Solicitation mail was at an annual level of 760 million pieces in August of 2001. As
9 of September 2002 total Solicitation mail was at an annual rate of 1.088 billion pieces
10 per year, having increased since September of 2000 and September of 2001 at rates of
11 1.5 percent and 2.7 percent per month respectively. Annualized, the growth rates were
12 respectively 20 percent and 38 percent.

- 13 • 760 million pieces of Solicitation mail represents the level of Solicitation mailings
- 14 as of August 2001.
- 15 • 1.308 billion pieces represents the level of Solicitation mail for 2003 assuming
- 16 growth subsequent to 2002 at the rate of growth from Sept 2000 to Sept 2002.
- 17 • 1.501 billion pieces of Solicitation mail represents the results of a growth rate
- 18 from Sept 2001 to Sept 2002 extrapolated to 2003.

19 Based on the extrapolation of Customer mail and Solicitation mail for 2002 at their
20 growth rates for 2002, one would obtain Customer mail at 722 million pieces, and
21 Solicitation mail at 1.5 billion pieces, for a total of 2.2 billion pieces. This estimate of
22 total mail is different from the estimate of 1.4 billion pieces provided by Capital One.
23 The estimate simply assumes that Capital One will continue to mail in its previous
24 patterns. Capital One has asserted that previous experience is not reflective of future
25 performance, but has provided no analysis substantiating future levels of mailings other

⁵ Direct Testimony of Donald Jean, Docket No. MC2002-2, COS-T-1 at 4, line 15.

1 than assertions from its managers.⁶ Essentially Capital One asserts that the year 2002
2 was a special case, with abnormally high levels of Solicitation mail. Accordingly, a
3 special estimate of Customer mail at 640 million pieces for 2003, representing the
4 results of a 10 percent growth rate from 2002 coupled with Solicitation mail at
5 760 million pieces generates the 1.4 billion-piece estimate. It is clear that the threshold
6 level for the initiation of discounts should start at not less than 1.4 billion pieces. Based
7 on previous experience, however, the overall level of mailings could be significantly
8 higher. Accordingly, discounts beginning at a lower level are inappropriate,
9 representing a free-rider problem. Furthermore, it would be desirable to have an
10 improved understanding of the exogenous factors driving the level of mail, which have
11 in the past caused the level of mail to increase more rapidly than is currently projected,
12 and which may have an impact on future projections.

13 V. A COMPANY-SPECIFIC DEMAND STUDY IS NEEDED FOR A FULL
14 UNDERSTANDING OF FUTURE MAILING LEVELS

15 A. Such a Study is Unavailable for Capital One and may not be Available for
16 Other Companies

17 A company-specific demand study would present forecasted volume as a
18 function of price and other exogenous factors related to business conditions. The
19 forecast would provide the basis for determining the volume level at which discounts
20 would be appropriate. The presentation of a demand study may not always, however,
21 be feasible. First, the level of study costs in comparison to NSA benefits may render
22 development of a study uneconomic for a mailer. Second, a specifically prepared study

⁶ Direct Testimony of Donald Jean on Behalf of Capital One Services, Inc., Docket No. MC2002-2, COS-T-1 at 3, lines 9-13.

1 would probably need to be subject to formal regulatory review. This could require the
2 disclosure of otherwise unverifiable private information specific to company operations;
3 this has to some degree been an issue in the current case.⁷

4 Finally, an appropriate statistical methodology for a company-specific study may
5 be very different from that of a typical demand study. There is a difference between
6 forecasting the number of units of a product that the public might purchase at a given
7 price and forecasting what a specific individual or firm might do. In the case of the
8 public's purchasing decisions for a product, actual sales are the result of a large number
9 of decision-makers acting independently. In the case of the single firm, Capital One,
10 only one decision-maker produces the projected volume of solicitation letters. The level
11 of Customer mail is also very dependent on the business decisions of Capital One,
12 consumer acceptance of solicitation offers, and the level of Solicitation mail. The
13 number of Customer mailings is a near-deterministic function of the number of existing
14 credit cards (i.e., monthly statements, a possible additional annual statement, and
15 notifications to customers who miss payment deadlines). These are likely to be
16 generated routinely. A regression analysis on Solicitation and Customer mailings over
17 time can be performed. Such an analysis may be meaningless, being subject to
18 changing management objectives and practices.

⁷ Presiding Officer's Ruling Granting Second Motion of Capital One Services, Inc. for Issuance of Protective Order, Docket No. MC2002-2.

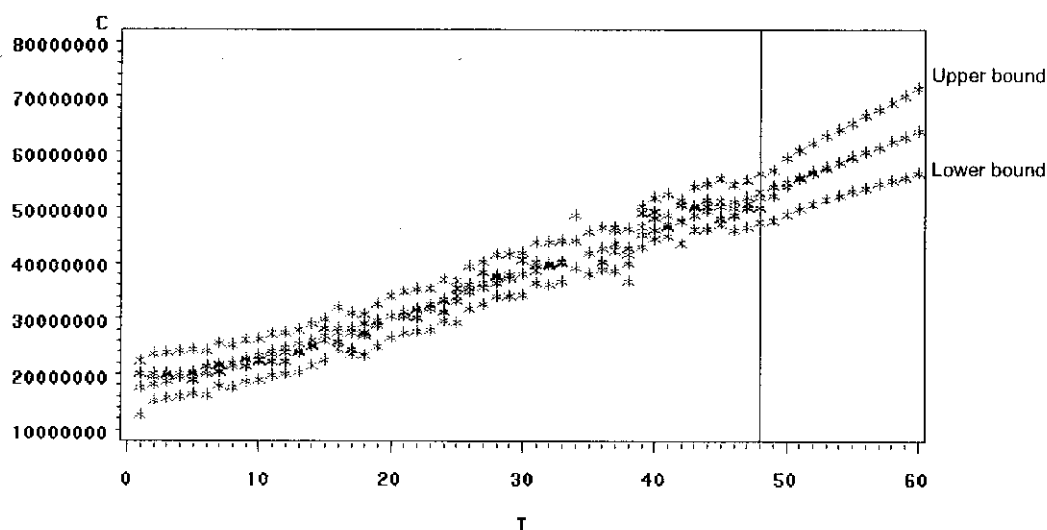
B. Time Trend Regression for the Measurement of Projected Mail Levels has not Worked Adequately for Capital One

Based on a regression trend analysis, the levels of actual and predicted mailing levels are presented in Graph 3 for Customer mailings and in Graph 4 for Solicitation mailings. The SAS programs for Customer and Solicitation mailings are presented in the Library Reference, OCA-LR-1/MC2002-2: Part 1 for Customer mailings, Part 2 for Solicitation mailings.

The time trend regression line simply finds the best fit based on the available data and extrapolates the previous trends. A trend analysis is inadequate in terms of analyzing turning points in the data and changing exogenous factors such as changing business conditions and strategies. Despite these limitations, a trend analysis does provide the basis for the comparison of a forecast with previous experience.⁸

Customer Mailings--Graph 3

Customer Mail: Pieces vs. Time



⁸ Equation 5 in Part 1 of Library Reference 1 provides the associated information.

- 1 For Customer mailings, the monthly data for Capital One mail pieces were
 2 regressed against time for 48 months, with the relationship extrapolated for another
 3 12 months. Month 1 is Oct-98; month 60 is Sep-03. The results are available in the
 4 Library Reference and the equations considered are summarized in Table 2.

Table 2					
Customer Mail: Summary of Regression Results					
	1	2	3	4	5
DW	2.03	1.9467	1.8424	1.93	2.05
Total RSQ	0.9725	0.9834	0.9828	0.9819	0.9778
t-Intercept	14.26	11.28	10.12	10.75	11.63
t-t	5.71	4.19	3.65	4.18	4.51
t-tsqr	1.19	1.12	1	0.83	0.98
SSE	1.53E+14	9.25E+13	9.60E+13	1.00E+14	1.23E+14
MSE	3.48E+12	3.08E+12	3.09E+12	2.65E+12	2.95E+12
SBC	1533	1564	1561	1537	1531
dv1		0.04	0.16		
dv2		1.49	1.1	1.21	
dv3		0.29	0.26		
dv4		-1.26	-0.72		
dv5		0.29	0.08		
dv6		0.28	0.11		
dv7		-0.79	-0.24		
dv8		1.67	1.49	1.61	
dv9		1.89	1.96	2.14	1.94
dv10		-3.53	-2.93	-3.19	-2.82
dv11		1.7	1.45	1.61	
dv12		1.17	1.34	1.5	
dv13		-1.13	-0.91		
AR1	-2.08	-3.62	-3.59	-4.23	-3.7
AR2		1.15			

- 5 The graph for Customer mailings appears to be a relatively smooth trend. The
 6 Customer regressions are characterized as follows:
- 7 • Equation 5 is the preferred regression. It was generated by the SAS Proc
 8 Autoreg procedure, with a one period lag used, given that a larger lag would be
 9 meaningless.

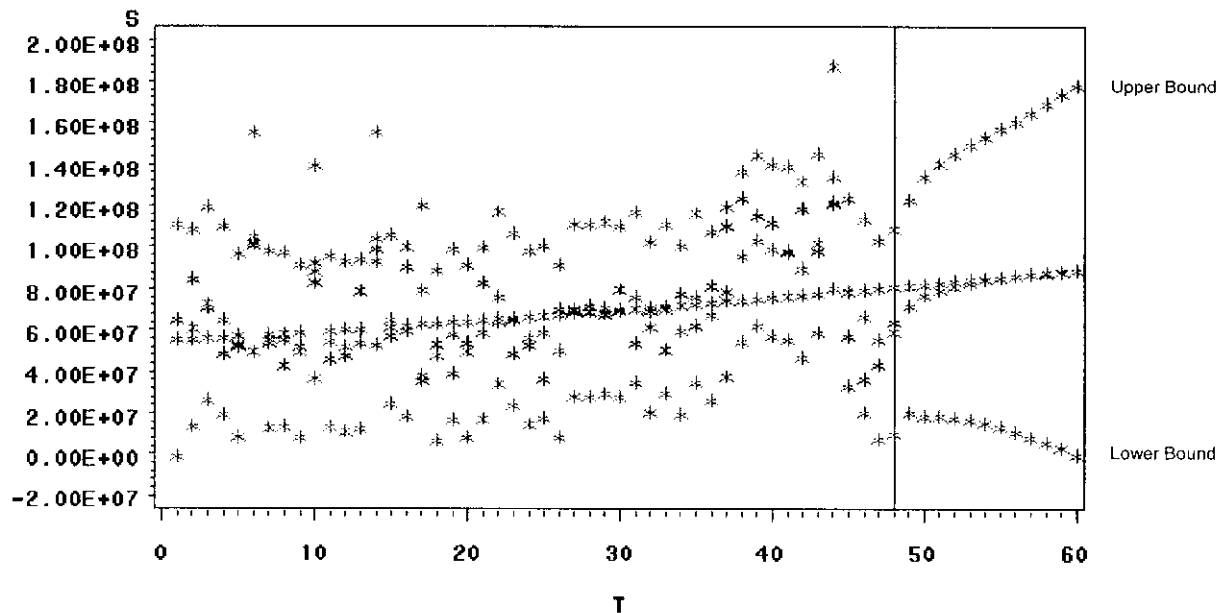
- 1 • A number of dummy variables were considered for the improvement of the
2 equation; several were found to be statistically significant.
- 3 • The R-squared and Durbin-Watson statistics are acceptable.
- 4 • The t value for TSQ is less than two but was left in the regression.
- 5 • The trend results and upper and lower bounds are forecasted for Months
6 49 through 60, corresponding to the time period October 2002 through
7 September 2003.
- 8 • It was clear in Graph 1 that Customer data appeared to be seasonal.
9 Accordingly, the Customer regression was run for n=12, but the results were
10 actually worse than for n=1, with a lower Durbin-Watson statistic. Accordingly,
11 the n=1 case was used, along with Dummy variables. As a practical matter, the
12 choice of either case will not make much difference in the results.
- 13 • Data were tested for heteroskedasticity, which did not appear to be a problem.
14 The test is delineated in the Library Reference.

15 **Solicitation Mailings**

16 The Solicitation mailings Graph 4 seems to imply that the level of Solicitation
17 mailings will rise slowly, based on the trend line. This appears to be due to a relatively
18 high level of mailings in 2002 in comparison to previous years. An examination of the
19 underlying data, as plotted in Graph 1 indicates that, over the four years for which data
20 were available, Capital One exhibited basically two levels of Solicitation mailings:
21 approximately 40-80 million pieces per month during 1998-2001, and approximately 100
22 million pieces per month for much of 2002, tapering off to a lower level starting in June
23 of 2002. It is not surprising, therefore, that the regression equations did not find a
24 strong, increasing relationship between Solicitation mail and time.

Graph 4

Solicitation Mail: Pieces vs. Time



- 1 The Solicitation mail regressions, with various time periods tested for lags, are
- 2 found in Part 2 of Library Reference 1. The equations are summarized in Table 3.
- 3 • For Equation 6, the $n=1$ lag regression was chosen over a longer lag alternative.
- 4 • A simple plotting of the data in Graph 1 led to the conclusion that the data are
- 5 cyclical. Accordingly, Equation 7 tested a number of dummy variables. Many of
- 6 the dummy variables were statistically insignificant.
- 7 • Equation 8 retained statistically meaningful dummy variables and an $n=1$ lag.
- 8 • Neither the data for Solicitation or Customer mail had problems with
- 9 heteroskedasticity. This was confirmed in the analyses presented in the Library
- 10 Reference.

Table 3 Solicitation Mail: Summary of Regression Results			
	6	7	8
DW	2.0482	1.98	2.09
Total RSQ	0.2614	0.67	0.5286
t--Intercept	3.97	2.52	3.13
t--t	-0.02	0.21	0.26
t--tsq	0.38	-0.02	0.07
SSE	2.12E+16	9.48E+15	1.35E+16
MSE	4.82E+14	3.06E+14	3.38E+14
SBC	1770	1782	1764
dv1		1.25	
dv2		3.36	3
dv3		2.32	2.04
dv4		2.2	2.01
dv5		1	
dv6		1.66	
dv7		1.11	
dv8		1.3	
dv9		1.42	
dv10		0.96	
dv11		1.57	
dv12		3.05	2.72
dv13		0.58	
AR1	-2.94	-4.7	-4.43
AR2			

1 The regression results for Solicitation Mail are of poor quality. This is probably
 2 due to the absence of some of the key driving variables and the apparent change in
 3 marketing approaches in 2002. The driving variables for Capital One are private
 4 unverifiable information along with the opinions of some of Capital One's managers.
 5 These undisclosed factors are the basis for the forecast presented by Capital One. It
 6 must be stressed that the Capital One forecast cannot be replicated: the necessary
 7 data are not available and were not in the regression. Even a simple trend analysis
 8 does not offer sufficient credibility upon which to base a forecast.

1 C. Accordingly, a Regression Analysis has not Worked in Forecasting Capital
2 One's Potential Future Mailings

3 Although one can obtain a trend analysis for Customer mailings, a trend analysis
4 for Solicitation mailings appears to be meaningless. The regression effort presented in
5 this testimony highlights how little is actually known about Capital One's level of
6 mailings. Capital One management has indicated fundamental shifts in their marketing
7 approaches in terms of choice of media and operations⁹. It is not surprising that a
8 regression analysis has not provided strong results. If one had access to Capital One's
9 private undisclosed information one might, of course, obtain better results. Such,
10 however, is not currently the case. The regression approach has failed in the case of
11 Capital One, probably due to the unavailability of private unverifiable information.

12 D. An Alternative to Regression Analysis is the Extrapolation of the Previous
13 Year's Level of Mailing Effort, Increased Somewhat to Allow for Additional
14 Company Efforts

15 The Appendix presents 12-month rolling totals for Customer and Solicitation mail.
16 Every December the 12-month roll becomes the total for a calendar year. Every month
17 the 12-month roll becomes the total for a 12-month year ending in that month.

18 A forecast of mail volume for the test year is necessary to establish a threshold
19 for the initiation of per piece discounts. OCA has studied a forecast for the next year
20 that is based on the level of the 12-month roll as of the end of the previous year,
21 adjusted for the growth that occurred during that year. Table 4 gives an example.

⁹ Direct Testimony of Stuart Elliott on Behalf of Capital One Services, Inc., COS-T-2, Docket No. MC2002-2, at 4, lines 9-19. Direct Testimony of Donald Jean on Behalf of Capital One Services, Inc., COS-T-1, Docket No. MC2002-2, at 3, line 11 and at 4, line 11.

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16 mail. Every December the 12-month roll becomes the total for a calendar year. Every
17 month the 12-month roll becomes the total for a 12-month year ending in that month.

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- 1 • Customer mail at the level of 582 million pieces is projected on the growth rate of
- 2 2001-2002 to be 722 million pieces in 2003.
- 3 • Solicitation mail, at 1.088 billion pieces in the 12 months ending September
- 4 2002, is projected to be 1.502 billion pieces in 2003, based on the growth rate
- 5 over 2001-2002. In the case of Capital One, such a projection may appear to be
- 6 unrealistic — but it is plausible when considered in the context of the information
- 7 presented by Capital One coupled with previous trends.
- 8 • Recognizing that the growth in Solicitation mail may be overstated, as indicated
- 9 by Capital One testimony, an alternative projection is provided: Solicitation mail
- 10 for the 12 months ending September 2001 is extrapolated for two years at the
- 11 growth rate for Solicitation mail over the period 2000-2001, obtaining a somewhat
- 12 lower projection.

Table 4				
	12 mo ending Sep-02	Growth 2001-2002	Projection 2003	Alternative Projection
Customer	582,872,941	1.238594341	721,943,126	721,943,126
Solicitation	1,088,407,932	1.379599819	1,501,567,386	864,590,059
Total	1,671,280,873		2,223,510,512	1,586,533,185

13 There are significant drawbacks to this approach. First, it is a simple extrapolation of

14 previous experience: i.e., mail volumes as of September 2002 extrapolated to 2003,

15 with a more reasonable growth rate applied for Solicitation mail. Second, in developing

16 the Alternative Projection, it was necessary to use analyst judgment rather than simply

17 letting the trends speak for themselves. The application of a revised growth rate

18 requires a degree of judgment and ignores potential migration to the Internet of some

19 billing statements.

20 VI. CONCLUSIONS

- 21 1. The projection of future mail levels is important, serving as the basis for the
- 22 avoidance of a free-rider problem. In this case, Capital One has arrived at a forecast

1 at the lower end of plausibility. However, the Capital One forecast is based on
2 opinion rather than on reproducible study and analysis. Without an analysis, one
3 does not know where to set the threshold for rebates. A major drawback of a poll of
4 operating personnel is that the poll may be inaccurate or subject to gaming.

5 2. The alternative of a regression analysis did not yield meaningful results. This is
6 probably due to the unavailability of private undisclosed information, such as
7 information on the overall drivers of mail, management policies, and the state of
8 various exogenous factors.

9 3. The extrapolation of the previous year's experience to the current projected year, is
10 a crude approach, expecting that future behavior will mirror past behavior.¹⁰
11 However, no evidence that is readily quantifiable has been presented to the contrary
12 in this case. This may be the least bad alternative: it does not rely on private
13 undisclosed information and involves minimal analyst judgment. In the case of
14 Capital One, however, the results are of mediocre quality.

15 4. Consideration of the various approaches to the estimation of the threshold volume
16 leads to the conclusion that the discount threshold should be based on publicly
17 available data and based on an estimating technique that requires a minimum of
18 analyst judgment. Whether a regression approach, either based on drivers which
19 would have to be publicly available or on simple time trends, would work is not clear;
20 this is an issue that will need to be resolved, possibly on a company-by-company
21 basis.

¹⁰ An alternative estimate using some judgment arrived at a projection of 1.6 billion pieces.

1 5. For the current NSA, the threshold should certainly be set at no less than 1.4 billion
2 pieces, not the significantly lower level advocated by Capital One. In fact, a higher
3 threshold could be justified.

4 6. Accordingly, the least bad approach to forecasting mail levels for the next
5 12 months in the case of Capital One may be an analysis of 12-month rolling totals,
6 with simple extrapolation to the following year. This approach is reproducible,
7 captures whatever trends are driving the business — either positively or negatively
8 — and is not particularly open to gaming. The drawback is that such an approach
9 may disadvantage a company such as Capital One whose mailings deviated
10 significantly upwards in the year prior to the test year. It should, however, be noted
11 that Capital One's explanation of the deviation has not been proven or substantiated
12 in testimony.

13 In order to have meaningful volume-based discounts, there has to be a good
14 understanding of the level of future business so as to avoid a free rider problem and to
15 justify the level of the discounts. The use of a 12-month roll may be the best forecasting
16 approach, given resource constraints and the need to remove unverifiable opinion from
17 the methodology. A regression or other approach might also yield meaningful
18 conclusions but should be based on publicly available information.

Data from Witness Elliott's Testimony and Interrogatories and Twelve Month Rolls

Date	Customer	Solicitation	Total	Time	12 mo Roll Customer	12 mo Roll Solicitation	12 mo Roll Total
Oct-98	20000000	64312211	84312211	Oct-98			
Nov-98	20000000	84513668	104513668	Nov-98			
Dec-98	20000000	70330103	90330103	Dec-98			
Jan-99	20093585	48713996	68807581	Jan-99			
Feb-99	18936302	51911135	70847437	Feb-99			
Mar-99	21429647	101113831	122543478	Mar-99			
Apr-99	20237967	53185873	73423840	Apr-99			
May-99	21493755	42784936	64278691	May-99			
Jun-99	21315898	51911418	73227316	Jun-99			
Jul-99	22366963	82763889	105130852	Jul-99			
Aug-99	22218406	45709167	67927573	Aug-99			
Sep-99	22283276	47420011	69703287	Sep-99			
Oct-99	23753037	78771652	102524689	Oct-99			
Nov-99	24924804	99036307	123961111	Nov-99			
Dec-99	28323271	56759404	85082675	Dec-99			
Jan-00	25733873	90404633	116138506	Jan-00			
Feb-00	24438019	35453537	59891556	Feb-00			
Mar-00	27320181	53057033	80377214	Mar-00			
Apr-00	29480138	38846756	68326894	Apr-00			
May-00	30351077	53642857	83993934	May-00			
Jun-00	30470815	82813549	113284364	Jun-00			
Jul-00	30068221	63641402	93709623	Jul-00			
Aug-00	32449688	48333024	80782712	Aug-00			
Sep-00	31289392	52860401	84149793	Sep-00			
Oct-00	35458669	36680749	72139418	Oct-00			
Nov-00	36222564	69978222	106200786	Nov-00			
Dec-00	38333630	69556071	107888701	Dec-00			
Jan-01	37538604	71609132	109147736	Jan-01			
Feb-01	37228200	67678601	104906801	Feb-01			
Mar-01	40595396	79707394	120302790	Mar-01			
Apr-01	39584216	53734153	93318369	Apr-01			
May-01	39613572	68816452	108430024	May-01			
Jun-01	40094283	50499839	90594122	Jun-01			
Jul-01	43936373	77390674	121327047	Jul-01			
Aug-01	41780602	61920684	103701286	Aug-01			
Sep-01	40206176	81359208	121565384	Sep-01			
Oct-01	46379476	109959062	156338538	Oct-01			
Nov-01	42756595	123429831	166186426	Nov-01			
Dec-01	49050084	114868000	163918084	Dec-01			
Jan-02	49347570	111473290	160820860	Jan-02			
Feb-02	46416492	90000000	136416492	Feb-02			
Mar-02	50472716	118835045	169307761	Mar-02			
Apr-02	50248542	98176516	148425058	Apr-02			
May-02	51306612	121404738	172711350	May-02			
Jun-02	48162673	56909685	105072358	Jun-02			
Jul-02	48732181	36351765	85083946	Jul-02			
Aug-02	50000000	43000000	93000000	Aug-02			
Sep-02	50000000	64000000	114000000	Sep-02			
					Customer	Solicitation	Total
					250375799	744670238	995046037
					254128836	759129679	1013258515
					259053640	773652318	1032705958
					267376911	760081619	1027458530
					273017199	801772256	1074789455
					278518916	785314658	1063833574
					284409450	737257860	1021667310
					293651621	722918743	1016570364
					302508943	733776664	1036285607
					311663860	764678795	1076342655
					319365118	745556308	1064921426
					329596400	748180165	1077776565
					338602516	753620555	1092223071
					350308148	711529652	1061837800
					361605908	682471567	1044077475
					371616267	695267234	1066883501
					383420998	676471733	1059892731
					396211179	708696797	1104907976
					409486394	735347158	1144833552
					419590472	750234555	1169825027
					428852967	765408150	1194261117
					438476435	733094440	1171570875
					452344587	746843712	1199188299
					461675501	760431372	1222106873
					470592285	788930179	1259522464
					481513092	862208492	1343721584
					488047123	915660101	1403707224
					498763577	960973030	1459736607
					510572543	1000837188	1511409731
					519760835	1023158587	1542919422
					529638155	1062286238	1591924393
					540302481	1106728601	1647031082
					551995521	1159316887	1711312408
					560063911	1165726733	1725790644
					564859719	1124687824	1689547543
					573079117	1105767140	1678846257
					582872941	1088407932	1671280873

1 CHAIRMAN OMAS: Mr. Smith, have you had an
2 opportunity to examine the packet of designated
3 written cross-examination that was made available to
4 you this morning in the hearing room?

5 THE WITNESS: Yes, sir.

6 CHAIRMAN OMAS: If the questions contained
7 in that packet were posed to you orally today, would
8 your answers be the same as those previously provided
9 in writing?

10 THE WITNESS: Yes, they would be.

11 CHAIRMAN OMAS: Are there any corrections or
12 additions that you would like to make to those
13 answers?

14 THE WITNESS: No, sir.

15 CHAIRMAN OMAS: Counsel, would you please
16 provide two copies of the corrected designated written
17 cross-examination of Witness Smith to the reporter?
18 That material is received into evidence and is to be
19 transcribed into the record.

20 (The document referred to was
21 marked for identification as
22 Exhibit No. OCA-T-1 and was
23 received in evidence.)

24 //

25 //

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
OF OFFICE OF THE CONSUMER ADVOCATE
WITNESS J. EDWARD SMITH
(OCA-T-1)

Party

American Postal Workers Union,
AFL-CIO

Capital One Services, Inc.

Newspaper Association of America

United States Postal Service

Interrogatories

APWU/OCA-T1-1-2

COS/OCA-T1-13, 17-19, 21-22

APWU/OCA-T1-4

COS/OCA-T1-1-3, 5-22

USPS/OCA-T1-1, 3-4

COS/OCA-T1-1-2, 6-7, 9

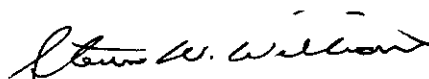
USPS/OCA-T1-1, 3-4

APWU/OCA-T1-1-4

COS/OCA-T1-1-3, 5-22

USPS/OCA-T1-1-5

Respectfully submitted,



Steven W. Williams
Secretary

INTERROGATORY RESPONSES OF
OFFICE OF THE CONSUMER ADVOCATE
WITNESS J. EDWARD SMITH (T-1)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory

APWU/OCA-T1-1
APWU/OCA-T1-2
APWU/OCA-T1-3
APWU/OCA-T1-4
COS/OCA-T1-1
COS/OCA-T1-2
COS/OCA-T1-3
COS/OCA-T1-5
COS/OCA-T1-6
COS/OCA-T1-7
COS/OCA-T1-8
COS/OCA-T1-9
COS/OCA-T1-10
COS/OCA-T1-11
COS/OCA-T1-12
COS/OCA-T1-13
COS/OCA-T1-14
COS/OCA-T1-15
COS/OCA-T1-16
COS/OCA-T1-17
COS/OCA-T1-18
COS/OCA-T1-19
COS/OCA-T1-20
COS/OCA-T1-21
COS/OCA-T1-22
USPS/OCA-T1-1
USPS/OCA-T1-2
USPS/OCA-T1-3
USPS/OCA-T1-4
USPS/OCA-T1-5

Designating Parties

APWU, USPS
APWU, USPS
USPS
Capital One, USPS
Capital One, NAA, USPS
Capital One, NAA, USPS
Capital One, USPS
Capital One, USPS
Capital One, NAA, USPS
Capital One, NAA, USPS
Capital One, USPS
Capital One, NAA, USPS
Capital One, USPS
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APWU, Capital One, USPS
APWU, Capital One, USPS
Capital One, NAA, USPS
USPS
Capital One, NAA, USPS
Capital One, NAA, USPS
USPS

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES APWU/OCA-T1-1-4

APWU/OCA-T1-1. Did you test various exogenous explanatory drivers in your equations? If so which ones and what were the results?

RESPONSE TO APWU/OCA-T1-1.

No. Capital One expressed its mail forecast in terms of management projections of the future level of mailings and the effect of a per-piece discount on the projections. The exogenous explanatory drivers of Capital One's mail volume and the marketing strategies used by Capital One remain private undisclosed information. Accordingly, such variables could not be used.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES APWU/OCA-T1-1-4

APWU/OCA-T1-2. Did you use Capital One's Standard mail solicitation volume in any of your regressions? If so, what were the results? If not, why not?

RESPONSE TO APWU/OCA-T1-2.

No. There was no information available to permit an adequate analysis.

For example, one would wish to consider the potential drivers of demand for mailing services, the decision process used to choose between Standard Mail, First-Class Mail, and the marketing strategy of Capital One as well as associated variables.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES APWU/OCA-T1-1-4

APWU/OCA-T1-3. You state on page 14 of your testimony that various dummy variables were considered for improvement of the equation for customer mail and several were found to be statistically significant. Which dummy variables were found to be statistically significant? Were dummy variables tested in the solicitation mail equations? If so, which ones, and were any of those dummy variables found to be statistically significant?

RESPONSE TO APWU/OCA-T1-3.

For Customer mail, see equations 2, 3, 4, and 5 (which correspond, respectively, to columns 2, 3, 4, and 5) of Table 2. A t value greater than 1.96 (for infinite sample size, slightly different for small samples) would denote statistical significance of the variable at the five- percent level.

For Solicitation mail, see equations 7 and 8 (which correspond, respectively, to columns 7 and 8) of Table 3. A t value greater than 1.96 (for infinite sample size, slightly different for small samples) would denote statistical significance of the variable at the five- percent level.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES APWU/OCA-T1-1-4

APWU/OCA-T1-4. You state on page 19 of your testimony that the extrapolation of the previous year's experience to the current projected year may be the least bad alternative to determining a threshold volume. Does this mean that you believe only two years of volume data are required to make an assessment of any company's trend volume? Is so, why? If not, how many years of volume data should be provided, in your opinion?

RESPONSE TO APWU/OCA-T1-4.

The extrapolation that I have presented is based on a one-year trend, with a selective choice of trend for the Alternative Projection. Analysts could easily disagree over the appropriate time period for the selection of a trend, and business conditions can change significantly from year to year, thereby significantly impacting a trend. In general, the trend for a previous year, assuming that the business conditions are not radically changed, could be used to project a future year. However, I base this observation on common sense, not a reference to the economics or marketing literature. If business conditions were radically changed, then one would need to make an adjustment, as I did in the Alternative Projection. Again, I base this observation on common sense, not a reference to the economics or marketing literature.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-1-12

COS/OCA-T1-1. Please refer to pages 2 and 3 of your testimony where you discuss the elasticity study used by witness Elliott, your understanding of the drivers of Capital One's First-Class Mail volume, and your understanding of the composition of workshared First-Class Mail. Based upon your understanding of the drivers of Capital One's First-Class Mail volume and the composition of workshared First-Class Mail, is it your opinion that the own-price elasticity for Capital One's First-Class Mail is more likely to be higher than the own-price elasticity of other workshared First-Class Mail or lower than the own-price elasticity of other workshared First-Class Mail. Please describe the basis of your response in detail.

RESPONSE TO COS/OCA-T1-1.

I don't know. Capital One has not provided detailed information on the drivers of workshared First-Class mail or its composition in comparison to workshared First-Class mail in general.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-1-12

COS/OCA-T1-2. Please refer to the four line passage of your testimony beginning on page 2 at line 21, where you state that "... Capital One's Solicitation mail may be quite different from other workshared First-Class mail. Workshared mail could contain billing, customer communication, and possibly other types of mail in addition to solicitation mail; such is not, however, the case for Capital One's Solicitation mail." Please also refer to Exhibit 6 of Witness Elliott's testimony, where the after-rates increase of 15,458,969 pieces is calculated that you discuss in your testimony on page 2 at lines 14-17.

- (a) Please confirm that Witness Elliott applies the Postal Service price elasticity for workshared First-Class letters to the total projected FY 2003 First-Class Mail volume for Capital One.
- (b) Please confirm that the total First-Class Mail volume for Capital One includes billing and customer communication mail, in addition to solicitation mail.

RESPONSE TO COS/OCA-T1-2.

- (a) Confirmed that Witness Elliott used the Postal Service's elasticity for workshared First-Class mail on a combined basis for Capital One—i.e., Solicitation and Customer Mail combined. This approach appears to be based on the assumption that the two types of mail can be summed and, subsequently, a single elasticity for workshared First-Class mail can be used. Also, implicit in the procedure is that Capital One's Solicitation mail is not different from that of other workshared First-Class mail. This appears to be an unrealistic assumption in terms of Capital One's Solicitation mail and the Solicitation mail of other organizations.
- (b) Confirmed.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-1-12

COS/OCA-T1-3. Please refer to pages 2-3 of your testimony and Appendix G, page 1 of the Postal Rate Commission's Opinion and Recommended Decision from Docket No. R2001-1 and assume that the unit contribution of Capital One's First-Class Mail letters is equal to the unit contribution of First-Class Mail letters as a whole.

- (a) Please confirm that the FY 2003 unit contribution for the First-Class Mail Letter subclass as shown in Appendix G is 18.437 cents per piece. If not confirmed, please explain fully.
- (b) Please confirm that the maximum block discount included in the negotiated service agreement (NSA) is six cents per piece.
- (c) Please confirm that for every new First-Class Mail letter that Capital One mails in response to the volume discounts, Capital One's Test Year contribution to institutional costs will increase by at least 12.437 cents (18.437 cents minus no more than 6 cents). If not confirmed, please explain fully.
- (d) Please confirm, ceteris paribus, that if Capital One's own-price elasticity is higher than estimated by Dr. Elliott, then the volume-discount portion of the Capital One NSA will make a larger contribution to institutional costs than estimated by USPS witness Crum.

RESPONSE TO COS/OCA-T1-3.

- (a) Although I have not testified on the derivation of the 18.437 cents per piece figure, I confirm that I have seen the number as represented in the interrogatory.
- (b) Confirmed.
- (c) Not Confirmed. For mailings beyond the level of mailings that would have otherwise occurred the statement is correct. However, the volume discount commences below the level of mailings that would have otherwise occurred, creating a free rider problem, and these revenue losses offset revenue gains.
- (d) Confirmed as a matter of arithmetic.

**ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-1-12**

COS/OCA-T1-5. Please refer to Graph 1 of your testimony on page 7 and the corresponding statistics in Appendix 1. The time series labeled as "Solicitation" appears to be a mislabeled time series for "Total." The time series labeled as "Total" appears to be some multiple of the "Total" time series. Please provide a corrected graph.

RESPONSE TO COS/OCA-T1-5.

Graph 1 of the testimony is incorrect. A correct graph is denoted as Chart 1 in the accompanying file OCACOS. The correct graph served as the basis for the development of the testimony. During the final preparation of the testimony I attempted to enhance the graph and inadvertently changed the graph. This does not, however, change any of the conclusions: all use of the graph in the testimony was based on the correct graph.

Please note that errata filed on January 3, 2002, included a revised Graph 1.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-1-12

COS/OCA-T1-6. Please refer to Graph 2 of your testimony on page 8 and the corresponding statistics in Appendix 1. The time series labeled as "Solicitation" appears to be a mislabeled time series for "Total." The time series labeled as "Total" appears to be some multiple of the "Total" time series. Furthermore, the graph appears to provide 12-month moving totals rather than 12-month moving averages. Please provide a corrected graph.

RESPONSE TO COS/OCA-T1-6.

Graph 2 of the testimony is incorrect. A correct graph is denoted as Chart 2 in the accompanying file OCACOS. The correct graph served as the basis for the development of the testimony. During the final preparation of the testimony I attempted to enhance the graph and inadvertently changed the graph. This does not, however, change any of the conclusions: all use of the graph in the testimony was based on the correct graph.

The graph provides the average yearly mailings for a 12-month year on a moving total basis. Given that the interrogatory indicates some confusion, the title has been revised to provide the heading 12-Month Moving Totals, which is the thought that I was attempting to convey.

Please note that errata filed on January 3, 2002, included a revised Graph 2.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-1-12

COS/OCA-T1-7. Please refer to page 16 of your testimony at line 1 where you state, "[t]he regression results for Solicitation Mail are of poor quality."

- (a) What is it about the regression results that indicates that they are of "poor quality"?
- (b) Conversely, what would be an indication of regression results that are not of "poor quality"?
- (c) In your regression analysis, did you fit any equations for Solicitation Mail that included a dummy variable that distinguished the eight-month period from October 2001 to May 2002? If yes, please provide the results and supporting documentation for all such equations. If no, please explain why you did not conduct such an analysis.

RESPONSE TO COS/OCA-T1-7.

- (a) I was concerned that the R squared statistics were low and that the time variables were statistically insignificant. Insignificance of the time variables is sufficient to eliminate the equations from consideration.
- (b) Some of the more important issues would be obtaining an adequate R square and statistically meaningful variables.
- (c) No. Such an analysis would have required the use of private unverifiable data. There is not sufficient information in this case to understand Capital One's marketing strategy and plans. Accordingly, there is an insufficient basis upon which to evaluate which months, if any, should be modeled with dummy variables. When one obtains a regression result that one does not prefer, it is frequently possible to modify the equation to obtain a better result. However, there was no meaningful reason other than private unverifiable data upon which to justify such a modification. Accordingly, such an analysis was not performed for the time period mentioned, although there was some attempt to model specific months (rather than an extended time period). If the analysis had been performed, the analysis would have been of little value. There is no way to know what the value of a dummy variable should be when extrapolating the equation to the future.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-1-12

COS/OCA-T1-8. Please refer to pages 17-18 of your testimony where you describe your extrapolation approach to projecting mail volumes from previous year's mail volumes.

- (a) Please confirm that, ceteris paribus, your extrapolation approach will overstate projected mail volume if growth rates during the projected year are smaller than they were in previous years.
- (b) Please confirm that, ceteris paribus, your extrapolation approach will overstate projected mail volume if the mail volume in the base year used to extrapolate from is unusually high compared to previous growth trends.

