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

RATE AND SERVICE CHANGES TO IMPLEMENT BASELINE NEGOTIATED SERVICE AGREEMENT WITH WASHINGTON MUTUAL BANK	Docket No. MC2006-3

RESPONSE OF UNITED STATES POSTAL SERVICE TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3
(November 8, 2006)

The United States Postal Service hereby provides responses to Presiding Officer's Information Request (POIR) No. 3, issued November 3, 2006. The following witnesses are sponsoring the identified responses to this POIR:

Witness Bernstein (USPS-RT-1): Questions 1, 2, 3 (a) and 5,(b)

Witness Ayub (USPS-T-1): Questions 3(b)-(d), 4, and 5 (a)

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS BERNSTEIN (USPS-RT-1) TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3, QUESTION 1

1. Please refer to USPS-RT-1 (revised October 23, 2006), pages 31-32. Witness Bernstein presents two illustrative examples of estimated changes in Washington Mutual's First-Class Mail volume in response to the proposed discounts. The first example uses overall (or average) workshare elasticities, while the second uses elasticities estimated based on assumptions about the price-sensitivity of First-Class advertising mailers in general, and Washington Mutual Bank specifically.
   a. The first example forecasts a volume increase of 7.2 percent. To estimate the number of additional pieces using this figure, would it be most appropriate to apply the 7.2 percent to Washington Mutual Bank's total First-Class Mail volume, First-Class advertising volume, or some other volume? Please explain the rationale for your response.
   b. The second example forecasts a volume increase of 41.9 percent. To estimate the number of additional pieces using this figure, would it be most appropriate to apply the 41.9 percent to Washington Mutual Bank's total First-Class Mail volume, First-Class advertising volume, or some other volume? Please explain the rationale for your response.

RESPONSE:

(a) The 7.2 percent increase could be applied to WMB's total First-Class Mail workshare letter volume if: a) the composition of WMB's mailings were the same as that of the typical First-Class Mail workshare letter mailer, and b) WMB's responsiveness to changes in prices (its price elasticity) were the same as estimated by witness Thress (in Docket No. R2006-1) for all First-Class Mail workshare letter mailers. I do not believe these conditions hold. WMB makes greater use of First-Class Mail workshare advertising mail than the typical First-Class Mail workshare letter mailer, relative to its volume of non-advertising First-Class Mail workshare mail and relative to its volume of Standard Mail. Therefore, its mail composition is different from that of the typical First-Class Mail workshare advertising mailer. Moreover, because of WMB's greater use of First-Class Mail workshare advertising mail, it is likely that its total volume of First-Class Mail workshare letters will be more sensitive to changes in the price-difference with Standard Mail than is estimated for all First-Class Mail workshare mail, which is predominantly non-advertising mail.

(b) The 41.9 percent figure should be applied to WMB's First-Class Mail workshare advertising volume. The figure was calculated based on reasonable own-price and price-difference elasticities for WMB's First-Class Mail workshare advertising mail, not for total volumes or for other volumes.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS BERNSTEIN (USPS-RT-1) TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3, QUESTION 2

2. On page 21, lines 17-18 USPS-RT-1 (revised October 23, 2006), witness Bernstein states that "…the 1.115 percent increase must be almost entirely reflected in changes in advertising volume…".
   a. Please confirm that the price-difference elasticity of First-Class Workshared letters estimated by witness Thress in his Docket No. R2006-1 testimony would be based in part on any changes in operational mail brought about by changes in the difference between the price of First-Class Workshared letters and the price of Standard Regular letters, even if this change operated through the change in accounts of banking institutions brought about by response to the change in price of First-Class Workshared letters.
   b. If confirmed, please discuss how this might affect witness Bernstein's analysis.
   c. If not confirmed, please explain the reasons for not confirming.

