

ORIGINAL

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

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OFFICE OF THE SECRETARY

Mailing Online Service, 1998)

Docket No. MC98-1

ANSWERS OF THE OFFICE OF THE CONSUMER ADVOCATE
TO INTERROGATORIES OF UNITED STATES POSTAL SERVICE
WITNESS: JAMES F. CALLOW (USPS/OCA-T100-1-8)
(March 1, 1999)

The Office of the Consumer Advocate hereby submits the answers of James F. Callow to interrogatories USPS/OCA-T100-1-8, dated February 19, 1999. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

Emmett Rand Costich

EMMETT RAND COSTICH
Attorney
Office of the Consumer Advocate



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TO INTERROGATORIES USPS/OCA-T100-1-8

USPS/OCA-T100-1. Please refer to your statement on page 7, lines 6-7, "For Mailing Online, a rebate system removes any competitive advantage on the part of the Postal Service vis-a-vis competitors for small-volume mailings."

(a) Please identify each Postal Service competitor to whom you refer, regardless of whether each is a small part of a larger firm, a single firm, a group of firms or an industry.

(b) For each competitor identified in response to part (a), please identify all factors upon which you rely in concluding that they constitute competitors.

A. (a) - (b) In preparing my testimony, I was not referring to any particular Postal Service competitor. I do not consider it necessary to identify any competitors (existing or otherwise) to conclude that the proposed waiver of the minimum volume requirements for Automation Basic rates would create an advantage for the Postal Service in the small-volume portion of the "hybrid" mail market. Consequently, I did not rely on any "factors" with respect to any particular competitor. Rather, I relied on the Commission's finding that, "[b]y exempting Mailing Online mailings from the threshold volume eligibility requirements that apply to its competitors, the Postal Service will be able to compete for at least the small-volume portion of the market on preferential terms." PRC Op. MC98-1 at 35.

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USPS/OCA-T100-2.

(a) Under your pricing formula, what existing mail category would be used to classify a batch consisting of a single mailpiece that the customer intends to enter as Standard (A) Mail?

(b) Would your answer to part (a) change if instead of a batch consisting of a single mailpiece, it consisted of:

- i. 100 pieces?
- ii. 201 pieces?
- iii. 350 pieces?
- iv. 501 pieces?

A. (a) I understand this question to be asking how the rate for a single mailpiece of Standard A Mail would be determined. In general, a customer submitting a single Standard A mailpiece to Mailing Online would pay either (1) the rate for which that mailpiece would qualify if entered as hardcopy directly with the Postal Service or (2) a blended discount rate reflecting the greater depths of sort resulting from Postal Service batching and presorting during the experiment, whichever is lower. In the first quarter, since there would be no experience-based volume data, the single Standard A mailpiece would pay the Standard A Automation Basic rate. In the second quarter, when an experience-based weighted average rate could be derived from first quarter presort-level volume data, the customer would pay the lower of the "stand-alone" rate (i.e., the First-Class single-piece rate) or a blended discount rate consisting of the proposed Automation Basic discount rate and the experience-based weighted average rate.

(b) No.

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USPS/OCA-T100-3. If a customer wishes to enter 100 pieces as Standard (A) Mail, how would the Mailing Online postage rate be determined using your pricing formula?

(a) To what extent, if any, is your answer based upon consideration of the service standard preferred by a Mailing Online customer?

(b) To what extent, if any, is your answer dependent upon the degree of batching attained by the Mailing Online system? Please explain your response fully.

A. As posed, this question cannot be answered with the specificity it deserves.

There is insufficient information in the question to determine the postage rate under my proposal. For example, the number of pages in the mailpiece would determine its weight and shape, both affecting the rate.

The determination of the rate to be paid by a customer submitting 100 pieces of Standard A Mail (or any amount of Standard A or First-Class Mail) involves three steps. First, the rate for which the mailpieces would qualify if entered as hardcopy directly with the Postal Service must be determined. Second, a blended discount rate is calculated by the postage pricing formula (i.e., Equation 1). Third, a comparison of the two rates is made, with the lower rate offered to the customer. To further discussion, the following examples are provided.