RESPONSE TO COS/OCA-T1-8.

(a) Confirmed.

(b) Confirmed.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-1-12

COS/OCA-T1-9. Please refer to page 18 of your testimony at lines 1-7, where you describe projections for 2003.

- (a) Please confirm that your projections for Customer and Solicitation Mail are for FY 2003, not for calendar year 2003.
- (b) Please describe the period of time used to calculate the "growth rate of 2001-2002" referred to in lines 1-2 and lines 4-5.

RESPONSE TO COS/OCA-T1-9.

- (a) Confirmed.
- (b) See Sheet 1 of Excel file OCACOS. September 01/September 02 is the time frame. For growth rates, computations can be traced for Customer mail from Cell D69 to Cell D55, which is the annualized growth of cell C55; the cell C55 contains the formula. For Solicitation Mail, cell D70 is identical to cell C63, a 12 month annualized growth rate of Cell 61.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-1-12

COS/OCA-T1-10. Please refer to page 18 of your testimony at lines 8-12, where you describe an "alternative projection" of Solicitation Mail for 2003.

- (a) Please confirm that these alternative projections for Customer and Solicitation Mail are for FY 2003, not for calendar year 2003.
- (b) What is the Solicitation Mail volume for the 12 months ending September 2001 that you use to extrapolate for your 2003 projection?
- (c) What is the "growth rate for Solicitation mail over the period 2000-2001" that you use for your extrapolation? Please provide a derivation of this growth rate.

RESPONSE TO COS/OCA-T1-10.

- (a) Confirmed.
- (b) 788,930,179 pieces, cell G38 of OCACOS Sheet1.
- (c) In OCACOS Sheet 1 Cell F70 is cell D65, the product of cell C65 (cell 64, the 12 month growth rate ending Sept 2001 extrapolated for two years) and cell G38 (the Solicitation mail 12 month total ending Sept 2001).

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-1-12

COS/OCA-T1-11. Please refer to Table 4 on page 18 of your testimony, where you provide the figures for your two projections for 2003. Please also refer to Exhibit 7 of Witness Elliott testimony.

- (a) Please confirm that the Solicitation Mail volume in your alternative projection is 636,977,327 pieces lower than your first projection of Solicitation Mail volume for 2003.
- (b) Please confirm that your alternative projection for Customer Mail volume for 2003 is the same as your first projection of Customer Mail volume for 2003.
- (c) Please confirm that, *ceteris paribus*, a lower level of Solicitation Mail is likely to lead to a lower level of growth in Customer Mail.
- (d) Please confirm that a reduction in Solicitation Mail volume by 636,977,327 pieces would result in 3,821,864 fewer new accounts, under the assumption of a 0.6 percent rate of new account yield from solicitations used by Witness Elliott in Exhibit 7.
- (e) Please confirm that 3,821,864 fewer new accounts would result in 23,886,650 fewer Customer Mail pieces, under the assumptions used by Witness Elliott in Exhibit 7 that an average account has 12.5 annual pieces of customer mail and that an average new account is active for half the year in which it is started.

RESPONSE TO COS/OCA-T1-11.

- (a) Confirmed
- (b) Confirmed
- (c) Confirmed on a *ceteris paribus* basis.
- (d) Confirmed that the computations are correct given the assumptions.
- (e) Confirmed that the computations are correct given the assumptions.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-1-12

COS/OCA-T1-12. Please refer to page 14 of your testimony at lines 23-24 where you state "It is not surprising, therefore, that the regression equations did not find a strong, increasing relationship between Solicitation mail and time."

- (a) Is there a statistically significant relationship between Solicitation mail and time in the volumes for the period from October 1998 to September 2001?
- (b) Is there a statistically significant relationship between Solicitation mail and time in the volumes for the period from October 2001 to May 2002?
- (c) Is there a statistically significant relationship between Solicitation mail and time in the volumes for the period from October 1998 to September 2001 when combined with the volumes for the period from June 2002 to September 2002?

RESPONSE TO COS/OCA-T1-12.

- (a) No statistically significant relationship based on the dataset from October 1998 through September 2002 was found; the relationship relative to September 2001 was not tested. The regression was not run for the time period.
- (b) No statistically significant relationship based on the dataset from October 1998 through September 2002 was found; the relationship relative to October 2001 and May 2002 was not tested. The regression was not run for the time period.
- (c) No statistically significant relationship based on the dataset from October 1998 through September 2002 was found. The regression was not run for the time period as stated in the interrogatory. See my response to COS/OCA-T1-7c.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-13-22

COS/OCA-T1-13. Please refer to your response to COS/OCA-T1-2(a) where you state, "Also, implicit in the procedure is that Capital One's Solicitation mail is not different from that of other workshared First-Class mail. This appears to be an unrealistic assumption in terms of Capital One's Solicitation mail and the Solicitation mail of other organizations." Please describe in what ways you believe Capital One's Solicitation mail is different than First-Class Solicitation mail sent by other organizations.

RESPONSE TO COS/OCA-T1-13.

The quality of the mailing list, the use of customer segmentation, and the total volume of Solicitation mail could result in Capital One's work-shared First-Class Solicitation mail being different from work-shared First-Class Solicitation mail sent by other organizations. The quality of the mailing list could impact the amount of UAA mail generated by the mailing, the number of potential customers reached per mailing, the speed with which customers are reached, and ultimately the response rates per thousand pieces. The use of customer segmentation could impact message content and customer response rates. Response rates can range from very low to 5% or more, depending on message, segmentation, and product. The volume of mail and how it is split between First-Class and Standard Mail could also be expected to be related to UAA, segmentation, and marketing strategy issues.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-13-22

COS/OCA-T1-14. Do you believe that the own-price elasticity for solicitation mail in total is higher than or lower than the own-price elasticity of billing and customer communication mail in total? Please describe your reasoning fully.

RESPONSE TO COS/OCA-T1-14.

I don't know. Separate own-price elasticities for Solicitation and Customer communication First-Class mail are unavailable. Such elasticities in the case of Capital One would be a function of Capital One's marketing strategy and business operations, both of which are private undisclosed information.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-13-22

COS/OCA-T1-15. Please refer to your response to COS/OCA-T1-2(a) where you state, "This approach appears to be based on the assumption that the two types of mail can be summed and, subsequently, a single elasticity for workshared First-Class mail can be used." Please confirm that in its calculation and use of a single elasticity for workshared First-Class Mail, the Postal Service also makes the assumption that the different types of workshared First-Class Mail can be summed and that the elasticity of that sum can be used for rate-setting purposes.

RESPONSE TO COS/OCA-T1-15.
Confirmed.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-13-22

COS/OCA-T1-16. Please refer to your response to COS/OCA-T1-7(a) where you state, "Insignificance of the time variables is sufficient to eliminate the equations from consideration."

- (a) Please confirm that a mail volume data series that is neither increasing nor decreasing over time is likely to produce regression results with time variables that are statistically insignificant. If not confirmed, please explain fully.
- (b) The above quoted statement from your response to COS/OCA-T1-7(a) implies that you would eliminate a regression equation from consideration for the mail volume data series described in subpart (a) of this interrogatory on the basis of its statistically insignificant time variables. Please explain whether this is the case.

RESPONSE TO COS/OCA-T1-16.

- (a) Confirmed. In such a case, the current year's volume could be used to predict the future year's volume.
- (b) Confirmed that this is the case for the equations that I have considered.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-13-22

OCA/COS-T1-17. Please refer to your response to COS/OCA-T1-9(b). Please confirm that your projection uses a growth rate derived from volume data covering the period from October 2000 to September 2002.

RESPONSE TO COS/OCA-T1-17.

Confirmed. The number 1,501,567,386 is based on the total Solicitation mailings during the 12 months ending September 2002 multiplied by the growth rate of these total 12 month mailings over the time period 12 months ending September 2001 to 12 months ending September 2002. The Solicitation mailings during the 12 months ending September 2001 include the total of the monthly mailings for the months October 2000 through September 2001. Similarly, the number 721,943,126 is based on total Customer mailings during the 12 months ending September 2002 multiplied by the growth rate of these total 12 month mailings over the time period September 2001 to September 2002. The Customer mailings during the 12 months ending September 2001 include the total of the monthly mailings for the months October 2000 through September 2001.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-13-22

OCA/COS-T1-18. Please refer to your response to COS/OCA-T1-10(c). Please confirm that your alternative projection uses a growth rate derived from volume data covering the period October 1999 to September 2001.

RESPONSE TO COS/OCA-T1-18.

Confirmed. The number 864,590,059 is based on total Solicitation mail pieces for the 12 months ending September 2001 and the growth rate of the total 12 month mailings over the time period September 2000 through September 2001, extrapolated through 2003. The Solicitation mailings during the 12 months ending September 2000 include the total of the monthly mailings for the months October 1999 through September 2000.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-13-22

OCA/COS-T1-19.

On page 3 of your testimony, you state that the payment of incentives at a lower than forecasted volume creates a significant free-rider problem, that is, the payment of an incentive where none is necessary, because the mail would have been sent even absent an incentive. I ask you to assume that the payment of the discount is not for the purpose of incenting First-Class volume but rather to incent the mailer, in this case Capital One, to enter into an agreement which has significant cost-savings opportunities for the Postal Service. On that assumption, would the payment of a discount for volume which would materialize in any event create the "free-rider" problem to which you allude. Please explain any affirmative answer.

RESPONSE TO COS/OCA-T1-19.

On the basis of the requested assumption, the answer is "yes". The free-rider problem does not go away. It merely changes appearance. Under your requested assumption, instead of paying discounts on volume that would have been mailed anyway, the Postal Service would be paying money to induce behavior that would have occurred anyway. Witness Jean has testified that Capital One will save money by accepting electronic returns in lieu of physical returns. Thus, there should be no need for the Postal Service to pay anything to get Capital One to accept electronic returns.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-13-22

OCA/COS-T1-20.

I direct your attention to your testimony at page 11, where you state that the number of Capital One customer mailings is a near-deterministic function of the number of existing credit cards, and to the testimony of Capital One witness Jean that the company has made a decision to convert substantial numbers of its statement mail to electronic statements over the next three years. (Tr. 2/40). If that statement turns out to be correct, is it not the case that the number of customer mailings will not be a "near-deterministic function of the number of existing credit cards," but, in fact, the growth of customer mail will slow, and, possibly, cause a reduction in the gross volume of customer mail?

RESPONSE TO COS/OCA-T1-20.

On a *ceteris paribus* basis—an assumption which appears to be inappropriate—the assertion that "the growth of customer mail will slow, and, possibly, cause a reduction in the gross volume of customer mail" may possibly be true.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-13-22

OCA/COS-T1-21. Please refer to your testimony on page 17 where you say that: "Although one can obtain a trend analysis for customer mailings, a trend analysis for solicitation mailings appears to be meaningless." I take it that you imply that a trend analysis for customer mailings is meaningful and valuable. If that is your view, please explain whether your trend analysis took account of the Company's testimony that it was already engaged in and intended to accelerate its conversion of customer mail to electronic communications over the term of the Negotiated Service Agreement. If the answer is in the negative, please explain why your trend analysis of customer mail has any value, given the fact that it does not take account of uncontroverted statements by the Company as to its future behavior.

RESPONSE TO COS/OCA-T1-21.

Capital One's private undisclosed information on its marketing programs would be needed in order to improve, modify, and upgrade the trend analysis. Thus there has been no opportunity for significant analysis. The available data provide the level of mailings; also provided is an unverifiable assertion that there will be a conversion of customer mail to electronic communications over the term of the Negotiated Service Agreement. The OCA analysis was performed based on the best available data. Capital One's statements about its future behavior are speculative. The data report what actually occurred, and the trend reports the implications.

ANSWERS OF OCA WITNESS J. EDWARD SMITH
TO INTERROGATORIES COS/OCA-T1-13-22

OCA/COS-T1-22. On page 17 of your testimony you state that: "It is not surprising that regression analysis has not provided strong results. If one had access to Capital One's private undisclosed information, one might, of course, obtain better results." Is it not the case that, even though you did have access to the Company's disclosed information that they intended to convert in an aggressive manner to electronic communications with their customers, as opposed to First-Class mail communications, that your regression analyses failed to take account of that fact in your calculations?

RESPONSE TO COS/OCA-T1-22.

Please see my response to OCA/COS-T1-21. Again, Capital One's statement of possible future actions is speculative. We must remember that Capital One's market planning process has generally been in terms of a six-month time horizon, requiring special efforts by managers in generating longer-term forecasts. Accordingly, incorporation of the qualitative and unsubstantiated information is of questionable value.

USPS/OCA-T1-1. Using that methods you discuss in your testimony and any other method you choose, please forecast Capital One's mail volume for October, November, and December. Please explain the rationale underlying your forecast. If you cannot provide a forecast, please explain.

RESPONSE TO USPS/OCA-T1-1.

Data for Capital One's First-Class Customer mail and Solicitation mail were presented in the OCACOS spreadsheet. The Capital One data are available from witness Elliott's testimony, COF-T-2, Exhibit 2, revised 11/1/02, Tr. 2/207, and presented for August and September 2002 in the response to OCA/COS-T2-5, Tr. 2/238. For purposes of this response, the updated August and September data were used. The objective of this response is to provide a forecast of Capital One's mail volume for October, November, and December of 2002.

Customer Mail: I forecast the Customer mail level for calendar year 2002 based on the growth rate for the 12 months ended September 2001 and the level of 12 month customer mailings as of December 2001. I then subtract the level of mailings for the nine months ended September 2002. The remainder is the total forecasted volume for October, November, and December 2002.

Solicitation Mail: I forecast the Solicitation mail level for calendar year 2002 based on the growth rate for the 12 months ended September 2001 and the level of 12 month solicitation mailings as of December 2001. I then subtracted the level of mailings for the nine months ended September 2002. The remainder is the total forecasted volume for October, November, and December 2002.

The calculations are delineated in the following table.

	Customer Mail	Solicitation Mail	Total Mail
12 mo ending Septmbr2000	338,602,516	753,620,555	1,092,223,071
12 mo ending Septmbr2001	470,592,285	788,930,179	1,259,522,464
Monthly growth rate	1.028	1.004	
Annual Growth Rate	1.390	1.047	
12 mo ending Decmbr2001	498,763,577	960,973,030	1,459,736,607
Projection 2002	693,185,314	1,005,997,806	1,699,183,120
Mail Pieces 9 mo ending September2002	443,200,101	728,770,157	1,171,970,258
Difference (Oct, Nov, Dec)	249,985,213	277,227,649	527,212,862

USPS/OCA-T1-2. Assume that Capital One's forecast for FY2003 for the Before Rates Volume was the following:

- a) 1.2 Billion pieces
- b) 1.3 Billion pieces

Please describe in detail how such a forecast would affect your testimony.

RESPONSE TO USPS/OCA-T1-2.

My testimony addresses the possible approaches for arriving at a forecast level and the need to avoid a free rider problem. On the assumption that the Capital One forecast is verifiable and is based on a methodology acceptable to the Postal Service, and consistent with the criteria in witness Callow's testimony, then the number would be suitable for the NSA.

My testimony would be unchanged in either case under the above conditions.

The free-rider problem would have been addressed, and an appropriate forecasting methodology would have been implemented. My testimony did not find a way in which to produce a regression based forecast, and I was limited to advocating an approach based on previous growth rates. Either of these approaches, or some other approach, should be acceptable if they avoid the free rider problem, are verifiable based on publicly available data, and acceptable to the Postal Service.

USPS/OCA-T1-3. Please confirm that in evaluating the proposed rate, classification, and fee changes in the Postal Service's Request, the Commission should consider the entire impact on contribution and not just the impact on one part of the proposed changes.

RESPONSE TO USPS/OCA-T1-3.

I confirm that the Commission should consider the impact on contribution generated by Capital One's competitors, the impact on contribution generated by Capital One, and whether or not there is a free rider problem.

USPS/OCA-T1-4. Please refer to the changes in rates, classification, and fees proposed by witness Callow. Also, please refer to Capital One Services, Inc. mailing volume history which is presented through July 2002 in Exhibit 2 to COS witness Elliot's testimony, COS-T-2, Tr. 2/207, and presented for August and September 2002 in the response to OCA/COS-T2-5, Tr. 2/238. Given your testimony, please state how that Postal Service would set Capital One's discount threshold and what the threshold would be. If you cannot provide a threshold and a rationale for the threshold, please explain why not.

RESPONSE TO USPS/OCA-T1-4.

Please see my testimony, Direct Testimony of J. Edward Smith, OCA-T-1. On page 10 I indicate that "A Company-Specific demand study is needed for a full understanding of future mailing levels". Although I attempted some regression analysis, such efforts were unsuccessful in the case of First-Class Solicitation mail.

Lacking a regression analysis basis for the forecasting of Capital One's mail volume, I used a simple extrapolation of trends, as presented in Table 4 at 18 of my testimony. Such an extrapolation assumes that the future will resemble the past. It is not clear that this approach, or alternatively a regression approach, will work for the estimation of mail volumes by Capital One if, in fact, Capital One has changed its marketing strategy. The prediction is presented under the heading "Alternative Projection" in Table 4.

I believe that the threshold for a year should be set at the estimated volume for the year; accordingly, volume in excess of the threshold would be eligible for a discount. This largely eliminates the problem of free riders.

Ultimately, in implementing a classification recommended by the Postal Rate Commission, the Postal Service will determine an acceptable procedure or procedures for the estimation of volume which takes into account problems of free riders, data availability, and impacts on competitors and their use of the mail.

USPS/OCA-T1-5. Please describe the forecasts of volumes you have done for publicly-held companies and the method you used to forecast them.

RESPONSE TO USPS/OCA-T1-5.

This response will present information on a variety of forecasting efforts in which I have been involved. The comments focus on forecasting efforts for a major electrical equipment manufacturer and a major distributor of natural gas. The information delineated under "All Other" represents forecasting efforts which were less elaborate. Generally, the choice of forecasting approach is a function of the level of effort which the management, client, or decision maker deems appropriate in view of the uncertainty, importance, or significance of the results.

Electrical Equipment

I modified, developed, or estimated forecasting models for the overall market level of orders for Alternating Current (AC) electrical power equipment in the United States. The electric utility industry and some major power users or producers order a variety of items related to the production and consumption of electricity. Major types of high voltage electric generation, transmission, and distribution products include the following:

- **Generation units:** Electricity is generally generated at voltages in excess of 13,000 volts by generation units powered by coal, natural gas, hydro power, oil, or nuclear sources. Generally a number of units are located in a power plant, and new orders may represent additions to an existing plant or the building of a new plant. There is a wide variety of equipment options. The units are complex, expensive, and produced in limited numbers in a given year.

- **Power transformers:** Power transformers step-up the 13,000 volt power from the generation unit to 525,000 volts (significantly more or less, depending on system design) for transmission.
- **Switchgear** generally resides next to the transformer, is of a similar capacity, and handles the switching of current with voltages as high as 765,000 volts or more. Although there is no downward limit on size, the cutoff point for forecasting purposes would be in the neighborhood of 13,000 volts.
- **Distribution transformers:** Distribution transformers are the pole pots or green ground boxes around residential neighborhoods; a larger voltage/size of transformer will be used in factories, generally transforming electricity to 440/230/115 volts rather than the 230/115 volts option.

The definition of the products indicates that they have one important factor in common: the demand for the products is driven by the need to produce and distribute electricity. Accordingly, in producing sales forecasts, the first requirement is to produce a forecast of the demand for electricity. The estimate of electric demand, measured in kilowatt hours, (kwh) is then used to estimate kilowatts (kw) of capacity. The kw capacity estimates translate into total product demand, with actual units consisting of some multiple of kw capacity. Depending on the type of equipment, there will be lags of six months to six years between identification of the need for the equipment (the order) and the actual manufacture of the product (the sale). Business forecasts of orders to be received by a specific company are based on the overall estimate of the total

market product demand, taking into account product ordering cycles, production cycles, and the oligopolistic equilibrium of the market.

1. Estimate the demand for electricity

The demand for electricity is a summation of the demands of a variety of end users--e.g., the residential, commercial, and industrial markets; there is also a variety of other, minor demands (e.g., transportation).

A. Commercial Sector

- Define the commercial sector in terms of building types; the model will typically have 10 different types of buildings.
- Obtain a baseline total of square feet of commercial space by building type for the base year; the estimate is based on commercial additions over a past time period with appropriate removal rates applied.
- Determine appropriate drivers of yearly construction additions to commercial sector square feet, by building type. Data for the drivers are available from forecasting services.
- Forecast new construction: Square feet of new commercial construction by building type can be forecasted through regression analysis of the drivers.
- Combine existing and estimated square feet of commercial building space by type of building for each type of building and year.
- Obtain annual electric consumption per square foot by end use and type of building; adjust for trends.
- Forecast future electric consumption on the basis of energy use per sq ft, end use, and square feet.

B. Industrial Sector

- Define major electric using industries--to be modeled separately.
- Non major industries--to be modeled as one or more "all-other" variables.
- Determine base year electric consumption
- Determine major electric drivers for each industry--generally based on economic forecasts purchased on an ongoing basis from major forecasting organizations.
- Determine level of drivers for future periods.
- Produce forecasts of energy use, taking into account the normal econometric procedures in dealing with time series data.

C. Residential Sector

- Determine existing residential stock of housing
- Determine energy use per square foot by end use.
- Determine market penetration by fuel type.
- Determine market drivers of new construction.
- Forecast new housing units.
- Generate forecasts for future energy consumption based on end use and number of units.

2. Derivation of capacity

The total electric consumption is a summation of the three major sectors plus a variety of other, minor sectors. This gives the total kilowatts consumed (generally expressed in terms of megawatt hours in order to eliminate a number

of zeros--MWH). This figure is a measure of output of electricity. It is not a measure of megawatts of installed generating capacity. Megawatt hours are translated into megawatts based on known usage patterns. These patterns change slowly, so no analysis of MW and MWH is generally needed, although such an analysis could be performed.

3. Finalization of the Forecast

To obtain forecasts of the demand for future product (i.e., generators, transformers, switch gear, etc.), determine the relationship between increases in MW capacity and product usage. This converts MW of capacity into MW of orders, with unit capacities and voltages generally a function of previous experience. Given that the high voltage AC electrical equipment market is an oligopoly with fixed shares at optimum prices by existing firms, one can determine the actual orders for a specific firm based on an unchanging oligopoly solution.

Natural Gas Forecasting

Working for a gas distribution utility I generated sales forecasts for gas in terms of end use sector, e.g., residential, commercial, multifamily.

1. Residential: The residential model generally corresponded to the design of a residential model for electric use. Heating is the dominant load, followed closely by hot water usage. The first input is end use by housing type for the existing housing stock. An analysis of trends in this usage is necessary. Forecasts of new residential construction housing generally drive major changes in future

consumption, with an allowance being made for changing technologies in end use efficiencies. In addition, an estimate of market penetration by fuel choice and end use is necessary, generally being based on existing trends.

2. Commercial and Multifamily, firm usage: Gas use in both types of space is dominated by boiler fuel or, alternatively, food processing needs, depending on building design and type. A commercial or multifamily model is based on an initial estimate of existing units, usage per square foot or unit, projected unit/square foot additions, and market penetration. Projections are usually derived via regression analysis employing appropriate drivers.

3. The total forecast for each year is a summation of the three sectors plus any miscellaneous uses the analyst chooses to include.

Other Industries

I have also worked on forecasting procedures in a variety of other industries. This work has frequently been less elegant in terms of the level of effort and, therefore, level of model complexity. The work has been focused on budgeting processes on a rapid turnaround basis. Industries have included shoes, information technology, engineered materials, and automated processing equipment. All forecasting work involves the identification of market drivers, the prediction of how the drivers will vary in the future, and the development of relationships between drivers and orders/sales.

1 CHAIRMAN OMAS: Is there any additional
2 written cross-examination for Witness Smith?

3 (No response.)

4 CHAIRMAN OMAS: This brings us now to oral
5 cross-examination. Four parties have requested oral
6 cross-examination. As Capital One and the Postal
7 Service are jointly sponsoring the proposal in this
8 case, consistent with our practice they will cross-
9 examine last.

10 The American Postal Workers Union AFL-CIO,
11 Mr. Luby?

12 MR. LUBY: Mr. Chairman, we have no cross-
13 examination.

14 CHAIRMAN OMAS: Thank you. Sir, would you
15 repeat that again and put the mike on so that the
16 reporter can transcribe it?

17 MR. LUBY: Mr. Chairman, we have no
18 examination at this time.

19 CHAIRMAN OMAS: Thank you, Mr. Luby.

20 MR. LUBY: Thank you.

21 CHAIRMAN OMAS: The Newspaper Association of
22 America, Mr. Baker?

23 (No response.)

24 CHAIRMAN OMAS: Capital One Services, Inc.,
25 Mr. May?

1 MR. MAY: Yes.

2 CROSS-EXAMINATION

3 BY MR. MAY:

4 Q Good morning, Mr. Smith.

5 A Good morning, Mr. May.

6 Q Would you please refer to your response to
7 USPS Question 4 to you?

8 A I have it.

9 Q In that answer you state, "Lacking a
10 regression analysis basis for the forecasting of
11 Capital One's mail volume, I used a simple
12 extrapolation of trends as presented in Table 4 at
13 page 18 of my testimony. Such an extrapolation
14 assumes that the future will resemble the past."

15 Now, your statement that such an
16 extrapolation assumes the future resembles the past
17 doesn't just apply to forecasting Capital One's mail
18 volume, right? This would apply to forecasting mail
19 volume for any participant in Mr. Callow's proposed
20 volume based declining block rates classification. Is
21 that correct?

22 A Assuming the Postal Service used this
23 approach. Yes, sir.

24 Q And what you mean by your statement that the
25 future will resemble the past is that future growth

1 rates will resemble past growth rates? Is that
2 correct?

3 A Yes. Yes, sir.

4 Q Now, you also note in response to this same
5 interrogatory, "It is not clear that this approach, or
6 alternatively a regression approach, will work for the
7 estimation of mail volumes by Capital One if in fact
8 Capital One has changed its marketing strategy."

9 This also is not a statement specific to
10 Capital One, is it? Wouldn't this apply to
11 forecasting of mail volumes by any participant in Mr.
12 Callow's classification if they had changed their
13 marketing strategy?

14 A Yes, sir.

15 Q Now would you please refer to your response
16 to Capital One's Question 8 to you? In that answer
17 you confirm that holding everything else equal, your
18 extrapolation approach will overstate projected mail
19 volume if growth rates during the projected year are
20 smaller than in previous years, and the converse is
21 also true that if growth rates during the projected
22 year are larger than in previous years then your
23 method will understate mail volume. Is that correct?

24 A Yes, sir.

25 Q And you further confirm in that

1 interrogatory that, everything else equal, your
2 extrapolation approach will overstate mail volume if
3 the mailer volume in the base year is unusually high.

4 A That's correct.

5 Q The converse is also true here as well? If
6 the base year is unusually low then your method will
7 understate mail volume?

8 A That's correct.

9 Q So you would agree then that your
10 extrapolation approach will not generate accurate mail
11 volume forecasts under the following circumstances:

12 1) if future growth rates do not resemble past growth
13 rates; 2) base year mail volumes are unusually low or
14 high; or 3) marketing strategies of the firm change.

15 Under any of those three circumstances your
16 extrapolation approach will not give an accurate
17 forecast. Is that correct?

18 A That's correct.

19 Q Now, would you also agree that those three
20 circumstances I just mentioned may hold true for many
21 firms who use first class mail?

22 A They may.

23 Q So if the Postal Service used your
24 extrapolation approach to estimate the volume
25 threshold for Witness Callow's proposed volume based

1 declining block rates classification, the volume
2 threshold would not always be set equal to actual test
3 year before rates volumes, would it?

4 A It would vary.

5 Q So there would be a significant free rider
6 problem as you have described it? That is, volume
7 thresholds may be set at less than actual test year
8 before rates volume with this proposal?

9 A No, sir. To be specific, a free rider is
10 defined as allowing the rebates to start or the
11 incentives to start below the projected volume. The
12 problem that you're identifying here is that the
13 technique that's mentioned here may not give you a
14 correct projected volume.

15 Q Well, yes, but if indeed your technique has
16 the result of understating what the volume will be
17 then don't you have the same free rider problem that
18 you complain about in the Cap One case?

19 A If in fact it does understate, and there's
20 no necessary reason that it would. It may. All
21 forecasts can have error in them, but, yes, if it does
22 understate then it tends to create that type of
23 problem.

24 Q And you did concede that under three sets of
25 circumstances which have general applicability to

1 first class mail users that any of those three
2 circumstances could product that effect, could it not?

3 A They could.

4 Q Your testimony contains a section entitled
5 The Basis For The Proposed Negotiated Service
6 Agreement Is Inadequate. Additional Information Is
7 Needed. That begins on page 2.

8 Do you expect that the Postal Service will
9 have access to more information on companies
10 participating in Witness Callow's proposed
11 classification than Capital One provided to the Postal
12 Service?

13 A I think it's possible.

14 Q Do you think they will, that they are likely
15 to, or that it's merely possible?

16 A I think they very well could have additional
17 information.

18 Q I know they could, but do you believe it is
19 likely that the Postal Service will get more inside
20 information from companies they are dealing with under
21 Mr. Callow's proposal than they got from Capital One
22 in this deal?

23 A I think they could obtain it. Beyond that,
24 I'm not qualified to state.

25 Q So you just don't know what will happen?

1 A That's correct.

2 Q At page 10 of your testimony there's a
3 section entitled A Company Specific Demand Study Is
4 Needed For A Full Understanding Of Future Mail Levels.

5 Do you expect that the Postal Service will
6 have access to company specific demand studies for
7 companies participating in Mr. Callow's proposed
8 classification?

9 A I don't know. The companies are coming to
10 the Postal Service asking for money to be given to
11 them in the form of various incentives, and the Postal
12 Service could certainly ask for such substantiation.

13 Q Well, I mean, might it not be the other way
14 around; that the Postal Service is going to mailers
15 asking the mailer to do something that's a good deal
16 for the Postal Service?

17 A I'm sure they could.

18 Q For all you know that's what happened in the
19 Capital One case?

20 A I don't know how it happened in Capital One.

21 Q For all you know that is what happened?

22 A It could have happened.

23 Q And so these mailers may not necessarily be
24 in this abject position that you suggest where they're
25 begging for something and are willing to turn over the

1 company jewels?

2 A I think that Mr. Callow has called for
3 forecasts and the deals to be put together on the
4 basis of publicly available information.

5 Q I noticed on page 10 of your testimony at
6 the bottom and top of page 11 that you say the level
7 of study costs in comparison to MSA benefits may
8 render development of a study uneconomic for a mailer.
9 A specific study would probably need to be subject to
10 formal regulatory review. This could require the
11 disclosure of otherwise unverifiable private
12 information specific to company operations.

13 This has to some degree been an issue in
14 this current case, so you seem to recognize that there
15 is a problem here by getting this wealth of
16 information that you believe you might need in order
17 to properly set volume levels.

18 A That has been the case in this case.

19 Q And you don't see that's going to be a
20 problem in other cases?

21 A Well, we need to have some sort of benchmark
22 for the forecast in order to avoid the free rider
23 problem and in order to have a meaningful NSA. One
24 option is to use publicly available data, which Mr.
25 Callow has advocated. Should the companies choose to

1 make other data available, that would be an option
2 open to them.

3 Q We'll get to that a little later, just what
4 kind of information you think is publicly available.
5 For the time being I'd like you to now look at your
6 answer to Question 7-A of Capital One.

7 In that response you state that, "Time
8 variables were statistically insignificant" in your
9 regression results for solicitation mail. Is that
10 right?

11 A Yes. Yes. There it is.

12 Q So there's no statistically significant
13 trend during this period? Is that what you're saying?

14 A None was shown in those equations.

15 Q Thank you. In your response to Question 17
16 from Capital One you confirm that your extrapolation
17 approach for projecting FY 2003 volumes uses data
18 covering the period from October 2000 to September
19 2002.

20 Thus, your extrapolation approach uses a
21 portion of the same data that was used for the
22 regression approach. Is that not right? It uses a
23 portion of the same data?

24 A That's not a yes or no question. If you'd
25 like me to amplify, the regression equations used the

1 entire set of data, as you've just indicated.

2 The extrapolation approach is initially
3 based upon the most recent year extrapolated, and that
4 gives a number that lacks credibility in the
5 neighborhood of 2.2 billion. Then I went back and
6 used a somewhat slower rate of growth prior to 9-11,
7 which gives you a number in the neighborhood, a total
8 number in the neighborhood of about 1.5 billion, so
9 they're not exactly the same.

10 Q Let me ask you again. Did you not use in
11 your extrapolation approach a portion, just some of
12 the same data, some of the same, that you used in your
13 regression approach?

14 A Yes.

15 Q Thank you. Now if you look at your answer
16 to Question 18 from Capital One, I think you there
17 confirm that your alternative extrapolation approach
18 for projecting FY 2003, your second extrapolation
19 approach, uses data covering the period from October
20 1999 to September 2001, a different period of time,
21 but an overlapping period. Isn't that correct?

22 A Yes.

23 Q Thus, your alternative extrapolation also
24 uses a portion of the same data that was used for the
25 regression approach portion?

1 A Yes, sir.

2 Q So your extrapolation approach and your
3 alternative extrapolation approach are each based on a
4 portion of the data that was used by the regression
5 approach you've just said, and you have testified that
6 the regression approach shows that there is no
7 statistically significant trend during this period of
8 time. That's what you answered in your answer to
9 Question 7.

10 A Yes. Yes, sir.

11 Q But your approach to estimating Capital
12 One's 2003 volumes uses a trend, a rather large trend,
13 38 percent annual increase for solicitations, which is
14 Table 4 on page 8 of your testimony.

15 A You say Table 4 on page 8?

16 Q Yes. I'm sorry. I've got the wrong table.
17 Excuse me. Table 4 is on page 18, not page 8. Excuse
18 me.

19 That table, Table 4, shows a rather large
20 trend and a 38 percent increase for solicitations for
21 Capital One for 2003. Is that not so?

22 A The heading under Projection 2003 shows a
23 substantial increase. To be specific, 38 percent
24 yielding a number of 1.5 billion.

25 Q And these forecasts helped you to your

1 conclusion, which you reach on page 6 of your
2 testimony, that Capital One's forecast is "at the
3 lower range of possible outcomes." That the Capital
4 One forecast was "at the lower range of possible
5 outcomes." Is that correct?

6 A Yes, sir, but I was referring when I said
7 that to the alternative projection; not the 2.2
8 billion, but the 1.586 billion --

9 Q Yes.

10 A -- on Table 4.

11 Q I don't understand this. If your approach
12 for determining Capital One's forecast is at the lower
13 range of possible outcomes, was the forecast of
14 Capital One's volume assuming that there is a
15 significant trend? Your regression analysis showed no
16 evidence that there is a trend at all. Explain that.

17 A That is not exactly the case, sir. The
18 regression analysis showed there was no trend using
19 all the data. The alternative projection excluded
20 that portion of the data that appeared to be,
21 according to Capital One, abnormal and was used. I
22 did not indicate that that did not show a statistical
23 trend.

24 Q My question was that your regression did not
25 show any trend.

1 A The regression analysis did not show a trend
2 over the total data set.

3 Q And we've already discussed that your
4 alternative approaches, your extrapolation approaches,
5 may very well not be accurate if any of those three
6 circumstances exist. I believe you agreed to that.
7 Is that correct?

8 A Yes.

9 Q They are again if future growth rates do not
10 resemble the past growth rates, if base year mail
11 volumes are unusually high or low or if marketing
12 strategies change, so under any of those three
13 circumstances your alternative approach also gives you
14 a faulty projection.

15 A No, sir. I don't think so. The alternative
16 approach took those three possibilities into account,
17 and then I used an earlier year's rate of growth and
18 an earlier year for the base year and extrapolated it
19 out specifically to see how that would affect the
20 projection in the event that we assumed that that one
21 year worth of data, approximately one year worth of
22 data, was abnormal.

23 Q Let me see if I understand what you're
24 saying. Are you denying that if the base year volumes
25 are unusually high that your extrapolation method will

1 not produce a false forecast?

2 A No, sir. I use a different base year.

3 Q If whatever base year you use is unusually
4 high?

5 A Capital One has indicated, at least by
6 inference, that the base year that I did use was not
7 unusually high because they've gone on to say that the
8 subsequent data subsequent to 9-11 are unusually high.

9 Q But how does any mailer know, unless they
10 have a crystal ball, whether their base year is
11 unusually high or low?

12 A Well, in this year I took Capital One's
13 testimony as the basis for knowing, and specifically
14 the alternative projection takes Capital One's
15 testimony into account.

16 Q On page 10 or page 15 of your testimony in
17 that same graph --

18 A Excuse me. Page 10 or 15?

19 Q Page 15. Excuse me. Graph 4. You have a
20 graph.

21 A Yes, sir.

22 Q The graph shows the trend line and the
23 projection of mail solicitation volume from one of
24 your regressions. Is that correct?

25 A Yes, it does.

1 Q And is it correct to say that the upper
2 bound and lower bound lines give some measure of the
3 uncertainty in the projection using the regression
4 approach?

5 A They do indeed. It's a very poor
6 regression, by the way.

7 Q What are the corresponding upper and lower
8 bounds for the projection based on your extrapolation
9 approaches?

10 A None were computed.

11 Q You didn't compute any?

12 A No, sir.

13 Q So you have no idea how large the
14 uncertainty is with respect to your extrapolation?

15 A That is correct. Neither I nor Capital One
16 produced a projection, allowing for uncertainty in
17 that case.

18 Q Again, while these forecasts help you to
19 conclude that Capital One's forecast was at the lower
20 range of possible outcomes, do you agree you haven't
21 assessed the uncertainty in that estimate?

22 A Well, I have two projections, one at 2.2
23 billion and one at .568, and I've taken into account
24 the qualitative comments of Capital One, so to some
25 degree we have a measure. We've taken into account

1 risk and uncertainty, but there is no specific
2 estimate.

3 Q That's what I mean. You do not have an
4 estimate?

5 A That's correct.

6 Q Now if you would look at your answer to
7 Capital One's Question 19? You were there asked to
8 assume that the payment of the discount to Capital One
9 was not for the purpose of incenting first class
10 volumes. That wasn't the reason, but rather to incent
11 Capital One to enter into an agreement which had
12 significant cost savings opportunities for the Postal
13 Service. That is the elimination of physical returns.

14 Assuming that, you were asked whether the
15 payment of a discount for mail that would materialize
16 in any event would still create the free rider
17 problem, and your response was yes, it would. You
18 state that the Postal Service would be paying
19 discounts for volumes that would be mailed anyway, and
20 the Service would be paying money to induce behavior
21 "that would have occurred anyway."