RESPONSE:

(a) - (c) The hypothetical suggests that when the price-difference between First-Class Mail workshare letter mail and Standard Regular mail decreases, there is an increase in First-Class Mail workshare advertising mail volume, which in turn generates more accounts, which itself in turn generates more First-Class Mail non-advertising workshare mail volume such as account statements. If this hypothetical truly explains mailer behavior, then its effect would be reflected in the historical volume data and captured in the price-difference elasticity estimated by witness Thress. I believe however that this effect is likely to be extremely minor. First, it is not clear that there will be much of a change in the total number of accounts resulting from the greater use of First-Class Mail workshare solicatations because there may also be a coinciding decrease in the use of Standard Mail solicitations. To the extent that First-Class Mail solicitations are more likely to generate a new account (the so-called "lift"), there might be an increase in the number of accounts. That, however, depends on the exact operating strategy of the mailer as to whether itseek s a given number of accounts, a given volume of mail, a given cost of mailings, or some other operating criteria. Moreover, given the generally low response rate associated with credit card solicitations (on the order of 0.4 percent) the overall increase in accounts, if it were to occur at all, would be small as would the overall number of new account mailings.

To illustrate, assume in response to a decrease in the price of First-Class Mail workshare letters, a company sends 100 million more First-Class Mail solicitations. Given a response rate of 0.4 percent, this would generate 400,000 more accounts and about 5 million more pieces of First-Class Mail operations mail over a twelve-month period. The overall increase in operational mailings then is just 5 percent of the total represented by the original increase in total First-Class Mail solicitation mailings. Moreover, if the 100 million piece increase in First-Class Mail solicitations resulted in a similar decrease in Standard Mail mailings, then the overall increase in accounts would be quite a bit less. Assuming a 20 percent lift, one would have expected that 100 million Standard Mail mailings would have generated 333,000 additional accounts, (400,000/1.2 = 333,333), thereby implying that the net increase in accounts would be only 66,667 and the total increase in operational mailings would be on the order of 1 million pieces. As such, the overall impact on First-Class Mail operations volume is an even smaller percentage of the original 100 million pieces.

Therefore, it appears that the direct increase in First-Class Mail workshare advertising mail volume represents 95 to 100 percent of the price-difference elasticity effect estimated by witness Thress. As such, this impact is minor and does not affect the statement that "the 1.115 percent increase must be almost entirely reflected in changes in advertising volume."

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS BERNSTEIN (USPS-RT-1) TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3, QUESTION 3, subpart (a)

3. Pages 33 through 39 of witness Bernstein's testimony (USPS-RT-1, revised October 23, 2006) argues that the contractual requirement for Washington Mutual Bank to send 90 percent of its credit card solicitation mail, or a minimum of 500 million pieces as First-Class Mail is a non -price factor affecting volume. The contractual requirement is referred to as the "Solicitation Mail Volume Guarantee" and appears in the contract at section II.J.

   a. Should the severity of the penalty for non-compliance associated with the Solicitation Mail Volume Guarantee be considered when analyzing this contract provision as a non-price factor affecting volume? Please include a discussion of how a hypothetical mailer might react to a penalty the mailer views as severe versus how a hypothetical mailer might react to a penalty a mailer considers relatively minor.

   b. Please confirm that at the Year 1 projected total mail volume of 713 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), and the Year 1 projected operational mail volume of 120 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), Washington Mutual Bank must send a minimum of 84.4 percent (500 million pieces) of its solicitation mail as First-Class Mail in order to comply with the Solicitation Mail Volume Guarantee (rounded up to the next higher tenth of one percent). If not confirmed, please explain and show all calculations.

      500 million (Solicitation Mail Volume Guarantee) / (713 million (total mail volume) – 120 million (operational mail volume)) = 84.4 percent

   c. Please confirm that at the Year 2 projected total mail volume of 750 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), and the Year 2 projected operational mail volume of 125 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), Washington Mutual Bank must send a minimum of 80 percent (500 million pieces) of its solicitation mail as First-Class Mail in order to comply with the Solicitation Mail Volume Guarantee. If not confirmed, please explain and show all calculations.

      500 million (Solicitation Mail Volume Guarantee) / (750 million (total mail volume) – 125 million (operational mail volume)) = 80 percent

   d. Please confirm that at the Year 3 projected total mail volume of 785 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), and the Year 3 projected operational mail volume of 130 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), Washington Mutual Bank must send a minimum of 76.4 percent (500 million pieces) of its solicitation mail as First-Class Mail in order to comply with the Solicitation Mail Volume Guarantee (rounded up to the next higher tenth of one percent). If not confirmed, please explain and show all calculations.

