

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

RATE AND SERVICE CHANGES TO IMPLEMENT
BASELINE NEGOTIATED SERVICE AGREEMENT
WITH BOOKSPAN

Docket No. MC2005-3

**RESPONSE OF POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE
(OCA/USPS-T1-1-7)**

The United States Postal Service hereby provides the response of witness Plunkett to the following interrogatory of the Office of the Consumer Advocate, filed on August 5, 2005: OCA/USPS-T1-1-7.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T1-1.

In PRC Op. MC2002-2, at para. 4036, the Commission stated:

The declining block rate feature requires an estimate of the baseline before rates mailing volume for comparison to the after rates mailing volume to determine whether the declining block rate feature has enticed new volume. The before rates volume has been referred to as the "anyhow volume" or the volume that Capital One would mail absent the NSA. Learning something about the declining block rate effect on volume further requires an assumption that other outside factors can be accounted for, or are not otherwise influencing volume.

- a. Please explain fully how the "Pricing Strategy" group has accounted for outside factors (other than the declining block rate) that might otherwise influence the volumes mailed by Bookspan.
- b. Please confirm that Bookspan would benefit from underestimating its volumes of solicitation letters for the period of the NSA. If you do not confirm, then please explain fully.
- c. Also confirm that one of the ways in which Bookspan would benefit from underestimating its volumes of solicitation letters would be to have discounts applied to volumes that it would have mailed anyway at undiscounted rates. If you do not confirm, then please explain fully.

OCA/USPS-T1-1 Response

- a. Witness Yorgey has described the analysis performed by the Postal Service during the negotiations with Bookspan. In the event that the Bookspan agreement is implemented, the Postal Service will further evaluate the empirical results to attempt to isolate the effect of declining block rate prices on Bookspan's mail volume by comparing actual volume growth with benchmarks that may include other direct marketing companies, Standard Mail more generally, and media spending by booksellers.
- b-c. Not confirmed. While a company might perceive possible benefits from "gaming" during the negotiation process, there are risks as well. For example, if the Postal Service believed, based on our research, that a company were underestimating its

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

planned mail volume during negotiations, then negotiations would be suspended until the issue was resolved. Having been involved in dozens of discussions with different customers over the last several years, I can attest to the fact that this specific issue has stalled several negotiations. Moreover, all companies are advised of the need to provide sworn testimony in the event that an agreement is consummated.

In this case, the interrogatory's hypothetical suggestion that Bookspan could be surreptitiously planning to vastly increase its letter solicitation mailings regardless of the existence of rate incentives is simply not credible in light of the empirical evidence regarding decreasing volume trends and a stagnant if not shrinking market. (The safeguards built into the proposed rate structure require an increase in letter solicitation volume of 20 percent over the average of the last three years before discounts can be paid.)

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T1-2. In PRC Op. MC2002-2, at para. 4039, the Commission advised the Postal Service to “to develop an improved testing methodology for use in the future” for measuring the effects on volumes of a declining block rate.

- a. Please describe in detail all Postal Service efforts to develop an improved testing methodology.
- b. How successful have such efforts been?
- c. What is the proof of success of these efforts? Please provide any such proof.
- d. Have you and witness Yorgey employed such an improved testing methodology in preparing the Docket No. MC2005-3 filing? If so, what is the testing methodology employed? If not, why not? Please answer each question contained in part d. of this interrogatory in full detail.

OCA/USPS-T1-2 Response

- a. A methodology of the kind suggested by the Commission is best applied to empirical data. Of course, empirical experience with NSAs is limited. During the course of this limited experience, the Postal Service has experimented with various benchmarks for comparison purposes. For instance, during the second year of the Capital One agreement, we are comparing Capital One’s First-Class Mail volume against several benchmarks: all First-Class Mail presort, all banks’ solicitation volumes, and Capital One’s Standard Mail. Comparing Capital One’s volume to these benchmarks should provide the basis for an informed judgment regarding the effect of declining block rates on Capital One’s volume. This analysis can then be modified as needed and applied to other NSA customers.
- b. With fairly limited experience, the analysis provides further support to the utility of declining block rates.
- c. The Postal Service anticipates providing a supplement to the next data collection report on the Capital One NSA.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

- d. In the absence of any empirical results with Bookspan, it is not possible to replicate the same analysis. However, the insights gained in analyzing Capital One results were used to inform the Postal Service's positions during negotiations.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T1-3. Please describe all methods, techniques, sources, and reference materials used by the "Pricing Strategy" group to develop independent volume estimates for potential NSA partners.