22 I assume you mean by behavior not requiring
23 physical return of the returns.

24 A Yes, sir.

25 Q Does that answer not contradict the

1 assumption that you were asked to make; that is, that
2 the cost saving behavior by Capital One would not
3 occur in the absence of the discount? That's the
4 assumption I asked you to make, is it not?

5 A It is the assumption that you asked me to
6 make, and the assumption, in my opinion, is highly
7 unrealistic and irrelevant, but I suppose if you wish
8 to make that assumption then we'll change the answer
9 to no.

10 Q Thank you. I would like the answer to the
11 question.

12 A Not that I agree with that answer.

13 Q I know. If the answer is no on that
14 assumption then there isn't a free rider problem. Is
15 that correct?

16 A If you wish to make an assumption, and you
17 can always assume anything, you are correct, sir.

18 Q Now, is it not the case that if the NSA
19 fails of approval and implementation the Postal
20 Service will have to continue to physically return UAA
21 mail to Capital One at a cost potentially considerably
22 greater than the cost to the post office of providing
23 a volume discount?

24 A Unless they can arrange some other
25 arrangement with Capital One. Yes, sir.

1 Q Now, in your answer to Question 19 you state
2 that since Capital One will save money by electronic
3 returns "there should be no need for the Postal
4 Service to pay anything to get Capital One to accept
5 electronic returns," right?

6 A That's correct.

7 Q Is it not the case that the facts are
8 demonstrably opposite to your contention? That is,
9 that the agreement reflects the fact that the Postal
10 Service did have to agree to pay discounts to Capital
11 One in order to get Capital One to agree to accept
12 electronic returns in lieu of physical returns. Isn't
13 that what the agreement says?

14 MR. COSTICH: Mr. Chairman, I think we're
15 getting into legal interpretation of the contract or
16 pure crystal ball gazing type speculation if this
17 witness is to try to testify about what was in the
18 minds of Capital One or the Postal Service when they
19 negotiated this contract.

20 CHAIRMAN OMAS: Mr. Smith, try to answer the
21 question from Mr. May and proceed.

22 BY MR. MAY:

23 Q Do you understand the question?

24 A Mr. May, would you repeat it back?

25 Q Sure.

1 A You can phrase it more quickly if you wish.

2 Q Yes. I mean, isn't it the case that the
3 facts are demonstrably opposite to what you contend;
4 that Capital One should have been willing to enter
5 into this because electronic returns are good for them
6 without getting a discount? That was what you said.

7 Isn't it the case that the facts are
8 demonstrably opposite to that because the agreement
9 represents what the parties were willing to do at
10 least at this particular time, does it not?

11 A The answer to your question is no.
12 Specifically, I don't believe there's anything on the
13 record here that shows that this type of negotiation,
14 the details of the negotiation, nor does it indicate
15 in any point that Capital One indicated to the Postal
16 Service that they would not take these returns if they
17 did not get the payment.

18 You're making an assumption when you
19 describe the agreement, but none of us were there at
20 the agreement, and we don't know that that was part of
21 the agreement, and we're left in a quandary wondering
22 what that agreement was based on.

23 Q Well, it is a fact, though, is it not, that
24 indeed the Postal Service gets to avoid physical
25 returns, and the Postal Service has to pay discounts

1 and give electronic information? They have to do
2 that. That is the fact of what this agreement is, is
3 it not?

4 A That is a summary of the agreement, sir.

5 Q Thank you. In your response to Questions 21
6 and 22 to Capital One you dismiss as "speculative"
7 Capital One's statement that it intended to convert
8 its customer mail to electronic communications over
9 the term of the negotiated service agreement in a very
10 aggressive manner affecting as much as 25 percent of
11 their customer mail. You've dismissed that as
12 speculative. That's what you call it in your answers
13 to 21 and 22, correct?

14 A Yes, sir.

15 Q I take it that any forward looking
16 statements are simply "speculative", but when you take
17 the past and then extrapolate from the past future
18 trends you don't believe that's speculative?

19 A Let's start off and break this compound
20 question down into two parts. Starting with the past
21 and moving forward, that's forecasting. Obviously
22 forecasts are always open to error.

23 Starting with the current and extrapolating
24 into the future, the reason I call it speculative is
25 we don't have any analysis or data presented that

1 suggests to us that Capital One, A, will actually make
2 this attempt and, B, that such an attempt will be
3 successful even if they make it.

4 There are substantial questions in the
5 marketing literature about the use of the internet in
6 relation to customer relationship management. I would
7 have to say until we've seen more information that
8 this is speculative.

9 Q Is it your understanding that Capital One's
10 testimony was that they are already doing this?

11 A It's my understanding they have begun to try
12 to do some of this.

13 Q No. Do you understand their testimony to be
14 that they are already actually doing it?

15 A I guess I don't know.

16 Q Well, if they are already actually doing it.
17 Not 25 percent, but if they are already actually doing
18 it would that cause you to change your
19 characterization of their testimony as speculative?

20 A No, sir, it would not. It would simply
21 indicate to me that they are making an effort. I have
22 no idea whether that effort will succeed, nor do I
23 have any idea on the basis of which that effort is
24 going forward. Therefore, I have to call it
25 speculative.

1 Q Can you tell the Commission any reason why
2 the Commission should disbelieve Capital One witnesses
3 when they testify under oath, as they have, that they
4 intend to convert in a very aggressive manner their
5 customer mail to electronic communications by as much
6 as 25 percent over the course of this three year
7 agreement?

8 Why should the Commission not believe them
9 when they've taken an oath that that's what they
10 intend to do?

11 A Intentions do not equal resolution of the
12 intended items. Of course they're under oath and of
13 course they intend to do that, but whether they will
14 be successful and actually do that is another
15 question.

16 Q But wouldn't you agree that that's far less
17 speculative than your presumption that the past will
18 replicate itself in the future, which is how you got
19 your volume estimates?

20 A The basis for the base replicating the
21 future is the basis for forecasting, and I took into
22 account a number of the issues that Capital One
23 raised, which made that much less speculative than it
24 would otherwise allegedly have been.

25 Now, I think I can't go beyond that in terms

1 of degree and comparing degrees of speculativeness
2 because that's getting a little off of my testimony.

3 Q All right. In response to USPS Question 1,
4 utilizing your methodology of forecasting -- do you
5 have that?

6 A Yes, sir. Yes, sir.

7 CHAIRMAN OMAS: Excuse me. Mr. May, would
8 you bring the mike a little closer?

9 MR. MAY: I'm sorry.

10 CHAIRMAN OMAS: Thank you.

11 BY MR. MAY:

12 Q Now, in your response to USPS 1, utilizing
13 your methodology of forecasting you forecast Capital
14 One's volumes both for customer and solicitation first
15 class mail for this last October, November and
16 December of 2002. Is that not correct?

17 A Yes, sir.

18 Q So that's new. That's never been in the
19 record before. Capital One had no testimony about
20 what those months would be. At the time they put in
21 their testimony they didn't have any information about
22 that, did they?

23 A I assume not.

24 Q Okay. Now, how badly would it trouble you
25 and your faith in your forecasting methodology if it

1 were to turn out that the volumes for those three
2 months are in fact different than you forecast to an
3 extreme degree?

4 A It would suggest that this approach has
5 failed at this point.

6 Q In response to USPS 3, you confirm that the
7 Commission should consider overall impacts from the
8 NSA, including the impact on contribution generated by
9 Capital One and whether or not there is a free rider
10 problem.

11 Now, isn't it the case that in considering
12 the impact on contributions generated by Capital One
13 the Postal Service did consider what you call the free
14 rider problem? In other words, did they not subtract
15 the cost of the discounts irrespective of whether they
16 are from volumes that would or would not have
17 materialized in the absence of the NSA? They
18 subtracted it, didn't they, from the deal?

19 A Well, the way an economist would answer that
20 is no. You would set the threshold at the expected or
21 forecasted volume. In the case of Capital One, that
22 was 1.408 or whatever billion pieces. They in fact
23 started the discounts before that, so I as an
24 economist would say there is a free rider problem
25 there.

1 Q Let me ask you the question again. Did they
2 not subtract the cost of those discounts, the
3 discounts that began at 1.225 billion on up to the
4 1.4? Did they not subtract those from the cost of the
5 deal?

6 A There is an arithmetic computation in the
7 test run.

8 Q Yes, which is how they got to the net
9 contribution, right?

10 A Yes, sir.

11 Q So they did take that into account, didn't
12 they?

13 A They performed the arithmetic.

14 Q What is inaccurate about the arithmetic?
15 Does it matter whether their forecast was right or
16 wrong if it materializes that indeed they mail 1.4
17 million, which the Postal Service has assumed when it
18 calculated the value of the deal to it? They
19 subtracted all those discounts, did they not?

20 A They did.

21 Q And so whether or not the stuff would be
22 there or not, they already deducted that, deducted
23 that discount as an offset against the savings they're
24 going to make from not having to make physical
25 returns?

1 A Well, in the analysis of programs and the
2 economic literature, you try not to create a free
3 rider problem. They've got one there. I guess you
4 can say they arithmetically adjusted for it, but it is
5 still there, and it shouldn't be there. That's our
6 testimony.

7 Q Well, you don't think it should be there,
8 but you do admit that the Postal Service accounted for
9 it?

10 A Yes, sir.

11 Q Now, would you oppose an agreement which
12 will produce \$1 worth of savings for the Postal
13 Service, although the Postal Service would also have
14 to lose 50 cents in revenue by giving a discount on
15 volume that everyone would agree would materialize
16 whether there was an agreement or not?

17 A Well, that --

18 Q Just listen. If you want me to do this,
19 it's going to save you \$1. Then I want you to give me
20 50 cents. Would you oppose such an agreement?

21 A I guess I don't really understand your
22 hypothetical situation.

23 Q Let me try to restate it. The Postal
24 Service is made an offer by a mailer. The mailer says
25 look, I will let you avoid doing something. It will

1 saye you \$1. You won't have to do that for me
2 anymore, and you'll save \$1. In other to do that, I
3 want you to give me 50 cents. That's not a bad deal,
4 is it?

5 A No. I don't see it particularly analogous
6 to this situation particularly.

7 Q I didn't say it was. I'm asking you was
8 that a good deal?

9 A As you describe it it probably is, yes.

10 MR. MAY: I think that's all I have, Mr.
11 Chairman.

12 CHAIRMAN OMAS: Thank you, Mr. May.

13 During your cross-examination Mr. Baker
14 entered, and he says he declines to cross-examine.

15 We'll go to the Postal Service, and I think
16 today our cross-examiner will be Ms. McKenzie. Is
17 that correct?

18 MS. MCKENZIE: That is correct, Mr.
19 Chairman.

20 CHAIRMAN OMAS: Thank you.

21 CROSS-EXAMINATION

22 BY MS. MCKENZIE:

23 Q Good morning, Mr. Smith.

24 A Good morning.

25 Q I'd like to direct your attention to Table

1 1, your Table 1, Column G.

2 A Could you give me a page reference, please?

3 Q Page 5.

4 A I have it.

5 Q If you would refer to Column G, Lines 4 to
6 5?

7 A I have it.

8 Q Okay. You list Forecasted Statements and
9 Solicitations. I was wondering where you obtained
10 those numbers?

11 A I'm sorry. You said Column G, Lines 4 and
12 5. It's Customer Mail and Solicitation Mail. Is that
13 correct?

14 Q Correct,

15 A And they total to the 1.423. Those sum to
16 that.

17 Q Correct.

18 A Therefore, we hold 640,000 customer mail
19 constant because that's the amount that Capital One
20 forecast that it would have in that year, and that
21 gives you the remainder of which is 783.

22 Q Now, where do you say that Cap One
23 forecasted the 640 in the year? Maybe we should first
24 talk what year are you talking about? Are you talking
25 about in the base year?

1 A Yes. For the year 2003.

2 Q For the year 2003. And is that the test
3 year after rates?

4 A It's whatever year is under consideration.
5 It's 2003. It's whatever year Witness Jean was
6 testifying to.

7 Q Okay. But I believe Witness Jean testified
8 to the 1.408 number, correct?

9 A Yes.

10 Q Okay. And you're referring to the 1.423?

11 A That's correct.

12 Q All right. Is that a number that you
13 derived from Dr. Elliot's testimony?

14 A Well, the 1.408 is Witness Jean's number.
15 You take Dr. Elliot's additions due to the
16 implementation of the service agreement, and you get
17 1.423.

18 We hold the customer mail constant at
19 640,000. In other words, we accept Witness Jean's
20 640,000, and then through arithmetic we arrive at
21 783,458,969.

22 Q But that's not the way that Dr. Elliot did
23 it, was it? Didn't he also apply the elasticities to
24 customer mail?

25 A Yes, I think he did, but I'm taking Witness

1 Jean's proposal or statement that customer mail would
2 be 640,000 and assuming that this will affect the
3 solicitation mail.

4 Q Was there something wrong with Dr. Elliot's
5 estimates and the test year after rates?

6 A It's just the way I did it.

7 Q It's just the way you did it?

8 A That's correct.

9 Q You just decided to do it differently?

10 A I felt this was the simplest and most
11 straightforward way that I saw.

12 Q Why wouldn't you apply the elasticities to
13 customer mail?

14 A I didn't apply elasticities to anything. I
15 took the additional pieces at 15 to get to the 1.423,
16 so that includes whatever is in Dr. Elliot's
17 testimony. Then I took Witness Jean's statement of
18 640,000 to get the first difference.

19 Q Okay. And although I suspect you don't have
20 Witness Elliot's information before you, do you have
21 any reason to doubt that his numbers with respect to
22 customer mail and solicitation mail -- he had 776
23 million pieces of solicitation mail and 647 million
24 pieces of for statements. Do you have any reason to
25 disagree with those numbers?

1 A I have simply -- I have no particular reason
2 to disagree with them. I've told you how I've
3 computed this, and it's been based upon Witness Jean,
4 and I took Witness Elliot's additions.

5 Q Right. Well, basically you took his totals,
6 and then you just minused 640 --

7 A Yes. Sure.

8 Q -- to come up with the 783?

9 A Right.

10 Q And why did you do it that way?

11 A I was trying to look at the effect at higher
12 levels of mail also, and I didn't want to get into
13 redoing his computations and possibly introducing
14 judgment as I got to additional levels of mail since
15 this is to show the effect in a given year, so I took
16 the 640,000. That's fine.

17 Q So you decided not to take an elasticity
18 approach to it?

19 A The elasticity has already been factored in
20 in Witness Elliot's analysis. Therefore, any
21 additional mail is assumed to be solicitation mail.

22 Q So that when you get to Column J where you
23 are just seeing what the effects are at 1.6 billion
24 pieces of mail --

25 A Yes.

1 Q -- that would be 960 million pieces of
2 solicitation mail?

3 A That's correct.

4 Q But you've held customer mail constant?

5 A That's correct. I'm assuming that the
6 elasticity is working on the solicitation mail since
7 Capital One has indicated that customer mail is a
8 function of the number of accounts.

9 Therefore, I find it difficult to imagine
10 that that would elicit additional customer mail
11 through the elasticity, and I see the elasticity
12 working on the solicitation mail.

13 Q Well, does that make sense?

14 A Yes, it does.

15 Q But I mean in terms of, you know, if Cap One
16 is going to mail 1.6 billion pieces and they're not
17 going to get any more customers than if they were --

18 A Well, I believe the additional customers
19 have already been factored in in Witness Jean in the
20 sense that he added 640 million, which I think has a
21 total of 640 million pieces of customer mail, which is
22 a bit more than they had the previous year.

23 There is a small, and I think it would
24 probably be very small, amount of additional customer
25 mail that might be generated from the additional

1 mailings at the 960 level which isn't shown here, but
2 that would be fairly small, assuming that the
3 customers are added at a uniform rate throughout the
4 year. It's really not a whole lot to worry about in
5 terms of rounding.

6 Q But still I'm having a hard time
7 understanding. I mean, the chart seems to show that,
8 you know, Cap One may decide to mail an extra 200
9 million pieces, yet obtain no new customers.
10 Shouldn't that be factored into your chart?

11 A They will obtain a small number of
12 additional customers at the rate of point six-tenths
13 of a customer I believe it is per 100 mailings, so
14 there could be a minor change to this if one wished to
15 make it. It would be de minimis. I didn't think it
16 was worth obfuscating the underlying mathematics to do
17 it, but these are approximations.

18 Q Okay. Now in your response to Postal
19 Service Interrogatory No. 5 you listed your background
20 in forecasting.

21 A That's correct.

22 Q From what I see, it appears that most of the
23 background is in forecasting for a major electrical
24 equipment manufacturer and a major distributor of gas.

25 A Those are two areas in which I've worked.

1 Q All right. Are there any other substantive
2 areas, you know, where you've had extensive
3 forecasting experience?

4 A Yes. I've been involved in forecasting to
5 some degree in information services -- that's
6 computers, hardware and software -- engineered
7 materials, certain types of consumer goods.

8 Q And are all of those reflected in this
9 answer?

10 A No. They're just briefly mentioned in a tag
11 on, a couple paragraphs at the end.

12 Q In my reading of your answer, it would
13 appear to me, and I want you to respond as to whether
14 you thought this was a fair assessment, that the bulk
15 of your background in developing forecasts has to do
16 with industry segments, as opposed to forecasting for
17 an individual company.

18 A No. These are for individual companies.

19 Q Well, I understand for an individual
20 company, but isn't, for example, when the major
21 electrical equipment manufacturer is asking you to
22 forecast they're trying to predict what the demand for
23 their product is going to be. Is that correct?

24 A Right, An individual company.

25 Q Right. Have you been predicting, for

1 example, sales for an individual company?

2 A Yes.

3 Q What an individual company will be in terms
4 of, as with Cap One, what their solicitations are
5 going to be? You're predicting how much they're going
6 to promote?

7 A I have predicted the dollars worth of orders
8 and shipments which is forecast.

9 Q And did you use exogenous factors when you
10 were making those predictions?

11 A Yes, I did.

12 Q What do you mean by exogenous factors?

13 A The drivers of the forecast. In other
14 words, why does somebody want the product? In the
15 case of Capital One, we would be asking why does
16 Capital One want to mail? Mailing is not an end to
17 Capital One. It's a means to add accounts.

18 Similarly for an electrical manufacturer,
19 you're forecasting what are we going to sell based
20 upon how does the market look.

21 Q And were all these exogenous factors
22 publicly available that you used when you were making
23 forecasts in the electrical equipment manufacturers?

24 A Yes. Because markets drive business,
25 generally speaking, business data are a function of

1 the economy. That's publicly available data.

2 Q So you were looking at the broad economy
3 would be one way, one of the factors that you might
4 look at?

5 A I was looking at the economy and sometimes
6 in rather specific detail and not at all broadly in
7 many cases.

8 Q Can you give me some examples? What kind of
9 detail?

10 A Well, if you wished to predict the
11 consumption of electricity in Washington, D.C. in the
12 office building sector, you would gather data on
13 square feet of office space. You would gather data on
14 consumption per square foot as measured in terms of
15 heating, air conditioning, lighting and so forth.

16 You would gather forecasts generally from
17 other companies such as Data Resources, Wharton, that
18 the Postal Service also uses -- you're probably
19 familiar with -- in terms of forecasts for the future.
20 You would estimate additions of commercial space, and
21 you would estimate decline rates or conservation rates
22 for various end uses.

23 Doing all of this would eventually give you
24 a forecast of electrical consumption in the
25 Washington, D.C. office building segment.

1 Q And that would be a forecast that any
2 electrical equipment manufacturer could use?

3 A Yes.

4 Q What about information that might be just
5 specific to one equipment manufacturer?

6 A Well, in that case you would then total this
7 across the country so you've got the overall level of
8 demand. You'd have to translate that into capacity,
9 and after you had that it would serve as the basis for
10 a marketing plan.

11 Generally speaking, an oligopoly like the
12 electric utility industry you would get the same share
13 from year to year, give or take a little, and that
14 would be the basis of your actions. Everybody can get
15 these data. They're publicly available.

16 Q Now, the Postal Service, if it were to
17 prepare forecasts with respect to an NSA, should they
18 be using exogenous factors?

19 A Yes.

20 Q And with respect to Capital One or an NSA
21 like that, what exogenous factors should they use?

22 A Well, I would think that there would be some
23 publicly available data on the credit card industry.
24 For example, you might turn to DRI WEFA to look at,
25 for example, expenditures on consumer durables/

1 non-durables and relate that to the overall demand for
2 credit cards.

3 In the case of Capital One you've got their
4 mailings for a bunch of years, and you could see how
5 their mailings were a function of the overall market.
6 You would also be able to take some -- possibly look
7 to see if their share of the market was changing.

8 There are some available data on share of
9 market. You could even ask them if they'd like to
10 make that publicly available. That's how you'd get
11 started.

12 Q But what about in the area of marketing and
13 advertising? Isn't a factor to decide whether you
14 should advertise more what the response has been to
15 past advertising?

16 A Well, I don't know that for Capital One or
17 for any company. If you're talking about how do you
18 determine a media buy, what you typically do is you
19 test responses to advertisements in various media and
20 calculate the number of people you reach per \$1,000
21 and the success rate.

22 Now we're getting into some rather technical
23 information that certainly is almost certainly
24 available to Capital One, but I'm sure it wouldn't be
25 immediately publicly available unless they chose to

1 make it so.

2 Q Is that an exogenous factor?

3 A That could be.

4 Q That would be an exogenous factor as well?

5 A It depends. I can't imagine that the media
6 buy plans of Capital One are immediately relevant to
7 their credit cards except insofar as they're reflected
8 in their mailings, and I've already told you how to
9 get the mailings without asking for that data.

10 Q But if you were going to forecast
11 solicitations, wouldn't that type of information, the
12 responses to prior solicitations, for example, or
13 other media buys, be relevant?

14 A It might be to Capital One, but you've got
15 data on solicitations over a bunch of months. The
16 data are right there. You could ask for more. You've
17 got information on the state of the economy over those
18 months. You can certainly get from DRI WEFA data cut
19 and diced in a variety of ways that will tell you
20 almost anything.

21 Accordingly, you can relate solicitation
22 mail or total mail or whatever to the state of the
23 economy, and you can determine whether there's a
24 trend. If there's a trend, there are econometric ways
25 in which you can take that into account and move on,

1 and you would get an answer.

2 Q Now, I believe you testified that you took
3 into account some of the issues that Cap One raised.
4 I thought it was in terms of in making your forecast
5 you did take into account some of the issues that Cap
6 One raised. Is that correct?

7 A In response to a question from Mr. May, he
8 raised three issues. One of them was that Capital
9 One's -- I don't have a perfect recall of Mr. May's
10 statements, but whatever they were at that time I said
11 that we took those into account.

12 Q Well, I'm not actually that interested in
13 Mr. May's statement. I'm more interested in your
14 statement. I don't even think you necessarily
15 identified them. You said yes, I took into account
16 issues that Cap One had raised.

17 When you did your forecasts, what issues of
18 Cap One's did you take into account?

19 A Well, to be specific, Cap One has argued or
20 has stated that the situation after September 1, 2001,
21 was abnormal as far as considering solicitation mail.

22 Accordingly, in making the alternative
23 forecast I used the year 2000 and extrapolated forward
24 based on growth rates prior to 2001, prior to
25 September of 2001, and that is the basis on which

1 Capital One's statements were taken into account.

2 Q Why didn't you take that into account for
3 the customer mail?

4 A Capital One has suggested that customer mail
5 is a function of the number of orders they get, and it
6 seems to be a relatively deterministic function.

7 Q Well, if they mail more solicitations,
8 doesn't it logically make sense they will get more
9 customer accounts?

10 A Yes, it does. In fact, I extrapolated
11 forward for customer mail in the same way, so it's
12 consistent.

13 Q Yes, but you made an adjustment, did you
14 not, in your alternative forecast projection for the
15 September 11 impact?

16 A On solicitation mail, yes.

17 Q On solicitation mail, but you did not make a
18 similar adjustment for customer mail?

19 A No, because, as I said, it seems to be a
20 relatively smooth function rising at a relatively
21 predictable rate.

22 Q But if they lower their amount of
23 solicitations, doesn't it tend to suggest that they
24 will have a lower amount of customer mail?

25 A I haven't the slightest idea. You can lower

1 the number of solicitations and improve your return
2 rate per solicitation if you use the appropriate
3 segmentation and targeting. I think that may be what
4 Capital One is doing these days, but I don't know.

5 Q Thank you. I'd like you to turn your
6 attention to your answer to Postal Service
7 Interrogatory 2.

8 A I have it.

9 Q I wanted to make sure I understood one of
10 your statements in that response. In the first
11 paragraph, the last line, you say, "Then the number
12 would be suitable for the NSA."

13 Were you stating that if the FY 2003 Capital
14 One volume forecast was 1.2 billion, then the NSA
15 would be permissible under your standards?

16 A And is verifiable and based on a methodology
17 acceptable to the Postal Service and consistent with
18 the criteria in Mr. Callow's testimony. Yes.

19 Q Okay. But 1.2 billion then would be fine?

20 A That would be fine under those
21 circumstances.

22 Q Okay. I'd like to turn your attention to
23 the next interrogatory answer, Question 3. I'll read
24 the question. "Please confirm that in evaluating the
25 proposed rate classification and fee changes in Postal

1 Service requests the Commission should consider the
2 entire impact on contribution and not just the impact
3 on one part of the proposed changes."

4 Now, your answer states, "I confirm that the
5 Commission should consider the impact on contributions
6 generated by Capital One's competitors, the impact on
7 contributions generated by Capital One and whether
8 there is a free rider problem."

9 With respect to the impact on contributions
10 generated by Capital One's competitors, previous to
11 the Cap One case have you ever testified regarding the
12 contribution impact on competitors of the users of the
13 mail?

14 A No.

15 Q How would you recommend that the Commission
16 do this?

17 A I would recommend that it listen very
18 carefully to Dr. Penzer and ask him about that. I was
19 aware of this problem before Dr. Penzer's testimony,
20 but did not raise it. He has raised it, and I think
21 he is probably more prepared than I am to address it.

22 Q But the question is that they have to
23 consider the impact on contributions; not that there
24 might be an impact on competition, but specifically
25 you stated they have to measure the impact on

1 contribution. How would the Commission do this?

2 A Well, as Dr. Penzer indicates, this is a
3 very complex area involving a large oligopolist --
4 presumed oligopolist, Capital One, as well as a number
5 of oligopolists, smaller oligopolists, and -- yes?

6 Q I was going to say I was more interested in
7 what you thought, not what Dr. Penzer thought.

8 A This is what I also think.

9 Q Okay.

10 A I, too, am an economist, and this is a case
11 of oligopoly game theory, which gets horrendously
12 complex. Anyway, what's involved is you're asking to
13 what degree do the other folks decrease their use of
14 the mail because Postal Service is getting a larger or
15 preferred market advantage.

16 Assuming that Capital One through this NSA
17 gets a big market advantage and expands its use of
18 mail, but as a result causes these other folks to use
19 much less mail, that's how you would estimate that
20 problem.

21 Q But how would you estimate the lower use by
22 Cap One's competitors?

23 A Well, based upon Capital One's increased
24 market share it may be a relevant issue. Beyond that
25 I'm not sure how. We'd have to ask Penzer, or I'd

1 have to research this further. I'm just saying that
2 they should consider it.

3 Q But you don't know how they would do it?

4 A I think Dr. Penzer would be the answer.

5 Q Okay. All right. Just a moment, please.

6 (Pause.)

7 Q In your work in forecasting for the electric
8 equipment manufacturer or the major distributor of
9 gas, did you forecast purchasers by customer of the
10 utility?

11 A I've done that on occasion.

12 Q But you did it in terms of doing just
13 publicly available information trying to anticipate
14 what their market segment was, for example, and
15 dividing it?

16 A To be specific, when you get down to that
17 level you've got a total estimate, and you say what
18 did they do in the past? That's what they'll do in
19 the future.

20 MS. MCKENZIE: Okay. Thank you. The Postal
21 Service is done, Mr. Chairman.

22 CHAIRMAN OMAS: Thank you, Ms. McKenzie.

23 Is there anyone else who wishes to cross-
24 examine Witness Smith?

25 (No response.)

1 CHAIRMAN OMAS: Are there any questions from
2 the bench?

3 (No response.)

4 CHAIRMAN OMAS: Mr. May?

5 MR. MAY: I do have follow up. I don't know
6 whether you want to have the bench go before me.

7 CHAIRMAN OMAS: There is no one from the
8 bench, so proceed.

9 FURTHER CROSS-EXAMINATION

10 BY MR. MAY:

11 Q Just following up briefly on your comments
12 on competitors and competition, how much of an
13 advantage would Capital One have to get for it to show
14 up in the diminution of the use of the Postal Service
15 by the other members of this oligarchy?

16 A I think that's an important question, and I
17 think it's well worth exploring. I don't know.

18 Q You have no idea? I mean, suppose they only
19 had a one penny discount. Is that likely to have an
20 effect?

21 A We're not talking about pennies. We're
22 talking about millions of dollars. To be specific,
23 how many millions worth of dollars worth of rebates/
24 discounts do they need to get before they get a
25 competitive advantage over a possibly significantly

1 smaller firm? That's something that I'm sure could be
2 estimated. I don't have an answer.

3 Q Well, it is the case, is it not, that while
4 indeed these pennies add up to millions they are,
5 nevertheless, penny discounts, aren't they? They're a
6 few pennies, are they not?

7 A Adding up to a few million.

8 Q Yes. We all understand that. If you
9 multiply one penny by some big number you get there.

10 A Yes, sir.

11 Q My question, though, is you say you have no
12 idea just how much and at what point in the credit
13 card industry it will have an effect? You don't know?

14 A You can estimate this variously as to the
15 amount of money that Capital One will walk away from
16 this NSA with. I have speculated idly that it can be
17 \$10 to \$20 million. It might be more. It might be
18 less.

19 \$10 to \$20 million is probably not a lot of
20 money to Capital One, although it's a lot of money.
21 I'm sure it's a lot in terms of looking at that money.
22 To a much smaller competitor, and there are much
23 smaller competitors, \$20 million or \$10 million might
24 be a whole lot of money.

25 Q Well, can you tell us why if there are

1 competitors, a number of whom are very big companies,
2 they don't seem to be aware that they're going to be
3 injured; at least they haven't addressed any
4 complaints to this Commission about this deal, have
5 they, whereas the newspapers certainly have? They've
6 been in here hollering and screaming about what's
7 going to happen, but no other credit card company has
8 showed up.

9 Is it just they're not aware that they're
10 about to be injured? Is that the problem? How do you
11 explain that?

12 A It is purely speculative to wonder whether
13 they are aware, whether they follow postal economics
14 or what they're up to.

15 Q Perhaps they think they can get their own
16 deal. Is that a possibility?

17 A It's always a possibility.

18 MR. MAY: That's all, Mr. Chairman.

19 CHAIRMAN OMAS: Thank you, Mr. May.

20 Mr. Costich, do you need some time with your
21 witness for redirect?

22 MR. COSTICH: Could I have a few minutes,
23 Mr. Chairman?

24 CHAIRMAN OMAS: Why don't we go ahead and
25 take 10 minutes? We'll take our morning break and

1 come back at 11:00. I'm giving you a little bit more
2 than 10 minutes.

3 (Whereupon, a short recess was taken.)

4 CHAIRMAN OMAS: Before we begin, as I
5 mentioned earlier, the scheduling for tomorrow. I
6 indicated that I would allow counsel to make comments.
7 Several have discussed things with me, and I think
8 I've come to the conclusion that we would begin
9 tomorrow around 10:30 or 11:00 in an effort -- Mr.
10 Penzer does have to leave and be at the airport around
11 3:30 or 4:00. We would start around 10:30 or 11:00 in
12 the morning.

13 If there is a blizzard it will mean nothing
14 to anyone except poor Mr. Penzer, but I think what
15 we'll do is if that is all right with everyone we'll
16 start later in the morning at around 11:00 and try to
17 go through it.

18 MR. MAY: A Solomonic decision.

19 CHAIRMAN OMAS: Thank you.

20 Ms. McKenzie?

21 MS. MCKENZIE: That's fine. Eleven o'clock.

22 CHAIRMAN OMAS: Is that fine with you?

23 MS. MCKENZIE: Yes.

24 CHAIRMAN OMAS: Mr. Baker, everybody, Mr.
25 Luby? He seems to have gone.

1 MR. LUBY: No. I'm right here.

2 CHAIRMAN OMAS: Oh, thank you. Hi. I'm
3 sorry.

4 MR. LUBY: I'm not in the script. That's
5 fine.

6 CHAIRMAN OMAS: No, sir. I didn't mean
7 that. It's just I had my glasses on, and you're
8 magnified so I couldn't tell what was what. I was
9 looking for you over there. That's fine.

10 We will convene tomorrow morning at 11:00 to
11 hear Mr. Penzer's testimony.

12 Mr. Costich?

13 MR. COSTICH: Thank you, Mr. Chairman. The
14 OCA has no redirect.

15 CHAIRMAN OMAS: Thank you. Mr. Smith, that
16 completes your testimony here today. The Commission
17 appreciates your contribution to the record, and you
18 are now excused.

19 (Witness excused.)

20 CHAIRMAN OMAS: Mr. Costich, would you
21 introduce your next witness, please?

22 MR. COSTICH: Thank you, Mr. Chairman. The
23 OCA calls James F. Callow.

24 CHAIRMAN OMAS: Mr. Callow, will you stand,
25 please, and raise your right hand?

1 Whereupon,

2 JAMES F. CALLOW

3 having been duly sworn, was called as a
4 witness and was examined and testified as follows:

5 CHAIRMAN OMAS: Thank you. Please be
6 seated.

7 (The document referred to was
8 marked for identification as
9 Exhibit No. OCA-T-2.)

10 DIRECT EXAMINATION

11 BY MR. COSTICH:

12 Q Mr. Callow, do you have before you two
13 copies of a document marked for identification as
14 OCA-T-2?

15 A Yes, I do.

16 Q Are you familiar with this document?

17 A Yes, I am.

18 Q Was it prepared by you or under your
19 supervision?

20 A Yes.

21 Q If you were to testify orally today, would
22 this be your testimony?

23 A Yes.

24 MR. COSTICH: Mr. Chairman, I will hand two
25 copies of Mr. Callow's testimony to the reporter and

 Heritage Reporting Corporation
 (202) 628-4888

1 ask that it be admitted into evidence.

2 CHAIRMAN OMAS: Without objection, so
3 ordered.

4 Hearing none, I will direct counsel to
5 provide the reporter with two copies of the corrected
6 direct testimony of James F. Callow. That testimony
7 is received and will be transcribed into evidence.

8 (The document referred to,
9 previously identified as
10 Exhibit No. OCA-T-2, was
11 received in evidence.)

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OCA-T-2
Docket No. MC2002-2

DIRECT TESTIMONY

OF

JAMES F. CALLOW

ON BEHALF OF

THE OFFICE OF CONSUMER ADVOCATE .

December 20, 2002

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OCA-T2 Attachment A

OCA-T2 Attachment B

DIRECT TESTIMONY
OF
JAMES F. CALLOW

1 I. STATEMENT OF QUALIFICATIONS

2 My name is James F. Callow. I am a Postal Rate and Classification Specialist. I
3 have been employed by the Postal Rate Commission since June 1993, and since
4 February 1995 in the Office of the Consumer Advocate (OCA).

5 I have testified before the Commission in Docket Nos. R2000-1, MC98-1, R97-1,
6 MC96-3, and MC95-1. My testimony in Docket No. R2000-1 examined three issues
7 related to First-Class Mail. I proposed that the rate for single-piece letters be
8 maintained at 33 cents in order to mitigate the growing institutional cost burden on First-
9 Class Letter Mail. Second, I proposed a new approach for setting the single-piece First-
10 Class rate that would provide a longer period of rate stability for household mailers,
11 while permitting smaller, more predictable rate adjustments desired by business
12 mailers. Finally, I proposed elimination of the nonstandard surcharge for First-Class
13 "low aspect ratio" (e.g., square or nearly square) letter mail because advances in
14 technology have made the surcharge unnecessary. I also testified on rebuttal in Docket
15 No. R2000-1. That testimony addressed the proper methodology for forecasting the
16 number of additional ounces per piece for single-piece First-Class Letter Mail in the test
17 year.

18 In Docket No. MC98-1, I proposed a computer-implemented postage pricing
19 formula for Mailing Online as an alternative to the single average discount rate,
20 Automation Basic (within class and shape), proposed by the Postal Service for all

1 mailings using Mailing Online. In Docket No. R97-1, I proposed a restructuring of post
2 office box fee groups to better reflect costs of providing box service in high and low cost
3 post offices. My testimony in Docket No. MC96-3 opposed the Postal Service's non-
4 resident surcharge on post office boxholders, and proposed alternative box fees
5 designed to equalize inter-group cost coverage and reduce the disparity in cost
6 coverage by box size. In Docket No. MC95-1, my testimony summarized the comments
7 of persons expressing views to the Commission and the Office of the Consumer
8 Advocate on postal rates and services.

9 As a Special Assistant to former Commissioner H. Edward Quick, I participated
10 in Docket Nos. R94-1, MC93-2 and MC93-1. In Docket No. R94-1, I was assigned
11 responsibility for substantive subject areas considered by the Commission in its Opinion
12 and Recommended Decision. Specifically, I analyzed quantitative testimony of the
13 Postal Service with respect to the estimation of workers' compensation costs and
14 evaluated rate design proposals of the Postal Service and other parties related to
15 special postal services.

16 Prior to joining the Commission, I held positions on the legislative staff of a US
17 Senator and a Member of Congress from Michigan, and served as an aide to the
18 Governor of the State of Michigan in Washington.

19 I am an accountant by training. In 1985, I earned an MS degree in
20 accounting from Georgetown University. My course work included cost accounting and
21 auditing. In 1977, I obtained my BA degree from the University of Michigan-Dearborn
22 with a double major in political science and history and a minor in economics.

23

1 II. PURPOSE AND SCOPE

2 This testimony proposes two new experimental mail classifications in First-Class
3 Mail. Both experimental classifications are based upon the two principal features of the
4 Negotiated Service Agreement (NSA) between the Postal Service and Capital One
5 Services, Inc. (herein "Capital One") presented in this proceeding. These experimental
6 classifications improve upon the two principal features of the NSA, and would be
7 available to all First-Class mailers authorized by the Postal Service.

8 The first experimental classification would provide authorized First-Class mailers
9 with electronic address correction information at no charge for their First-Class Mail that
10 is undeliverable-as-addressed (UAA). Mailers entering presorted First-Class Mail
11 endorsed "Change Service Requested" would receive electronic notices of address
12 corrections for mailpieces that are forwarded and in lieu of the physical return of
13 mailpieces that cannot be forwarded. Under the experiment, mailers that update and
14 correct their address databases within two business days of receiving electronic notices
15 would receive such notices at no charge. At the present time, mailers participating in
16 the Address Change Service (ACS) program pay 20 cents for each electronic notice.