500 million (Solicitation Mail Volume Guarantee) / (785 million (total mail volume) – 130 million (operational mail volume)) = 76.4 percent

RESPONSE:

(a) Yes, the severity of the penalty should be considered when analyzing the impact on mail volume resulting from the above provisions of the contract. The more severe the penalty, the more the mailer will be disposed to comply with contract provisions. For example, suppose absent the penalty, a mailer would have sent 495 million pieces. With a penalty set at $250,000, the mailer could avoid a cost of $250,000 by sending 5 million more pieces, which might be a sufficiently large incentive to induce the mailer to increase volume to the 500 million piece requirement. If the penalty were only $25,000, the incentive might not be large enough to induce the mailer to increase its mailings by 5 million more pieces than otherwise planned.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS AYUB (USPS-T-1) TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3, QUESTION 3, subparts (b)-(d)

3. Pages 33 through 39 of witness Bernstein's testimony (USPS-RT-1, revised October 23, 2006) argues that the contractual requirement for Washington Mutual Bank to send 90 percent of its credit card solicitation mail, or a minimum of 500 million pieces as First-Class Mail is a non-price factor affecting volume. The contractual requirement is referred to as the "Solicitation Mail Volume Guarantee" and appears in the contract at section II.J.

a. Should the severity of the penalty for non-compliance associated with the Solicitation Mail Volume Guarantee be considered when analyzing this contract provision as a non-price factor affecting volume? Please include a discussion of how a hypothetical mailer might react to a penalty the mailer views as severe versus how a hypothetical mailer might react to a penalty a mailer considers relatively minor.

b. Please confirm that at the Year 1 projected total mail volume of 713 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), and the Year 1 projected operational mail volume of 120 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), Washington Mutual Bank must send a minimum of 84.4 percent (500 million pieces) of its solicitation mail as First-Class Mail in order to comply with the Solicitation Mail Volume Guarantee (rounded up to the next higher tenth of one percent). If not confirmed, please explain and show all calculations.

    500 million (Solicitation Mail Volume Guarantee) / (713 million (total mail volume) – 120 million (operational mail volume)) = 84.4 percent

c. Please confirm that at the Year 2 projected total mail volume of 750 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), and the Year 2 projected operational mail volume of 125 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), Washington Mutual Bank must send a minimum of 80 percent (500 million pieces) of its solicitation mail as First-Class Mail in order to comply with the Solicitation Mail Volume Guarantee. If not confirmed, please explain and show all calculations.

    500 million (Solicitation Mail Volume Guarantee) / (750 million (total mail volume) – 125 million (operational mail volume)) = 80 percent

d. Please confirm that at the Year 3 projected total mail volume of 785 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), and the Year 3 projected operational mail volume of 130 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), Washington Mutual Bank must send a minimum of 76.4 percent (500 million pieces) of its solicitation mail as First-Class Mail in order to comply with the Solicitation Mail Volume Guarantee (rounded up to the next higher tenth of one percent). If not confirmed, please explain and show all calculations.

500 million (Solicitation Mail Volume Guarantee) / (785 million (total mail volume) – 130 million (operational mail volume)) = 76.4 percent

RESPONSE:

(b) – (d) Confirmed.

4. Assume the Year 1 projected total mail volume of 713 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), and the Year 1 projected operational mail volume of 120 million pieces (see WMB-T-1 at 9, Table 4, revised June 8, 2006), and assume that Washington Mutual Bank fails to comply with the Solicitation Mail Volume Guarantee by only mailing 499 million pieces of solicitations mail by First-Class Mail, thus failing to send one million pieces of First-Class Mail that otherwise would have allowed compliance. All other solicitations are mailed by Standard Mail. Given these assumptions, what is the dollar value of discounts provided to Washington Mutual Bank at this point? What is the penalty in dollars that Washington Mutual Bank is liable to pay the Postal Service at this point? Please show all calculations.