Example 1: Assume the 100 mailpieces of Standard A Mail belong in Job-Type A and each mailpiece is one page (i.e., Page Count 1). Job-Type A consists of letter-size (8.5x11) mailpieces. Assume further that the 100 mailpieces are submitted to Mailing Online during the first quarter of the experiment.

Since the 100 piece mailing falls below the minimum volume requirement for Standard A Mail, the mailing would qualify as "if entered as hardcopy" for the First-

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Class first-ounce single-piece rate (33 cents). Under my proposal, the blended discount rate must also be calculated for comparison to determine the lowest rate offered to the customer. The postage pricing formula uses the proposed Standard A Automation Basic rate (18.3 cents) and the experience-based weighted average rate. However, there is no "experience" in the first quarter with which to derive a weighted average rate. Consequently, the blended discount rate calculated by the pricing formula would be $18.3 \text{ cents} (x(0) + 18.3(1-0))$, the Standard A Automation Basic rate proposed by the Postal Service.

Example 2: Assume the same facts as Example 1, except that the 100 mailpieces are submitted to Mailing Online during the second quarter of the experiment. Assume further that, during the first quarter, Job-Type A/Page-Count 1 was a very common job type, and all (100 percent) of the mailpieces were presorted to the 5-Digit level. At the end of the first quarter, there would be an experience-based weighted average rate of 16 cents ($1.00 \times 16 \text{ cents}$) in the Job-Type A/Page-Count 1 "look-up" table.

The rate for the 100 mailpieces as "if entered as hardcopy" would again be the First-Class first-ounce single-piece rate (33 cents). The postage pricing formula would then calculate the blended discount rate to compare with the "hardcopy" rate. In the second quarter, the blended discount rate for the 100 mailpieces would be 18.2 cents ($16(1/36) + 18.3(1-(1/36))$). This rate would be offered to the customer.

Example 3: Assume the same facts as Example 1, except that each of the 100

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mailpieces is 18 pages and weighs four ounces. Each mailpiece is a flat. Again, assume the mailpieces are submitted during the first quarter of the experiment.

The rate as "if entered as hardcopy" must first be determined. Since the 100 piece mailing falls below the minimum volume requirement for Standard A Mail, the First-Class four-ounce single-piece rate (99 cents) would apply. Then the blended discount rate must be calculated for comparison to determine the lowest rate offered to the customer. The pricing formula uses the proposed Standard A Automation Basic rate (41.4 cents) and the experience-based weighted average rate. However, there is no "experience" in the first quarter with which to derive a weighted average rate. Consequently, the blended discount rate would be 41.4 cents ($x(0) + 41.4(1-0)$), the Standard A Automation Basic rate for a four ounce flat proposed by the Postal Service.

Example 4: Assume the same facts as Example 3, except that the 100 mailpieces are submitted to Mailing Online during the second quarter of the experiment. Also assume that, during the first quarter, Job-Type A/Page-Count 18 was a very common job type, and all (100 percent) of the mailpieces were presorted to the 3/5-Digit level. At the end of the first quarter, there would be an experience-based weighted average rate of 37.2 cents (1.00×37.2 cents) in the Job-Type A/Page-Count 18 "look-up" table.

The rate for the 100 mailpieces as "if entered as hardcopy" would again be the First-Class four-ounce single-piece rate (99 cents). The postage pricing formula would then calculate the blended discount rate to compare with the "hardcopy" rate. In the second quarter, the blended discount rate for the 100 mailpieces would be 41.3 cents

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$(37.2(1/36) + 41.4(1-(1/36)))$. This rate would be offered to the customer.

(a) The Postal Service has proposed service standards (i.e., cut-off times, print site processing times, etc.) for Mailing Online mailings. Those same service standards would be applicable to customer mailings under my proposal. I do not propose to change those service standards.

(b) My postage pricing formula uses experience-based weighted average rates to calculate a blended discount rate. Experience-based weighted average rates are derived from presort-level volume data collected during the experiment. Presort-level volume data is collected from mailings where the Postal Service has batched mailpieces. To the extent the Postal Service can batch mailpieces and presort those batches more deeply than necessary to qualify for the proposed Automation Basic discount rates, the experience-based weighted average rates used in the pricing formula will reflect the deeper discount rates achieved.

