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

Rate and Service Changes To Implement   )   Docket No. MC2006-3
Baseline Negotiated Service Agreement   )
With Washington Mutual Bank   )

RESPONSES OF OFFICE OF CONSUMER ADVOCATE
WITNESS JAMES F. CALLOW TO INTERROGATORIES OF
UNITED STATES POSTAL SERVICE (USPS/OCA-T1-5-9)
(September 11, 2006)

_____

The Office of Consumer Advocate hereby submits the answers of James F. Callow

to interrogatories USPS/OCA-T1-5-9, dated August 28, 2006, as revised on August 31,

2006. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

_____
SHELLEY S. DREIFUSS
Director
Office of Consumer Advocate

EMMETT RAND COSTICH
Attorney

901 New York Avenue, NW Suite 200
Washington, D.C. 20268-0001
(202) 789-6830; Fax (202) 789-6891
e-mail: costicher@prc.gov

ANSWERS OF OCA WITNESS JAMES F. CALLOW
TO INTERROGATORIES USPS/OCA-T1-5-9

USPS/OCA-T1-5.

Please refer to page 25, lines 11 to 16, and page 26, lines 1 to 3, of your testimony where you estimate the USPS's investment costs, annual administrative costs, negotiation costs, and litigation costs associated with the Washington Mutual NSA.

(a) Please confirm that Washington Mutual Bank will incur similar costs associated with the NSA. If you cannot confirm, please explain.

(b) Have you attempted to estimate or quantify the costs of the NSA to Washington Mutual? If yes, please provide the results of your analysis.

RESPONSE TO USPS/OCA-T1-5

(a) I can confirm that Washington Mutual will incur similar types of costs.

However, I do not know whether those costs will be similar in magnitude to the costs

incurred by the Postal Service.

(b) No. The purpose of my testimony was to estimate the financial value of the

agreement to the Postal Service, the regulated entity.

USPS/OCA-T1-6.

Please refer to page 24, lines 17 to 19, of your testimony. You state that "if Washington Mutual mails First-Class Mail solicitation letters exceeding 550 million, 549 million, and 548 million in Years 1, 2, and 3, respectively, the agreement is not worthwhile as a financial proposition."

a) Please confirm that the volume threshold you identify in your testimony for Year 1 of the Washington Mutual NSA is 550 million First-Class Mail solicitation pieces. If you cannot confirm, please explain.

b) If Washington Mutual fails to mail more than 550 million First-Class Mail solicitation pieces during Year 1 of the agreement, can it be inferred that Washington Mutual will receive no benefit from the NSA? If no, please identify the benefits Washington Mutual may receive under the NSA if it fails to mail more than 550 million First-Class Mail solicitation pieces during Year 1 of the agreement.

RESPONSE TO USPS/OCA-T1-6

(a) Not Confirmed. The volume threshold used in the Panzar analysis is 490 million—the same threshold used in the financial model of the Postal Service (see USPS-T-1 (Ayub), Appendix A (REV 6-7-06), Page 7). The volume figure of 550 million represents the volume at which the Postal Service will lose First-Class Mail contribution in Year 1 of the agreement if Washington Mutual mails total First-Class Mail solicitation letters exceeding 550 million.

(b) No. As shown in OCA-T-1, Attachment 1, if Washington Mutual "fails to mail more than 550 million First-Class Mail solicitation pieces" (i.e., Washington Mutual mails First-Class Mail solicitation letters greater than 490 million through 550 million) in Year 1 of the agreement, it will receive the "Total Mailer Discounts" in Column [4] associated with the "After Rates Volume (Actual)" shown in Column [2].

USPS/OCA-T1-7

Please refer to page 15, lines 14 to 16, of your testimony. You state, "I therefore apply the Panzar analysis to Washington Mutual's forecast volumes utilizing a price-difference, rather than an own-price, elasticity of demand."

a) Please explain the meaning of the term "price-difference elasticity" as you use it in your testimony.

b) Do you agree with the proposition that every individual mailer has a price-difference of elasticity demand of -0.1115? If no, please explain.

c) Did you consider or evaluate the Panzar test using different estimates of price-difference elasticity of demand? If yes, please provide the results of your analysis.

