

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

**RESPONSES OF POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
(VP/USPS-T1-8-15)**

The United States Postal Service hereby provides the responses of witness Plunkett to the following interrogatories of Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc., filed on September 6, 2005: VP/USPS-T1-8-15.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking

Scott L. Reiter

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2999, Fax -5402
scott.l.reiter@usps.gov
September 20, 2005

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T1-8.

Please refer to your testimony at page 5, lines 17-18, where you state that “[i]n crafting NSAs, the Postal Service tries in advanced to identify competitors of the NSA partner and functionally equivalent customers.” Without naming any specific firm, please indicate all types or categories of firms that the Postal Service has identified to date as functionally equivalent customers to the proposed Bookspan NSA.

Response:

Without the benefit of a Recommended Decision in this case, an absolute determination of functional equivalence is difficult. The companies of which we are currently aware that may be interested in functionally equivalent NSAs use Standard Mail Regular letters to acquire customers and to offer them subscription-based products through the mail.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T1-9.

Please refer to your testimony at page 6, lines 7-11, where you state that “the universe of potential NSA customers ... who present substantial cost savings opportunities ... [is limited to] a relatively small number of customers, and ... NSAs are generally not the ideal way to implement cost savings initiatives.” Based on your direct experience in negotiating NSAs with Postal Service customers, please provide a brief description of all potential cost savings initiatives of which you have become aware — other than those in the Cap One (Docket No. MC2002-2) and functionally equivalent NSAs — regardless of whether they may or may not result in a future NSA, and regardless of whether the cost savings opportunity is sufficient to justify the perceived transaction costs.

Response:

For instance, the Postal Service considered a proposal whereby a customer would allow the Postal Service to select specific entry points for its First-Class Mail. Bookspan originally offered a proposal for enhanced worksharing of some of their mail but it did not result in significant cost savings. The Postal Service has also discussed various incentives for improved mail quality in many classes of mail. In one instance, the Postal Service considered automatic diversion of mail to a customer's nearest physical location in instances where the address on the face of the envelope might be different.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T1-10.

Please refer to your response to OCA/USPS-T1-1(b-c), where you state that “all companies are advised of the need to provide sworn testimony in the event that an agreement is consummated.”

- a. When negotiating NSAs with prospective partners, on net balance, do you find that the requirement for the company to provide sworn testimony is more of a help, or more of a hindrance, to conclusion of a successful negotiation? Please explain the basis for your answer.
- b. Does the requirement for a company that is party to an NSA to provide sworn testimony in support of the NSA have a substantial impact on the company's transaction cost? Please explain.

VP/USPS-T1-10 Response

- a. This requirement generally complicates discussions to some extent, but also has benefits. Few companies have experience in postal litigation, and are naturally sensitive to how discovery will be conducted, and how public statements by their managers and officers will be received. (This may explain in part why litigants often hire consultants or representatives of trade associations.) On the other hand, as I indicated in the answer cited in the question, this requirement is likely to ensure that information presented to the Postal Service as the basis for an NSA is sufficiently reliable that a representative of the company is willing to present it to the Commission as sworn testimony.
- b. Yes. In our experience most NSA customers have no prior experience in postal ratemaking, and therefore no dedicated legal or analytical resources of the kind typically used to prepare testimony. As has been demonstrated, all previous NSA customers have engaged outside legal representation from firms with established practice in postal ratemaking.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T1-11.

Please refer to your response to OCA/USPS-T1-4(b), where you state that "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."

- a. Would you recommend that the requirement for sworn testimony by one or more witnesses from the co-proponent be eliminated?
- b. Would you recommend that the requirement for review by the Commission be eliminated?
- c. Do internal Postal Service reviews and requirements materially increase the transaction cost for customers that are party to NSAs?

Response:

- a. I am advised that testimony by the co-proponent is not required by the Commission's rules, but it certainly seems advisable, given the current regulatory scheme, if the Postal Service is to support its request for a recommended decision.
- b. No. However, I would recommend that after-the-fact review would be a superior approach.
- c. Those internal reviews that are driven by the need to prepare testimony that will undergo review by the Commission and by the need to secure a Board of Governors vote prior to filing a request with the Commission certainly do.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T1-12.