17 The second experimental classification would provide interested First-Class
18 mailers access to volume-based declining block rates in exchange for receiving address
19 correction information under the proposed experimental address correction service. A
20 unique volume threshold would be determined for each mailer based upon the mailer's
21 historical First-Class volume data. Discounts would be provided for mail volumes above
22 the threshold, with the discounts increasing in size as the volume of additional mail
23 increases. However, the total amount of discounts available to any one mailer would be

1 limited by a maximum volume determined from each mailer's unique volume threshold.

2 A mailer could claim the highest discounts allowable up to the maximum volume.

3 The Postal Service would be required to provide a written statement to any
4 mailer denied authorization to participate in either experimental mail classification,
5 giving the reasons for any denial. Both experimental classifications would operate for a
6 period of three years.

7 The experimental mail classifications, unlike the NSA, offer Capital One and all
8 other First-Class mailers access to volume-based declining block rates on terms similar
9 in many respect to those contained in the NSA. However, the experimental
10 classifications eliminate the need to negotiate individual agreements with each mailer
11 and to rely on unverifiable, private information. Finally, the experimental classifications
12 collectively present an opportunity to obtain additional contributions to institutional cost
13 while limiting the Postal Service's financial risk, and to reduce costs to the Postal
14 Service and mailers.

15

1 III. EXPERIMENTAL AUTOMATED ADDRESS CORRECTION SERVICE SHOULD
2 BE OFFERED AT NO CHARGE TO AUTHORIZED FIRST-CLASS MAILERS
3 THAT RECEIVE AND UTILIZE ELECTRONIC ADDRESS CORRECTION
4 INFORMATION

5 In this proceeding, the Postal Service presents for the first time a Negotiated
6 Service Agreement (NSA) to the Postal Rate Commission and requests a
7 recommendation decision.¹ The NSA, concluded between Capital One and the Postal
8 Service (herein "Capital One NSA"),² would provide Capital One with access to
9 increasingly larger discounts for new incremental volumes of First-Class Mail above a
10 negotiated volume threshold.³ In exchange for access to volume-based discounts,
11 Capital One agrees to accept electronic address correction notices at no charge for its
12 First-Class "solicitation" mail that is undeliverable-as-addressed,⁴ i.e., forwarded or, in
13 the absence of electronic notices, physically returned. The Postal Service proposes
14 changes in the Domestic Mail Classification Schedule (herein "DMCS") to implement
15 the Capital One NSA.⁵

¹ USPS-T-1 (Bizzotto), at 5; see *also* Request of the United States Postal Service for a Recommended Decision on Experimental Changes to Implement Capital One NSA (herein "Request"), at 3.

² The entire text of the Capital One NSA is reproduced in the Request, Attachment G.

³ A second and lower volume threshold was also negotiated with Capital One. That lower threshold provides Capital One access to discounts starting at a lower level in the second and third year of the NSA if Capital One's mail volume falls below the threshold in the first year of the agreement. See Tr. 4/721. (OCA/USPS-T2-7)

⁴ Under the NSA, Capital One's First-Class Mail is segregated into two types: customer mail and solicitation mail. Capital One NSA (Request, Attachment G), Article III, paragraphs C. Customer mail is used to communicate with existing account holders. Solicitation mail is used in direct mail marketing campaigns to target credit-worthy customers. See Tr. 2/38-40 (Jean, COS-T-1).

⁵ Request, Attachment A.

1 I believe the two principal features of the Capital One NSA—volume-based
2 declining block rates and free electronic address correction notices—should be offered,
3 with modifications, as two experimental mail classifications to all First-Class mailers
4 meeting certain requirements.⁶ The Experimental Automated Address Correction
5 Service would provide all First-Class mailers authorized by the Postal Service electronic
6 address correction notices, at no charge, for mailpieces that are forwarded and in lieu
7 of the physical return of mailpieces that cannot be forwarded. To obtain free electronic
8 notices, mailers would be required to take specific actions to improve their address
9 databases that are used for subsequent mailings. The second classification,
10 Experimental Volume-Based Declining Block Rates, would provide interested First-
11 Class mailers that receive electronic notices via the Experimental Automated Address
12 Correction Service access to volume-based declining block rates. Such First-Class
13 mailers, if authorized, would have access to declining block rates on objective terms,
14 eliminating the need for separate negotiations with individual mailers and reliance on
15 unverifiable, private information.

16 A. The Proposed Experimental Address Correction Service Is Available to
17 Authorized First-Class Mailers Participating in the Address Change
18 Service Program

19 Address Correction Service is a special service available for a fee to all mailers.
20 The service provides “a mailer both an addressee’s former and current address, if the

⁶ The specific terms of OCA’s proposed experimental mail classifications are provided in proposed changes to the DMCS, presented in OCA-T2 Attachments A and B accompanying this testimony.

1 correct address is known to the Postal Service . . . [or] the reason why the Postal
2 Service could not deliver the mailpiece as addressed.”⁷

3 The Postal Service’s Address Change Service (ACS) program provides address
4 corrections electronically.⁸ In order to receive electronic address corrections, mailers
5 are assigned a unique ACS Participant Code. The Participant Code is applied to the
6 mailpiece in the address block above the addressee’s name, along with the mailer’s
7 “keyline,” or account number, which identifies a specific address record in the mailer’s
8 address database.⁹ A mailpiece must also display one of two endorsements, Address
9 Service Requested (ASR) or Change Service Requested (CSR), which determines the
10 information content of the electronic notice and subsequent handling of the mailpiece
11 by the Postal Service.¹⁰ When a mailpiece is UAA, the mailer is provided an electronic
12 notice containing the keyline and the correct address, if available, or the reason for non-
13 delivery of the mailpiece.¹¹ A fee of 20 cents is charged for each electronic notice.¹²

14 Under OCA’s experimental classification, electronic address correction notices
15 would be provided at no charge to First-Class mailers authorized by the Postal Service
16 that participate in the ACS program. The current fee of 20 cents for each electronic

⁷ DMCS § 911.11.

⁸ USPS-T-4 (Wilson), at 3. A complete description of the Address Change Service program is provided in Postal Service Publication 8, *Address Change Service* (September 1998). As used herein, the title “Address Change Service” refers to the Postal Service’s program that provides electronic address corrections, and the title “Address Correction Service” refers to the special service described at DMCS § 911.

⁹ USPS-T-4 (Wilson), at 3.

¹⁰ See Domestic Mail Manual (DMM), § F010.5.1.

¹¹ USPS-T-4 (Wilson), at 3.

¹² DMCS Fee Schedule 911.

1 notice would be waived, provided mailers correct and update their address databases
2 and take other actions to improve their address databases.

- 3 1. Authorized Address Change Service participating mailers must
4 correct address databases with free electronic information with
5 respect to forwarded mailpieces

6 Pursuant to the ACS program, an undeliverable-as-addressed mailpiece
7 endorsed ASR that is forwarded generates an electronic notice. For an undeliverable-
8 as-addressed mailpiece endorsed CSR, that mailpiece is destroyed rather than
9 forwarded, and an electronic notice is generated. The notice is generated based upon
10 the information in the Computerized Forwarding System (CFS) database.¹³ Beginning
11 in January 2003, the Postal Service will offer all mailers a new option, Change Service
12 Requested, Option 2, whereby a CSR-endorsed mailpiece will be forwarded to the new
13 address rather than destroyed.¹⁴

14 There is no requirement under the ACS program that participating mailers
15 retrieve or receive electronic notices, absent a commitment to do so at a stated
16 frequency.¹⁵ Nor is there a requirement that participating mailers correct address
17 databases with information from the program.¹⁶ The Postal Service maintains,
18 however, that the 20 cent address correction fee provides an incentive for participating

¹³ Tr. 3/545 (APWU/USPS-T4-8). According to the Postal Service, more than 200 CFS units have been established nationwide to centralize handling of mail for forwarding, and generate ACS electronic "fulfillment" notices. See USPS-T-4 (Wilson), at 1; see also Postal Service Publication 8, *Address Change Service* (September 1998), at 5.

¹⁴ USPS T-4 (Wilson), at 4.

¹⁵ Tr. 3/584 (OCA/USPS-T4-18(a)).

¹⁶ Tr. 3/650.

1 mailers to correct address databases.¹⁷ In the case of the Capital One NSA, there is no
2 requirement that Capital One receive electronic address correction notices, which
3 trigger Capital One's obligation to "update" its address databases.¹⁸

4 Under the experimental classification, electronic address correction notices
5 would be provided at no charge to ACS participating mailers authorized by the Postal
6 Service whose mailpieces bear the endorsement CSR, Option 2. However, mailers
7 would be required to correct, not just "update," their address databases in order to
8 prevent incorrect addresses from being used in another mailing. And, unlike the ACS
9 program, mailers would have an affirmative obligation to use address correction
10 information to correct their address databases, and to do so within two days of receiving
11 electronic notices. This requirement is expected to reduce the number of mailpieces
12 that are repeat forwards to the same address.¹⁹ Moreover, mailers would be required to
13 provide the Postal Service with a commitment to retrieve or receive electronic address
14 correction notices at least weekly.

15 In addition, the proposed experimental classification would require First-Class
16 mailers to comply more frequently with the requirements of the Move Update program.
17 The program, implemented in 1996, requires mailers to "update [] their address files for
18 customer change-of-address within 180 days of the mail entry date" in order to obtain

¹⁷ Institutional, OCA/USPS-T4-14.

¹⁸ Tr. 4/743 (OCA/USPS-T2-33(a)-(b)). The Postal Service maintains, however, that Capital One's obligation to "update" its databases "applies only if Capital One wishes to have address correction fees waived and pieces counted toward the discount thresholds." *Id.*

¹⁹ See Tr. 2/374; *see also* Tr. 2/352.

1 presort discounts.²⁰ Mailers may comply with this “pre-mailing address hygiene”
2 requirement by running their address databases against the National Change of
3 Address (NCOA) database and utilizing the *FASTforward* system.²¹ Under the
4 experimental classification, mailers must utilize NCOA “matching” or *FASTforward*
5 within 60 days prior to mailing.²² The Address Change Service program is an after-the-
6 fact method to correct address databases and comply with Move Update
7 requirements.²³ Consequently, under the experimental classification, mailers cannot
8 avoid premailing address hygiene and rely solely on the ACS program to satisfy Move
9 Update requirements.

- 10 2. Authorized Address Change Service participating mailers must
11 update address databases with free electronic information with
12 respect to mailpieces that would otherwise be physically returned

13 Pursuant to the ACS program, an electronic notice is generated for an
14 undeliverable-as-addressed mailpiece endorsed CSR that cannot be forwarded. Such
15 a mailpiece is destroyed. In the absence of CSR endorsement, the mailpiece would be
16 physically returned to the mailer. Unlike electronic notices for forwarded mailpieces,
17 however, no “move-related” information is available. Mailers are simply informed as to
18 the reasons for the non-delivery of the mailpiece as addressed. Reasons for non-

²⁰ Tr. 3/549 (APWU/USPS-T4-11).

²¹ A complete description of the *FASTforward* system can be found at <http://www.usps.com/ncsc/addressservices/moveupdate/fastforward.htm>.

²² See OCA-T2 Attachment A, § 610.43..

²³ See Tr. 4/713 (NAA/USPS-T2-21(d)); *see also* Tr. 3/649.

1 delivery include: Not Deliverable as Addressed—Unable to Forward (Forwarding Order
2 Expired); Attempted—Not Known; and, Refused.²⁴

3 Under the experimental classification, electronic address correction notices
4 would be provided at no charge for mailpieces endorsed CSR, Option 2 that cannot be
5 forwarded. However, mailers must “update” their address databases with the reasons
6 for non-delivery within two days of receiving electronic notices. In the case of Capital
7 One, updating involves incorporating address correction information that identifies an
8 address as having generated a “return” into an address database.²⁵ With the NSA,
9 Capital One will receive return information more quickly, as well as the reasons for the
10 return.²⁶ Such information would be a factor in a mailing decision process that could
11 result in a mailpiece being sent to an address that has had a prior return.²⁷ Under the
12 experimental classification mailers must use return information to update address
13 databases for all future mailings.

14 3. As an experiment, data should be collected on authorized Address
15 Change Service participating mailers’ use of the electronic address
16 correction information

17 The Postal Service proposes a data collection plan “[i]n order both to implement
18 and analyze the effect” of the Capital One NSA.²⁸ The Postal Service further proposes

²⁴ Tr. 3/582 (OCA/USPS-T4-17(d)). “The 10 most common non-move related reasons a mail piece is UAA are: Not Deliverable as Addressed—Unable to Forward (Forwarding Order Expired); Attempted—Not Known; Refused; No Such Number; Insufficient Address; Moved—Left No Address; Temporarily Away; No Such Street; and, No Mail Receptacle.” Id.

²⁵ See Tr. 4/746 (OCA/USPS-T2-36(a)-(c)); see also Tr. 2/123-24.

²⁶ See Tr. 2/137.

²⁷ Tr. 2/135.

²⁸ USPS-T-2 (Plunkett), at 12.

1 that data collected under the plan would be reported annually following the end of each
2 fiscal year, with the first report being made available after the end of FY 2003.²⁹

3 The Postal Service's data collection plan is inadequate for the Capital One NSA,
4 if recommended by the Commission, and for the proposed experimental mail
5 classification. The plan fails to collect data on the volume of Capital One's First-Class
6 solicitation mail that is forwarded, or the volume that is processed through CFS units or
7 forwarded locally.³⁰ Moreover, the plan does not take into account the phased
8 deployment of the Postal Automation Redirection System (PARS)³¹ during the three-
9 year period the NSA is in effect. Deployment of PARS will reduce Postal Service costs
10 of processing UAA mailpieces.³²

11 For the proposed experimental classification, a more extensive data collection
12 plan is required. That plan should include the collection of data on the following
13 items:³³

²⁹ Id.

³⁰ Under the Postal Service's current system of processing UAA mail, certain forwarded mailpieces are not processed through CFS units: mailpieces forwarded from "a destination delivery unit not covered by a CFS unit," and those "forwarded locally." See Institutional, APWU/USPS-T2-11(a) (revised 11/19/02).

³¹ PARS uses new and enhanced optical character readers (OCRs) to identify and intercept UAA letters earlier in the mail sorting process, automatically label such letters, and redirect them to the correct address. PARS is expected to reduce the total processing time (and cost) for UAA letters, as compared to the current method of processing. See "Memo to Mailers," United States Postal Service, Volume 37, Number 8, August 2002, at 1-2. The first phase of PARS deployment—beginning in July 2003 and scheduled for completion in May 2004—will include 53 processing and distribution plants, automating nearly 25 percent of all forwarded letters once Phase I is fully implemented. Phase II of PARS deployment is expected to begin shortly after the conclusion of Phase I, extending deployment to the remaining processing plants by the fall of 2006. Institutional, APWU/USPS-T4-13(d)-(f).

³² Tr. 3/540 (APWU/USPS-T4-3).

³³ If the Capital One NSA is recommended by the Commission, the Postal Service's data collection plan should include all the items of the data collection plan for this proposed experimental classification, except the first three items, which are inapplicable.

- 1 • the number of First-Class mailers authorized by the Postal Service to
2 receive electronic address correction notices under the experimental
3 classification;³⁴
4
- 5 • the number of First-Class mailers requesting authorization under the
6 experimental classification whose requests were denied. This data shall
7 be accompanied by all documentation supporting the Postal Service's
8 determination to deny authorization;
9
- 10 • the number of First-Class mailers authorized by the Postal Service under
11 the experimental classification whose authorization was withdrawn. This
12 data shall be accompanied by all documentation supporting the Postal
13 Service's determination to withdraw authorization;
14
- 15 • the total number of unique permit accounts used by each authorized First-
16 Class mailer to enter presorted First-Class mailpieces;
17
- 18 • the volume of presorted First-Class mailpieces by rate category entered
19 for each unique permit account;³⁵
20
- 21 • the volume of presorted First-Class mailpieces that are forwarded, and the
22 mailer's volume of repeat forwards.³⁶ The data collected should include
23 the volume of mailpieces forwarded through CFS units, forwarded from
24 destination delivery units not covered by a CFS unit, forwarded locally,
25 and forwarded through PARS. To collect these data, a special study
26 supported by accompanying documentation and calculations will be
27 required;
28

³⁴ Pursuant to OCA's proposed changes to the DMCS, mailers must be authorized by the Postal Service to use both experimental classifications. OCA-T2 Attachment A, § 610.41; OCA-T2 Attachment B, § 620.41. Where the Postal Service declines to authorize a mailer pursuant to the experimental classifications, the Postal Service should report the reasons for any decision not to authorize such a mailer.

³⁵ This data was requested in the Postal Service's data collection plan. See USPS-T-2 (Plunkett), at 12.

³⁶ The Postal Service does not know the total number of First-Class mailpieces that are forwarded, although it has "some sense" for mailpieces "captured within processing in our CFS units." See Tr. 3/657. Nor does the Postal Service collect data on the number of mailpieces forwarded by specific First-Class mailer. Id. Moreover, Capital One has "no way to estimate" the total number of solicitation mailpieces that were forwarded in previous or future years. Tr. 2/89 (OCA/COS-T1-9(c)); see also Tr. 2/98 (OCA/COS-T1-18). As part of the data collection plan, the Postal Service should complete a special study on the volume of Capital One's forwarded mail for solicitation mailpieces.

- 1 • the volume of presorted First-Class mailpieces physically returned to the
2 mailer;³⁷
3
- 4 • the number of electronic address correction notices provided to each
5 authorized First-Class mailer for forwarded mailpieces, and separately for
6 mailpieces that would otherwise be physically returned,³⁸ including the
7 number processed by CFS units and PARS;
8
- 9 • the costs to the Postal Service of monitoring, by mailer, compliance with
10 the requirements of the experimental classification, including the
11 underlying documentation and calculations used to develop the cost
12 figures;³⁹
13
- 14 • an estimate of cost savings to the Postal Service of providing electronic
15 notifications in terms of facilities closed (if any), craft positions eliminated,
16 other labor cost savings, etc. A special study supported by accompanying
17 documentation and calculations will be required to report these cost data;
18 and
19
- 20 • separate estimates of the cost savings to the Postal Service of providing
21 electronic notices for 1) pieces that are forwarded and 2) in lieu of the
22 physical return of pieces that cannot be forwarded, including the effect on
23 such cost estimates resulting from the implementation of PARS. A
24 special study supported by accompanying documentation and calculations
25 will be required to report these cost data.
26

27 The Postal Service should report data developed separately or collected from
28 existing data systems, such as the permit system or the address management system,
29 annually within three months of the close of each fiscal year. The first report should be
30 made available after the end of fiscal year 2003. Data developed as part of special
31 studies should be reported six months after conclusion of the three-year experiment, or

³⁷ This data was requested in the Postal Service's data collection plan. See USPS-T-2 (Plunkett), at 12.

³⁸ This data was requested in the Postal Service's data collection plan. Id.; see also Tr. 4/733 (OCA/USPS-T2-23).

³⁹ In addition to the monitoring costs for the Capital One NSA, the Postal Service should report the costs of negotiating and litigating the agreement. Moreover, the Postal Service should report such negotiation and litigation costs for any subsequent NSA concluded by the Postal Service.

1 concurrently with a Postal Service request for a permanent classification change,
2 whichever is earlier.

3 B. Offering the Proposed Experimental Address Correction Service At No
4 Charge Reduces Costs to the Postal Service and First-Class Mailers

5 The proposed experimental address correction service will reduce costs to the
6 Postal Service and authorized First-Class mailers. According to the Postal Service,
7 each electronic notice reduces costs to the Postal Service when a First-Class mailpiece
8 is forwarded or in lieu of physical return. Witness Crum estimates that an electronic
9 notice is less costly to provide than physically returning a mailpiece to the mailer.⁴⁰ This
10 estimate of reduced costs, based upon Capital One's circumstances, would be the
11 same for any First-Class mailer that received electronic notices in lieu of physical
12 returns in the same manner as Capital One.⁴¹ Witness Crum also maintains that in the
13 case of Capital One, electronic notices reduce Postal Service costs by reducing the
14 number of mailpieces that are repeat forward to an address.⁴² This estimate of reduced
15 costs, although less certain than the savings for avoided physical returns, suggests that
16 additional cost reductions will accrue to the Postal Service from electronic address
17 correction notices for forwarded mailpieces.⁴³

18 Moreover, electronic notices are expected to reduce mailers' costs. Mailers
19 currently participating in the ACS program will receive their electronic notices at no

⁴⁰ USPS-T-3 (Crum), at 5; see also Tr. 2/389-90.

⁴¹ See Tr. 2/296-97 (OCA/USPS-T3-7 and 8).

⁴² See Tr. 2/284 (NAA/USPS-T3-11); see also Tr. 2/320-21 (Response of United States Postal Service Witness Crum to Presiding Officer's Information Request No. 2, Question 7).

⁴³ Tr. 2/303-04 (OCA/USPS-T3-16(d)).

1 charge, saving the 20-cent per piece fee for electronic notifications. Mailers not
2 participating in the ACS program pay nothing for forwarding and return of their First-
3 Class mailpieces, as free forwarding and return is a service feature of First-Class Mail.
4 However, receiving electronic notices in lieu of physical returns is expected to reduce
5 mailers' costs of handling such mailpieces.⁴⁴ In the case of Capital One, savings will
6 include a reduction in the amount of "keying" associated with mailpieces that are
7 currently physically returned.⁴⁵ Moreover, electronic notices will provide mailers with
8 more timely and "richer" data for use in updating address databases.⁴⁶

9

⁴⁴ Tr. 2/85 (OCA/COS-T1-3(b)).

⁴⁵ See Tr. 2/113 (OCA/COS-T1-32(d)).

⁴⁶ Tr. 2/42 (Jean, COS-T-1); *see also* Tr. 2/134.

1 IV. EXPERIMENTAL VOLUME-BASED DECLINING BLOCK RATES SHOULD BE
2 OFFERED TO INTERESTED FIRST-CLASS MAILERS THAT RECEIVE
3 ADDRESS CORRECTION INFORMATION UNDER THE EXPERIMENTAL
4 ADDRESS CORRECTION SERVICE

5 First-Class mailers receiving electronic notices under the proposed experimental
6 address correction service would have access to volume-based declining block rates.

7 As proposed here, interested mailers could elect volume-based declining block rates,
8 whereby mailers pay otherwise applicable First-Class rates and receive discounts for
9 additional volumes. Structured in this manner, volume-based declining block rates
10 serve as an incentive for interested mailers to provide additional volumes of First-Class
11 Mail while minimizing financial risks to the Postal Service.

12 A. Volume-Based Declining Block Rates Can Be Structured to Offer
13 Interested First-Class Mailers Incentives to Provide Additional Volumes of
14 Mail

15 The Capital One NSA features a volume threshold for discounts determined
16 through negotiation.⁴⁷ Under the NSA, Capital One will have access to volume-based
17 discounts when its qualified First-Class Mail volume exceeds a threshold of 1.225 billion
18 mailpieces. Discounts begin at 3 cents and rise by one-half cent for additional, or
19 incremental, quantities of mail above the volume threshold.

20 Unlike the Capital One NSA, I propose that a unique volume threshold be
21 developed by the Postal Service for each interested First-Class mailer based upon the
22 mailer's known, historical mail volume. Like the Capital One NSA, however, larger
23 discounts would be available for incremental volumes calculated from that unique
24 volume threshold. In contrast to the NSA, the total discounts available to any one

⁴⁷ USPS-T-2 (Plunkett), at 5.

1 mailer would be limited to a maximum quantity of mail equal to 15 percent of a mailer's
2 unique volume threshold.

- 3 1. A unique volume threshold for each mailer will determine the initial
4 discount for additional volume

5 For the proposed experimental classification, a mailer's recent historic First-
6 Class Mail volume can be used to develop a volume threshold. Such historic volume
7 data, if publicly available and verifiable, provide an objective basis for estimating future
8 volume. Mail volumes provided by First-Class presort mailers likely to be interested in
9 the experimental classification are verifiable by the Postal Service through mailer
10 identification of their permit accounts.⁴⁸ Using its own and/or publicly available data,
11 the Postal Service must develop each mailer's unique volume threshold under the
12 experimental classification. In other words, volume thresholds must be developed
13 without reliance on unverifiable statements of mailers.

- 14 2. Larger discounts will be available for additional mail volumes,
15 based upon incremental volume ranges

16 Discounts would be available for additional volumes in excess of the mailer's
17 unique threshold. Increasingly larger discounts will be available as mailers provide
18 additional volumes of First-Class Mail. The amount of discounts available is based
19 upon the quantity of additional volume or "incremental volume blocks." The absolute
20 size of each incremental volume block is calculated as a proportion of each mailer's
21 unique volume threshold.

⁴⁸ Institutional, OCA/USPS-4; *see also* Institutional, OCA/USPS-3.

Table 1 shows the structure of discounts to be provided Capital One where volumes exceed the 1.225 billion threshold. A 3-cent discount is provided for the first incremental volume block of 50 million mailpieces. Discounts increase by one-half cent for each incremental volume block of 50 million mailpieces, up to 1.375 billion. After 1.375 billion mailpieces, discounts continue to increase by one-half cent, but the incremental volume blocks increase to 75 million mailpieces, with a maximum discount of 6 cents for volumes in excess of 1.6 billion mailpieces. Column 3 shows the percentage increase in volume from the volume threshold required by Capital One to obtain each successively larger discount.

TABLE 1

Structure of Declining Block Discounts
Capital One NSA

[1] <u>Incremental Volume Blocks</u>	[2] <u>Incremental Volume Blocks</u>	[3] <u>% Change</u>	[4] <u>Discount</u>
1,225,000,001 to	1,275,000,000	4.1%	\$0.030
1,275,000,001 to	1,325,000,000	8.2%	\$0.035
1,325,000,001 to	1,375,000,000	12.2%	\$0.040
1,375,000,001 to	1,450,000,000	18.4%	\$0.045
1,450,000,001 to	1,525,000,000	24.5%	\$0.050
1,525,000,001 to	1,600,000,000	30.6%	\$0.055
1,600,000,001 to	above		\$0.060

I propose a similarly structured schedule of discounts for each interested mailer, based upon their unique volume threshold. Table 2 shows the rate schedule for my proposed experimental classification, incorporating Capital One's volume threshold, i.e., "Discount Threshold," for illustration. Using the approximate percentage increase for each incremental volume block applicable to Capital One from Table 1, I establish incremental volume blocks that increase by 4, 8 and 12 percent for the first three volume blocks, and 18, 24 and 30 percent for the last three volume blocks. Capital

1 One's volume threshold is highly problematic, as described in the testimony of witness
 2 Smith (OCA-T-1). However, based upon Capital One's threshold of 1.225 billion
 3 mailpieces, the incremental volume blocks and available discounts would be those
 4 shown (for illustration) in Table 2.

TABLE 2**RATE SCHEDULE 620A**

Discount Threshold = 1,225,000,000

[1] <u>Incremental Volume Blocks</u>		[2]	[3] <u>% Change</u>	[4] <u>Discount</u>
1,225,000,001	to	1,274,000,000	4.0%	\$0.030
1,274,000,001	to	1,323,000,000	8.0%	\$0.035
1,323,000,001	to	1,372,000,000	12.0%	\$0.040
1,372,000,001	to	1,445,500,000	18.0%	\$0.045
1,445,500,001	to	1,519,000,000	24.0%	\$0.050
1,519,000,001	to	1,592,500,000	30.0%	\$0.055
1,592,500,001	to	above		\$0.060

5
 6 Unlike the Capital One NSA, the total amount of discounts available to any one
 7 mailer would be limited under this proposed experimental classification. A mailer could
 8 claim discounts on a maximum volume equal to 15 percent of each mailer's unique
 9 volume threshold. However, the mailer could claim the highest discounts allowable on
 10 the mailer's incremental volume up to the maximum volume of 15 percent. The 15
 11 percent maximum volume represents the percentage difference between Capital One's
 12 projected volume of 1.408 billion and its volume threshold of 1.225 billion, i.e., 15
 13 percent $[(1.408 - 1.225) / 1.225]$ (rounded to the nearest integer). Thus, fifteen percent
 14 of Capital One's volume threshold equals 183.75 million $(0.15 * 1.225)$ mailpieces.

15 An example, based upon Capital One's volume threshold, incremental volume
 16 blocks and discounts shown in Table 2, can illustrate the operation of the 15 percent

limit.⁴⁹ For purposes of this example, assume Capital One mails 1.8 billion mailpieces in a year. Absent the discount limit, Capital One could claim discounts for volumes at each incremental volume block as shown in Rate Schedule 620A: 3 cents per piece for incremental volume of 49 million (1.274 - 1.225 billion) mailpieces, 3.5 cents per piece for the next incremental volume of 49 million (1.323 - 1.274 billion) mailpieces, etc. Capital One could also claim 6 cents per piece for the remaining incremental volume of 207.5 million (1.8000 - 1.5925 billion) mailpieces. The total discounts claimed would equal \$28.6 million $[(\$0.030 * (1.274 - 1.225 \text{ billion})) + (\$0.035 * (1.323 - 1.274 \text{ billion})) + (\$0.040 * (1.372 - 1.323 \text{ billion})) + (\$0.045 * (1.4455 - 1.3720 \text{ billion})) + (\$0.050 * (1.5190 - 1.4455 \text{ billion})) + (\$0.055 * (1.5925 - 1.5190 \text{ billion})) + (\$0.060 * (1.8000 - 1.5925 \text{ billion}))]$. With discounts limited to 15 percent of the volume threshold, the total amount of discounts claimed by Capital One would be \$11.25 million $(\$0.060 * 183.75 \text{ million})$.

Assume in another year Capital One mails 1.5925 billion mailpieces, which falls within the last bounded incremental volume block. The total amount of discounts claimed would be limited to 183.75 million $(0.15 * 1.225 \text{ billion})$ mailpieces times the

⁴⁹ This same example, based upon Capital One's volume threshold, incremental volume blocks and discounts proposed in the NSA, would produce the following results: Absent the discount limit, if Capital One mails 1.8 billion mailpieces, it could claim discounts for volumes at each incremental volume block as shown in Table 1: 3 cents per piece for incremental volume of 50 million (1.275 - 1.225 billion) mailpieces, 3.5 cents per piece for the next incremental volume of 50 million (1.325 - 1.275 billion) mailpieces, etc. Capital One could also claim 6 cents per piece for the remaining incremental volume of 200 million (1.800 - 1.600 billion) mailpieces. The total discounts claimed would equal \$28.5 million $[(\$0.030 * (1.275 - 1.225 \text{ billion})) + (\$0.035 * (1.325 - 1.275 \text{ billion})) + (\$0.040 * (1.375 - 1.325 \text{ billion})) + (\$0.045 * (1.45 - 1.375 \text{ billion})) + (\$0.050 * (1.525 - 1.450 \text{ billion})) + (\$0.055 * (1.600 - 1.525 \text{ billion})) + (\$0.060 * (1.8000 - 1.600 \text{ billion}))]$. With discounts limited to 15 percent of the volume threshold, the total amount of discounts claimed by Capital One would be \$11.25 million $(\$0.060 * 183.75 \text{ million})$. Assume in another year Capital One mails 1.600 billion mailpieces, which falls within the last bounded incremental volume block. The total amount of discounts claimed would be limited to 183.75 million $(0.15 * 1.225 \text{ billion})$ mailpieces times the highest applicable discounts in the discount schedule. Thus, Capital One could claim total discounts (continued on next page)

highest applicable discounts in the discount schedule. Thus, Capital One could claim total discounts equal to \$9.4 million $[(\$0.055 * (1,592.5 - 1,519.0 \text{ million})) + (\$0.050 * (1,519.0 - 1,445.0 \text{ million})) + (183.75 \text{ million} - ((1,592.5 - 1,519.0 \text{ million}) + (1,519.0 - 1,445.0 \text{ million}))) * \$0.045]$.

3. Data should be collected on the discounts paid to, and volumes provided by, mailers

By design, volume-based discounts are not cost-based; the size of the discounts is not related to specific estimates of cost reductions to the Postal Service.⁵⁰ As a consequence, data collected under the experimental volume-based declining block rate classification can be more limited.

In more specific terms, the data collection plan for this proposed experimental classification should include the following items:⁵¹

- the number of First-Class mailers authorized by the Postal Service that received discounts under the experimental classification;
- the number of First-Class mailers requesting authorization under the experimental classification whose requests were denied. This data shall be accompanied by all documentation supporting the Postal Service's determination to deny authorization;
- the number of First-Class mailers authorized by the Postal Service under the experimental classification whose authorization was withdrawn. This data shall be accompanied by all documentation supporting the Postal Service's determination to withdraw authorization;

equal to \$9.4 million $[(\$0.055 * (1,600.0 - 1,525.0 \text{ million})) + (\$0.050 * (1,525.0 - 1,450.0 \text{ million})) + (183.75 \text{ million} - ((1,600.0 - 1,525.0 \text{ million}) + (1,525.0 - 1,450.0 \text{ million}))) * \$0.045]$.

⁵⁰ Tr. 2/350-51; see also Institutional, OCA/USPS-T3-14.

⁵¹ If the Capital One NSA is recommended by the Commission, the Postal Service's data collection plan should include all the items of the data collection plan for this proposed experimental classification, except the first four items, which are inapplicable.

- 1 • the publicly available and/or verifiable First-Class Mail volume data relied
2 upon by the Postal Service in determining each mailer's unique volume
3 threshold, including all supporting documentation and calculations used in
4 determining the volume threshold;
5
- 6 • the total number of unique permit accounts used by each authorized First-
7 Class mailer to enter First-Class mailpieces;
8
- 9 • the volume of First-Class mailpieces by rate category entered for each
10 unique permit account;⁵²
11
- 12 • the amount of discounts paid by rate category for each authorized First-
13 Class mailer;⁵³ and
14
- 15 • the costs (if any) to the Postal Service of monitoring mailer compliance
16 with the requirements of the experimental classification.
17

18 Data collected pursuant to this experimental classification should be reported at
19 the same time as data collected for the proposed experimental address correction
20 service is reported.

21 B. Linking Volume-Based Declining Block Rates and Experimental Address
22 Correction Service Reduces Risk to the Postal Service and Increases the
23 Likelihood of Additional Contributions to Institutional Costs

24 Volume-based declining block rates pose financial risks to the Postal Service.
25 These financial risks arise because of the lack of certainty in establishing a volume
26 threshold. The most significant of these risks is the payment of discounts for volumes
27 that would be mailed even in the absence of the discounts.⁵⁴ Consequently, where the
28 volume threshold is set too "low," discounts are paid for mail volumes on which no
29 discount would otherwise be warranted. Less problematic is the failure of additional

⁵² This data was requested in the Postal Service's data collection plan. See USPS-T-2 (Plunkett), at 12.

⁵³ This data was requested in the Postal Service's data collection plan. Id.

⁵⁴ See the testimony of OCA witness Smith (OCA-T-1).

1 volumes to materialize. A volume threshold set too “high” would prevent mailers from
2 providing volumes in excess of the threshold, thereby precluding additional
3 contributions to institutional costs.

4 For many reasons, the establishment of the “correct” volume threshold is
5 unknowable. However, the risks associated with establishing a threshold can be
6 minimized. One means is to base the threshold upon publicly available and verifiable
7 historical volume data. Moreover, linking the volume-based declining block rates with
8 known measures that reduce costs to the Postal Service also minimizes financial
9 risks.⁵⁵ Finally, limiting the total amount of discounts paid to any one mailer is another
10 means of limiting the Postal Service’s financial risk. This experimental classification
11 relies on all three means.

12 Under the experimental classification, a First-Class mailer’s access to the
13 volume-based declining block rates is linked to participation in the experimental address
14 correction service. In this manner, financial risks to the Postal Service are reduced.
15 Every piece of First-Class Mail “returned” electronically reduces Postal Service costs,
16 and thereby makes an additional contribution to the Postal Service—even if mail
17 volumes do not exceed the volume threshold. Moreover, it appears additional savings
18 accrue to the Postal Service when electronic notices reduce the number of mailpieces
19 that would be repeat forwards. Only where mail volumes exceed the threshold are
20 discounts paid, and the incremental volumes are likely to provide an additional

⁵⁵ The structure of the volume-based discounts also serves to reduce financial risks to the Postal Service. Under the NSA and this proposed experimental classification, discounts are paid only for incremental mail volumes above a volume threshold rather than for the entire volume of mail. USPS-T-2, at 4; see also Tr. 4/831.

1 contribution to institutional costs. In this manner, linking access to volume-based
2 declining block rates with the experimental address correction service provides some
3 protection to the Postal Service from the financial risks associated with volume-based
4 declining block rates if offered independently.⁵⁶

5 More directly, limiting the total amount of discounts paid to each mailer limits the
6 Postal Service's financial risk associated with developing a volume threshold that is too
7 "low." At the same time, however, limiting the total amount of discounts available limits
8 the additional contribution the Postal Service can obtain from the mailer.

9 Moreover, under the experimental classification, the Postal Service has an
10 affirmative duty to find that any First-Class mailer, if authorized access to the volume-
11 based declining block rates, will generate an additional contribution to institutional
12 costs. To the extent the Postal Service does not find an additional contribution will be
13 likely, it may decline to authorize a mailer's access to the volume-based declining block
14 rates.

15

⁵⁶

Institutional, OCA/USPS-T3-14; *see also* Tr. 4/849-50.

V. THE PROPOSED EXPERIMENTAL CLASSIFICATIONS FOR ADDRESS CORRECTION SERVICE AND VOLUME-BASED DECLINING BLOCK RATES ARE CONSISTENT WITH THE POSTAL REORGANIZATION ACT

The Postal Reorganization Act, at Sections 3622 and 3623, requires that the Postal Rate Commission make recommended decisions on requested changes to the mail classification schedule and rates and fees in accordance with the policies of the Act, and several specific "factors." The factors, or criteria, to be considered with respect to mail classification changes are enumerated in Section 3623(c), paragraphs 1 through 6.

- 1) the establishment and maintenance of a fair and equitable classification system for all mail;
- 2) the relative value to the people of the kinds of mail matter entered into the postal system and the desirability and justification for special classifications and services of mail;
- 3) the importance of providing classifications with extremely high degrees of reliability and speed of delivery;
- 4) the importance of providing classifications which do not require an extremely high degree of reliability and speed of delivery;
- 5) the desirability of special classifications from the point of view of both the user and of the Postal Service; and
- 6) such other factors as the Commission may deem appropriate.

The criteria to be considered with respect to changes in postal rates and fees are found in Section 3622(b), paragraphs 1 through 9.