The other source of presort-level volume data is mailings which have qualified for rates as if entered in hard copy directly with the Postal Service. Volume data from these mailings will also be reflected in the derivation of the experience-based weighted average rates and, in turn, through the pricing formula.

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USPS/OCA-T100-4.

(a) Please confirm that the Postal Service's proposed use of the basic automation presort categories requires both waiver of volume minimums and forbearance from still deeper discounts.

(b) Would your pricing approach involve a waiver of the volume minimums, at least during the first period when automation basic rates apply? Please explain.

(c) Does your pricing formula diminish the impact of the waiver of volume minimums as the weight of actual experience overcomes the starting points. Please explain your response fully.

(d) Please confirm that your pricing formula would eliminate the forbearance from deeper discounts.

(e) Would elimination of the forbearance from deeper discounts constitute a competitive advantage, or competitive disadvantage, for Postal Service competitors. Please explain your answer fully.

(f) If elimination of the forbearance from deeper discounts constitutes a competitive advantage for the Postal Service, how do you reconcile this conclusion with your assertion that "setting postage charges for Mailing Online on the basis of actual experience eliminates ... any anti-competitive effect of waiving minimum volume requirements" Please explain your answer fully.

A. (a) Confirmed.

(b) Yes. See my response to MASA/OCA-T100-7(a).

(c) Yes. See OCA-T-100 at 29-31, lines 9-14, lines 1-14, and lines 1-6, respectively.

(d) Confirmed.

(e) - (f) Neither. Eliminating the competitive advantage available only to the Postal Service, as proposed in Mailing Online, and permitting the Postal Service to offer deeper presort discounts, as I have proposed, creates a "level playing field," at least in terms of postal pricing. Under my proposal, the Postal Service would no longer be able to offer Automation Basic rates to small-volume mailings that did not qualify. Neither could competitors. Similarly under my proposal, the Postal Service would be

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able to offer discounts greater than Automation Basic. So would competitors.

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USPS/OCA-T100-5. Please refer to your statement on page 16, lines 6-8: "No competing provider is able to consistently offer a lower price unless the competitor has lower costs or is willing to accept less than a 25 percent profit margin" [footnote omitted].

(a) Please confirm that the Postal Service is using contractors to provide printing services for Mailing Online.

(b) Please confirm that any such contractors hoping to make a profit on their Mailing Online print jobs must build a profit margin into the price with which they bid on a Mailing Online contract.

(c) Please confirm that, as a result of the need to build a printer's profit margin into contract prices, the total mark-up on the printer's costs (as opposed to contract prices) is greater than 25 percent.

(d) Please confirm that at least some potential Mailing Online competitors (e.g., Pitney Bowes or some MASA members) should be able to provide printing services from an internal rather than an external source.

(e) Please confirm that a Mailing Online competitor may be able to realize profits greater than 25 percent while still keeping pre-mailing prices below the proposed Mailing Online fees.

A. (a) Confirmed.

(b) - (c) Not confirmed. I have no knowledge of what might motivate a printing contractor when fashioning its bid.

(d) Confirmed.

(e) Confirmed.

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USPS/OCA-T100-6.

(a) Please confirm that the Postal Service fees and postage for Mailing Online pieces, as proposed, mean that the price of the first mailpiece (within shape, weight and print characteristic groups) is the same as the 500th, or 5000th.

(i) Please confirm that under the Postal Service pricing proposal, a job submitted on day ten of the experiment would be priced the same as it would be if submitted on day 100 (assuming no change in underlying printer contracts).

(ii) Please confirm that under your pricing formula, a job submitted on day ten of the experiment would not be priced the same as it would be if submitted on day 100 (assuming no change in underlying printer contracts).

(b) Please confirm that the Postal Service justifies its approach, in part, by the flat rate pricing typical of digital printing. See, e.g., Tr. 2/147; Tr. 7/1668, 1701, 1727.