Please refer to your testimony at page 2, lines 9-10, where you state that "NSAs have tremendous potential to improve the Postal Service's ability to price its products...."

- a. Is it your position that the Postal Service's pricing structure for its various products and services contains anomalies or incongruities that have "tremendous potential" for improvement and can be overcome by NSAs, at least for those customers that are party to an NSA? Please explain fully any answer that is not an unqualified affirmative.
- b. Aside from declining block discounts, which are discussed in your testimony, please provide two or three examples of other opportunities or situations where you think NSAs have tremendous potential to improve the Postal Service's ability to price its products.

Response:

- a. This was not the original meaning of my statement. But as a general observation, the Postal Service has thousands of prices and millions of customers. It would be surprising if there were not many instances where deaveraging created opportunities for more efficient pricing through direct negotiations with customers.
- b. In addition to declining block rates, other forms of incentives might be used effectively to induce additional volume, such as a temporary trial rate for customers who make no – or very limited – use of the mail to market their products. More importantly, my statement regarding the potential for NSAs was not based specifically on known potential agreements. With the exception of retail stores, virtually all businesses negotiate prices with their customers. I think it's reasonable to conclude that such a routine way of doing business would not have become so prevalent if it did yield improved results. Thus it is also reasonable to infer that the Postal Service, since it derives a substantial share of its revenues by providing services to business users, would also benefit by being

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

able to apply the same techniques used elsewhere. I would also suggest that the Postal Service's customers have long been a source of advances in postal pricing even before the advent of NSAs. I believe an efficient mechanism for negotiating business terms with individual customers would allow for more such advances in the future.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T1-13.

Please refer to your response to OCA/USPS-T1-5(a-b), where you state that "Standard Mail letters provide a larger contribution to institutional costs than do nonletters."

- a. Is it reasonable to infer from your statement that, from the viewpoint of increasing the contribution to institutional cost, the Postal Service prefers to have mailers enter Standard Mail letters more than Standard Mail nonletters? Please explain any answer that is not an unqualified affirmative.
- b. Is the increased contribution from conversion of flats to letters, as discussed by you (as well as by witness Yorgey (USPS-T-2, p. 6, ll. 13-16)), an indication that Standard Mail letters are overpriced relative to Standard Mail flats that weigh less than 3.3 ounces? Please explain any answer that is not an unqualified affirmative.

Response:

- a. The Postal Service prefers mail. All other things being equal, letters do contribute more than flats on average. Bookspan has been converting some of its flats to letters for its own business reasons. The NSA is not intended to address that fact, but our financial analysis must attempt to determine how the change in prices offered by the NSA will affect the conversion and the Postal Service's bottom line.
- b. No. If letters were overpriced, it does not seem that Bookspan would be converting its flats to letters.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T1-14.

Please refer to your testimony at page 4, line 19, where you state that “[t]he Bookspan NSA concerns only volume generation.” Also, please refer to your response to OCA/USPST1-5(j), where you state that “[i]nducing conversion is not the goal of this NSA.” In addition, please refer to your response to NAA/USPS-T1-1, where you state that “[t]he incentives in the Bookspan NSA are intended to increase contribution by virtue of volume increases.”