- 1) the establishment and maintenance of a fair and equitable schedule;
- 2) the value of mail service actually provided each class or type of mail service to both the sender and recipient including, but not limited to the collection, mode of transportation, and priority of delivery;

- 1 3) the requirement that each class of mail or type of mail service bear the
2 direct and indirect postal costs attributable to that class or type plus that
3 portion of all other costs of the Postal Service reasonably assignable to
4 such class or type;
5
- 6 4) the effect of rate increases upon the general public, business mail users,
7 and enterprises in the private sector of the economy engaged in the
8 delivery of mail matter other than letters;
9
- 10 5) the available alternative means of sending and receiving letters and other
11 mail matter at reasonable costs;
12
- 13 6) the degree of preparation of mail for delivery into the postal system
14 performed by the mailer and its effect upon reducing costs to the Postal
15 Service;
16
- 17 7) simplicity of structure for the entire schedule and simple, identifiable
18 relationships between rates or fees charged the various classes of mail for
19 postal services;
20
- 21 8) the educational, cultural, scientific, and informational value to the recipient
22 of mail matter; and
23
- 24 9) such other factors as the Commission deems appropriate.
25

26 I have considered the relevant classification criteria with respect to my
27 development of the proposed classifications for Experimental Automated Address
28 Correction Service and Experimental Volume-Based Declining Block Rates. In
29 proposing the rate and fee changes for the experimental classifications, I have
30 considered the relevant pricing criteria. The proposed experimental classifications
31 reflect my judgement as to the application of the classification and rate criteria.

32 A. The Proposed Experimental Address Correction Service Satisfies the
33 Classification and Rate Criteria of the Act

34 The Experimental Automated Address Correction Service is available to all First-
35 Class mailers authorized by the Postal Service that receive electronic address
36 correction information and undertake certain actions to improve their address

1 databases. In exchange for receiving electronic address correction information, the
2 current 20-cent fee for each electronic notice would be waived. These features of the
3 experimental classification and waiver of the current fee satisfy the classification and
4 pricing criteria of the Act.

- 5 1. The proposed experimental classification for address correction
6 service promotes fairness and equity, and would benefit First-Class
7 mailers and the Postal Service

8 The proposed classification for experimental address correction service
9 contributes to “the establishment and maintenance of a fair and equitable classification
10 system.” (Criterion 1) The proposed classification offers all authorized First-Class
11 mailers electronic address corrections at no charge. Mailers who can meet the
12 requirements not only receive electronic address corrections at no charge; they can
13 also access volume-based declining block rates, if interested.

14 The proposed electronic address correction service is a desirable “special
15 classification[] from the point of view of both the user and the Postal Service.”
16 (Criterion 5) From the point of view of First-Class mailers, CSR, Option 2 is a desirable
17 change in the ACS program.⁵⁷ The proposed experimental classification offers CSR,
18 Option 2 to all authorized First-Class mailers at no charge. From the point of the Postal
19 Service, offering electronic address corrections at no charge reduces costs to the
20 Postal Service from reduced physical returns and better addresses that reduce repeat
21 forwards. Moreover, offering electronic address corrections at no charge should induce
22 First-Class mailers to participate in the experimental classification, thereby increasing
23 the total reduction in Postal Service costs.

⁵⁷ Tr. 3/544 (APWU/USPS-T4-7).

1 2. Waiver of the electronic address correction fee promotes fairness
2 and equity in pricing, and satisfies other pricing criteria of the Act

3 Waiver of the current electronic address correction fee is responsive to “the
4 establishment and maintenance of a fair and equitable schedule.” (Criterion 1) Costs
5 to the Postal Service are reduced for every mailpiece that is not physically returned to
6 the mailer. Electronic notices for mailpieces that are forwarded are also expected to
7 reduce Postal Service costs. Under such circumstances, it is only fair and equitable
8 that the fee be waived. Moreover, waiving the fee is fair and equitable in another
9 sense: all authorized First-Class mailers may avoid the address correction fee for
10 undertaking the same requirements.

11 Waiver of the current electronic address correction fee also serves to enhance
12 “the value of mail service actually provided.” (Criterion 2) Mailers presently receiving
13 electronic address corrections would receive the same service at no charge. Mailers
14 who are not now but become participants in the ACS program could avail themselves of
15 the opportunity to obtain electronic address correction information under the
16 experimental classification at no charge.

17 Waiver of the electronic address correction fee will provide an additional
18 contribution to the institutional costs of the Postal Service. (Criterion 3) Postal Service
19 costs are reduced for every piece of First-Class Mail not physically returned and by
20 reducing the number of mailpieces that are repeat forwards, thereby generating
21 additional contribution to the institutional costs of First-Class Mail.

22 Waiver of the electronic address correction fee will have a beneficial effect on
23 business mail users of the proposed classification. (Criterion 4) No authorized First-
24 Class mailer under the experimental classification will experience an increase in fees.

1 Fees for current ACS participant mailers authorized under the experimental
2 classification will be waived. Mailers not currently ACS participants that become
3 authorized under the experimental classification will receive electronic address
4 correction notices at no charge.

5 Waiving the electronic address correction fee will improve “the degree of
6 preparation of mail for delivery into the postal system performed by the mailer and its
7 effect upon reducing costs to the Postal Service.” (Criterion 6) As noted previously,
8 reducing the number of First-Class mailpieces physically returned reduces costs to the
9 Postal Service. Similarly, reducing the number of mailpieces that are repeat forwards
10 reduces costs to the Postal Service. In order to obtain the fee waiver, mailers must
11 update their address databases with electronic address correction information with
12 respect to mailpieces that would otherwise be physically returned, and correct their
13 address databases with electronic information with respect to mailpieces that are
14 forwarded. Mailers must also comply more frequently with existing premailing address
15 hygiene requirements, which will further improve the quality of addresses used in
16 mailings.

17 Waiving the electronic address correction fee must be considered in the context
18 of the “simplicity of structure of the entire schedule and simple, identifiable relationships
19 between the rates or fees charged.” (Criterion 7) Waiving the fee adds a slight degree
20 of complexity to the fee schedule by effectively establishing another fee (e.g., \$0).
21 However, this fact should be balanced against the overall reduction in costs to the
22 Postal Service, and the elimination of the fee for participating mailers.

1 B. The Proposed Experimental Volume-Based Declining Block Rates Accord
2 with the Classification and Pricing Criteria of the Act

3 The Experimental Volume-Based Declining Block Rate classification offers
4 interested First-Class mailers volume-based discounts for incremental volumes of First-
5 Class Mail. This proposed classification satisfies the mail classification and pricing
6 criteria, and would benefit the Postal Service and interested First-Class mailers.

7 1. The proposed experimental classification for volume-based
8 declining block rates promotes fairness and equity, and would
9 benefit First-Class mailers and the Postal Service

10 The proposed classification for volume-based declining block rates creates "a fair
11 and equitable classification system." (Criterion 1) The proposed classification offers all
12 interested First-Class mailers access to discounted rates for additional mail volumes in
13 exchange for receiving address change information electronically. Mailers who
14 participate in the experimental address change service can, if interested, have access
15 to volume-based declining block rates.

16 The proposed classification responds to "the desirability of special classifications
17 from the point of view of both the user and the Postal Service." (Criterion 5) Volume-
18 based declining block rates under the experimental classification can be beneficial to
19 both mailers and the Postal Service. From the point of view of First-Class mailers, the
20 experimental classification presents an opportunity to obtain reduced rates for
21 incremental volumes. From the point of the Postal Service, offering volume-based
22 discounts as an experimental classification to interested First-Class mailers presents a
23 new opportunity to reduce costs, generate additional First-Class mail volume and obtain
24 additional contributions to institutional costs while limiting financial risks to the Postal
25 Service.

1 2. The proposed discounts for additional volume promote fairness
2 and equity in pricing, and satisfy other pricing criteria of the Act

3 The proposed discounts for additional mail volume contribute to “the
4 establishment and maintenance of a fair and equitable schedule.” (Criterion 1)
5 Interested First-Class mailers will have access to the same discounts on equivalent
6 terms. As a result, fairness and equity is enhanced as compared to the NSA. In this
7 manner, firms who view themselves as competitors are placed on an equal footing, at
8 least with respect to postal rates.

9 The proposed discounts would enhance “the value of the mail service actually
10 provided” to First-Class mailers. (Criterion 2) Discounts for incremental mail volumes
11 as proposed in the experimental classification are not presently a feature of the current
12 rate schedule. All interested First-Class mailers authorized by the Postal Service that
13 are able to provide additional volumes would receive existing mail services at a lower
14 price.

15 The proposed discounts should provide an additional contribution to the
16 institutional costs of the Postal Service. (Criterion 3) Given the relatively high
17 institutional cost coverage on presort First-Class Mail, additional volumes prompted by
18 the discounts should cover the cost of the volume-based discounts. Nevertheless, the
19 total amount of discounts paid will be limited. In this manner, the volume-based
20 declining block rates hold out the potential that mailers will offer additional volumes,
21 thereby generating additional contributions to the institutional costs of the Postal
22 Service and at the same time limit financial risks.

23 The proposed discounts will have a beneficial effect on business users of First-
24 Class Mail. (Criterion 4) Authorized mailers under the experimental classification will

1 pay lower rates on additional volumes of First-Class Mail in excess of their unique
2 volume threshold. First-Class mailers not participating in the experimental classification
3 will not experience any increase in rates.

4 The proposed discounts promote “simplicity of structure for the entire [rate]
5 schedule and simple, identifiable relationships between the rates or fees charged.”

6 (Criterion 7) The proposed rate schedule consists of seven new discounts, a modest
7 degree of complexity that should be manageable for sophisticated mailers likely to take
8 advantage of the volume-based discounts. Moreover, the proposed rate schedule of
9 volume-based discounts demonstrates simple, identifiable rate relationships. Interested
10 First-Class mailers offering additional volumes in excess of their unique threshold
11 receive discounts, which increase at incremental volume blocks above the threshold.

12

1 VI. CONCLUSION

2 I propose two new experimental mail classifications—Experimental Automated
3 Address Correction Service and Experimental Volume-Based Declining Block Rates—
4 as alternatives to the NSA concluded between the Postal Service and Capital One.
5 These experimental classifications are based upon, and improve upon, the two principal
6 features of the NSA, and would be available to all First-Class mailers authorized by the
7 Postal Service. Experimental Automated Address Correction Service would provide
8 authorized First-Class mailers electronic address correction notices at no charge,
9 provided mailers correct and update (and take other actions to improve) their address
10 databases used for subsequent mailings. The Experimental Volume-Based Declining
11 Block Rates classification would provide interested mailers participating in the
12 experimental address correction service access to volume-based declining block rates
13 on objective terms, thereby eliminating the Postal Service's need to negotiate
14 separately with individual mailers and reliance on unverifiable, private information.
15 Collectively, the experimental classifications present the Postal Service with an
16 opportunity to obtain additional contributions to institutional costs and to reduce costs,
17 while limiting the Postal Service's financial risk.

OCA-T2
Attachment A**DOMESTIC MAIL CLASSIFICATION SCHEDULE LANGUAGE****610 EXPERIMENTAL AUTOMATED ADDRESS CORRECTION SERVICE****610.1 Definition**

Experimental Automated Address Correction Service provides Address Correction Service described in section 911.11 to authorized First-Class mailers. Such mailers receive electronic records of address correction information for eligible First-Class Mail that is undeliverable-as-addressed. Experimental Automated Address Correction Service provided under this section will result in the forwarding of undeliverable-as addressed pieces that can be forwarded and the disposal by the Postal Service of undeliverable-as addressed pieces that cannot be forwarded.

610.2 Availability

Experimental Automated Address Correction Service is available only to First-Class mailers that participate in the Address Change Service program, are authorized by the Postal Service, and that enter eligible First-Class Mail defined under section 610.3.

610.3 Eligible First-Class Mail

Eligible First-Class Mail under this section is defined as presort First-Class Mail that bears the endorsement specified by the Postal Service. Eligible First-Class Mail does not include Business Reply Mail, Qualified Business Reply Mail, Cards, or Priority Mail.

610.4 Requirements of the Mailer

610.41 Mailers must receive authorization from the Postal Service to use Experimental Automated Address Correction Service; **provided**, the Postal Service finds there is a reasonable expectation that any mailer so authorized will make an additional contribution to institutional costs due to usage of Experimental Automated Address Correction Service. However, the Postal Service may deny authorization for any legitimate data collection, administrative or logistical reason.

- 610.42 Mailers must be Address Change Service participants. Mailers will provide the Postal Service with a commitment to retrieve or receive Address Change Service address correction records weekly or more often.
- 610.43 Mailers must comply with published Postal Service Move Update requirements through either NCOA match or FastForward, and use only addresses that have been processed against NCOA/CASS databases within the 60 calendar days prior to mailing.
- 610.44 Mailers must enter eligible First-Class Mail through unique permit accounts. Mailers will provide the Postal Service with the numbers of such unique permit accounts, which may be used only upon Postal Service acknowledgement. Mailers must use different permit accounts for ineligible First-Class Mail.
- 610.45 Mailers must notify the Postal Service of all return addresses for eligible First-Class Mail. Mailers must use different return addresses for ineligible First-Class Mail.
- 610.46 Mailers must meet the documentation and audit requirements of the Postal Service.

610.5 Requirements of the Postal Service

- 610.51 The Postal Service must provide a written statement to a mailer denied authorization pursuant to section 610.41, providing the reasons for denial. Each such statement shall state whether or not the reason(s) for denial are based upon a Postal Service determination that:
- (a) there is not a reasonable expectation that the mailer will make an additional contribution to institutional costs;
 - (b) data collection will be infeasible;
 - (c) administration of the Experimental Automated Address Correction Service for the mailer will be unduly difficult and/or costly; and/or
 - (d) logistics in providing Experimental Automated Address Correction Service to the mailer will be unduly difficult and/or costly.
- 610.52 Each statement required in section 610.51 (a) through (d) shall set forth the facts and reasons leading to a determination to deny authorization.

610.6 Waiver of Address Correction Fees

The fees for address correction in Fee Schedule 911 are waived for

eligible First-Class Mail pieces that are undeliverable-as-addressed and that bear the endorsement specified by the Postal Service; **provided**, the mailer meeting the requirements of section 610.4

- (a) corrects, with respect to forwarded pieces, in all its address databases those addresses identified in address correction records within 2 days after receipt of such records,
- (b) updates, with respect to pieces that would otherwise be physically returned, in all its address databases those addresses identified in address correction records within 2 days after receipt of such records, and
- (c) utilizes such corrected and updated address databases in all future mailings.

610.7 Cancellation

610.71 The Postal Service may withdraw authorization granted to a mailer pursuant to section 610.41 upon a finding that the expected additional contribution to institutional costs due to that mailer's usage of Experimental Automated Address Correction Service has not, and will not, materialize. If authorization is withdrawn, the Postal Service must provide a written statement to the affected mailer setting forth the facts and reasons for the withdrawal.

610.8 Expiration

This provision (Section 610) expires 3 years from the implementation date set by the Board of Governors.

610.9 Precedence

To the extent any provision of section 610 is inconsistent with any other provision of the Domestic Mail Classification Schedule, the former shall control.

OCA-T2
Attachment B**DOMESTIC MAIL CLASSIFICATION SCHEDULE LANGUAGE****620 EXPERIMENTAL VOLUME-BASED DECLINING BLOCK RATES****620.1 Definition**

Experimental Volume-Based Declining Block Rates are successively lower rates for incremental volumes of eligible First-Class Mail where such volumes exceed a threshold determined in accordance with section 620.6 below.

620.2 Availability

Experimental Volume-Based Declining Block Rates are available only to First-Class mailers that are authorized by the Postal Service, and are authorized Experimental Automated Address Correction Service mailers under section 610.

620.3 Eligible First-Class Mail

Eligible First-Class Mail under this section is defined as letter-shaped automation compatible First-Class Mail that bears the endorsement specified by the Postal Service. Eligible First-Class Mail does not include Business Reply Mail, Qualified Business Reply Mail, Cards, or Priority Mail.

620.4 Requirements of the Mailer

620.41 Mailers must receive authorization from the Postal Service to obtain access to volume-based declining block rates; **provided**, the Postal Service finds there is a reasonable expectation that any mailer so authorized will make an additional contribution to institutional costs from access to the volume-based declining block rates. However, the Postal Service may decline to provide an authorization for any legitimate data collection, administrative or logistical reason.

620.42 Mailers must enter eligible First-Class Mail through unique permit accounts. Mailers will provide the Postal Service with the numbers of such unique permit accounts, which may be used only upon Postal Service acknowledgement. Mailers must use different permit accounts for ineligible First-Class Mail.

620.43 Mailers must meet the documentation and audit requirements of the Postal Service.

620.5 Requirements of the Postal Service

620.51 The Postal Service must provide a written statement to a mailer denied authorization pursuant to section 620.41, providing the reasons for denial. Each such statement shall state whether or not the reason(s) for denial are based upon a Postal Service determination that:

- (a) there is not a reasonable expectation that the mailer will make an additional contribution to institutional costs;
- (b) data collection will be infeasible;
- (c) administration of the Experimental Automated Address Correction Service for the mailer will be unduly difficult and/or costly; and/or
- (d) logistics in providing Experimental Automated Address Correction Service to the mailer will be unduly difficult and/or costly.

620.52 Each statement required in section 620.51 (a) through (d) shall set forth the facts and reasons leading to a determination to deny authorization.

620.6 First-Class Mail Discounts

620.61 Discount Threshold

The Discount Threshold is defined and established by the Postal Service using only its own or publicly available data. The Discount Threshold may be adjusted in accordance with section 620.63 below.

620.62 Discounts

Eligible First-Class Mail is subject to the otherwise applicable First-Class Mail postage in Rate Schedule 221 less the discounts shown in Rate Schedule 620A, for each year in which the mailer meets the discount threshold. If, at the end of each postal fiscal year, the Postal Service determines the mailer has provided eligible First-Class Mail in excess of the discount threshold established in section 620.61 (or 620.63, if applicable), the Postal Service shall rebate to the mailer discounts only for volumes above the discount threshold. Each incremental discount applies only to the incremental volume within each volume block.

620.63 Threshold Adjustment

Revised 1-16-03

In the event that the mailer meeting the requirements of section 620.4 merges with or acquires an entity with annual First-Class Mail volume in excess of 0.75 percent of the discount threshold determined in section 620.51 in the year preceding the acquisition or merger, or in the event that, in any Postal Service fiscal year, the mailer merges with or acquires multiple entities with combined annual First-Class Mail volume in excess of 2.0 percent of the discount threshold determined in section 620.51, the discount threshold will be adjusted upward by the volume of eligible First-Class Mail sent by the other entity (or entities) during the 12 months preceding the merger or acquisition. In that event, beginning in the succeeding fiscal quarter following the date of acquisition or merger, Rate Schedule 620B would apply in lieu of Rate Schedule 620A.

620.64 **Discount Limitation**

Discounts will be paid on incremental volumes equal to no more than 15 percent of the discount threshold. The mailer may claim the highest allowable discount(s) available for incremental volumes up to 15 percent of the discount threshold. Thus, a discount threshold of one billion pieces yields a maximum volume of 150 million pieces on which a mailer may claim a discount. If actual volume is 1.3 billion pieces, discounts could be claimed for incremental volumes in the rate blocks between 1.15 billion and 1.3 billion pieces. According to Rate Schedule 620A, the total amount of discounts would be \$7.65 million, composed of 60 million pieces at \$0.055, 60 million pieces at \$0.050, and 30 million pieces at \$0.045.

620.7 **Rates**

The applicable discounts are set forth in the following rate schedules:

620A
620B

620.8 **Expiration**

This provision (Section 620) expires 3 years from the implementation date set by the Board of Governors.

620.9 **Precedence**

To the extent any provision of section 620 is inconsistent with any other provision of the Domestic Mail Classification Schedule, the former shall control.

EXPERIMENTAL VOLUME-BASED DECLINING BLOCK RATES

DISCOUNT TABLES

RATE SCHEDULE 620A

Discount Threshold =

DT

Incremental Volume Blocks		% Increase	Discount
DT(Rounded 000)+1	to DT*(1+0.04)	4.0%	\$0.030
DT*(1+0.04)+1	to DT*(1+0.08)	8.0%	\$0.035
DT*(1+0.08)+1	to DT*(1+0.12)	12.0%	\$0.040
DT*(1+0.12)+1	to DT*(1+0.18)	18.0%	\$0.045
DT*(1+0.18)+1	to DT*(1+0.24)	24.0%	\$0.050
DT*(1+0.24)+1	to DT*(1+0.30)	30.0%	\$0.055
DT*(1+0.30)+1	to above		\$0.060

RATE SCHEDULE 620B

For Adjusted Threshold

Discount Threshold =

DT

Adjustment =

A

Adjusted Threshold =

AT

Incremental Volume Blocks		% Increase	Discount
AT(Rounded 000)+1	to AT*(1+0.04)	4.0%	\$0.030
AT*(1+0.04)+1	to AT*(1+0.08)	8.0%	\$0.035
AT*(1+0.08)+1	to AT*(1+0.12)	12.0%	\$0.040
AT*(1+0.12)+1	to AT*(1+0.18)	18.0%	\$0.045
AT*(1+0.18)+1	to AT*(1+0.24)	24.0%	\$0.050
AT*(1+0.24)+1	to AT*(1+0.30)	30.0%	\$0.055
AT*(1+0.30)+1	to above		\$0.060

DT = "Discount Threshold" determined under DMCS Section 620.61.

A = "Adjustment" made pursuant to DMCS section 620.63.

AT = "Adjusted Threshold" resulting from adjustment to discount threshold pursuant to DMCS section 620.63.

1 CHAIRMAN OMAS: Mr. Callow, have you had the
2 opportunity to examine the packet of designated
3 written cross-examination that was made available to
4 you in the hearing room this morning?

5 THE WITNESS: I have.

6 CHAIRMAN OMAS: If the questions contained
7 in that packet were posed to you orally today, would
8 your answers be the same as those you previously
9 provided to us in writing?

10 THE WITNESS: They would be with two minor
11 typographical corrections. They are to the same
12 interrogatory, USPS/OCA-T-2-24. In the first line
13 610-A should be changed to 620-A, and in that same
14 response the line Response to USPS/OCA-T-2-23, the 23
15 should be changed to 24. With those corrections, yes.

16 CHAIRMAN OMAS: Are there any additional
17 corrections at this point?

18 THE WITNESS: None.

19 CHAIRMAN OMAS: Okay. Counsel, would you
20 please provide two copies of the corrected designated
21 written cross-examination of Witness Callow to the
22 reporter? That material is received into evidence,
23 and it is to be transcribed into the record.

24 //

25 //

1 (The document referred to was
2 marked for identification as
3 Exhibit No. OCA-T-2 and was
4 received in evidence.)

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Experimental Rate and Service
Changes to Implement Negotiated
Service Agreement with Capital One

Docket No. MC2002-2

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF OFFICE OF THE CONSUMER ADVOCATE
WITNESS JAMES F. CALLOW
(OCA-T-2)

Party

American Postal Workers Union,
AFL-CIO

Interrogatorie

APWU/OCA-T2-1, 3-8

COS/OCA-T2-6-7, 11, 13

NAA/OCA-T2-4-6

USPS/OCA-T2-2, 5, 13-14, 18, 20, 23

Capital One Services, Inc.

APWU/OCA-T2-3, 9

COS/OCA-T2-1-17, 20

NAA/OCA-T2-1, 6

USPS/OCA-T2-1-19

Newspaper Association of America

COS/OCA-T2-2

NAA/OCA-T2-7-9

USPS/OCA-T2-1, 4

United States Postal Service

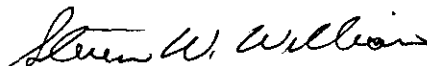
APWU/OCA-T2-1-9

COS/OCA-T2-1-16

NAA/OCA-T2-1-9

USPS/OCA-T2-1-24

Respectfully submitted,



Steven W. Williams
Secretary

INTERROGATORY RESPONSES OF
OFFICE OF THE CONSUMER ADVOCATE
WITNESS JAMES F. CALLOW (T-2)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory

APWU/OCA-T2-1
APWU/OCA-T2-2
APWU/OCA-T2-3
APWU/OCA-T2-4
APWU/OCA-T2-5
APWU/OCA-T2-6
APWU/OCA-T2-7
APWU/OCA-T2-8
APWU/OCA-T2-9
COS/OCA-T2-1
COS/OCA-T2-2
COS/OCA-T2-3
COS/OCA-T2-4
COS/OCA-T2-5
COS/OCA-T2-6
COS/OCA-T2-7
COS/OCA-T2-8
COS/OCA-T2-9
COS/OCA-T2-10
COS/OCA-T2-11
COS/OCA-T2-12
COS/OCA-T2-13
COS/OCA-T2-14
COS/OCA-T2-15
COS/OCA-T2-16
COS/OCA-T2-17
COS/OCA-T2-20
NAA/OCA-T2-1
NAA/OCA-T2-2
NAA/OCA-T2-3
NAA/OCA-T2-4
NAA/OCA-T2-5
NAA/OCA-T2-6

Designating Parties

APWU, USPS
USPS
APWU, Capital One, USPS
APWU, USPS
APWU, USPS
APWU, USPS
APWU, USPS
APWU, USPS
Capital One, USPS
Capital One, USPS
Capital One, NAA, USPS
Capital One, USPS
Capital One, USPS
Capital One, USPS
APWU, Capital One, USPS
APWU, Capital One, USPS
Capital One, USPS
Capital One, USPS
Capital One, USPS
APWU, Capital One, USPS
Capital One, USPS
APWU, Capital One, USPS
Capital One, USPS
Capital One, USPS
Capital One, USPS
Capital One
Capital One
Capital One, USPS
USPS
USPS
APWU, USPS
APWU, USPS
APWU, Capital One, USPS

NAA/OCA-T2-7	NAA, USPS
NAA/OCA-T2-8	NAA, USPS
NAA/OCA-T2-9	NAA, USPS
USPS/OCA-T2-1	Capital One, NAA, USPS
USPS/OCA-T2-2	APWU, Capital One, USPS
USPS/OCA-T2-3	Capital One, USPS
USPS/OCA-T2-4	Capital One, NAA, USPS
USPS/OCA-T2-5	APWU, Capital One, USPS
USPS/OCA-T2-6	Capital One, USPS
USPS/OCA-T2-7	Capital One, USPS
USPS/OCA-T2-8	Capital One, USPS
USPS/OCA-T2-9	Capital One, USPS
USPS/OCA-T2-10	Capital One, USPS
USPS/OCA-T2-11	Capital One, USPS
USPS/OCA-T2-12	Capital One, USPS
USPS/OCA-T2-13	APWU, Capital One, USPS
USPS/OCA-T2-14	APWU, Capital One, USPS
USPS/OCA-T2-15	Capital One, USPS
USPS/OCA-T2-16	Capital One, USPS
USPS/OCA-T2-17	Capital One, USPS
USPS/OCA-T2-18	APWU, Capital One, USPS
USPS/OCA-T2-19	Capital One, USPS
USPS/OCA-T2-20	APWU, USPS
USPS/OCA-T2-21	USPS
USPS/OCA-T2-22	USPS
USPS/OCA-T2-23	APWU, USPS
USPS/OCA-T2-24	USPS

APWU/OCA-T2-1

Have you estimated the changes in revenue and costs to the Postal Service of implementing the two experimental mail classifications that you propose in your testimony? If so, please provide those results and the assumptions that underlie your results. Please include in the description of your assumptions any changes that might arise from the implementation of PARS. If you have not made such cost and revenue estimates, why not?

RESPONSE TO APWU/OCA-T2-1

No. What I have tried to do is create classifications that substantially increase the likelihood that the Postal Service will generate an increase in contribution to institutional costs. That said, however, additional information is needed to estimate precise changes in revenue and costs associated with the experimental classifications. For the Experimental Volume-Based Declining Block Rates classification, I would need estimates of mail volume to be provided by, and the Postal Service-established volume threshold for, each mailer to estimate changes in revenues. For the Experimental Automated Address Correction Service, I would need an estimate of undeliverable-as-addressed (UAA) mailpieces to estimate changes in costs. I have made no assumptions with respect to the phased deployment of PARS. With respect to PARS, however, my data collection plan proposes that the Postal Service prepare a special study to develop

separate estimates of the cost savings to the Postal Service of providing electronic notices for 1) pieces that are forwarded and 2) in lieu of the physical return of pieces that cannot be forwarded, including the effect on such cost estimates resulting from the implementation of PARS.

OCA-T-2, at 14, lines 20-23.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES APWU/OCA-T2-1-9

1403

APWU/OCA-T2-2

Please confirm that all mailers participating in the experimental address correction classification that you propose would use the CSR-Option 2 endorsement.

RESPONSE TO APWU/OCA-T2-2

Confirmed. OCA-T-2, at 9, lines 4-6.

APWU/OCA-T2-3

You state on page 9 of your testimony that "mailers would have an affirmative obligation to use address correction information to correct their address databases, and to do so within two days of receiving electronic notices."

- a) Is this the same as requiring mailers to process all their future mailing lists against the information received from the ACS program? If not, please explain in more detail what actions the mailer would need to undertake to be in compliance with this requirement. Would this prohibit the mailer from mailing to an addressee at an address that has had a notice of a prior return?
- b) How would the Postal Service monitor compliance with this requirement?

RESPONSE TO APWU/OCA-T2-3

(a) Yes. Where the mailer receives an electronic notice with respect to a mailpiece that is forwarded, the mailer's obligation is to correct its address databases; that is, eliminate the name/address combination from use in any future mailing. Where the mailer receives an electronic notice in lieu of the physical return of a mailpiece, the mailer must update its address databases; that is, the mailer must note that an address is from a mailpiece that is electronically "returned," although the mailer would not be precluded from mailing to such an address.

This distinction between "corrected" and "updated" is practical and warranted. A mailer should be required to eliminate from future use a name/address in its address databases where an electronic notice provides the mailer with a correct move-related address. Doing so eliminates repeat forwards and reduces costs to the Postal Service. An electronic notice in lieu of physical return provides mailers with the reason for the non-delivery of a mailpiece. Such reasons include Not Deliverable as Addressed—Unable to Forward (Forwarding Order Expired), or Moved—Left No Address. In

practical terms, mailers are unlikely to reuse a name/address where the reasons are as provided above. However, there are other reasons for non-delivery, including Temporarily Away, or No Mail Receptacle. Thus, in such circumstances where a name/address is correct but the mailpiece is nevertheless "returned," a mailer might use this information in combination with other information available to it, to attempt another mailing that would have a higher likelihood of the mailpiece being delivered.

(b) The proposed DMCS for Experimental Automated Address Correction Service requires that mailers provide the Postal Service with a commitment to "retrieve or receive" address correction information weekly or more often. See OCA-T2 Attachment A, DMCS § 610.42. Mailer receipt of this information can be monitored by the Postal Service and is the starting point for compliance. Ultimately, the Postal Service should determine whether correcting address databases reduces the number of mailpieces that are repeat forwards to the same address. At the present time, however, the Postal Service does not collect data on the number of mailpieces forwarded by any specific First-Class mailer. Tr. 3/657. The data collection plan I propose would require the Postal Service to collect data on "the volume of presorted First-Class mailpieces that are forwarded, and the mailer's volume of repeat forwards." OCA-T-2, at 13, lines 21-22.

APWU/OCA-T2-4

You state on page 18 of your testimony that under your experimental volume-based declining block rates, a unique volume threshold for each mailer would be determined from "a mailer's recent historic First-Class Mail volume." Are you proposing to use a specific methodology for determining this unique threshold value? Is so, what methodology are you proposing? Once set, would these threshold amounts stay constant for all future years of the agreement?

RESPONSE TO APWU/OCA-T2-4

No. The proposed DMCS for Experimental Volume-Based Declining Block Rates directs that the "Discount Threshold" be "established by the Postal Service using only its own or publicly available data." See OCA-T2 Attachment B, DMCS § 620.61. In the absence of a mailer merging with or acquiring another entity, the unique volume threshold (i.e., Discount Threshold) once established for each mailer would be unchanged for the three-year period of the experiment.

APWU/OCA-T2-5

Under your proposed experimental volume-based declining block rates, when would the discounts be applied? Since mailers can claim the highest discount available based on the amount by which their mail volume exceeds their threshold amounts, would the discounts be provided as a retroactive rebate once the full year's volume is determined? If not, please explain further the procedures for implementing the discounts. If so, will the volume totals be determined through the PERMIT system based on a set of permit numbers registered at the time of the Postal Service approves the mailer to participate in the program?

RESPONSE TO APWU/OCA-T2-5

Discounts will be rebated to the mailer "at the end of each postal fiscal year" where "the Postal Service determines the mailer has provided eligible First-Class Mail in excess of the [mailer's] discount threshold." See OCA-T2 Attachment B, DMCS § 620.62. Yes. The proposed changes to the DMCS for Experimental Volume-Based Declining Block Rates states that "Mailers must enter eligible First-Class Mail through unique permit accounts [and] provide the Postal Service with the numbers of such unique permit accounts." Id., DMCS § 620.42. Moreover, mailers "must use different permit accounts for ineligible First-Class Mail." Id.

APWU/OCA-T2-6

Under your proposed experimental volume-based declining block rates, would the amount of the discounts available to each mailer be the same (for example always starting at 3 cents and progressing to 6 cents) but the threshold amounts differ or would the amount of the discounts available also be dependent on the size of the threshold amount? Would the size of the incremental blocks be adjusted to the specific mailer?

RESPONSE TO APWU/OCA-T2-6

Under the Experimental Volume-Based Declining Block Rates classification, each authorized mailer would have access to discounts that start at 3 cents and increase to 6 cents for mailpieces in excess of each mailer's volume threshold. The discounts—3.0, 3.5, 4.0, 4.5, 5.0, 5.5, and 6.0 cents—at each incremental volume block are unchanged for each mailer participating in the experimental classification. However, the size of each incremental volume block could be larger or smaller as between two mailers, since each incremental volume block is calculated as a fixed proportion of each mailer's volume threshold.

If it is assumed only two mailers participate in the Experimental Volume-Based Declining Block Rate classification, the difference in the size of each incremental volume block can be illustrated by comparing the table below with Table 2 in my testimony. OCA-T-2, at 20. Table 2 shows a "Discount Threshold" of 1.225 billion mailpieces. The table below assumes another mailer's Discount Threshold is 1 billion mailpieces. The absolute size of each incremental volume block in the table below is proportionally smaller as compared to the incremental volume blocks in Table 2. However, the discounts for each incremental volume block in each table are the same.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES APWU/OCA-T2-1-9

Discount Threshold =		1,000,000,000		
[1]		[2]	[3]	[4]
<u>Incremental Volume Blocks</u>			<u>% Change</u>	<u>Discount</u>
1,000,000,001	to	1,040,000,000	4.0%	\$0.030
1,040,000,001	to	1,080,000,000	8.0%	\$0.035
1,080,000,001	to	1,120,000,000	12.0%	\$0.040
1,120,000,001	to	1,180,000,000	18.0%	\$0.045
1,180,000,001	to	1,240,000,000	24.0%	\$0.050
1,240,000,001	to	1,300,000,000	30.0%	\$0.055
1,300,000,001	to	above		\$0.060

APWU/OCA-T2-7

Under your proposed experimental volume-based declining block rates, how would mergers or acquisitions among mailers be handled? Could a mailer meet its threshold target by purchasing another mailer and adding the acquired mail volume to its own?

RESPONSE TO APWU/OCA-T2-7

See OCA-T2 Attachment B, DMCS § 620.63. No. If a mailer authorized to participate in the Experimental Volume-Based Declining Block Rate classification merged with or acquired one or more entities, and the mergers and/or acquisitions met the requirements of OCA-T2 Attachment B, DMCS § 620.63, the "Discount Threshold" for the authorized mailer would "be adjusted upward by the volume of eligible First-Class Mail sent by the other entity (or entities) during the 12 months preceding the merger or acquisition." *Id.*

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES APWU/OCA-T2-1-9

1411

APWU/OCA-T2-8

Under your proposed experimental volume-based declining block rates, does the mail volume used to qualify for the discount have to be generated by the mailer? Could a mailer contract to mail other mailers volume in order to qualify for the discounts?

RESPONSE TO APWU/OCA-T2-8

Yes. No.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES APWU/OCA-T2-1-9

1412

APWU/OCA-T2-9

Under your proposed experimental volume-based declining block rates, the Postal Service can decline access to the volume-based declining block rates to a specific mailer if it does not believe that additional contribution to institutional costs can be generated. Are there any other reasons that the Postal Service can decline access to the volume-based declining block discounts to a specific mailer? If so what would those be?

RESPONSE TO APWU/OCA-T2-9

Yes. The Postal Service "may decline to provide an authorization for any legitimate data collection, administrative or logistical reason." See OCA-T2 Attachment B, DMCS § 620.41.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES COS/OCA-T2-1-4

COS/OCA-T2-1

Please refer to Section III of your testimony, which discusses your proposed experimental automated address correction service.

- (a) Please confirm that to be eligible for your proposed experimental automated address correction service, mailers would be required to allow the Postal Service to destroy, rather than physically return, its undeliverable-as-addressed First-Class mailpieces. If not confirmed, please explain fully.
- (b) Please describe in detail the minimum annual volume requirements that you propose for the experimental classification.

RESPONSE TO COS/OCA-T2-1

(a) Not Confirmed. The proposed changes to the DMCS for Experimental Automated Address Correction Service states "disposal by the Postal Service." See OCA-T2 Attachment A, DMCS § 610.1. It is correct, however, that undeliverable-as-addressed (UAA) mailpieces that cannot be forwarded will not be physically returned.

(b) There is no explicit minimum annual volume requirement. However, small-volume mailers are likely to be discouraged by the proposed changes to the DMCS for Experimental Automated Address Correction Service that require mailers to use NCOA or the *FASTforward* system. See OCA-T2 Attachment A, DMCS § 610.43.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES COS/OCA-T2-1-4

COS/OCA-T2-2

Assume that a mailer with ten million annual returned First-Class Mail letters is willing to participate in the proposed experimental automated address correction service, but only if it receives a discount of at least five cents per return. Please further assume that participating in this service will reduce Postal Service costs by 17 cents per return.

- (a) Please confirm that this mailer would not participate in your proposed experimental automated address correction service. If not confirmed, please explain fully.
- (b) Please confirm that providing a five cent per return discount would incent this mailer to participate in the service and that participating in the service would increase this mailer's contribution to the Postal Service by \$1.2 million ((17 cents per piece – 5 cents per piece) x ten million pieces).
- (c) Have you surveyed any First-Class mailers to assess whether they would participate in the experimental automated address correction service (as proposed)? If so, please provide a summary of your findings.