RESPONSE:

Assumed Total Mail Volume (First-Class Mail and Standard Mail)		713 million
First-Class Mail Operations Volume	120 million	
First-Class Mail Marketing Volumte	499 million	
Total First-Class Mail Volume		619 million
Assumed Standard Mail volume		94 million

Assuming that WMB's total mail volume is 713 million pieces, and assuming that 619 million pieces of that total are First-Class Mail (120 + 499 million), we can assume that 94 million pieces of mail would be Standard Mail (713 – 619 million). If this were the case, WMB would be in violation of the contractual requirement identified in the "Solicitation Mail Volume Guarantee" which appears in the contract at section II.J. Given the assumptions above, WMB would not have mailed 500 million pieces via First-Class Mail and the ratio of WMB's First-Class Mail to its total solicitation mail volume would be only be 84 percent (499 / (499 + 94)). As a consequence, WMB would be subject to a penalty of $250,000.

Moreover, the agreement provides Postal Service with the ability to terminate the agreement at any time. The Postal Service will monitor WMB's volume trends on a quarterly basis (see Agreement, Section IV, part F). If the volume trends indicated that WMB wouldnot satisfy the Solicitation Mail Volume Guarantee, the Postal Service would be able to terminate the agreement before the end of the year.

For a discussion of the likely impact of the penalty on WMB's mailing behavior given the assumptions above, please refer to witness Bernstein's answer to question 3, subpart (a).

Additionally, given the assumptions described above WMB, would receive incentives on the 129 million pieces above the threshold (619 Total First-Class Mail Volume – 490 Threshold). Under that scenario, WMB would have to increase its total postage spending by $12.2 million (net of incentives) to receive the $5.9 million incentives.

	Threshold	Incentive	Actual Volume	Incentive	Increase Postage Spend
490,000,000	505,000,000	$ 0.035	15,000,000	$525,000	$1,578,000
505,000,000	520,000,000	$ 0.040	15,000,000	$600,000	$1,503,000
520,000,000	560,000,000	$ 0.045	40,000,000	$1,800,000	$3,808,000
560,000,000	710,000,000	$ 0.050	59,000,000	$2,950,000	$5,321,800
		Total	129,000,000	$5,875,000	$12,210,800

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS AYUB (USPS-T-1) TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3, QUESTION 5, subpart (a)

5. Page 37 of witness Bernstein's testimony (USPS-RT-1, revised October 23, 2006) states that "[i]n order to receive the discount, WMB would have to send at least 90 percent of its marketing mail as First-Class Mail."
   a. Do all parties to the contract agree that Washington Mutual Bank will not receive any discounts if it does not send at least 90 percent of its marketing mail as First-Class Mail?
   b. Does the terminology "or a minimum of 500 million credit card solicitations" affect the accuracy of witness Bernstein's statement or change the response to question a. above?

RESPONSE:

(a) If Washington Mutual mails less than 500 million First-Class Mail marketing pieces then it is required by the NSA to send at least 90 percent of its marketing mail as First-Class Mail. If it fails to meet this requirement, the contract may be terminated. The 500 million piece minimum requirement is also a non-price requirement in the same manner as the 90 percent requirement.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS BERNSTEIN (USPS-RT-1) TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3, QUESTION 5, subpart (b)

5. Page 37 of witness Bernstein's testimony (USPS-RT-1, revised October 23, 2006) states that "[i]n order to receive the discount, WMB would have to send at least 90 percent of its marketing mail as First-Class Mail."
   a. Do all parties to the contract agree that Washington Mutual Bank will not receive any discounts if it does not send at least 90 percent of its marketing mail as First-Class Mail?
   b. Does the terminology "or a minimum of 500 million credit card solicitations" affect the accuracy of witness Bernstein's statement or change the response to question a. above?

RESPONSE:

(b) The statement quoted above is a shortened version of my statement on page 33 which reads, "A key feature of this proposed NSA is the requirement that WMB send at least 90 percent (or a minimum of 500 million pieces) of its marketing mail as First-Class Mail." The statement of page 37 refers only to the 90 percent requirement because that is the focus of that section of my testimony. I acknowledge that WMB could receive discounts under the NSA if it mailed a minimum of 500 million credit card solicitations. Importantly, the existence of the 500 million piece minimum requirement does not change the conclusions from my analysis of the 90 percent requirement. Either of these requirements represents a non-price factor affecting the after-rates volume of First-Class Mail workshare letters sent by WMB. Therefore, my conclusion that WMB's after-rates volume cannot necessarily be estimated by looking solely at price-elasticities remains true.

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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