- a. Would any NSA that is functionally equivalent to the proposed Bookspan NSA be concerned only with an increase in volume and an increase in contribution by virtue of volume increases?
- b. Please refer to your response to NAA/USPS-T1-2, where you state that “[i]f you are asking if I would recommend the NSA [if] ... the agreement merely provided discounts for Standard Mail solicitation letters that produced no additional mail volume other than an incremental increase in Standard Mail solicitation letters, I would say no.” Changing the question slightly, would you recommend an NSA if the agreement provided declining block discounts for Standard Mail solicitation nonletters that converted to Standard Mail solicitation letters, and had an expectation for a large volume of conversion from flats with negative or low unit contribution to letter-shaped mail with a high unit contribution, but no expectation of any increase in volume (i.e., no multiplier effect)? Please explain the basis for your answer, regardless of whether it is affirmative or negative.
- c. When you evaluate an NSA that produces some small amount of new volume, coupled with a shift in volume from a category with negative or low contribution (e.g., flats) to a high contribution category (e.g., letters), in terms of the gross contribution derived from (i) new volume, and (ii) conversion, what is the minimum percentage of the NSA’s gross contribution that you would expect to require from new volume? That is, in the case of the proposed Bookspan NSA, the contribution from new volume is about three-eighths of the gross contribution, while the contribution from conversion is about five-eighths of the gross contribution. Assuming that the new volume may possibly result in some unquantifiable multiplier effect, in terms of the gross contribution, how small can the percentage contribution be for new volume before you would not recommend it? (I.e., One-fourth? One-fifth? One-tenth?)
- d. For this NSA, as well as any functionally equivalent NSA that “concerns only volume generation,” should any increased contribution from conversion be treated as incidental, rather than integral, to Postal Service benefits derived from the NSA?
- e. If the proposed Bookspan NSA solely concerns generation of new volume, and inducing conversion is not a goal of the Bookspan NSA, please explain why the Commission, when evaluating the expected outcome, should not discount, or ignore altogether, the incremental contribution to overhead that is expected to be derived by converting existing mail from a flat to letter-shaped format.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

Response:

- a. All NSAs must produce an increase in contribution. The Bookspan NSA is based on increases in volume, and, presumably, a functionally equivalent agreement would be as well.
- b. To the extent price signals are intended to affect customer decisions about shape, I think such signals are best sent through changes in the tariff rates. Having said that, there may be some unique circumstance – of which I am currently unaware – where an NSA might be include such an incentive.
- c. The Postal Service has not evaluated any other agreements of this kind, thus there have been no decisions regarding a minimum standard of the kind suggested here. In general, the Postal Service prefers to evaluate an agreement in its entirety rather than to establish rigid criteria for specific features of possible agreements.
- d. As I indicated in response to parts (b) and (c) above and in the answers cited by the questions, conversion was neither the goal nor the focus of the negotiations and ultimately the NSA. Similarly, I would not expect it to be the goal or the focus of functionally equivalent NSAs. As here, in any event, the net effect of conversion must be measured and should be considered.
- e. By definition, NSAs provide customized prices for customers that had previously been paying tariff rates. Thus the prevailing tariff rates are a part of the context in which any NSA will be evaluated. When one of an NSA customer's prices is changed at the margin, it is therefore likely to affect how that customer uses all postal products that can in any way be substituted for one another. This may be

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

reflected in movement between and among different shapes, or among different subclasses. In any event, evaluation of the effects of an NSA should include a reasonable attempt to account for any such movements.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORY OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T1-15.

This question involves a hypothetical. Please suppose that the Postal Service's rate for Standard Mail letters and the minimum piece rate for Standard Mail nonletters (i.e., flats that weigh less than 3.3 ounces) were set so as to derive the same unit contribution from each product without giving any kind of special discount or other rate incentive. Under this hypothetical, the Postal Service would be relatively indifferent as to whether mailers entered Standard Mail letters or flats. Further, if a discount were given for converting flats to a letter format, the Postal Service would not realize any increased contribution from such conversion, but rather a net reduction in contribution. If rates were set as posited here, and discounts were restricted to net new volume, then under the proposed Bookspan NSA all conversion of flats to letters would not result in any increased contribution, the contribution from new Standard Mail letters over three years would be \$3,264,351 (as shown in USPS-T-2, App. A, p. 9, l. 1), total incremental discounts would be \$960,000 (id., l. 5), and the Total USPS Value would be reduced from \$7,433,738 (id., l. 6) to \$2,304,351. Under these conditions, please indicate whether you would recommend the NSA, and explain why or why not?

Response:

Hypothetically speaking, I would recommend any NSA that conformed to the criteria of the Act and that produced a value greater than zero, because all such agreements would make the Postal Service and its customers better off.

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.

Scott L. Reiter

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
September 20, 2005