RESPONSE TO COS/OCA-T2-2

(a) Unable to confirm. The interrogatory does not indicate whether discounts to be provided to a mailer under the proposed Experimental Volume-Based Declining Block Rates would be sufficient to induce the mailer to participate in the Experimental Automated Address Correction Service. There are no discounts for mailers that participate in the Experimental Automated Address Correction Service. Discounts are available only for interested mailers under the Experimental Volume-Based Declining Block Rate classification.

(b) Confirmed.

(c) No.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES COS/OCA-T2-1-4

COS/OCA-T2-3

Please refer to pages 17-23 of your testimony where you discuss your proposed alternative discount structure. On page 17, lines 12-14, the caption notes that your alternative discount structure offers "incentives to provide additional volumes of mail." Assume that the volume threshold for a mailer is 1,225,000,000.

- (a) Please provide the discount that this mailer would receive if it mailed 1,409,000,000 pieces of First-Class Mail.
- (b) Please provide the discount that this mailer would receive if it increased its First-Class Mail to 1,410,000,000 pieces.
- (c) Based on the discounts calculated in (a) and (b) above, what is the incentive per piece that is being offered to this mailer to increase its First-Class Mail volume above 1,409,000,000 pieces?
- (d) Using Witness Elliott's Method 1 for calculating After-Rates Volume, as shown in Exhibit 6 of COS-T-2, what increase in this mailer's First-Class Mail would result from the incentive calculated in section (c) above?

RESPONSE TO COS/OCA-T2-3

- (a) \$6,802,500. (See OCA-T-2 at 20 for derivation of the "volume limit.")

Amount Mailed =		1,409,000,000				
Volume Limit =		183,750,000				
Discount Threshold =		1,225,000,000				
[1]	[2]	[3]	[4]	[5]	[6]	[7]
<u>Incremental Volume Blocks</u>		<u>% Change</u>	<u>Difference</u>	<u>Discount Volume</u>	<u>Discount</u>	<u>Revenue</u>
1,225,000,001	1,274,000,000	4.0%	48,999,999	48,750,003	\$0.030	\$1,462,500
1,274,000,001	1,323,000,000	8.0%	48,999,999	48,999,999	\$0.035	\$1,715,000
1,323,000,001	1,372,000,000	12.0%	48,999,999	48,999,999	\$0.040	\$1,960,000
1,372,000,001	1,409,000,000	18.0%	36,999,999	36,999,999	\$0.045	\$1,665,000
TOTAL				183,750,000		\$6,802,500

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES COS/OCA-T2-1-4

(b) \$6,817,500. (See OCA-T-2 at 20 for derivation of the "volume limit.")

Amount Mailed =		1,410,000,000				
Volume Limit =		183,750,000				
Discount Threshold =		1,225,000,000				
[1]	[2]	[3]	[4]	[5]	[6]	[7]
<u>Incremental Volume Blocks</u>		<u>% Change</u>	<u>Difference</u>	<u>Discount Volume</u>	<u>Discount</u>	<u>Revenue</u>
1,225,000,001	1,274,000,000	4.0%	48,999,999	47,750,003	\$0.030	\$1,432,500
1,274,000,001	1,323,000,000	8.0%	48,999,999	48,999,999	\$0.035	\$1,715,000
1,323,000,001	1,372,000,000	12.0%	48,999,999	48,999,999	\$0.040	\$1,960,000
1,372,000,001	1,410,000,000	18.0%	37,999,999	37,999,999	\$0.045	\$1,710,000
TOTAL				183,750,000		\$6,817,500

(c) \$0.015 [(\$6,817,500 - \$6,802,500) / (1.410 - 1.409 billion)]. See response to parts (a) and (b) above.

(d) 5,156,649. See below.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES COS/OCA-T2-1-4

**Response to COS/OCA-T2-3(d), based upon Exhibit 6: SLS
Consulting Projection of First-Class Mail Volume - Method 1**

FY 2003 Capital One Before-Rates Projection

First-Class Mail Solicitation Volume	769,000,000	[1]
First-Class Mail Customer Mail Volume	640,000,000	[2]
Total First-Class Mail	1,409,000,000	[3]

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

Price Elasticity - Workshared First-Class Letters	-0.071	[4]
Marginal Price Discount from NSA (Percent)	-5.2%	[5]
First-Class Mail Volume Increase (Percent)	0.4%	[6]
First-Class Mail Solicitation Volume Increase (Pieces)	2,814,381	[7]
First-Class Mail Customer Mail Volume Increase (Pieces)	2,342,268	[8]
Total First-Class Mail Volume Increase (Pieces)	5,156,649	[9]
After-Rates First-Class Mail Solicitation Volume (Pieces)	771,814,381	[10]
After-Rates First-Class Mail Customer Mail Volume (Pieces)	642,342,268	[11]
Total After-Rates First-Class Mail Volume (Pieces)	1,414,156,649	[12]

[1] Assumption, COS/OCA-T2(c)

[2] Capital One testimony

[3] = [1] + [2]

[4] R2001-1 USPS-T-7 at 51

[5] = - \$0.015 / \$0.291, where \$0.015 is the discount per piece calculated in part (c) above and \$0.291 is the Capital One per-piece average First-Class Mail postage

[6] = [4] • [5]

[7] = [1] • [6]

[8] = [2] • [6]

[9] = [7] + [8]

[10] = [1] + [7]

[11] = [2] + [8]

[12] = [10] + [11]

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES COS/OCA-T2-1-4

COS/OCA-T2-4

If Capital One applied to participate in your proposed volume discount classification in FY 2003, what would its volume threshold be? If you can't provide a specific figure, what process would be used to determine Capital One's volume threshold for FY 2003?

RESPONSE TO COS/OCA-T2-4

The proposed changes to the DMCS for Experimental Volume-Based Declining Block Rates directs that the "Discount Threshold" be "established by the Postal Service using only its own or publicly available data." See OCA-T2 Attachment B, DMCS § 620.61.

COS/OCA-T2-5

You have proposed discounts for First-Class Mail volumes above a unique volume threshold "determined for each mailer based upon the mailer's historical First-Class volume data." (Page 3).

- (a) Is the decline in First-Class Mail volume currently a serious problem confronting the Postal Service?
- (b) Does your threshold requirement prohibit the Postal Service from halting First-Class Mail volume declines for a particular mailer by offering that mailer a discount to maintain volumes?
- (c) Does your "threshold" approach obviate the possibility of the so-called "free rider" problem, that is, the possibility that discounts may be granted for First-Class Mail volume increments which would have materialized in the absence of the discount? Please explain your answer.

RESPONSE TO COS/OCA-T2-5

(a) The volume of First-Class Mail has declined recently. If this is a permanent trend, it is a serious problem.

(b) No.

(c) No. The financial risks to the Postal Service of establishing a volume threshold for any mailer cannot be entirely eliminated. However, the risks can be minimized in several ways. Under the Experimental Volume-Based Declining Block Rates classification, a First-Class mailer's access to declining block rates is linked to participation in the Experimental Automated Address Correction Service. According to the Postal Service, every piece of First-Class Mail "returned" electronically reduces Postal Service's costs, and thereby makes an additional contribution to the Postal Service. USPS-T-3 (Crum) at 5. Moreover, the total amount of discounts available to any one mailer is limited to a maximum quantity of mail equal to 15 percent of that

mailer's volume threshold. Such a limit also reduces the Postal Service's financial risk associated with developing a volume threshold that is too "low."

COS/OCA-T2-6

On page 4 of your testimony, you state that your experimental classifications “could eliminate the need to negotiate individual agreements with each mailer and to rely on unverifiable, private information.” Please confirm that this necessarily means that the only criteria that the Postal Service could use in determining a volume threshold is actual volume data for a particular mailer, and the Service cannot include any evidence relating to the intentions or plans of that mailer. In responding, please state as explicitly as you can what you regard as the “objective terms”, as you use that phrase on page 6 of your testimony, as the basis for accessing declining block rates.

RESPONSE TO COS/OCA-T2-6

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 this necessarily means that the only criteria that the Postal Service could use in determining a volume threshold is actual volume data for a particular mailer . . .”

Not confirmed. The Postal Service could use any publicly available information in establishing a mailer’s volume threshold, including historic volume data verified by the Postal Service.

“Please confirm that . . . the Service cannot include any evidence relating to the intentions or plans of that mailer.”

Not confirmed. The Postal Service could use any publicly available information, such as SEC filings, relating to the intentions or plans of a mailer in establishing that mailer’s volume threshold.

Publicly available information, such as SEC filings, provide an objective basis for establishing a volume threshold because such filings are made for purposes other than

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES COS/OCA-T2-5-12

the establishment of a volume threshold. Historic volume data, if verified, also provides an objective basis for establishing a volume threshold, as it permits the Postal Service to make an independent judgement about the value of such data in establishing a mailer's volume threshold.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES COS/OCA-T2-5-12

1423

COS/OCA-T2-7

On page 18 of your testimony, you state that for your experimental classification "a mailer's recent historic First-Class Mail volume can be used to develop a volume threshold." Please explain in detail how this data would be developed so that it would present an objective and verifiable volume threshold, and in the course of that explanation please explain how data can be both "recent" and "historic".

RESPONSE TO COS/OCA-T2-7

A mailer's recent historic First-Class Mail volume data could be developed from the permit system based on the mailer's specific identification of its permit account numbers. The Postal Service could verify the mail volumes entered through such permit accounts in past years. The Postal Service could also use volume data from mailing statements provided by a mailer in establishing a mailer's volume threshold.

All prior annual volume data of a mailer would be "historic." Annual volume data closer in time to the present would be "recent."

COS/OCA-T2-8

On page 25 of your testimony, you state that the Postal Service "has an affirmative duty to find that any First-Class mailer, if authorized access to the volume- based declining block rates, will generate an additional contribution to institutional costs." You then say that if the Postal Service finds that such additional contribution is not likely, "it may decline to authorize a mailer's access to the volume-based declining block rates." While, as you say, the Postal Service "may" decline to authorize a mailer's access to the volume-based declining block rates, may they nevertheless do so?

RESPONSE TO COS/OCA-T2-8

No. Please refer to the proposed DMCS for Experimental Volume-Based

Declining Block Rates at OCA-T2 Attachment B, DMCS § 620.41, which states

Mailers must receive authorization from the Postal Service to obtain access to volume-based declining block rates; **provided**, the Postal Service finds there is a reasonable expectation that any mailer so authorized will make an additional contribution to institutional costs from access to the volume-based declining block rates.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES COS/OCA-T2-5-12

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COS/OCA-T2-9

On page 9 of your testimony, you state that in the case of the Capital One NSA, "there is no requirement that Capital One receive electronic address correction notices. ..." In the footnote on that same page, however, you acknowledge that the Service maintains that Capital One will have such an obligation if it wishes to have the address correction fees waived and pieces counted toward the discount thresholds. Do you contest the Postal Service's claim, and, if you do not, is it not then the case that, in order to qualify for the free electronic address correction service and volume discounts, Capital One will have to, as you say, "receive" electronic address correction notices?

RESPONSE TO COS/OCA-T2-9

According to the Postal Service, there is no requirement that Capital One receive electronic address correction notices. Tr. 4/743. As you state, however, it would be in Capital One's interest to receive electronic notices if it wishes to have address correction fees waived and pieces counted toward the discount thresholds.

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES COS/OCA-T2-5-12

COS/OCA-T2-10

On page 9 you say that, under your proposal, "mailers would be required to correct, not just update, their address databases in order to prevent incorrect addresses from being used in another mailing." Please explain your understanding of the distinction between "correct" and "update".

RESPONSE TO COS/OCA-T2-10

As stated in my response to APWU/OCA-T2-3(a), where the mailer receives an electronic notice with respect to a mailpiece that is forwarded, the mailer's obligation is to correct its address databases; that is, eliminate the name/address combination from use in any future mailing. Where the mailer receives an electronic notice in lieu of the physical return of a mailpiece, the mailer must update its address databases; that is, the mailer must note that an address is from a mailpiece that is electronically "returned," although the mailer would not be precluded from mailing to such an address.

This distinction between "corrected" and "updated" is practical and warranted. A mailer should be required to eliminate from future use a name/address in its address databases where an electronic notice provides the mailer with a correct move-related address. Doing so eliminates repeat forwards and reduces costs to the Postal Service. An electronic notice in lieu of physical return provides mailers with the reason for the non-delivery of a mailpiece. Such reasons include Not Deliverable as Addressed—Unable to Forward (Forwarding Order Expired), or Moved—Left No Address. In practical terms, mailers are unlikely to reuse a name/address where the reasons are as provided above. However, there are other reasons for non-delivery, including Temporarily Away, or No Mail Receptacle. Thus, in such circumstances where a name/address is correct but the mailpiece is nevertheless "returned," a mailer might use

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES COS/OCA-T2-5-12

this information in combination with other information available to it, to attempt another mailing that would have a higher likelihood of the mailpiece being delivered.

COS/OCA-T2-11

On page 12 of your testimony, you criticize the Postal Service's data collection plan as inadequate because it fails to collect data on the volume of Capital One's First-Class solicitation mail that is forwarded and also fails to account for the volume of forwards processed through CFS units or forwarded locally, and you criticize the agreement because it does not require the Postal Service to do a special study to determine the amount of forwarding and return for Capital One. And on page 13 of your testimony, you state that, under your proposal, the data to be collected for each mailer will include the volumes of mail pieces forwarded, repeat forwards, those processed through CFS units, those forwarded from destination delivery units not covered by CFS units, those forwarded locally and those forwarded through PARS; and to get this data "a special study supported by accompanying documentation and calculations will be required." Assume that hundreds, perhaps even thousands, of mailers choose to take advantage of your classifications, is it your testimony that for each such mailer, the Postal Service should make a "special study" to determine how much mail is forwarded for that particular mailer in all its variations of forwarding as you have described?

RESPONSE TO COS/OCA-T2-11

For purposes of the experiment, I would not expect the Postal Service to authorize hundreds, let alone thousands, of mailers to participate in the Experimental Automated Address Correction Service for administrative reasons. Small-volume mailers are likely to be discouraged by the experimental classification's requirement that mailers use NCOA or the *FASTforward* system. Moreover, the number of originators entering First-Class Mail volumes in excess of 250 million pieces a year was less than 30 in the most recent two years for which data is available. See Institutional, OCA/USPS-3. That said, the only mailer-specific data related to forwarded mailpieces in my data collection plan is the "mailer's volume of repeat forwards." Nevertheless, I would expect the Postal Service to collect mailer-specific data on forwarded mailpieces where such data can be collected from automated systems (i.e., CFS units, and PARS when deployed) without preparation of a special study for each mailer.

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TO INTERROGATORIES COS/OCA-T2-5-12

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COS/OCA-T2-12

In attachment B to your testimony, the DMCS schedule language, in 620.64 you give an example of the discounts that would be available on an increase of a billion mailings to 1.3 billion pieces. In that example, you multiply the volume blocks by the rate discounts as listed in your schedule 620A. Please confirm that the rates you use in the example are misstated by being one half cent per piece more than applicable, and that the actual total amount of discounts would be \$7,650,000, rather than the \$8.4 million you list there. Specifically, is it not the case that the discounts would be sixty million pieces at 5.5 cents per piece, sixty million pieces at 5 cents per piece, and thirty million pieces at 4.5 cents per piece?

RESPONSE TO COS/OCA-T2-12

Confirmed. An appropriate erratum will be filed.

Amount Mailed = 1,300,000,000
Volume Limit = 150,000,000
Discount Threshold = 1,000,000,000

[1]	[2]	[3]	[4]	[5]	[6]	[7]
<u>Incremental Volume Blocks</u>		<u>% Change</u>	<u>Difference</u>	<u>Discount Volume</u>	<u>Discount</u>	<u>Revenue</u>
1,000,000,001	1,040,000,000	4.0%	39,999,999		\$0.030	
1,040,000,001	1,080,000,000	8.0%	39,999,999		\$0.035	
1,080,000,001	1,120,000,000	12.0%	39,999,999		\$0.040	
1,120,000,001	1,180,000,000	18.0%	59,999,999	30,000,002	\$0.045	\$1,350,000
1,180,000,001	1,240,000,000	24.0%	59,999,999	59,999,999	\$0.050	\$3,000,000
1,240,000,001	1,300,000,000	30.0%	59,999,999	59,999,999	\$0.055	\$3,300,000
TOTAL				150,000,000		\$7,650,000

COS/OCA-T2-13

Please refer to your response to COS/OCA-T2-4; page 17-18 of OCA-T-1, which describes witness Smith's extrapolation approach; and page 3 of your testimony where you state, "A unique volume threshold would be determined for each mailer based upon the mailer's historical First-Class volume data."

- (a) Under your proposed volume discount classification, is the Postal Service free to calculate the discount threshold using any method that it chooses so long as the method uses "its own [USPS] or publicly available data"? If your response is anything other than an unqualified yes, please describe how much freedom the Postal Service will have in setting the discount threshold based upon "its own or publicly available data."
- (b) Please confirm that your proposal does not require that the Postal Service use the extrapolation approach proposed by witness Smith to determine the discount threshold and explain fully why your proposal does not require the Postal Service to use this approach.
- (c) Please define fully "publicly available data" as used in your proposed Domestic Mail Classification Schedule language and list all forms of publicly available data that the Postal Service can use in calculating the discount threshold.
- (d) Please explain whether publicly available data, as used in your proposed DMCS language, must be historical.

RESPONSE TO COS/OCA-T2-13

(a) Yes. However, the word "data" should be interpreted broadly to mean information, not just numeric data.

(b) Confirmed. Witness Smith's forecasting model is based upon the data for one mailer—Capital One. It is one among several forecasting models that could be used by the Postal Service to establish the volume threshold for a mailer. I did not specify a single forecasting model or method in order to permit the Postal Service to develop the most appropriate method based upon the type, quantity and quality of mailer information available to it.

(c) Publicly available information was specified so the Postal Service could not use private information that would otherwise be unavailable for public inspection and

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES COS/OCA-T2-13-16

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review. 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."

(d) No. The Postal Service is not limited to using historical information.

COS/OCA-T2-14

Please refer to page 2 of OCA-T-1 where witness Smith states, "I conclude that the previous year's mail volume adjusted by previous levels of growth can serve as an estimator of the next year's level of mail volume. Such a number may be deficient, as is the case for Capital One, apparently due to changes in marketing approaches." Please refer further to page 18 of OCA-T-1 where he states, "The application of a revised growth rate requires a degree of judgment and ignores potential migration to the Internet of some billing statements." Please refer further to page 3 of your testimony where you state, "A unique volume threshold would be determined for each mailer based upon the mailer's historical First-Class volume data."

- (a) In your opinion, is it preferable for the Postal Service to set the discount threshold based upon a "deficient" Test Year volume forecast based solely upon USPS and publicly available data or a more accurate forecast that is based partially on a mailer's judgment and that has subsequently been reviewed by Postal Service experts? Please explain your response fully.
- (b) Given that, as witness Smith notes in his testimony, mailers change marketing approaches and that some billing statements may begin to migrate to the internet, do you believe that the Postal Service can accurately forecast Test Year volume based solely upon the mailer's historical First-Class volume data? Please explain your response fully.

RESPONSE TO COS/OCA-T2-14

(a) The proposed DMCS for the Experimental Volume-Based Declining Block Rate classification directs that the volume threshold be established by the Postal Service using only its own or publicly available data. See OCA-T2 Attachment B, DMCS § 620.61. This question presumes that a forecast based upon Postal Service and publicly available information will be "deficient" while one based upon a mailer's judgement and reviewed by the Postal Service is not. Under either method, establishment of the "correct" volume threshold for any mailer is unknowable. Thus, I don't know whether a mailer's volume forecast is "more accurate." There is, however, an obvious incentive for the mailer to provide a "low" forecast so discounts can be claimed on a larger volume of mail. It is for this reason that my proposal precludes the

Postal Service from basing a mailer's volume threshold on "mailer judgement." Consequently, the requirement that the Postal Service use only 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 total amount of discounts available to any one mailer.

(b) No. I do not propose that the Postal Service rely solely upon a mailer's historical First-Class volume data. The Postal Service can use its own or publicly available information. Such information might include forecasts or other prospective statements by a mailer that are publicly available and independently verifiable.

COS/OCA-T2-15

Please refer to your response to COS/OCA-T2-2(a) where you state, "Unable to confirm. The interrogatory does not indicate whether discounts to be provided to a mailer under the proposed Experimental Volume-Based Declining Block Rates would be sufficient to induce the mailer to participate in the Experimental Automated Address Correction Service." Please also refer to page 17 of your testimony, which notes that only mailers participating in the Experimental Automated Address Correction Service would have access your Experimental Volume-Based Declining Block Rates. Finally, please refer to your response to COS/OCA-T2-3.

- (a) Please confirm that, if access to volume-based discounts were not contingent on participation in the Experimental Automated Address Correction Service, the mailer described in COS/OCA-T2-2 would not participate in your proposed Experimental Automated Address Correction Service.
- (b) Please confirm that it is your opinion that because you propose only to allow mailers who participate in the Experimental Automated Address Correction Service to participate in the Experimental Volume-Based Declining Block Rates, access to the volume-based discounts might induce mailers to participate in the Experimental Automated Address Correction Service classification. Please explain your response fully.
- (c) Similarly, since the Capital One NSA is proposed as a package deal that includes elements of both your Experimental Automated Address Correction Service and your Experimental Volume-Based Declining Block Rates, can the volume discounts be viewed as inducements both to increase mail volume and to waive its right to physical returns? Please explain your response fully.
- (d) Please confirm that, to keep the total NSA discount given to Capital One constant, if a percentage of the cost savings from Capital One waiving its right to physical returns were passed through in the form of a per-return discount, the total volume discount given to Capital One as part of the NSA would need to be reduced. If not confirmed, please explain fully.
- (e) Please confirm that reducing the volume discount portion of the negotiated service agreement would reduce the incentive for Capital One to maintain and grow its use of First-Class Mail. If not confirmed, please explain fully.

RESPONSE TO COS/OCA-T2-15

(a) Confirmed, by definition. There are no discounts for mailers that participate in the Experimental Automated Address Correction Service.

(b) Confirmed. There are no discounts for mailers that participate in the Experimental Automated Address Correction Service. Thus, any mailer seeking

discounts would have to participate in the Experimental Volume-Based Declining Block Rate classification.

(c) I agree the Capital One Negotiated Service Agreement (NSA) is proposed as a package deal where the volume discounts can be viewed as inducements both to increase mail volume and for Capital One to waive its right to physical returns.

(d) Confirmed. Under the NSA, holding the total amount of discounts available to Capital One constant, while passing a portion of the cost reduction from reducing physical returns to Capital One in the form of a per piece discount, would by definition reduce the amount of volume-based discounts.

(e) While the incentive would be reduced, I cannot predict how Capital One would react, if at all.

COS/OCA-T2-16

Please refer to your response to COS/OCA-T2-3(c) where you calculate per-piece incentive to increase mail volume from 1.409 billion pieces to 1.41 billion pieces. Furthermore, assume that the rate that an individual participant in your Experimental Volume-Based Declining Block Rates classification pays to mail First-Class Mail letters (in the absence of the volume discounts) is uniformly 29.1 cents per piece.

- (a) Please confirm that the per-piece incentive to mail First-Class Mail letters above 1.15 times the discount threshold in your proposed classification is always less than or equal to two cents per piece. If not confirmed, please explain fully and provide the maximum per-piece incentive for mailing volume above 1.15 times the discount threshold.
- (b) Please confirm that the per-piece discount between the discount threshold and 1.15 times the discount threshold in your proposed classification is always greater than or equal to 3 cents per piece. If not confirmed, please explain fully.
- (c) Please confirm that for First-Class Mail letters sent by this mailer in the volume block between the volume threshold and 1.15 times the volume threshold, the effective rate (29.1 cents minus the per-piece incentive) is no more than 26.1 cents per piece.
- (d) Please confirm that for First-Class Mail letters sent by this mailer in the volume block above 1.15 times the volume threshold, the effective rate (29.1 cents minus the per-piece incentive) is no less than 27.1 cents per piece.
- (e) Would you agree that declining-block rates refer to rates that decline as quantity increases? If not confirmed, please provide your definition.
- (f) Would you agree that the definition of declining-block rates in subpart (e) does not describe your proposal for First-Class Mail letters above 1.15 times the discount threshold? If not confirmed, please explain fully.

RESPONSE TO COS/OCA-T2-16

- (a) Confirmed.
- (b) Confirmed, by definition. There are no discounts less than 3 cents.
- (c) Confirmed.
- (d) Confirmed.
- (e) Confirmed.
- (f) Confirmed. The purpose of the volume limit is to reduce the total amount of discounts available to any one mailer, and thereby limit the financial risk to the Postal

Service. The cost for this "insurance" is a limitation on the additional contribution the Postal Service can obtain from the mailer. The benefit from this "insurance" is the preservation of a portion of the reduction in costs to the Postal Service from "electronic" returns.

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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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TO INTERROGATORIES COS/OCA-T2-18-22

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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TO INTERROGATORIES COS/OCA-T2-18-22

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-T2-20

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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TO INTERROGATORIES NAA/OCA-T2-1-9

NAA/OCA-T2-1

Please refer to pages 15, line 18 to page 16, line 3 of your testimony, where you summarize the cost and charges of physical returns and electronic address correction service.

- a. Please confirm that the Postal Service estimates an average mailstream processing cost of 29.95 cents (USPS-LR-1/MC2002-2, page 1) to return a piece of Capital One First-Class Mail from the CFS back to the mailer, for which the effective charge is zero because it is a service feature of First-Class mail.
- b. Please confirm that the Postal Service estimates that the cost of providing electronic Address Change Service ("ACS") for non-forwardable First-Class Mail is approximately 14.5 cents (USPS-LR-1/MC2002-2, page 2), and that this 14.5 cent cost also supports the current 20 cent charge for eACS.
- c. Is pricing at zero a service that costs the USPS an estimated 29.95 cents to provide sending economically efficient price signals?

RESPONSE TO NAA/OCA-T2-1

(a) Confirmed that the "Mailstream Processing" cost to physically return a mailpiece to the mailer is 29.95 cents.

Not confirmed that the charge to the mailer is zero. The 29.95 cent average Mailstream Processing cost to physically return a mailpiece is borne by all First-Class mailers in the First-Class rates paid by such mailers, including the mailer that receives the returned mailpiece. That charge, however, is not explicit.

(b) Confirmed that the estimated cost of providing electronic Address Change Service (ACS) for First-Class mailpieces that cannot be forwarded is 14.5 cents. The 14.5 cents is also the test year attributable cost for electronic ACS, which is marked-up to 20 cents.

(c) Sometimes bundling a number of valuable services can be efficient. As stated in my response to Part a. above, the charge to the mailer is not zero. If

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consumers want to purchase a bundle of services under a single, average rate, those bundled services should be offered to consumers.

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NAA/OCA-T2-2

Please refer to page 16, lines 7-8, of your testimony. Do the "more timely and 'richer' data" for mailers to use in updating their address databases have value to mailers?

RESPONSE TO NAA/OCA-T2-2

According to the testimony of Capital One witness Jean, electronic "return mail data [] will improve timeliness, and we expect the improved information to increase the quality of our address database and reduce our return rate, due to enhanced address suppression on subsequent mailings." Tr. 2/42 (Jean, COS-T-1). The receipt of this "more timely and 'richer' data" in electronic notices in lieu of physical returns is expected to reduce mailers' costs. Tr. 2/85.

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TO INTERROGATORIES NAA/OCA-T2-1-9

NAA/OCA-T2-3

Please confirm that under your proposed discount rate schedule, the discounts that a mailer could claim are not tied to a particular incremental volume block, but instead are based on the highest volume block that a mailer's volume happens to achieve. If you cannot confirm, please explain the relationship between the incremental volume blocks and the discounts which a mailer could claim.

RESPONSE TO NAA/OCA-T2-3

Not confirmed for a mailer whose mail volume is less than 45 percent of its volume threshold. Discounts available to the mailer will be associated with one or more incremental volume blocks, since mail volume of less than 45 percent would fall within one or more incremental volume blocks. Such a mailer, however, could only claim discounts on a maximum quantity of mail equal to 15 percent of the mailer's volume threshold. Moreover, the mailer could claim the highest discounts allowable up to the maximum volume of 15 percent. Two examples illustrate this situation. In Example 1, if a mailer offers mail volume equal to 30 percent of its volume threshold, the mailer could claim discounts of 4.5 cents on pieces equal to 3 percent of its volume threshold, 5.0 cents on 6 percent and 5.5 cents on an additional 6 percent of its threshold.

EXAMPLE 1

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

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See also my response to USPS/OCA-T2-10(e).

Example 2 shows a mailer that offers mail volume equal to 44 percent of its volume threshold. The mailer could claim discounts of 5.5 cents on 1 percent of its volume threshold and 6.0 cents on 14 percent of its threshold.

EXAMPLE 2

Amount Mailed =		144,000,000				
Volume Limit =		15,000,000				
Discount Threshold =		100,000,000				
[1]	[2]	[3]	[4]	[5]	[6]	[7]
<u>Incremental Volume Blocks</u>		<u>% Change</u>	<u>Difference</u>	<u>Discount Volume</u>	<u>Discount</u>	<u>Revenue</u>
100,000,001	104,000,000	4.0%	3,999,999		\$0.030	
104,000,001	108,000,000	8.0%	3,999,999		\$0.035	
108,000,001	112,000,000	12.0%	3,999,999		\$0.040	
112,000,001	118,000,000	18.0%	5,999,999		\$0.045	
118,000,001	124,000,000	24.0%	5,999,999		\$0.050	
124,000,001	130,000,000	30.0%	5,999,999	1,000,001	\$0.055	\$55,000
130,000,001	144,000,000	44.0%	13,999,999	13,999,999	\$0.060	\$840,000
TOTAL				15,000,000		\$895,000

Confirmed for a mailer whose mail volume is greater than or equal to 45 percent of its volume threshold. Discounts provided to the mailer will be the highest available, since mail volume of more than 45 percent would fall entirely outside the last bounded incremental volume block. Again, such a mailer could claim discounts on a maximum quantity of mail equal to 15 percent of the mailer's volume threshold. And, the mailer could claim the highest discounts allowable up to the maximum volume of 15 percent. A final example will illustrate this situation. In Example 3, if a mailer offers mail volume equal to 50 percent of its volume threshold, the mailer could claim discounts of 6.0 cents on 15 percent of its threshold.

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TO INTERROGATORIES NAA/OCA-T2-1-9

EXAMPLE 3

Amount Mailed =		150,000,000				
Volume Limit =		15,000,000				
Discount Threshold =		100,000,000				
[1]	[2]	[3]	[4]	[5]	[6]	[7]
<u>Incremental Volume</u>	<u>Blocks</u>	<u>% Change</u>	<u>Difference</u>	<u>Discount Volume</u>	<u>Discount</u>	<u>Revenue</u>
100,000,001	104,000,000	4.0%	3,999,999		\$0.030	
104,000,001	108,000,000	8.0%	3,999,999		\$0.035	
108,000,001	112,000,000	12.0%	3,999,999		\$0.040	
112,000,001	118,000,000	18.0%	5,999,999		\$0.045	
118,000,001	124,000,000	24.0%	5,999,999		\$0.050	
124,000,001	130,000,000	30.0%	5,999,999		\$0.055	
130,000,001	150,000,000	50.0%	19,999,999	15,000,000	\$0.060	\$900,000
TOTAL				15,000,000		\$900,000

See also my response to USPS/OCA-T2-10(f).

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TO INTERROGATORIES NAA/OCA-T2-1-9

NAA/OCA-T2-4

Please refer to page 24 of your testimony, where you discuss your proposal that incremental volume thresholds for declining block rates should be based upon "publicly available and verifiable historical volume data."

- a. To what "publicly available and verifiable historical volume data" do you refer?
- b. Are mailing statements "publicly available"?
- c. Assume mailer A receives a volume discount under your proposal and its competitor B wants to determine whether mailer A's volumes and eligibility for discounts are calculated accurately. Could it do so? If so, how? If not, why not?

RESPONSE TO NAA/OCA-T2-4

(a) - (b) The changes to the DMCS for the Experimental Volume-Based Declining Block Rate classification directs that the "Discount Threshold" be "established by the Postal Service using only it's own or publicly available data." OCA-T2 Attachment B, DMCS 620.61. The Postal Service's own information about a mailer's historical volume should be "publicly available and verifiable historical volume data." Such historical volume data could be developed from the permit system based on the mailer's specific identification of its permit account numbers. The Postal Service could verify the mail volumes entered through such permit accounts in past years. The Postal Service could also use volume data from mailing statements provided by a mailer in establishing a mailer's volume threshold. The intent of the proposed change to the DMCS referenced above is to make the establishment a volume threshold transparent. However, to the extent that the Postal Service cannot or will not make mailing statements publicly available, the Postal Service should not rely on such statements.

(c) I interpret this question to mean that competitor B could undertake a contemporaneous or "real time" review of the Postal Service's method used to establish

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TO INTERROGATORIES NAA/OCA-T2-1-9

the volume threshold for mailer A. I did not consider this possibility. In developing the Experimental Volume-Based Declining Block Rate classification, I contemplated that the Postal Service's establishment of the volume threshold for any mailer would be transparent to the Commission and anyone interested—although not contemporaneously. It is for this reason that my data collection plan proposes that the Postal Service provide

the publicly available and/or verifiable First-Class Mail volume data relied upon by the Postal Service in determining each mailer's unique volume threshold, including all supporting documentation and calculations used in determining the volume threshold;

OCA-T-2 at 23, lines 1-4.

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TO INTERROGATORIES NAA/OCA-T2-1-9

NAA/OCA-T2-5

Under your proposal, could the volume thresholds upon which a mailer's eligibility for declining volume discounts be set at levels below:

- a. the mailer's recent historical volumes?
- b. the mailer's projected volume?

Please explain your answer.

RESPONSE TO NAA/OCA-T2-5

(a) - (b) Yes, provided that the Postal Service relies on publicly available and independently verifiable information in establishing a mailer's volume threshold.

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NAA/OCA-T2-6

Please refer to page 25, lines 9 through 12, of your testimony, where you state that the Postal Service would have an "affirmative duty" to find that any First-Class mailer authorized to use the volume discount proposal would "generate an additional contribution to institutional costs."

- a. At what level in the Postal Service would this determination be made? At the postal facility of entry? At headquarters? Please explain.
- b. Would the additional contribution to institutional costs have to come from postage paid by the mailer?
- c. If the additional contribution could be based upon expected cost savings, how would the Postal Service identify the particular mailer to whom cost savings should be credited?

RESPONSE TO NAA/OCA-T2-6

(a) I did not consider who would be the responsible party or parties within the Postal Service to comply with the requirement that the "Postal Service find there is a reasonable expectation" a mailer will generate an additional contribution to institutional costs. See OCA-T2 Attachment B, DMCS § 620.41. Thus, I have not specified a responsible party or parties. The Postal Service is best situated to determine this issue.

(b) – (c) The Postal Service can increase the contribution to institutional costs in two ways. It can charge mailers higher rates, holding costs constant. Or it can maintain the same rates, and reduce costs. Thus, my response to Part b. is No, since the additional contribution to institutional costs could come from a reduction in costs under the Experimental Automated Address Correction Service, rather than additional postage paid by the mailer.

Prior to authorizing a mailer to participate in the Experimental Volume-Based Declining Block Rate classification, the Postal Service must make a finding that there is a reasonable expectation that each mailer will make an additional contribution to

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TO INTERROGATORIES NAA/OCA-T2-1-9

institutional costs. Thus, each mailer, and the classification on its own, is expected to provide an additional contribution to institutional costs. That said, the financial risks to the Postal Service of establishing a volume threshold for any mailer cannot be entirely eliminated. The "reasonable expectation" that a mailer's access to volume-based declining block rates will generate additional contribution may not be realized. For that reason, I have linked a mailer's access to volume-based declining block rates to participation in the Experimental Automated Address Correction Service to increase the likelihood that the Postal Service will generate an additional contribution to institutional costs. According to the Postal Service, every piece of First-Class Mail "returned" electronically reduces the Postal Service's costs, and thereby makes an additional contribution to the Postal Service. USPS-T-3 (Crum) at 5. Moreover, it appears that electronic notices reduce Postal Service costs by reducing the number of mailpieces that are repeat forwards. Tr. 2/284.

Under the Experimental Automated Address Correction Service, the additional contribution will be derived from a reduction in costs from avoiding physical returns and reducing the number of repeat forwards. The identity of a particular mailer participating in this experimental classification can be determined by the requirement that "Mailers must enter eligible First-Class Mail through unique permit accounts." See OCA-T2 Attachment A, DMCS § 610.44. The estimated reduction in costs to the Postal Service from a particular mailer could be determined from my data collection plan, which proposes that the Postal Service provide "the number of electronic address correction notices provided to each authorized First-Class mailer for . . . mailpieces that would otherwise be physically returned." OCA-T-2 at 14, lines 4-6. An estimate of the

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES NAA/OCA-T2-1-9

average cost reduction to the Postal Service of providing all mailers with electronic notices for mailpieces that are forwarded would have to await completion of a special study by the Postal Service, which is also proposed in my data collection plan. See OCA-T-2 at 14, lines 20-25.

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TO INTERROGATORIES NAA/OCA-T2-1-9

NAA/OCA-T2-7

Please refer to page 25, line 12 through 13, where you state that if the Postal Service "does not find an additional contribution will be likely, it may decline to authorize a mailer's access to the volume-based declining block rates." (emphasis added)

- a. Under your proposal, could the Postal Service authorize a mailer to use the volume discounts if it determines that the net change in contribution would be zero? If so, please explain under what circumstances it could do so.
- b. Under your proposal, could the Postal Service authorize a mailer to use the volume discounts if it determines that the net change in contribution would be negative? If so, please explain why.

RESPONSE TO NAA/OCA-T2-7

(a) - (b) No. Please refer to the proposed DMCS for Experimental Volume-

Based Declining Block Rates at OCA-T2 Attachment B, DMCS § 620.41, which states

Mailers must receive authorization from the Postal Service to obtain access to volume-based declining block rates; **provided**, the Postal Service finds there is a reasonable expectation that any mailer so authorized will make an additional contribution to institutional costs from access to the volume-based declining block rates.

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TO INTERROGATORIES NAA/OCA-T2-1-9

NAA/OCA-T2-8

Please refer to the written denial of eligibility referred to in proposed DMCS section 610.5 in Attachment A to your testimony. Would a denial by the Postal Service of access to volume-based declining discounts be subject to administrative or judicial review? If so, please explain what review would be available? If not, please explain why not.