- a. Please describe all methods, techniques, sources, and reference materials used by the "Pricing Strategy" group to corroborate volume estimates provided to the group by potential NSA partners.
- b. Please describe in detail all methods, techniques, sources, and reference materials used by the "Pricing Strategy" group to develop independent volume estimates for Bookspan for each of the three years of the NSA.
- c. Please provide all documents, spreadsheets, workpapers, calculations, and computations produced by the "Pricing Strategy" group to develop independent volume estimates for Bookspan for each of the three years of the NSA (or any other future time period).
- d. Please provide all documents, spreadsheets, workpapers, calculations, and computations produced by any other part of the Postal Service to develop independent volume estimates for Bookspan for each of the three years of the NSA (or any other future time period).
- e. Were any volume estimates for Bookspan obtained by the Postal Service from any entity outside of the Postal Service? If so, name this entity. If so, provide all documents, spreadsheets, workpapers, calculations, and computations produced by any such entity to develop independent volume estimates for Bookspan for future time periods.
- f. Please describe in detail all methods, techniques, sources, and reference materials used by the "Pricing Strategy" group to corroborate volume estimates provided to the Postal Service by Bookspan for each of the three years of the NSA (or any other future time period).
- g. Please provide all documents, spreadsheets, workpapers, calculations, and computations produced by the "Pricing Strategy" group to corroborate volume estimates provided to the Postal Service by Bookspan for each of the three years of the NSA (or any other future time period).
- h. Please provide all documents, spreadsheets, workpapers, calculations, and computations produced by any other part of the Postal Service to corroborate volume estimates provided to the Postal Service by Bookspan for each of the three years of the NSA (or any other future time period).
- i. Was any entity outside the Postal Service (e.g., TNS Media Intelligence) used to corroborate the volume estimates presented by Bookspan in this proceeding? If so, name this entity. If so, provide all documents, spreadsheets, workpapers, calculations, and computations produced by any such entity to corroborate volume estimates provided by Bookspan for future time periods.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T1-3 Response

If the Implication of this interrogatory is that the Postal Service should independently derive a point estimate of a potential NSA partner's volumes, I do not do agree. An independent estimate of this kind, however well developed, would still be prone to error, since it requires a precise projection far out into the future. Conversely, by conducting sensitivity analysis on a range of plausible outcomes, and comparing customer forecasts against such a range, we can effectively assess the future performance of an NSA under the prevailing assumptions and act accordingly.

a. When evaluating a prospective NSA partner's volumes, we consult a number of independent sources that may be incorporated into our analysis, depending upon their apparent utility. These sources include SEC filings, stock analyst reports, trade association publications, company reports, company press releases, competitor information, and macroeconomic forecasts. In addition to published information, the Pricing Strategy group occasionally consults outside experts to aid in decision making. For instance, we have spoken with industry analysts in order to follow up on published information.

b-d. The information sources used to evaluate Bookspan's volume projections are contained in the testimony of witness Yorgey. Techniques include spreadsheet analysis, research, and sensitivity analysis.

e. No.

f-h. See my response to parts b-d.

i. No.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T1-4. Witness Yorgey testifies that: “The multiplier effect is not relied upon in estimating the financial impact of the NSA on postal finances.” USPS-T-2, n. 13. She adds that: “The incentives will encourage Bookspan to mail additional solicitation letters” Id. at 2. If the multiplier effect is not relied upon, and providing discounts is intended to stimulate the mailing of additional solicitation letters, why didn’t you recommend offering the type of discount proposed in this proceeding to any Standard Mailer to stimulate increased use of automatable Standard Mail letters?

- a. Why aren’t you recommending offering the type of discount proposed in this proceeding to any First-Class Mailer of automatable solicitation letters to stimulate increased use of First-Class letters?
- b. Please specify all of the characteristics of Bookspan that make it so unique as to warrant a discount that other mailers of Standard Mail and First-Class Mail are denied.

OCA/USPS-T1-4 Response

The multiplier effect is not relied on in the financial analysis. It is quite explicitly relied on as a key condition of this NSA and for functionally equivalent NSAs.

- a. Due to the potential risks in such a structure, the Postal Service believes they should be offered at this time only where there are specific contractual provisions designed to protect the Postal Service and other ratepayers by ensuring that the negotiated incentives are employed solely by the customer, and that the Postal Service has appropriate termination rights. A general classification would not allow the same protections as those afforded by signed agreements.
- b. It is not my position that Bookspan is unique enough to warrant a pricing structure that all other mailers should be denied. The Postal Service is committed to extending functionally equivalent agreements to any similarly situated companies, as was done subsequent to the implementation of the Capital One NSA. Furthermore, I continue to hope – naively perhaps – that the transaction costs of NSAs can be reduced so as to make NSAs viable for a larger number of customers.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T1-5. Witness Yorgey states that: “An intended effect of this agreement is that the declining block rates may encourage Bookspan to increase its conversion of Standard Mail solicitation material prepared and claimed at nonletter rates to mailpieces prepared and claimed at letter-size rates.” USPS-T-2, n. 14.