(c) Please confirm that your pricing formula for Mailing Online postage does not preserve this characteristic of flat rates over time (assuming no change in underlying printer contracts).

(d) Of two otherwise identical Mailing Online jobs, one consisting of 20 pieces and one consisting of 2000, would respective job sizes have any impact on per-piece handling costs? Please explain your answer fully.

A. (a) Confirmed.

(i) Confirmed.

(ii) Not confirmed. The determination of postage under my proposal would be the same for the duration of the experiment. Customers would pay the lesser of their "stand alone" rate or the blended discount rate calculated via the postage pricing formula. However, the blended discount rate may or may not change over time with changes in the experience-based weighted average rate and the increase in the weighting factor. See OCA-T-100 at 35, lines 6-13.

(b) Confirmed.

(c) Confirmed. Under my proposal, the pricing formula was specifically designed to adjust postage rates to reflect the batching and presorting experience of

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the Postal Service during the experiment, so as to eliminate the Postal Service's competitive advantage in the small-volume portion of the "hybrid" mail market over time.

(d) It depends on whether the Mailing Online job types can be merged before printing. If merged, pieces from either mailing should have the same processing costs. If not merged, the larger mailing could have lower costs by generating full trays. This would be true under my proposal as well as under the Postal Service's proposal.

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USPS/OCA-T100-7.

(a) Please confirm that it would theoretically be possible to establish one or more rate categories unique to Mailing Online.

(b) Please confirm that your pricing formula for Mailing Online postage would likely end up charging customers postage rates that do not correspond exactly with any existing mail categories.

(c) Please explain whether you believe your proposal, if adopted, would constitute the establishment of one or more rate categories unique to Mailing Online. Identify all factors that you rely upon in formulating your opinion. If you considered any factors only to reject reliance upon them, please identify those and explain your reasons for rejecting them.

(d) Please confirm that rate categories unique for Mailing Online could conceivably be established in this Commission proceeding, or in a later one.

(e) Please compare and contrast the respective pluses and minuses of establishing unique mail categories for Mailing Online in this proceeding as opposed to any request for a permanent Mailing Online service.

A. (a) Confirmed. This is not my proposal.

(b) It is true that the blended discount rate calculated under my pricing formula would not correspond to any rate that exists at present. Since this is an experimental case, I am proposing an experimental pricing formula to calculate a blended discount rate.

(c) I did not consider whether, or to what extent, my pricing formula would constitute one or more rate categories. I am proposing an experimental pricing formula to calculate a blended discount rate in the context of an experimental case.

(d) Although this question appears to require a legal conclusion, I believe the Commission has the authority to recommend changes in rates and classifications during this proceeding, or subsequent proceedings.

(e) I gave no consideration to the establishment of Mailing Online as a

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permanent classification.

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USPS/OCA-T100-8.

(a) Under your pricing formula for Mailing Online postage, could one outcome be use of saturation rate categories for some pieces? Please explain your answer fully.

(b) Would use of saturation rate categories be a competitive advantage or disadvantage for the Postal Service or any other providers?

A. (a) No. Under the Postal Service's proposal, saturation rate categories are not available for Mailing Online mailpieces. The same is true under my proposal. I propose that customers pay "rates for which their mailpieces would qualify *if* entered as hardcopy directly with the Postal Service." (emphasis added) See OCA-T100 at 3, lines 14-15. However, customers *are* submitting their mailings through Mailing Online and, as a consequence, they will not qualify for saturation rates.

(b) The inability to offer saturation rates would appear to place the Postal Service at a competitive disadvantage.

DECLARATION

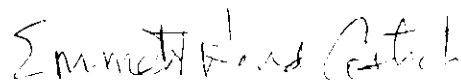
I, James F. Callow, declare under penalty of perjury that the answers to interrogatories USPS/OCA-T100-1-8 of the United States Postal Service are true and correct, to the best of my knowledge, information and belief.

Executed March 1 1999

James F Callow

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the rules of practice.

A handwritten signature in black ink that reads "Emmett Rand Costich". The signature is written in a cursive style with some capital letters.

EMMETT RAND COSTICH
Attorney

Washington, DC 20268-0001
March 1, 1999