RESPONSE TO USPS/OCA-T1-7

(a) I use the term "price-difference" elasticity as an alternative for the term "discount" elasticity.

(b) No. The price-difference elasticity of -0.1115 is the average response for Standard Mail Regular letters converting to First-Class Mail. As such, it is unlikely that any particular mailer would have a price-difference elasticity identical to the average.

(c) No.

USPS/OCA-T1-8

Please refer to page 16, lines 8 and 9, of your testimony. You state that neither "the Postal Service nor Washington Mutual, however, supplied a price-difference (or own-price) elasticity specific to Washington Mutual in this proceeding."

    a) Did you attempt to estimate Washington Mutual's cross-price elasticity? If yes, please provide the results of your analysis.

    b) Did you consider how cross-price elasticity could be used in the development of the Panzar test? If yes, please provide the results of your analysis.

    c) If you were to replicate your analysis under the Panzar test using the USPS's average own-price elasticity for First-Class Mail and Standard Mail, what would be the results of your analysis?

RESPONSE TO USPS/OCA-T1-8

    (a) – (b) No. A cross-price elasticity was not relevant to the development of the Panzar analysis presented in my testimony.

    (c) The Postal Service's average own-price elasticity for First-Class Mail workshared letters and Standard Mail letters were not relevant to the development of the Panzar analysis presented in my testimony. However, see my response to WMB/OCA-T1-(g), where I use the average First-Class Mail workshared letters own-price elasticity (-0.129934) and the average price-difference elasticity (-0.111483) in the Panzar analysis.

USPS/OCA-T1-9

Please refer to page 16, lines 10 to 12, of your testimony. You state, "I use the 'Average Standard Regular Letters Discount (relative to First-Class)' developed by witness Thress (USPS-T-7) in Docket No. R2006-1."

    a) Please explain why you decided to use the Average Standard Regular Letters Discount for developing the Panzar test.

    b) Did you consider using the average First-Class Mail and Standard Mail own-price elasticity and cross-price elasticity for developing the Panzar test? If yes, please provide the results of your analysis.

RESPONSE TO USPS/OCA-T1-9

    (a) In response to OCA/USPS-T1-25(a) – (c), witness Ayub states that

the relevant elasticities are the own-price elasticity of WMB's First-Class Mail and the elasticity of WMB's First-Class Mail with respect to the discount between First-Class Mail and Standard Mail (rather than the cross-price elasticity).

    Witness Ayub further states, in response to OCA/USPS-T1-27, that "Using a

discount elasticity[ ] similar to the one used by Witness Thress [USPS-T-7] in Docket

No. R2006-1 to model shifts between First-Class Presort mail and Standard Mail

regular" results in the following equation:

$$Q_0 = Q_1 \left(\frac{p_0}{p_d} \right)^{E_p} \left(\frac{d_0}{d_d} \right)^{E_d}$$

where the term E_d represents "discount elasticity."

    However, I assume, like witness Ayub, that Washington Mutual's forecast after-

rates volumes are to be derived entirely from the conversion of solicitation letters from

Standard Mail to First-Class Mail for purposes of estimating the financial value of the

agreement. As a result, witness Ayub subsequently confirms, in response to

OCA/USPS-T1-29(c), that the form of the equation should be as follows

$$Q_0 = Q_1 \left[1 - \left(\frac{d_0}{d_d} \right)^{E_d} \right]$$

since he implicitly assumes an own-price elasticity of 0 for Washington Mutual's First-

Class Mail volume.

Accordingly, the only relevant elasticity to be applied is the "discount elasticity,"

presented in Table 16 of witness Thress' testimony (USPS-T-7), which he identifies as

the "Average Standard Regular Letters Discount (relative to First-Class)."

(b) No. According to witness Ayub, Washington Mutual's First-Class Mail

solicitation letters volume is to be derived entirely from the conversion of Standard Mail

solicitation letters to First-Class Mail. For purposes of estimating the financial value of

the agreement, there is no other source for Washington Mutual's First-Class Mail

volume. Accordingly, I assume an own-price elasticity of 0. Moreover, as indicated by

witness Ayub, a cross-price elasticity is not relevant to the estimation of demand for

Washington Mutual.