RESPONSE TO NAA/OCA-T2-8

I do not know. I am not a lawyer. Consequently, I gave no consideration to this issue. But see Response of United States Postal Service to Presiding Officer's Information Request No. 4, January 4, 2003.

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TO INTERROGATORIES NAA/OCA-T2-1-9

NAA/OCA-T2-9

Would a decision by the Postal Service to allow mailer A to receive the volume-based discounts that you propose be subject to administrative or judicial review by a competitor of mailer A? By another mailer that is not a competitor of mailer A? Please explain why or why not.

RESPONSE TO NAA/OCA-T2-9

I do not know. I am not a lawyer. Consequently, I gave no consideration to this issue. But see Response of United States Postal Service to Presiding Officer's Information Request No. 4, January 4, 2003.

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

USPS/OCA-T2-1

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

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

RESPONSE TO USPS/OCA-T2-1

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

USPS/OCA-T2-2

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

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

RESPONSE TO USPS/OCA-T2-2

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

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

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

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

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

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

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

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

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

USPS/OCA-T2-3

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

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

Please show all calculations used to prepare these forecasts.

RESPONSE TO USPS/OCA-T2-3

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

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

USPS/OCA-T2-4

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

RESPONSE TO USPS/OCA-T2-4

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

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

USPS/OCA-T2-5

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

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

Please explain and show all calculations.

RESPONSE TO USPS/OCA-T2-5

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

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

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

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

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

USPS/OCA-T2-6

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

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

RESPONSE TO USPS/OCA-T2-6

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

(b) Not applicable.

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

USPS/OCA-T2-7

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

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

RESPONSE TO USPS/OCA-T2-7

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

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

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

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

USPS/OCA-T2-8

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

RESPONSE TO USPS/OCA-T2-8

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

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

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

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

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

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

USPS/OCA-T2-9

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

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

RESPONSE TO USPS/OCA-T2-9

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

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

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

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

USPS/OCA-T2-10

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

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

RESPONSE TO USPS/OCA-T2-10

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

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

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

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

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

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

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

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

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

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

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

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

USPS/OCA-T2-11

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

RESPONSE TO USPS/OCA-T2-11

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

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

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

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

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

FY 2003 Capital One Before-Rates Projection

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

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

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

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

USPS/OCA-T2-12

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

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

Please show all calculations used to prepare these forecasts.

RESPONSE TO USPS/OCA-T2-12

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

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

USPS/OCA-T2-13

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

Please show all calculations and assumptions.

RESPONSE TO USPS/OCA-T2-13

(a) Confirmed.

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

Revised 2-3-03

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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

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\$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.

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

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

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

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

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.

USPS/OCA-T2-14

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

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

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

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

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

RESPONSE TO USPS/OCA-T2-14

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

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

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USPS/OCA-T2-15

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

RESPONSE TO USPS/OCA-T2-15

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

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USPS/OCA-T-2-16

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

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

RESPONSE TO USPS/OCA-T2-16

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

(c) The proposed changes to the DMCS simply direct that the Postal Service establish the volume threshold for each mailer using its own or publicly available data.

The absence of a specific forecasting model or any other method permits the Postal Service to develop the most appropriate method based upon the type, quantity and quality of mailer information available to it.

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USPS/OCA-T-2-17

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

RESPONSE TO USPS/OCA-T2-17

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

USPS/OCA-T-2-18

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

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

RESPONSE TO USPS/OCA-T2-18

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

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USPS/OCA-T2-19

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

RESPONSE TO USPS/OCA-T2-19

(a) Confirmed.

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

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USPS/OCA-T2-20

Are there differences in average per-piece discounts (total First-Class Mail workshare discounts plus proposed DMCS 620 discounts over total volume) between larger and smaller mailers? If so, please explain and provide examples. If not, please explain why not.

RESPONSE TO USPS/OCA-T2-20

There are no differences in total average per-piece discounts (i.e., total First-Class Mail workshare discounts plus proposed volume-based discounts over total volume) between larger and smaller mailers because of access to volume-based declining block rates. The availability of the volume-based declining block rates for every mailer is proportional to each mailer's volume threshold. Thus, a mailer with a volume threshold of 100 million receives a 3-cent discount if it offers additional mail volume of 4 million pieces—an amount equal to 4 percent of its threshold, which establishes the 3-cent incremental volume block. Similarly, a mailer with a volume threshold of 1.0 billion receives a 3-cent discount if it offers 40 million pieces in excess of the volume threshold.

Any change in total average per-piece discounts between larger and smaller mailers would be caused by differences in workshare discounts provided to larger and smaller mailers. In general, a larger mailer would be able to achieve a greater depth of sort than a smaller mailer that mails to the same geographic area. However, a larger mailer that mails on a nationwide basis might achieve less depth of sort than a smaller, localized mailer. Such a smaller mailer might achieve a greater depth of sort on average than the larger nationwide mailer, resulting in a greater average per piece workshare discount. Thus, when combined with the proportional volume-based

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discounts, there could be differences in the total average per piece discounts between larger and smaller mailers. However, such differences are caused by differences in the average workshare discount.

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USPS/OCA-T2-21

For purposes of this interrogatory, the term "presort bureau" refers to mailers that consolidate, barcode, and sort mail prepared by its customers. As such the bureaus do not necessarily maintain the address lists for the mail that they process. The address lists are maintained by their customers.

- a) Please confirm that presort bureaus would not be eligible for the experimental automated address correction service you propose. If you do not confirm, please explain.
- b) Please confirm that presort bureaus would not be eligible for the experimental automated address correction service you propose if they mail under their own (the presort bureau's) permit. If you do not confirm, please explain.
- c) Please confirm that presort bureaus would not be eligible for the experimental automated address correction service you propose if they mail under their customer's permit. If you do not confirm, please explain.
- d) Please explain under what circumstances presort bureaus would qualify for your proposed experimental volume-based declining block rates.
- e) Please list all other types of mail service providers (e.g., printers, consolidators etc.) that would not qualify for your proposed experimental volume-based declining block rates. For each listed type of mail service provider, explain why they would not be eligible.

RESPONSE TO USPS/OCA-T2-21

(a) Confirmed.

(b) Confirmed.

(c) Not confirmed. If a presort bureau enters mail using a permit account of an "originator," and the Postal Service approves use of that permit account, then that mail would qualify. Nevertheless, the Postal Service may deny authorization to the "originating" mailer for any "legitimate data collection, administrative or logistical reason." See OCA-T2 Attachment A, DMCS § 610.41.

(d) I did not intend that presort bureaus would participate in the Experimental

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Volume-Based Declining Block Rate classification. Consequently, I did not consider under what circumstances presort bureaus might participate in the classification.

(e) In developing the Experimental Volume-Based Declining Block Rate classification, I did not consider the various types of mail service providers that would *not* qualify for volume-based declining block rates. Rather, I contemplated that First-Class mailers, specifically "originators" of First-Class Mail, would have access to volume-based declining block rates, provided they complied with the requirements of the experimental classification.

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USPS/OCA-T2-22

Under your proposed Experimental Volume-Based Declining Block Rates,

- a) Please confirm that, under the example provided in your proposed DMCS language 620.64, as revised, the mailer who claims the discounts of \$.05 to \$.06 would not be able to claim discounts of \$.03, \$.035, and \$.04 on any of its volume. If you do not confirm, please explain.
- b) Please confirm that a mailer would not be able to claim the full range of discounts: \$.03, \$.035, \$.04, \$.045, \$.05, \$.055, and \$.06. If you do not confirm, please explain and provide a hypothetical showing how this is possible.

RESPONSE TO USPS/OCA-T2-22

(a) Confirmed, with the correction that the mailer would not claim a discount of \$.06, as stated in the question. Please see my response to COS/OCA-T2-12. Based upon the example in OCA-T2 Attachment B, DMCS § 620.64 (revised 1-16-03), the response to COS/OCA-T2-12 shows the calculation of discounts for a mailer with a Discount Threshold of 1 billion pieces and a 15 percent volume limit of 150 million pieces ($1 \text{ billion} * 0.15$) that enters 1.3 billion pieces. The mailer claims the highest discounts allowable on its incremental volume up to the maximum volume of 15 percent. Thus, the total amount of discounts would be \$7.65 million, composed of 60 million pieces at \$.055, 60 million pieces at \$.050, and 30 million pieces at \$.045.

(b) Confirmed.

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USPS/OCA-T2-23

Please refer to the discount example in your proposed DMCS § 620.64.

- a) Please confirm that the marginal incentive for additional volume above 1.3 billion pieces is 1.5 cents. That is, one piece is added at a 6 cent discount, but one piece that had a 4.5 cent discount falls out of the 150 million pieces qualifying for a discount, and thus no longer gets any discount. If you do not confirm, please explain.
- b) Please confirm that there is no marginal incentive for additional volume over 1.45 billion pieces, because one piece with a 6 cent discount simply replaces another piece with a 6 cent discount. If you do not confirm, please explain.
- c) Please confirm that, in comparison to the cumulative total discount at 1.3 billion pieces of \$7.65 million, the cumulative total discount at 1.2 billion pieces would be \$6.35 million, and that, in this instance, the marginal unit discount when adding 100 million pieces of mail (from 1.2 to 1.3 billion) would be \$1.3 million divided by 100 million pieces, or 1.3 cents. If you do not confirm, please explain.

RESPONSE TO USPS/OCA-T2-23

(a) Confirmed.

(b) Confirmed.

(c) Not confirmed. The example in this question calculates the *average*, not the marginal, incentive or discount on pieces between 1.2 and 1.3 billion. Based upon a volume of 1.2 billion pieces, increasing the amount mailed by 100 million pieces is not a "marginal" increase. This additional volume represents an increase of 8.33 percent (100 million / 1.2 billion). The *marginal* incentive or discount, as shown in Part a) above, remains \$0.015 (\$0.060 – \$0.045); that is, when one piece is added at a \$0.060 discount another piece is excluded from the 150 million volume limit on which a \$0.045 discount can be claimed.

The \$0.013 average incentive or discount presented in the question is a

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weighted average of marginal incentives of \$0.010 or \$0.015. Thus, where the "Amount Mailed" increases from 1.2 billion up to 1.23 billion (i.e., 1,229,999,999) pieces, the marginal incentive is \$0.015. Where the "Amount Mailed" increases from 1.23 billion up to 1.24 billion (i.e., 1,239,999,999) pieces, the marginal incentive is \$0.010. Where the "Amount Mailed" increases from 1.24 billion up to 1.27 billion (i.e., 1,269,999,999) pieces, the marginal incentive is \$0.015. Finally, where the "Amount Mailed" increases from 1.27 billion up to 1.3 billion (i.e., 1,299,999,999) pieces, the marginal incentive is \$0.010.

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USPS/OCA-T2-24

Under the Postal Service's proposed rate schedule 620A, please confirm that the marginal incentive for additional pieces over 1.6 billion is 6 cents.

RESPONSE TO USPS/OCA-T2-24

Confirmed.

1 CHAIRMAN OMAS: Is there any additional
2 written cross-examination for Witness Callow?

3 MR. REITER: Yes, Mr. Chairman. The Postal
4 Service would like to designate Witness Callow's
5 answers to Postal Service Interrogatories 25, 26 and
6 27.

7 CHAIRMAN OMAS: Without objection. This now
8 brings us to oral cross-examination.

9 MR. COSTICH: Mr. Chairman?

10 CHAIRMAN OMAS: Yes?

11 MR. COSTICH: Excuse me. This is Mr.
12 Costich. There was one correction in the set that was
13 just provided by the Postal Service. The correction
14 has been made in the copies that were provided to the
15 reporter, but I think we should note it on the record.

16 THE WITNESS: The correction, Mr. Chairman,
17 is to USPS/OCA-T-2-27. In the fourth unnumbered line
18 the amount \$0.007 should be changed to \$0.008. Those
19 are included in the packet.

20 CHAIRMAN OMAS: Good. Thank you.

21 Now this brings us to oral cross-
22 examination. Three parties have requested oral cross-
23 examination. First, the American Postal Workers
24 Union, AFL-CIO, Mr. Luby?

25 //

1 CROSS-EXAMINATION

2 BY MR. LUBY:

3 Q Mr. Callow, if I understand your testimony,
4 you proposed and discussed two experimental niche
5 classifications. Is that correct?

6 A That's correct.

7 Q All right. Do I understand that it's your
8 proposal that these two niche classifications should
9 be put in place instead of approving the negotiated
10 service agreement between Capital One and the Postal
11 Service?

12 A That's correct.

13 Q All right. And so you're not suggesting
14 that these niche classifications be put in place in
15 addition to approving the Capital One agreement?

16 A No.

17 Q Now, in the course of developing your
18 testimony or otherwise have you made any estimates as
19 to how many mailers would take advantage of each of
20 your niche classifications?

21 A No.

22 Q Have you, in developing your testimony, made
23 any estimate of the impact of the two niche
24 classifications that you've proposed on the Postal
25 Service's finances?

1 A No, I did not because I would need
2 additional information in order to do that.

3 Q All right. So there's no data that you've
4 developed on that issue at all?

5 A No.

6 Q All right. Now, have you calculated or
7 developed any estimate of the total volume and the
8 expense and revenue impact of each of the niche
9 classifications you're proposing for any of the years
10 of your proposed experiment?

11 A No.

12 Q Are you aware of any previous experimental
13 classifications such as what you're proposing here,
14 which was implemented without an analysis of the
15 financial impact of the experiment over its term?

16 A I can't say as I do.

17 Q Now, if I understand your proposal, under
18 the experimental declining block rates you've
19 discussed the discounts that mailers receive would be
20 rebated to them at the end of the year. Is that
21 correct?

22 A That's correct. I believe we responded to
23 that in an interrogatory to APWU.

24 Q Okay. Now, will there be, to the best of
25 your knowledge, any indication on the mail piece that

1 would tell the Postal Service that the mail piece is
2 part of the declining block rate classification?

3 A Are you asking whether the mail piece itself
4 will identify?

5 Q Yes.

6 A Not to my knowledge, but I believe that's
7 something that should be left to the Postal Service to
8 determine. It's not something I considered. I
9 believe the only indication would be change service
10 requested.

11 Q All right. Aside from that, you're not
12 aware of any other indication?

13 A In the testimony of the Postal Service, I am
14 not aware that they indicated there would be anything
15 else on the mail piece, so I have not included
16 anything else in my proposal.

17 Q All right. You have not proposed that?

18 A That's correct.

19 Q All right. Now, if I understand your
20 proposal is it accurate to say that neither the Postal
21 Service nor the mailer would know until the end of the
22 year the size of the discount applied to various mail
23 pieces that are part of this experiment?

24 A I proposed that the determination be made at
25 the end of the year, that the Postal Service make the

1 determination of how much to rebate to the mailers be
2 determined at the end of the year.

3 Q I guess then it would stand to reason that
4 you wouldn't know the amount of the discount until
5 that determination was made at the end of the year?

6 A Under my proposal, that's correct.

7 Q All right. Now, would you agree that the
8 Postal Service is going to have substantial financial
9 planning difficulties with a system that rebates
10 discounts at the end of the fiscal year and doesn't
11 allow the Postal Service to determine the size of the
12 discount until the end of the fiscal year?

13 A I don't believe so. Mailers will be paying
14 full rates and will have use of that money during the
15 course of the year and at the end of the year would
16 rebate what is due the mailer based upon their Postal
17 Service determination of what additional volume or new
18 volume was provided.

19 Q In terms of understanding what the Postal
20 Service is going to have to do, you're saying that
21 it's not going to be a problem for the Postal Service
22 to project the financial impact of this experiment
23 without knowing just how much of a discount they're
24 going to have to apply based on this experiment?

25 A No. At the end of the year they will make

1 the determination of the volume that was new and that
2 is deserving of discounts and will be able to do that.

3 Q All right. But they won't know their
4 exposure until the end of the year after they've made
5 their plans?

6 A That's correct, but they'll have use of the
7 money for the entire year.

8 Q All right. Here I'm referencing pages 12
9 through 4 of your testimony.

10 A I'm sorry. Twelve through?

11 Q Through 14. I apologize. Pages 12 through
12 14 of your testimony. You speak there about data
13 collection.

14 A Yes.

15 Q In developing this testimony, did you become
16 familiar or do you have any familiarity with the
17 Postal Service's normal data collection processes for
18 associating cost with certain types of mail?

19 A Generally. It's not something I
20 investigated for purposes of this testimony, but if
21 you're asking about, you know, RPW, IOCS, things like
22 that.

23 Q I guess my question is you didn't
24 investigate that issue or familiarize yourself with
25 that issue as part of the preparation of this testimony?

1 A I did not.

2 Q Now turning to page 3 of your testimony, I
3 think you indicate there that a unique volume
4 threshold would be determined for each mailer based on
5 the mailer's historical first class mail volume. Is
6 that an accurate account of what you're saying?

7 A Yes. I would want to add, though, that we
8 should not get too hung up on the term data because it
9 could be information, not just numeric numbers. I
10 would expect, however, that the Postal Service would
11 want to use historical volume data where it was
12 available.

13 Q Now, it's not in your testimony, but I
14 believe it's in your answer to Capital Service's
15 Interrogatory 13. You state, "I did not specify a
16 single forecasting model or method in order to permit
17 the Postal Service to develop the most appropriate
18 method based upon the type, quantity and quality of
19 mailer information available to it." Do you recall
20 that response?

21 A Yes.

22 Q Is it your understanding or is it your
23 recommendation that the Postal Service would use the
24 same method and comparable data to set each company's
25 threshold amount, or did you mean that the Postal

1 Service should use whatever method and data it deems
2 appropriate for each company to change those methods
3 from company to company?

4 A As I thought about this, it is an experiment
5 that I contemplated that companies would come to the
6 Postal Service. Companies interested in the volume
7 based rates would come to the Postal Service with
8 varying amounts of information.

9 The Postal Service itself could develop from
10 permit system mailer statements volume data, but other
11 information might only come from the mailer. As I
12 thought about it, they would have an opportunity in
13 effect to experiment and develop and use different
14 methods.

15 Q All right. If I understand that response,
16 it is your intent that the Postal Service would have
17 the leeway to select whatever method it deems
18 appropriate and could change it from company to
19 company?

20 A It could.

21 Q All right. Going to the issue of the
22 threshold amount here, other than the Postal Service's
23 permit system data what other data sources would you
24 expect them to rely on in determining the threshold
25 amount?

1 A Mailing statements would be one.

2 Q Anything else?

3 A They could use other verifiable information
4 that was public.

5 Q I believe it's in your answer to Capital
6 Service's Interrogatory 6. You indicate that SEC
7 filings could be used as a possible source of
8 information.

9 A That would be one source, yes.

10 Q All right. Have you looked at any SEC
11 documents that were submitted as part of the
12 justification for Capital One's mail volume?

13 A Not in great detail, no.

14 Q In any detail?

15 A I saw there were 8-K documents.

16 Q Okay. You identified them as SEC documents,
17 but nothing more than that?

18 A No.

19 Q Now, do you think these sorts of documents
20 provide the kind of detail that's necessary to
21 determine the magnitude of the company's future mail
22 volume?

23 A I think they can help, just like, for
24 example, using information from Data Resources might
25 be useful in determining direction of the economy.

1 SEC documents, as I understand them, tend to
2 be filed for purposes or events that have a material
3 effect on the company, and they tend to be made or
4 they, as I understand it, would be made for purposes
5 other than influencing a volume threshold, so, yes,
6 they could be used.

7 Q But if I understand your testimony, they
8 could be used, but they wouldn't be sufficient in
9 themselves as a predictor of mail volume?

10 A Well, probably not. I mean, at some point
11 the Postal Service is going to have to make a judgment
12 if the mailer -- if for some reason the Postal Service
13 can't develop say historic data and the only thing it
14 has is some statements of the mailer, they may not be
15 able to determine a volume threshold. Therefore, they
16 wouldn't authorize the mailer to participate.

17 Q Do you have any or did you research or
18 investigate how many companies are involved in the
19 permit system?

20 A I believe there was an interrogatory
21 response to -- I take that back. They identified some
22 large mailers, but I do not know how many. I don't
23 recall how many there were at the time.

24 MR. LUBY: Thank you, sir. Thank you,
25 Mister Chairman.

1 CHAIRMAN OMAS: Thank you, Mr. Luby. Mr.
2 May, Capital One Services, Incorporated.

3 MR. MAY: Thank you.

4 CROSS-EXAMINATION

5 BY MR. MAY:

6 Q Just a few more questions about what kind of
7 information about volumes for a candidate under your
8 classification, what would satisfy you. In your
9 responses to Capital One's Questions 6 and 14(b), you
10 say that the Postal Service would not be limited to a
11 mailer's historical first-class mail volume, but on
12 both answers you say they could use the company's own
13 or publicly available information, and in Question 6
14 you give an example of such information. You say an
15 SEC filing.

16 A Uh-huh.

17 Q Do you really think that a mailer is going
18 to make an SEC filing where the mailer actually in the
19 filing says, we're going to mail X pieces of mail next
20 year?

21 A No. There may be information such as a
22 contract that might affect mailing. There may be some
23 other information that might be useful to the Postal
24 Service. I guess my point here is that it may be
25 useful. It shouldn't be ruled out, and that was the

1 purpose of identifying it.

2 Q What kind of mailer's own information?
3 Other than the mailer saying, "Well, I've had our boys
4 working on this, and they came out of the back room,
5 and they said, Gee, things are going to be tough next
6 year. We're probably going to mail less than we did
7 last year. Let me show you this study." Is that
8 going to get it done for what the Postal Service needs
9 to know in order to project the threshold?

10 A Probably not.

11 Q Can you tell us what would satisfy your
12 description?

13 A Yeah. I think what you're getting at is
14 verifiable information. A contract, for example, that
15 might say a mailer might have an arrangement with
16 another advertiser that included an advertising piece
17 that it obligates the mailer to mail a certain amount,
18 and that contract is then canceled. That might be
19 useful information for the Postal Service to know. If
20 the mailer says, "We have commitments from thousands
21 of people that they want their advertising over the
22 Internet via e-mail as opposed to via mail, and here
23 are thousands of names of people who say, starting at
24 a certain date, we want to get our advertising via e-
25 mail," that would be useful, I think, to the Postal

1 Service.

2 Q Well, I assume there is some evidence that
3 corroborates the companies' forecasts, but it
4 certainly would not enable you to independently
5 replicate their forecasts, would it, not the
6 information you've cited?

7 A I'm not asking the Postal Service to
8 replicate the mailers' forecasts. I'm asking it to
9 make an independent forecast.

10 Q The Postal Service itself.

11 A Correct.

12 Q And they would do this using what
13 information? I'm still trying -- to they have found
14 out that somebody has canceled a contract, and they
15 have found out that the mailers said, "Gee, a lot of
16 our customers have said they don't want mail anymore;
17 they want the Internet," and then, based on that, the
18 Postal Service is supposed to forecast this mailer's
19 mail?

20 A No. As I mentioned earlier, the Postal
21 Service could use permit data from the mailer, could
22 use mailing statements. That would give them
23 historical volume information.

24 Q I know about the historical information, but
25 I'm asking you about your answer where you said, no,

1 that in addition to that, the historical information,
2 they could use its own or publicly available
3 information.

4 A Yes.

5 Q And I'm just trying to imagine, if you put
6 aside the question of historical information, which is
7 useless unless you assume that the past will exactly
8 predict the future, putting that aside, is there any
9 other way that the Postal Service can independently
10 come to a reasoned judgment about what a mailer's
11 future volume will be?

12 A You start with the historical information,
13 and then, to the extent that there is other
14 information that is publicly available and can be
15 verified, they can use that.

16 Q But the historical information is always the
17 beginning point in your prescription, that no matter
18 what these other indicia are, it would all begin with
19 their historical information, and then the Postal
20 Service would use this other independent, verifiable
21 information to then adjust that with the historical
22 information.

23 A That would be my expectation.

24 Q And you think that would give you reliable
25 projections?

1 A It will give them an independent projection
2 that will be reliable.

3 Q Again, I asked -- I don't know whether you
4 were here -- I asked your colleague, Mr. Smith, the
5 other OCA witness, who had --based upon this
6 methodology which you and he endorse, he was asked to
7 predict what the October, November, December Cap One
8 solicitation mailings were, solicitation and customer
9 mail, which he did. That's in the record. I assume
10 you know that.

11 A I guess I'm still back on the point where
12 you said the methodology.

13 Q Yes. Using your and his methodology for
14 making forecasts, he was asked by the Postal Service
15 to predict what Capital One's first-class solicitation
16 and customer volumes would be for this last October,
17 November, and December, which he did, and that answer
18 was put into the record today.

19 A I haven't proposed a methodology.

20 Q Pardon me?

21 A I haven't proposed a methodology.

22 Q Well, you have endorsed the one Mr. Smith
23 has used, have you not?

24 A I don't believe Witness Smith endorsed a
25 methodology. He put forward an approach.

1 Q Do you think there is a distinction between
2 a methodology and an approach? If there is, tell us
3 what that distinction is.

4 A My understanding is he did not direct the
5 Postal Service to use that methodology. In my
6 testimony, I did not say that the Postal Service
7 should use that methodology.

8 Q But that is your testimony. You said that
9 the Postal Service should use historical data, and to
10 the extent that there is anything in addition to that
11 that's publicly verifiable, it should then adjust
12 that. That's what your testimony and your responses
13 to these questions are, that they should use
14 historical information. You just got through telling
15 us that that would be the beginning for the Postal
16 Service on any forecast of what volumes are, and that
17 is exactly what Mr. Smith did, the other OCA witness
18 did, in his forecast. He used historical information
19 to then predict what October, November, and December
20 were. You're not aware of that?

21 A I did not propose that the Postal Service
22 use the methodology that Witness Smith put forward.

23 Q What do you understand his methodology to
24 be?

25 A My understanding is it's called an

1 extrapolation approach.

2 Q And he is extrapolating what?

3 A Historical information.

4 Q Exactly, and isn't that what you have
5 advocated, --

6 A No.

7 Q -- the use of historical information?

8 A The use of historical information. That's
9 correct.

10 Q Yes. And using what else, if it's
11 available.

12 A Mr. Smith used an extrapolation approach.
13 There are other methodologies. One might be a
14 regression.

15 Q He rejected the regression approach.

16 A I haven't suggested that the Postal Service
17 reject that approach.

18 Q Mr. Smith doesn't speak for the OCA?

19 A He is a witness for the OCA.

20 Q I know. So I suppose he does speak for the
21 OCA, and perhaps you're the wrong person to ask.

22 MR. COSTICH: Mr. Chairman, the OCA's
23 classification language speaks for itself, and it does
24 not contain any requirement to adopt any particular
25 methodology. I think there is a confusion here

1 between using historical data and using historical
2 data in one particular way. The OCA has not proposed
3 any particular way to use historical data.

4 CHAIRMAN OMAS: Mr. May, move on.

5 BY MR. MAY:

6 Q But I gather you do, nevertheless, feel that
7 it will be necessary for the Postal Service to use
8 some method other than simply accepting the company's
9 word for what its forecast will be.

10 A It will have to come up with a method.

11 Q But you're not advocating any particular
12 one.

13 A I am not.

14 Q You're just kind of leaving that up to the
15 Postal Service.

16 A That's correct.

17 Q And suppose the Postal Service decides,
18 well, fine. We'll ask the mailer. Would you accept
19 that?

20 A They have to develop the forecast, not
21 accept the mailer's forecast.

22 Q And suppose they tell you, Well, we
23 developed it. How did you develop it? We asked the
24 mailer. That's not going to get it done, is it, as
25 far as you're concerned?

1 A If the mailer can support the forecast with
2 independent information.

3 Q But I believe you've already testified that
4 as a practical matter, without historical information
5 as the beginning point, there is no possibility of
6 other independent information from which a forecast
7 can be made.

8 A No. There is other independent information.
9 SEC filings would be one.

10 Q And I asked you whether you thought a mailer
11 was going to put in his SEC filing the exact forecast
12 of the volumes that that mailer would make, and you
13 said, no, you didn't think he would do that.

14 A No, but there might be other information
15 that would be useful.

16 Q Useful, yes, but the point is, how is one to
17 construct a forecast? This is a practical problem
18 that inheres in your proposal because -- the Postal
19 Service must have a publicly verifiable way of
20 forecasting the threshold volume for the candidates
21 for this experiment, and you have simply dumped in the
22 Postal Service's lap, I take it, the problem of how
23 can they do that.

24 A This is an experiment, and I would expect
25 the Postal Service to experiment in developing a

1 methodology that it could use.

2 Q Okay. In this forecast that it comes up
3 with, if the forecast is based on extrapolation or
4 whatever other technique, but the forecast ends up to
5 have understated what, indeed, the mailer's volume is
6 going to be, then you haven't avoided what Mr. Smith
7 calls a free-rider problem, have you?

8 A No.

9 Q Another point. Some of the practicalities.
10 In response to Capital One's Question 11, you state
11 that you would not expect the Postal Service to
12 authorize hundreds, let alone thousands, of mailers to
13 participate in the experiment, and you say for
14 administrative reasons. You went on to say that
15 small-volume mailers would likely be discouraged by
16 the NCOA or fast-forward requirements. Isn't it a
17 fact that there are not just hundreds but thousands of
18 large-volume, first-class mailers?

19 A I believe that response goes on to identify
20 there were less than 30 in excess of 250 million that
21 mailed more than 250 million pieces a year.

22 Q Surely you're not defining a small-volume
23 mailer as one who mails less than 250 million pieces a
24 year, are you?

25 A No.

1 Q Is that really responsive to my question?

2 A Well, the point of the quote in the
3 interrogatory that small-volume mailers are likely to
4 be discouraged tried to get at the fact that address-
5 change service is a way for mailers to meet the move-
6 up-date requirement and that what this classification
7 proposal also would require the mailer to do would be
8 to do NCOA or fast forward as well, so there would be
9 an additional cost, and for small mailers, they may
10 not be willing to undertake that cost.

11 Q But putting aside for the time being your
12 intention to discriminate against small-volume
13 mailers, --

14 A I've done no such thing.

15 Q I think you described your proposal as one
16 that by its very nature will discourage small-volume
17 mailers, but putting that aside, I'm not asking you
18 about small-volume mailers. I ask you again, isn't it
19 the case that there are thousands of large-volume,
20 first-class mailers, and why would they be discouraged
21 by NCOA and move-up date requirements?

22 A I don't know if they would be.

23 Q Well, then why do you imagine that there
24 will not be thousands of applicants for your proposal?

25 A There may be.

1 Q But your testimony was that you wouldn't
2 expect there to be all of these burdens thrust upon
3 the Postal Service because you didn't think that there
4 would be hundreds, let alone thousands, of
5 experimenters. Isn't that your testimony?

6 A I guess what I would like to say is that the
7 Postal Service can decide how many mailers it wants to
8 accept into the program or into the experimental
9 classification, and they have ample opportunity, if
10 they don't think they can logistically manage a number
11 of companies for data-collection reasons or for other
12 administrative reasons, not to let thousands of
13 companies into the program.

14 Q I won't ask you whether you believe that's
15 legally discriminatory, but let me ask you what your
16 expertise is. Do you not regard that as an
17 unreasonable discrimination?

18 A No.

19 Q Why not?

20 A Because it's an experiment, and the Postal
21 Service, if it has a legitimate reason it can't
22 logistically manage thousands of mailers, it could
23 limit the number of participants.

24 Q Would that be on a first-come basis?

25 A It might be.

1 Q Wouldn't it have to be to avoid
2 discrimination?

3 A Probably.

4 Q And if the experiment is a success, and,
5 therefore, it's to be permanently implemented, do you
6 expect the Postal Service to continue such
7 discrimination and say only this select group can get
8 this deal, even now that it's a permanent
9 classification, or would you expect that it if
10 succeeds, your proposal would become available to all
11 mailers who can meet the requirements?

12 A I would expect if this became a permanent
13 classification, that the Postal Service would commit
14 the resources to permit all companies who were willing
15 to meet the requirements to participate.

16 Q Have you calculated the costs to the Postal
17 Service, administrative and otherwise, to fulfill your
18 requirements that every participant in the experiment
19 would have to have the Postal Service collect all
20 kinds of data, including the volumes, the number of
21 mail pieces that were forwarded, the number of repeat
22 forwards, forwards processed through CFS units,
23 forwards from destination delivery units not covered
24 by CF units separately, separately those forwarded
25 locally, and another separate count for those

1 forwarded through PARS? Have you counted on the
2 administrative costs of doing that kind of detailed
3 record keeping?

4 A The reason these were included is because
5 the Postal Service based its costs on the reduction in
6 repeat forwards, and it's going to have to develop
7 better estimates and will probably have to develop
8 this information in order to develop those better
9 estimates. I would suspect that the Postal Service
10 would rely on sampling for a special study.

11 Q Another line of thought. Would you agree
12 that declining first-class mail volume, if not the
13 most serious threat facing the Postal Service, is
14 certainly among them? Would you agree to that?

15 A Are you referring to a particular response?

16 Q No. I'm just talking about the basis of
17 your -- one of the aspects of your proposal.

18 A Well, if it's a permanent problem, if it's a
19 permanent trend, it's a serious problem.

20 Q Now, your threshold, the way you've proposed
21 the thresholds, the Postal Service should have to
22 determine the threshold, precludes the Postal Service,
23 as I understand your proposal, from setting a
24 threshold that is lower, and knowingly lower, than
25 their previous volume. If that's so, wouldn't that

1 prevent the Postal Service from giving discounts not
2 for increased first-class mail volume but as an
3 attempt to try to retard the decline of first-class
4 mail volume?

5 A Well, it seems to me, if the purpose of a
6 volume-based rate is to induce new mail volume, that
7 by making the rates available, if you will, only for
8 the forecast, that the mailer would provide more than
9 a lower amount in order to claim the discounts.

10 Q Could a mailer approach the Postal Service
11 under your proposal and say, "Listen, we mailed a
12 hundred million pieces last year, and for a variety of
13 reasons we we'll be happy to tell you about, one of
14 them is we've got customers who said they don't want
15 more mail, communicate with us in a different way, or
16 send us our bills electronically. We don't want that
17 coming in the mail anymore." And so they tell the
18 Postal Service, "Look, we might be able to keep our
19 volume above 90 million, but we're going down from a
20 hundred to 90 million unless we get some break on the
21 rate. If we get a little break on the rate, we could
22 probably retard that decline." So the Postal Service
23 says, "Fine. Your threshold is 90 million. So if you
24 keep anything above 90 million, we're going to give
25 you a discount." Does your proposal allow them to do

1 that?

2 A No.

3 Q Wouldn't that make sense to do that?

4 A You would be paying the mailer to do what
5 they intended to do anyway.

6 Q No. This is a case where the mailer
7 intended to mail 90 million pieces, and the Postal
8 Service is saying, okay, your threshold is 90 million,
9 and so they will only get a discount on mailings above
10 90 million. They had been mailing 100 million. They
11 said, "Look, for various reasons, including the one
12 you usually guess, advertisers don't want to get their
13 mail anymore; they want to get it through media," or
14 perhaps in such a case as the Capital One case where
15 they have customers who said let's do this
16 electronically, so they don't send them statements
17 anymore.

18 So they tell the Postal Service, "It looks
19 to us, for these reasons, we're not going to have 100
20 million next year. We're only going to have 90
21 million pieces. Now, if you give us a little bit of
22 an incentive, we might keep some of that 10 million in
23 the system." So the Postal Service says, "Fine. Your
24 threshold is 90 million pieces," even though the year
25 before they mailed 100 million, and they say, "Good.

1 Okay. Anything above 90 million, you get a discount
2 on." And they calculate it so that the discount they
3 are giving is less than the markup, the profit they
4 are making on that additional mail. So it eats into
5 the discount they give them, three, four cents,
6 whatever it is a piece, eats into the contribution to
7 overhead that first-class mail would normally make.
8 My question is, does your proposal allow them to do
9 that?

10 A If the Postal Service determines --
11 independently sets the threshold at 90 million, they
12 could do that.

13 Q Now, we've also determined, I think, that if
14 a first-class mailer has no returns at all, has 100
15 percent success rate with his addresses, and we do
16 know that the Postal Service numbers are that, indeed,
17 for first-class mail overall there is only, like, a
18 little over one percent of returns. So if a mailer
19 had no returns at all, they are still eligible to get
20 these discounts, aren't they?

21 A That's correct. If they participated in the
22 experimental address-correction service.

23 Q Let's say something probably a little more
24 real world. If this mailer only has one percent
25 returns, of course, then he also would be eligible.

1 Isn't that right?

2 A Correct.

3 Q Now, do you have any way of knowing whether
4 the amount of money that the Postal Service will save
5 by not having to return only one percent of their
6 mail, the savings they will make on that; would that
7 be equal to or less than the volume discounts that
8 this mailer may get?

9 A I don't know.

10 Q Well, if it isn't, if the Postal Service is
11 saving nothing, then that discount is coming entirely
12 out of the Postal Service, is it not? There's no
13 savings to help pay for that discount.

14 A In my proposal, the Postal Service is
15 obligated to make a finding before they permit or
16 authorize a mailer to participate in volume-based
17 rates, so they would have to make some judgment about
18 whether the mailer would make an additional
19 contribution.

20 Q Could you elaborate on that? What finding
21 do they have to make?

22 A They have to make a finding that the mailer
23 that's authorized access to volume-based rates is
24 going to provide an additional contribution.

25 Q Well, I thought the finding they were going

1 to have to make is that the discount the mailer is
2 getting is on mail that arguably would not have been
3 mailed otherwise.

4 A Yes.

5 Q And that it is in no way dependent upon or
6 contingent upon a separate finding that, in addition
7 to that, the Postal Service is going to avoid some
8 costs. I don't see that in your proposal anywhere
9 that the Postal Service must avoid costs as a
10 condition for admission to this experiment.

11 A No. You participate in the experiment on
12 address-correction service, and then the Postal
13 Service would authorize the mailer to participate,
14 authorize them access to volume-based rates.

15 Q But in my hypothetical, participation in
16 this address correction is zero because they have no
17 returns; and, therefore, for that mailer they would
18 not save one single penny because of the mailer's
19 participation in the address-correction program.
20 Isn't that correct?

21 A Yes.

22 Q And in the case which is not too atypical
23 apparently of a first-class mailer who only has one
24 percent returns, you have no idea whether the amount
25 of cost avoidance from participation in the address-

1 correction program for one percent of their mail would
2 save enough to pay for these discounts. You don't
3 know.

4 A No.

5 Q So the Postal Service might lose money on
6 this.

7 A It might.

8 Q Under your proposal.

9 A It might.

10 Q Is it possible for the Postal Service to
11 lose money on the Capital One deal? If the Postal
12 Service's calculations about costs and volumes are
13 correct, is it possible for the Postal Service to lose
14 money on the Capital One deal?