- a. Please explain why the Postal Service views this as a desirable outcome.
- b. Is it correct that one of the reasons the Postal Service views this as desirable is that Standard Mail letters are lower in cost and higher in contribution than Standard Mail flats? USPS-T-2 at 12, lines 1 – 2. Please explain fully any negative answer.
- c. Since automatable Standard Mail letters are lower in cost and higher in contribution than Standard Mail flats, why do you not recommend comparable discounts for other Standard Mail flats to induce them to convert to automatable Standard Mail letters? Explain fully.
- d. Is it correct that First-Class Mail one-ounce flats are higher in cost and lower in contribution than one-ounce First-Class Mail automatable letters?
 - i. If so, then why don't you recommend offering discounts to First-Class Mail one-ounce flats to induce them to convert to an automatable letter format?
 - ii. If not, then explain fully.
- e. Please provide the average attributable cost of a one-ounce First-Class flat.
- f. Please provide the average attributable cost of an automatable one-ounce First-Class letter.
- g. Please provide the average contribution to institutional costs for a one-ounce First-Class flat.
- h. Please provide the average contribution to institutional costs for an automatable one-ounce First-Class letter.
- i. For figures provided in response to parts e. through h. above, include any calculations, as well as citations to source materials.
- j. As a general matter, what are the advantages to the Postal Service of trying to induce conversion of higher cost, lower contribution flats to automatable letter format through NSAs, which involve high administrative, litigation, and transaction costs, as opposed to rectifying the current uneconomic rate structure through a straightforward change in prices that send correct price signals?

OCA/USPS-T1-5 Response

- a.-b. Standard Mail letters provide a larger contribution to institutional costs than do nonletters. Therefore, the Postal Service and all of its customers are better off as a result of this conversion.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

c.-d. I have not analyzed the effect that such price changes would have at the subclass level. They are beyond the scope of the Bookspan NSA and would have to be considered within the context of an omnibus rate case.

e-i. It is my understand that this information is available in Docket No. R2005-1.

j. Inducing conversion is not the goal of this NSA. That issue is addressed, as I indicate above, as part of the overall rate structure, which is also before the Commission at this time, but in another docket. In connection with the NSA, we have recognized as a factual predicate that Bookspan has been converting, and would—NSA or no NSA—continue to convert flats to letters, because the current rate structure already provides the incentive for it to do so. The NSA is designed to increase the volume of Standard Mail solicitation letters, and recognizes that, given Bookspan's conversion trend, the source of the increase will be both new letters and letters converted from flats. See also witness Yorgey's response to OCA/USPS-T2-10.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T1-6. Please describe in detail all of the research activities performed by the “Pricing Strategy” group to familiarize itself with the book club industry. Please describe in detail all of the research activities performed by the “Pricing Strategy” group to familiarize itself with industries for “analogous club[s].” (“Analogous club” is a phrase used in proposed DMCS section 620.11).

OCA/USPS-T1-6 Response.

For the most part, these activities are described in the testimony of witness Yorgey (USPS-T2, pp 7-10). In addition, my staff periodically reviews volume and revenue information on customers across a range of industries, and during the preparation of the Bookspan case this included discussions with and about companies who have business models similar to Bookspan. As none of these is expected to yield an NSA in the near future, we have not conducted systematic analysis on any one of them. Furthermore, the Postal Service considers customer discussions – which may extend over a period of months – to be one of the most valuable ways to research customers and the industries in which they operate.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T1-7. Proposed DMCS section 620.12 contains the phrase “customers demonstrating a similar or greater multiplier effect.”

- a. Please define Bookspan’s multiplier effect.
- b. What would an analogous club have to demonstrate for the Postal Service to find that such a club had a multiplier effect:
 - i. equal to Bookspan’s multiplier effect?
 - ii. greater than Bookspan’s multiplier effect?
 - iii. less than Bookspan’s multiplier effect?
- c. Is this evaluation of the multiplier effect intended to be (1) quantitative or (2) qualitative? Explain fully.
- d. Please confirm that any mailer whose primary use of the mail is regular billing, e.g., a monthly bill is mailed to each customer, would demonstrate a “multiplier effect” if additional solicitation pieces produced new customers? If you do not confirm, then please explain.

OCA/USPS-T1-7 Response

- a. Bookspan’s multiplier effect is explained in the testimony of witness Posch, Bookspan-T-1.
- b.-c. Evaluation of the multiplier effect is intended to be qualitative. The proposed DMCS provision was intended to indicate that to qualify for a functionally equivalent NSA, a customer would have to be engaged in a similar business model and exhibit similar mailing behavior. The phrase “or greater” was included to indicate that multiplier effect mailings at a level notably less than Bookspan’s would not be viewed as functionally equivalent. It was not intended to imply quantitative measurement. Viewed strictly quantitatively, a customer’s multiplier effect is theoretically a function of the frequency, class, weight, zone, subclass, shape, and perhaps other characteristics of a customer’s mail. This complexity makes quantitative comparison between customers impracticable. More importantly, I do not believe that such a comparison is preferable in evaluating functional equivalency.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

- d. Although the generation of regular billings could be called a multiplier effect, the reality is that most such mailers today are encouraging electronic presentment and/or payment of bills. Regardless, the single response cycle of monthly billing and payment is not the qualitative equivalent of Bookspan's multiple response cycles of catalog mailings--more frequent than monthly--which generate either response cards or shipments of books, which in turn generate payments of invoices, and other correspondence, all by mail.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

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