15 A Based on the numbers they put forward, no.

16 Q Thank you. Now, just one further item.
17 You, in your testimony, go on at some length taking
18 your proposal through each one of the rate-making
19 criterion, classification criterion, one, two, three,
20 four, five. Explain how your proposal meets those
21 criteria. I asked you in Question 17 from Capital One
22 whether you would do the same thing for the Capital
23 One proposal. In other words, I asked you would you
24 agree the Capital One proposal also met all of the
25 various criteria in the same way your proposal did,

1 and while you did say that, yes, the Capital One
2 proposal met a number of the criteria, you said that a
3 couple of others, it did not, and most specifically,
4 criterion number one, you said that Capital One NSA,
5 and I'm quoting you, "is not fair and equitable."

6 Correct?

7 A Correct.

8 Q So, according to you, it would fail that
9 very first test.

10 A Yes.

11 Q Now, you also said in that answer on the
12 second page of your answer at the top, explaining why
13 you think it's not fair and equitable, no other mailer
14 can meet all of the terms and conditions of the NSA.

15 Do you see that?

16 A Correct.

17 Q What are those terms and conditions that no
18 one else can meet?

19 A A threshold of 1.225 possibly.

20 Q Well, indeed, some others might meet that,
21 but isn't it more the case that the condition and term
22 that no other mailer can meet is that no other mailer
23 has almost 10 percent returns of their first-class
24 solicitations? Isn't that what's unique about this?

25 A Not as I looked at it. I thought there were

1 specific terms and conditions that Cap One and the
2 Postal Service negotiated that no other mailer could
3 meet.

4 Q Well, again, back to the fair-and-equitable
5 question, if only Cap One can produce those kinds of
6 savings to the Postal Service because they alone have
7 10 percent returns, which the avoidance of those
8 physical returns would generate a huge amount of
9 money, a cost savings for the Postal Service, and that
10 that money is then used to partially pay -- part of
11 that money is used to pay for all of the discounts,
12 why is it not fair and equitable that mailers do not
13 get the same discount deal when they can't, none of
14 them can generate the same kind of savings for the
15 Postal Service that Capital One can? So why is it not
16 fair and equitable to give this particular deal to
17 Capital One and perhaps a different deal to someone
18 else who can't generate these kinds of savings?

19 A My proposal would permit Capital One to
20 generate those kinds of savings for the Postal
21 Service. It would also permit other mailers who might
22 have returns less than Capital One that would generate
23 savings for the Postal Service to participate in
24 volume-based rates.

25 Q Again, I'm not quarreling with the fairness

1 and equity of your proposal. What I'm asking you
2 about is your statement that the Cap One thing is not
3 fair and equitable, and I'm asking you why it's not
4 fair and equitable to give this deal alone to Capital,
5 this particular deal, since only Capital One can
6 generate the kinds of savings for the Postal Service
7 that the Postal Service will get out of this deal and
8 no other deal.

9 A Because, as I've said before, no other
10 mailer can meet the terms and conditions of the NSA,
11 and yet there are other mailers that could provide
12 cost savings to the Postal Service that shouldn't be
13 excluded because they can't meet the terms and
14 conditions of the NSA.

15 Q Well, but you would have no way of knowing
16 whether the Postal Service is going to do deals with
17 them, do you?

18 A Under my proposal, they wouldn't have to do
19 deals with the Postal Service. They could come in and
20 seek participation.

21 Q You mean if they are one of the 30 that got
22 in line first.

23 A Could be.

24 Q I see. And also, they can get these
25 discounts even though they don't save any money for

1 the Postal Service, you've so testified.

2 A The Postal Service -- I've tried to build
3 into or incorporate into the classification a number
4 of features that protect the Postal Service's
5 financial interests, one of which is they need to make
6 a finding on cost savings in the experimental address-
7 correction service and that a mailer would provide
8 additional contribution should they be provided access
9 to volume-based rates.

10 Q Well, let me ask you this. Suppose they
11 didn't have a 1.2 billion number in this particular
12 deal, but suppose that Capital One NSA said that in
13 order to get a discount, volume discount, the mailer
14 had to generate twice as many savings from
15 participation in the address-correction program as the
16 cost of the discounts. Would that be discriminatory -
17 -

18 A That's not what the proposal --

19 Q -- and not fair and equitable?

20 A That's not my proposal.

21 Q I'm asking you whether you think such a
22 proposal would be fair and equitable.

23 A No. I haven't proposed it.

24 Q I'm asking you about another proposal.
25 You've opined about the fairness and equity of the

1 Capital One proposal, and now I'm asking you about
2 another deal that's done, another proposal which just
3 says that in order to participate and get volume
4 discounts, the mailer had to generate savings to the
5 Postal Service through participation in the address-
6 correction program where those savings were twice the
7 amount of the discounts, would that be fair and
8 equitable, and if not, why?

9 A I guess I don't understand your example.
10 It's not something I propose that the Postal Service
11 has to find that the mailer has to generate twice the
12 cost savings.

13 Q I'm trying to examine what your criterion
14 is, how you understand criterion, what you think fair
15 and equitable means, and I've given you a hypothetical
16 proposal that says we will give volume discounts to
17 mailers who, through participation in the address-
18 correction program, will save for the Postal Service
19 twice as much money as the discounts they get, and if
20 they don't do that, they can't get discounts. Is that
21 a fair and equitable proposal, or would it be, as you
22 understand what criterion one means when it talks
23 about fair and equitable?

24 A That's not how I looked at this.

25 Q I'm asking you to look at this

1 hypothetically. I'm not asking you about your
2 proposal. I'm trying to examine what you think fair
3 and equitable means because you've used it in making a
4 determination -- you've decided what fair and
5 equitable means under criterion one by saying your own
6 proposal is fair and equitable. I'm trying to examine
7 what you think fair and equitable means.

8 A That other mailers could have access to
9 volume-based rates.

10 Q Well, in the proposal I gave to you, any
11 mailer who can save the Postal Service twice as much
12 as the cost of the discounts can have access to it.
13 Is that fair and equitable?

14 A Other mailers who may not generate as much
15 cost savings should also have access.

16 Q Why? Why is it fair and equitable that a
17 mailer who is going to generate no savings for the
18 Postal Service, why is that fair and equitable when he
19 gets the same treatment as a mailer such as Capital
20 One who is going to generate arguably twice the
21 savings as the amount of the discount. What is fair
22 and equitable about that?

23 A Because both classifications stand on their
24 own. Access to participation in the experimental
25 address-correction service; the Postal Service should

1 make a finding that they are going to generate some
2 cost savings and that --

3 Q Excuse me. Is that part of -- I thought you
4 just said it was not one of your proposals.

5 A No. It is part. We can look at --

6 Q That the Postal Service must make a finding
7 that it will generate cost savings.

8 A Let me back up.

9 Q All right.

10 A This is in Attachment A to my testimony.

11 Q Uh-huh.

12 A Mailers must receive authorization from the
13 Postal Service to use experimental, automated,
14 address-correction service, provided the Postal
15 Service finds there is a reasonable expectation that
16 any mailer so authorized will make an additional
17 contribution to institutional costs due to usage of
18 experimental, automated, address-correction service.

19 Q But nowhere does it require that the
20 contribution be enough to pay for the discounts.

21 A It doesn't.

22 Q And that isn't your proposal, is it?

23 A That's correct.

24 Q Now, you are familiar with the fact, of
25 course, that the rate schedule is honeycombed with all

1 kinds of rate categories where, in exchange for
2 avoiding postal costs, a mailer gets a discount.
3 You're familiar with that.

4 A I'm sorry. Could you repeat that?

5 Q You are aware, are you not, that the postal
6 rate schedule, through every class and subclass, is
7 honeycombed with all kinds of rate categories which
8 are rate discounts that the Postal Service gives to
9 particular mailers who do certain things that avoid
10 costs for the Postal Service?

11 A Correct.

12 Q And, indeed, normally the Commission will
13 not give a discount that's more than the amount of
14 cost savings, --

15 A Correct.

16 Q -- with rare exceptions. All right. So
17 then why is it unreasonable for the Postal Service to
18 say, We're not going to give a discount here unless
19 you save us at least as much in avoidance of our costs
20 as the discount? What is unfair about that?

21 A My understanding is that we're talking about
22 volume-based rates for which there is no cost. By
23 definition, they are volume-based rates. You get a
24 discount for additional volume, not for cost savings,
25 and the way I've structured my proposal is the cost

1 savings occur in the experimental, automated, address-
2 correction service.

3 Q I'm not talking about your proposal. I'm
4 talking about another proposal. If you would just try
5 to focus on the one I'm talking about. What is wrong
6 with a proposal where the Postal Service says, We will
7 not give you a discount. If we're going to give you
8 discounts that cost us a million dollars a year, then
9 you have to avoid two million dollars of our costs by
10 doing X or avoiding X. Why is that any different than
11 the Postal Service giving rate discounts, giving the
12 enhanced carrier route discount, Standard A, in
13 exchange for the fact that the mailer does all kinds
14 of things to avoid costs for the Postal Service, and
15 mailers who don't do that do not get that discount.
16 Isn't that right?

17 A Correct.

18 Q Why is that any different than the
19 hypothetical I'm posing to you.

20 A Because other mailers can't take advantage
21 of it.

22 Q No mailer can take advantage of the enhanced
23 carrier route rate unless that mailer is able to save
24 the Postal Service a certain amount of money and an
25 amount of money that is, frankly, considerably less --

1 there is considerable more savings than the actual
2 discount. And if you're a mailer, and you can't do
3 that, you don't get the enhanced carrier rate. So
4 it's not available to all mailers. It's available to
5 all mailers who can do the things or avoid the things
6 that will save the Postal Service money, and that's
7 what I'm asking you about here, a proposal that says
8 you'll get a discount if you can do these things or
9 avoid these things that will save us all of this
10 money. What's the difference?

11 A Under your hypothetical, no other mailer can
12 do that because of the way the NSA is structured.

13 Q All I said was that the Postal Service said
14 that you must save us more money than we're spending
15 in discounts. Now, who says that no other mailer can
16 achieve that?

17 A The NSA.

18 Q I'm not talking about Capital One NSA. I'm
19 talking about the hypothetical I gave you.

20 A It doesn't strike me as a question of
21 fairness. It strikes me as a question of if you
22 generate costs, as a regular discount, the rate is
23 based on the cost or the cost savings in the case of a
24 discount. Cap One, according to Postal Service,
25 generates cost savings on the return side and pays out

1 discounts in volume-based rates, but as I look at the
2 classification criteria, no other mailer could take
3 advantage of that.

4 Q And the reason no other mailer can take
5 advantage of that particular -- is because no one else
6 can save the Postal Service twice as much money as
7 they are paying out in discounts. It's simply the
8 fact that no one else can do it. It's not that the
9 Postal Service won't let them do it; it's that they
10 are not able to do it. Isn't that the case?

11 A I don't believe so. There must be other
12 mailers out there who could generate savings, if
13 that's the criteria you want to use.

14 Q No one has come forward with one yet. They
15 have been asked in this proceeding. Do you know of
16 any?

17 A That's speculation. I don't know of any,
18 but I don't think the way the NSA is written, it just
19 excludes people.

20 Q Do you know of any first-class mailer that
21 has returns of 10 percent other than Capital One?

22 A There are none in this case.

23 Q Do you know of any at all?

24 A No.

25 Q Do you know of any that have five percent

1 returns?

2 A My proposal would accommodate mailers with
3 five percent.

4 Q But it also would accommodate mailers with
5 one-half of one percent.

6 A Correct. And it would accommodate Cap One.

7 Q And so your proposal would allow people to
8 get discounts that are far greater than any savings
9 they are giving to the Postal Service. Why is that
10 fair and equitable?

11 A The Postal Service has to determine up front
12 whether there's going to be cost savings.

13 Q There are going to be cost savings. There
14 will be cost savings on one one-hundredth of one
15 percent of returns. It may be they are only going to
16 save five bucks, but that's a savings.

17 A Then the Postal Service probably wouldn't
18 authorize that mailer if they can't make a finding
19 that there is no additional contribution.

20 Q There would be a contribution, wouldn't
21 there? Any time a return doesn't have to be made,
22 even if it's only a handful of them, the Postal
23 Service saves some money. It may be only pennies, but
24 isn't it a contribution?

25 A Yes.

1 Q So doesn't that satisfy your definition?

2 A It could, yes.

3 Q And the consequence, the Postal Service
4 could lose a great deal of money on the volume
5 discounts it's having because there's no offsetting
6 savings. Isn't that right?

7 MR. COSTICH: Mr. Chairman, I think counsel
8 misunderstands the OCA's classification proposals.
9 There is no way under our proposal that the Postal
10 Service can lose money on volume-based discounts.
11 They have to make a separate finding that they will
12 make money. So I think counsel's questions are based
13 on a misunderstanding of the proposal.

14 MR. MAY: Mr. Chairman, now that counsel has
15 finished coaching the witness, I will say this, that
16 the proposal is that there is no way that this
17 proposal can guarantee any such thing. If they are
18 correct about the threshold they set, if they can read
19 the tea leaves and correctly predict what the volume
20 is so that all of the discounts will be on additional
21 volume, then that's right, but they themselves admit
22 that that's quite speculative and that if, indeed,
23 they are wrong about that, that is all going to be
24 losses. And my question to this witness is, well, and
25 those losses, there will be no corresponding cost

1 savings to pay for those losses because the amount of
2 returns that will be avoided in saving money are so
3 significant, they will not make up for the losses if
4 there is a failure to predict correctly what the
5 future volumes are.

6 I don't think I misunderstand what the
7 proposal is, but the witness has been on for some time
8 telling us what his proposal is. I assume he knows
9 what his proposal is. I'm not putting words in his
10 mouth. I've tried. It hasn't worked.

11 CHAIRMAN OMAS: Mr. Callow, let's try and
12 see if we can satisfy Mr. May with some answer.

13 THE WITNESS: Under both classification
14 proposals, the Postal Service must make a finding that
15 there is a reasonable expectation that the mailer
16 authorized will generate an additional contribution.

17 BY MR. MAY:

18 Q And, indeed, there is no guarantee that that
19 will happen.

20 A That's correct.

21 Q And, indeed, there is no guarantee that it
22 will happen even if their volume projections are
23 correct if they are not making any corresponding cost
24 savings from the address-correction program. Isn't
25 that right?

1 A No. They could make additional contribution
2 if they establish the volume threshold and that
3 everything above the threshold was new volume.

4 Q Even though there's no cost savings.

5 A Even if there's no cost savings.

6 Q Now, isn't that a different proposal than
7 the Cap One proposal? Isn't the Cap One proposal a
8 proposal where the Postal Service, among other things,
9 tells them, We aren't going to pay you any discounts
10 unless, (a), we save all of this money on returns and
11 you also exceed the threshold?

12 A That's correct.

13 Q And that does distinguish it from your
14 program.

15 A That's correct.

16 MR. MAY: That's all, Mr. Chairman.

17 CHAIRMAN OMAS: Thank you, Mr. May. Ms.
18 McKenzie, do you have any idea how long you'll need
19 with this witness?

20 MR. REITER: Mr. Reiter does. I would guess
21 about 15 or 20 minutes.

22 CHAIRMAN OMAS: Well, if it's about 15 to 20
23 minutes, I think maybe we should just go on and try to
24 wrap it up. Ms. McKenzie. Oh, Mr. Reiter, it's your
25 turn.

1 MR. REITER: Yes, it is.

2 CHAIRMAN OMAS: Excuse me.

3 MR. REITER: I'm sorry if I didn't make that
4 clear.

5 CHAIRMAN OMAS: Okay. Thank you. Mr.
6 Reiter, proceed.

7 MR. REITER: Thank you, Mr. Chairman.

8 CROSS-EXAMINATION

9 BY MR. REITER:

10 Q Good afternoon, Mr. Callow.

11 A Good afternoon.

12 Q Up until today, have you used the term,
13 "niche classification," to apply to your proposals?

14 A I have not.

15 Q And am I correct in guessing that you just
16 picked that up from Mr. Luby's otherwise excellent
17 cross-examination this morning?

18 A I'm sorry. Whose other?

19 Q Mr. Luby. I believe he used the term, so
20 you then used it in response to his questions. That's
21 my recollection.

22 CHAIRMAN OMAS: Mr. Reiter, would you pull
23 the mike up a little closer to you, please?

24 MR. REITER: I will.

25 THE WITNESS: You're right. I believe he

1 did use the term.

2 BY MR. REITER:

3 Q So you don't consider your proposals to be
4 niche classifications.

5 A I guess I hadn't thought of them in that
6 term, no.

7 Q So you don't consider them to be.

8 A No.

9 Q I believe you've been asked some questions
10 about this, but I want to clarify. Do you have any
11 idea as to how the Postal Service would ensure
12 compliance with the requirement that a mailer claim
13 discounts only for its own mail? Do you have any idea
14 how the Postal Service would do that?

15 A Is there an interrogatory on this?

16 Q I really wasn't referring to a specific
17 answer. I'm just trying to clarify. I think there
18 was some discussion earlier today on some of the
19 compliance issues, and I just want to be clear that
20 it's your testimony that you don't have a
21 recommendation on how the Postal Service would do
22 that.

23 A I don't. I haven't given thoughts to how
24 the Postal Service would monitor compliance with this.

25 Q And similarly, you haven't come up with a

1 way that the Postal Service could ensure compliance
2 with the requirement that mailers getting free ACS
3 update their address lists. Is that correct also?

4 A Well, I believe there was an interrogatory
5 on this, and I believe, since that's a requirement in
6 order to have discounts, ACS is a way to comply with
7 move-up date, that whatever monitoring the Postal
8 Service does for mailers currently participating in
9 the ACS program would continue under my proposal.

10 Q I believe there was an issue that's been
11 explored vis-a-vis the Cap One agreement as to whether
12 Cap One would actually have to make corrections in
13 their lists and how the Postal Service would know
14 that, and I think that flows over to your proposal as
15 well, does it not? It's separate from the move-up-
16 date requirements.

17 A Yes. I guess my thoughts on that were that
18 whatever compliance the Postal Service had
19 contemplated for that requirement for Cap One would be
20 applicable to mailers that would participate in the
21 experimental address-correction service.

22 Q So you're referring to provisions of the
23 actual NSA between the Postal Service and Cap One.

24 A Well, no. The provisions require correction
25 or update mailing lists within two days, I believe, is

1 the requirement in the NSA. It's also the requirement
2 in my proposal. But the monitoring of that is not
3 addressed in my proposal, and I had thought that
4 whatever monitoring or compliance the Postal Service
5 intended for Cap One for that requirement would also
6 be applicable or could be used for mailers that were
7 authorized in the experimental address-correction
8 service.

9 Q So you're contemplating that the provisions
10 of the agreement with Cap One would exist in some
11 other form with respect to mailers participating in
12 your proposal. Is that correct?

13 A No. I'm contemplating that whatever
14 monitoring you had intended for compliance with the
15 two-day requirement would apply or could be used for
16 mailers under my proposal.

17 Q Hasn't Cap One under the agreement agreed to
18 let the Postal Service come in and take a look at its
19 data?

20 A Yes.

21 Q So a mailer participating under your
22 proposal would have to make a similar agreement in
23 order for the Postal Service to be able to do similar
24 compliance. Isn't that right?

25 A If that's what the Postal Service wants.

1 Q Are you suggesting that the Postal Service
2 should not ensure compliance?

3 A No, no. What I'm driving at is that the way
4 that the language of the proposed domestic
5 classification reads, that mailers must meet the
6 documentation audit requirements of the Postal
7 Service, so that would be, in effect, open ended, but
8 I had contemplated that whatever monitoring of
9 compliance you had intended for Cap One would be
10 applicable but not required as part of my proposal.

11 Q So you're not suggesting that the Postal
12 Service ought to ensure compliance with that.

13 A Oh, it should ensure compliance, but --

14 Q -- but it doesn't have to.

15 A No. It should ensure compliance, and the
16 proposed language would permit the Postal Service to
17 write rules or requirements to do that, and they may
18 be identical to the Cap One requirement, but they may
19 not be.

20 Q Where would you contemplate those rules or
21 requirements to exist?

22 A I don't know. However the Postal Service
23 does it now.

24 Q Are you imagining that the Postal Service
25 would have an NSA-type agreement or an agreement

1 similar to the one it has with Cap One, that at least
2 those provisions that cover some of these compliance
3 issues, that we would need to have a similar agreement
4 with each mailer, or are you contemplating that there
5 would be some sort of DMM-type provision that would
6 apply to everybody?

7 A I think it was the latter, that there would
8 be a more general, DMM-type requirement.

9 Q But didn't you also testify that it might be
10 different for different mailers, depending on the
11 circumstances?

12 A That was for purposes of the establishment
13 of the volume threshold, not for purposes of
14 compliance.

15 Q Didn't you also say that the Postal Service
16 could experiment with some of these mechanisms?

17 A It could, yes.

18 Q So we would be changing the DMM on a
19 frequent basis. Is that your suggestion?

20 A No. This is getting kind of far afield. I
21 would think the Postal Service would want, for
22 purposes of monitoring and compliance, something that
23 was workable and that they would put into the DMM that
24 all mailers would know, that postal operations people
25 would know, or whoever is managing this experimental

1 classification, so it would be clear. There wouldn't
2 be a number of different monitoring requirements.

3 Q So it would not be tailored to specific
4 mailers, and it would not be something that the Postal
5 Service would experiment with during the course of the
6 experiment. Is that what you're now saying?

7 A The way I wrote the DMCS language was it was
8 up to the Postal Service to determine those
9 requirements and that I contemplated that you would
10 have one -- that it would be basically in the rules
11 and regulations that that information would be
12 provided.

13 Q So you're agreeing with me that if there are
14 generally applicable rules and regulations, that they
15 would not vary by mailer, and they would not be
16 experimented with, to use your language, during the
17 experiment.

18 A Not in monitoring and compliance. I would
19 think for efficiency you would want to keep them the
20 same.

21 Q Okay. On the issue of special studies for
22 some of the data requirements, and I'm specifically
23 looking at some of the things that you have on page 13
24 of your testimony in the last bullet, volume of mail
25 pieces forwarded through CFS units, forwarded from

1 destination delivery units not covered by a CFS unit,
2 forwarded locally, and forwarded through PARS. Do you
3 have any notion of how the Postal Service would be
4 able to collect those data for a specific mailer?

5 A I don't.

6 Q Is there any identification on the mail
7 piece that would tell a data collector to even flag
8 one of those?

9 A No. I don't have a solution for that, I
10 guess. This is one of those issues where the Postal
11 Service has a great deal of expertise in developing
12 special studies. Again, I assume there would be some
13 sampling. The design of the special study would have
14 to address these issues.

15 Q How would you sample pieces that you can't
16 find?

17 A I don't know. I'm not familiar with
18 designing special studies.

19 Q But you're proposing that as a requirement
20 of your recommended classification and data collection
21 on that experiment, aren't you?

22 A Those were issues where there was not
23 information, and the purpose of identifying them was
24 to permit the Postal Service to come up with a special
25 study. I have not gone into the practical problems of

1 what it would take to do that.

2 Q I understand that, but it isn't just permit
3 the Postal Service to do a special study. When the
4 Commission makes a recommendation of an experimental
5 service, it includes in that recommendation
6 requirements for data collection that are supposed to
7 come back to it, and if that recommendation includes
8 data-collection requirements for data that can't be
9 collected, that doesn't really help anyone, does it?

10 A Then I would assume the Postal Service would
11 inform the Commission that there is no way to collect
12 that data as part of the special study.

13 Q Would it be helpful to the Commission if we
14 told them that before the end of this case, you
15 imagine?

16 A I would expect you might do it on brief.

17 Q I believe earlier you said, and I
18 apologize -- I don't remember who you said this to,
19 but that the Postal Service based its costs in this
20 case on reductions in repeat forwards. Do you
21 remember saying that?

22 A Yes.

23 Q Is it your understanding that there are any
24 costs or savings related to forwarding in the Postal
25 Service's presentation here?

1 A I think I should be clear here. I
2 understand that Witness Crum did not include cost
3 savings from forwarding in his estimate. That said,
4 the Commission asked, and Witness Crum provided, and
5 estimate of cost savings regarding the reduction in
6 repeat forwards. So there is an estimate of cost
7 savings associated with repeat forwards, but there is
8 a fair amount of uncertainty associated with those
9 cost savings because the assumptions themselves were
10 uncertain. In including a special study about
11 forwarding, I was attempting to get at that. Given
12 the Commission's interest, I was attempting to have
13 the Postal Service determine whether those assumptions
14 and cost savings were realistic and should be counted.

15 Q Do you think there is perhaps some
16 relationship between the fact that the Postal Service
17 didn't include those costs in cost savings and our
18 previous discussion as to the difficulty in getting
19 such data?

20 A There is probably an element of that, yes.

21 Q On a different subject, do you expect that
22 mailers of bills and statements would participate in
23 your proposed classifications?

24 A I don't know. In developing these
25 proposals, I understood that there would be mailers

1 who had business models different than Cap One, and I
2 did not want to exclude them. So I don't know whether
3 mailers of bills and statements alone would
4 participate, but this proposal doesn't preclude them
5 from doing so if they want to.

6 Q And if they wanted, then the Postal Service
7 would be in the position of disposing of that type of
8 mail, would it not?

9 A Well, yes, if they agree to change service
10 requested, that's correct. If they are willing to
11 toss bills and statements.

12 Q Willing to have the Postal Service toss.

13 A That's correct.

14 Q Would you think it would be prudent to limit
15 that situation to solicitations or at least other mail
16 that doesn't have such sensitive, personal information
17 in it?

18 A Not at this point. I think this is an
19 experimental classification. Mailers are going to
20 have to make a judgment, and the Postal Service will
21 have to deal with that.

22 Q And there are, of course, increased disposal
23 costs for the Postal Service in general related to
24 this. Isn't that true?

25 A I don't recall seeing any estimates of

1 disposal costs.

2 Q Right. What I was talking about was the
3 disposal of bills and statements, which probably would
4 require a higher level of disposal, if that makes any
5 sense, compared with solicitations.

6 A I don't know.

7 Q Is it your understanding that mailers are
8 generally eager to share information publicly
9 regarding how much of what kind of mail they injure
10 and where and when they do that?

11 A Probably not.

12 Q And that's because mailers would treat such
13 information as proprietary and commercially sensitive.

14 A Yes.

15 Q They wouldn't want it shared with their
16 competitors. Is that right?

17 A At a minimum.

18 Q Do you know personally of any mailer who
19 wants to share such information and participate in
20 your experiment?

21 A I don't. However, I know there are
22 provisions under the Commission's rules, to the extent
23 the Commission relied, for example, on mailing
24 statements, that that information could be made
25 available publicly under protective conditions.

1 Q That's within the context of a proceeding
2 before the Commission.

3 A That's correct.

4 Q And that wouldn't be the situation with the
5 information that the Postal Service would need under
6 your proposal. Is that right?

7 A That's not true. If the Postal Service used
8 mailing-statement data under the data-collection plan,
9 it could report those things and ask that they be put
10 under protective condition.

11 Q So that competitors of those mailers would
12 not be able to see them, precisely the people probably
13 most interested in verifying the deals that the Postal
14 Service is entering into.

15 A My understanding is that there have been
16 other instances where mailers have been asked to put
17 information into the record, and it's been put under
18 protective condition, and that's the standard
19 practice.

20 Q Right. And don't those protective
21 conditions normally exclude competitors of the owner
22 of that sensitive data from seeing the data as opposed
23 to their lawyers or consultants?

24 A Oh, yes. It prevents the mailer from seeing
25 it but not the attorneys and others who might use it.

1 Q Earlier in your discussion with Mr. Luby, I
2 think you agreed with his understanding that no
3 experiments recommended by the Commission had been
4 implemented by the Board of Governors without prior
5 consideration of the financial implications over the
6 term of the experiment. Is that correct?

7 A Yes.

8 Q Are you aware of any multi-year experiments
9 that have been approved and taken place that focused
10 during the litigation stage only on the financial
11 ramifications for a one-year test period?

12 A I'm sorry. Could you repeat that, please?

13 Q Yes. Are you aware of cases in which a
14 multi-year experiment was put into place based on
15 consideration of the financial implications for a one-
16 year test period --

17 A I'm not aware of it.

18 Q -- such as a test year that's normally used
19 in these proceedings?

20 A I don't know.

21 Q Let me ask it a little differently. In past
22 experiments that have lasted for two or three years, -

23 -

24 A Yes.

25 Q -- are you aware of any of those that have

1 been approved based on an examination of only a one-
2 year test year?

3 A Not to my knowledge.

4 Q So your testimony is that they have not
5 been.

6 A Correct.

7 Q Earlier, I believe you said that at some
8 point the Postal Service has to make a judgment about
9 mailers' volumes in order to qualify for declining
10 block rates under your proposal. Does that sound like
11 a correct characterization of what you said?

12 A Yes. It has to establish a volume
13 threshold. Maybe I was too loose with the words, but
14 what I meant is that they have to establish a volume
15 threshold.

16 Q And what would that be based on? Would
17 there be no judgment involved?

18 A The Postal Service would have to make a
19 judgment, yes. It would have to establish a volume
20 threshold.

21 Q Right. That is what you said. Has the
22 Postal Service made a judgment about whether Capital
23 One should qualify for declining block rates in this
24 proposed case in this NSA?

25 A It has.

1 Q And has the Postal Service made a similar
2 judgment that other companies do not qualify?

3 A For the Capital One NSA, yes.

4 Q And do you accept the Postal Service's
5 judgment in this case on that?

6 A I've proposed alternatives to the Capital
7 One NSA, and Capital One could qualify, so the
8 Commission should recommend these classifications as
9 an alternative to the NSA to permit other mailers --

10 Q I asked whether you accepted the Postal
11 Service's judgment in this case that Capital One
12 should qualify and others not.

13 A No.

14 Q But you're willing to accept the Postal
15 Service's judgment as to whether mailers will qualify
16 under your proposal.

17 A Yes.

18 Q Capital One NSA and your two proposed
19 experiments all focus exclusively on first-class mail.
20 Is that right?

21 A Correct.

22 Q And do you recall from earlier testimony,
23 and as you discussed earlier with Mr. May, that one
24 feature of Capital One's mailing practices that make
25 it unique is the use of first-class mail for its

1 solicitations?

2 A I'm aware that that is Cap One's business
3 model, yes.

4 Q And by simple inference, therefore, many of
5 Cap One's competitors must use standard mail for their
6 solicitations. Is that right?

7 A I don't know. You're asking about things
8 I'm not aware of.

9 Q If you accept the premise that Cap One is
10 unique in its use of first-class mail for
11 solicitations, then it necessarily leads to that
12 conclusion that others do not use it. Isn't that
13 correct?

14 A I don't know about other mailers. That's my
15 answer.

16 Q Right, but you do know about Capital One.

17 A I do.

18 Q From what you've heard here, and do you
19 dispute the testimony that they are unique in that
20 regard, their high use of first-class mail for their
21 solicitations?

22 A I know they use first-class solicitations.
23 I don't know whether they are unique.

24 Q All right. If you assume that they are,
25 then would it be a fair conclusion that other mailers

1 primarily use other means, and if we're talking about
2 the mail, that would be standard mail?

3 A If you assume they are unique, yes.

4 Q So wouldn't it be likely, then, that those
5 other mailers, if, as has been alluded to, are working
6 with the Postal Service on developing their own NSAs,
7 would probably be focused on standard mail more than
8 first-class mail, to the extent that it would cover
9 their solicitations. Would you agree with, at least,
10 the logic of that?

11 A Yes.

12 Q Would you say this is an accurate statement
13 of the OCA's position in this docket? Since any NSA,
14 by definition, involves only one mailer, it is not
15 fair and equitable, and, therefore, no NSA would ever
16 be acceptable to the OCA.

17 A I couldn't make such a global statement. I
18 was asked about this case, so I can't answer that
19 question.

20 MR. REITER: Thank you. That's all I have,
21 Mr. Chairman.

22 CHAIRMAN OMAS: Is there any follow-up? Mr.
23 Baker?

24 MR. BAKER: Thank you, Mr. Chairman.

25 CROSS-EXAMINATION

1 BY MR. BAKER:

2 Q I want to follow up very briefly with a line
3 of cross about counsel for Capital One, who is
4 inquiring about your understanding of fairness and
5 equity in the context of only Capital One having an
6 exceptionally high rate of physical returns. First,
7 today, are all first-class mailers paying for Capital
8 One's physical returns through their first-class
9 rates?

10 A Yes. All first-class mailers are paying for
11 all returns through the rates.

12 Q And that's because physical returns is a
13 service feature of first-class mail.

14 A That's correct.

15 Q And so all first-class mailers are paying
16 for that in an amount essentially proportionate to
17 their volume. Is that right?

18 A Yes.

19 Q Okay. Now, in December hearings, I used a
20 hypothetical credit card company. I called it Capital
21 Two, and I want you to consider this situation where
22 Capital Two is a first-class mailer that has a four
23 percent physical return rate, and I want you to
24 further consider that the Postal Service has come to
25 it to urge it to accept electronic address-correction

1 service, CSR, in lieu of the physical returns that
2 they have been insisting on to date. Are you with me
3 so far?

4 A I am.

5 Q Okay. Now, they have several options here.
6 One would be they could comply with that request,
7 could they not?

8 A They could.

9 Q And if they did, then they would be
10 obtaining the electronic address confirmation, which
11 is presumably better than physical in the sense that
12 it's faster and more efficient, and they would be
13 paying the current 20-cent fee for each of those
14 corrections. Correct?

15 A That's correct.

16 Q And if they did that, all first-class
17 mailers would benefit from the reduced costs and the
18 higher fees, just as proportionately they have been
19 paying for the physical returns previously. Correct?

20 A Yes. The returns are being taken out of the
21 system and saving the Postal Service money.

22 Q Now, a second option for Capital Two would
23 be just to tell the Postal Service to go jump in the
24 lake. We just want to insist on our current rights.
25 Is that correct?

1 A Yes.

2 Q Okay. And a third option might be for them
3 to hold out for an NSA. Is that correct? They might
4 say, "Well, we'll do it if you give us an NSA so that
5 we get a bigger cut of the savings from this just like
6 Capital One did rather than just having it spread
7 among all of the first-class mailers proportionately."
8 So they could try to hold out for an NSA of that type
9 and try to negotiate one. Right?

10 A I guess they could negotiate, sure.

11 Q And if the Postal Service refused to
12 negotiate with them and said, "You're not eligible for
13 one because, frankly, we don't think you're imposing
14 as high costs on us as Capital One did; therefore, we
15 don't think you're eligible," would you regard that as
16 fair and equitable?

17 A I hadn't contemplated that the Postal
18 Service -- maybe if you could repeat that last part.

19 Q All right. I'm asking you to consider that
20 Capital Two attempts to negotiate an NSA along the
21 lines of the one before this Commission, but the
22 Postal Service declines to do so on the grounds that
23 it just isn't worth it as much to the Postal Service
24 because, frankly, the costs of Capital Two's physical
25 returns aren't all that high, aren't as high as

1 Capital One's, and there is just less in it for the
2 Postal Service. And my question is, would you regard
3 the refusal of the Postal Service to enter into that
4 NSA with Capital Two to be a fair and equitable action
5 by the Postal Service?

6 A Well, if we're talking about a negotiation,
7 I would assume either party could conclude not to
8 negotiate, so, yeah, the Postal Service could conclude
9 not to negotiate.

10 Q Would it be fair and equitable for them to
11 refuse to enter into an NSA with Capital Two solely
12 because Capital Two's costs are not as high as Capital
13 One's?

14 A I guess they could conclude that.

15 Q So it's your testimony, then, that the
16 fairness and equity criterion is satisfied if the NSA
17 is made available only to the mailer who has imposed
18 the biggest costs on the Postal Service and not anyone
19 else. Is that correct?

20 A No. My proposal is intended for mailers
21 that would have a return that could have a return rate
22 less than Capital One as well as Capital One.

23 Q But you just told me that the Postal Service
24 refusing to enter into an agreement with Capital Two
25 because its physical return costs are lower would be

1 fair and equitable.

2 A But that's an NSA. I'm talking about an
3 experimental classification that would be open to all
4 mailers, and you're proposing an NSA, and that's not
5 what I proposed. The Postal Service could be
6 arbitrary and say, "We're not going to negotiate with
7 you because we don't want to. We don't like you."
8 But with an experimental classification, it's open to
9 all mailers.

10 Q Can one be arbitrary? Can the Postal
11 Service be arbitrary and be acting fairly and
12 equitably?

13 A You know, you're asking me about a
14 negotiation. That's not what I proposed. The Postal
15 Service, I assume, could have many reasons why it
16 would not want to negotiate with a mailer. This, what
17 I've proposed, is intended for mailers, in addition to
18 Capital One, who might not have returns as high as
19 Capital One that would be permitted under my
20 classifications.

21 Q Is it your understanding that the fairness-
22 and-equity criterion of the act may mean something
23 different if it's applied to an experimental
24 classification than if it's applied to an NSA, which
25 itself proposes an experimental classification?

1 A No. The criterion applies.

2 MR. BAKER: No more questions, Mr. Chairman.

3 CHAIRMAN OMAS: Thank you, Mr. Baker. Mr.
4 Costich, would you like some time with your witness?

5 MR. COSTICH: Just a minute, Mr. Chairman,
6 if that's all right.

7 CHAIRMAN OMAS: Thank you.

8 (Whereupon, at 12:50 p.m., a brief recess
9 was taken.)

10 CHAIRMAN OMAS: Mr. Costich?

11 MR. COSTICH: Thank you, Mr. Chairman. The
12 OCA has no re-direct.

13 CHAIRMAN OMAS: Thank you. Mr. Callow, that
14 concludes your testimony here today. We appreciate
15 your contribution to the record, and you are now
16 dismissed.

17 THE WITNESS: Thank you.

18 (The witness was excused.)

19 CHAIRMAN OMAS: As we discussed earlier,
20 ladies and gentlemen, that completes our business
21 today, and we will meet at 11 a.m. tomorrow morning.
22 Have a good afternoon. Thank you.

23 (Whereupon, at 12:51 p.m., the hearing was
24 adjourned, to be reconvened on at 11 a.m., on February
25 7, 2003.)

REPORTER'S CERTIFICATE

DOCKET NO.: MC2002-2
CASE TITLE: Experimental Rate and Service Changes to
Implement Negotiated Service Agreement with
Capital One Services, Inc.
HEARING DATE: February 6, 2003
LOCATION: Washington, D.C.

I hereby certify that the proceedings and evidence are
contained fully and accurately on the tapes and notes
reported by me at the hearing in the above case before the
Postal Rate Commission.

Date: February 6, 2003


Beth Roots

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