

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

Postal Rate Commission  
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RATE AND SERVICE CHANGES TO IMPLEMENT  
FUNCTIONALLY EQUIVALENT NEGOTIATED  
SERVICE AGREEMENT WITH BANK ONE  
CORPORATION

Docket No. MC2004-3

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS PLUNKETT  
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE  
(OCA/USPS-T1-36-45)  
(August 16, 2004)

The United States Postal Service hereby provides its response to the following interrogatories of the Office of Consumer Advocate: OCA/USPS-T1-36-45, filed on August 5, 2004, including the errata to Interrogatory 38(n) and (o) also filed on August 5, 2004. The errata attached the entire text for Interrogatory 38 and did not note a revision that appeared in the revised Interrogatory 38(m). Witness Plunkett's attached response to Interrogatory 38 includes a response to the revised Interrogatory 38(m).

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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**OCA/USPS-T1-36.** Please refer to your response to OCA/USPS-T1-19, and the attachment to this interrogatory.

- a. Please refer to Table 1, Year 1 – ACS Related Savings in the attachment. Please confirm that BOC's Year 1 ACS unit cost saving for letters is \$0.01591200  $[(\$0.55 - 0.34) * 0.09 * 0.85 * 1.00]$ , where  $(\$0.55 - 0.34)$  represents the difference between manual return unit costs and electronic return unit costs, 0.09 represents BOC's physical return rate, 0.85 represents the ACS success rate, and 1.00 represents BOC's solicitation mail as a percent of extra BR volume. If you do not confirm, please explain and show all calculations.
- b. Please refer to Table 1, Year 1 – ACS Related Savings in the attachment. Please confirm that BOC's Year 1 ACS unit cost saving for flats is \$0.05726308  $[(\$1.06 - 0.45) * 0.11 * 0.85 * 1.00]$ , where  $(\$1.06 - 0.45)$  represents the difference between manual return unit costs and electronic return unit costs, 0.11 represents BOC's physical return rate, 0.85 represents the ACS success rate, and 1.00 represents BOC's solicitation flats eligible for ACS. If you do not confirm, please explain and show all calculations.
- c. Please refer to Table 1, Year 1 – ACS Related Savings in the attachment. Please confirm that BOC's BR Equilibrium First-Class Letter Volume is 610,040,414  $[645,040,414 - (35,043,000 - 43,000)]$ . If you do not confirm, please explain and show all calculations.
- d. Please refer to Table 1, Year 2 – ACS Related Savings in the attachment. Please confirm that BOC's Year 2 ACS unit cost saving for letters is \$0.01654848  $[(\$0.57 - 0.36) * 0.09 * 0.85 * 1.00]$ , where  $(\$0.57 - 0.36)$  represents the difference between manual return unit costs and electronic return unit costs, 0.09 represents BOC's physical return rate, 0.85 represents the ACS success rate, and 1.00 represents BOC's solicitation mail as a percent of extra BR volume. If you do not confirm, please explain and show all calculations.
- e. Please refer to Table 1, Year 2 – ACS Related Savings in the attachment. Please confirm that BOC's Year 2 ACS unit cost saving for flats is \$0.05955361  $[(\$1.10 - 0.47) * 0.11 * 0.85 * 1.00]$ , where  $(\$1.10 - 0.47)$  represents the difference between manual return unit costs and electronic return unit costs, 0.11 represents BOC's physical return rate, 0.85 represents the ACS success rate, and 1.00 represents BOC's solicitation flats eligible for ACS. If you do not confirm, please explain and show all calculations.
- f. Please refer to Table 1, Year 2 – ACS Related Savings in the attachment. Please confirm that BOC's BR Equilibrium First-Class Volume is 615,174,506  $[650,174,506 - (35,043,000 - 43,000)]$ . If you do not confirm, please explain and show all calculations.
- g. Please refer to Table 1, Year 3 – ACS Related Savings in the attachment. Please confirm that BOC's Year 3 ACS unit cost saving for letters is \$0.01721042  $[(\$0.60 - 0.37) * 0.09 * 0.85 * 1.00]$ , where  $(\$0.60 - 0.37)$

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represents the difference between manual return unit costs and electronic return unit costs, 0.09 represents BOC's physical return rate, 0.85 represents the ACS success rate, and 1.00 represents BOC's solicitation mail as a percent of extra BR volume. If you do not confirm, please explain and show all calculations.

- h. Please refer to Table 1, Year 3 – ACS Related Savings in the attachment. Please confirm that BOC's Year 3 ACS unit cost saving for flats is \$0.06193575  $[(\$1.15 - 0.48) * 0.11 * 0.85 * 1.00]$ , where  $(\$1.15 - 0.48)$  represents the difference between manual return unit costs and electronic return unit costs, 0.11 represents BOC's physical return rate, 0.85 represents the ACS success rate, and 1.00 represents BOC's solicitation flats eligible for ACS. If you do not confirm, please explain and show all calculations.
- i. Please refer to Table 1, Year 3 – ACS Related Savings in the attachment. Please confirm that BOC's BR Equilibrium First-Class Volume is 620,763,439  $[655,763,439 - (35,043,000 - 43,000)]$ . If you do not confirm, please explain and show all calculations.

**RESPONSE:**

(a)-(i) I can confirm your arithmetic if in subparts (f) and (i) you are referring to BR Equilibrium First-Class *Letter* Volume, not to BR Equilibrium First-Class Volume. Please note that the assumptions underlying this method of calculating return cost savings at various levels of Before Rates First-Class Mail letter volumes produce greater cost savings than the method used to generate OCA/USPS-T1-35, Table 4.

**OCA/USPS-T1-37.** Please refer to the last sentence in your response to OCA/USPS-T1-19, which states “For example, if 100% of the incremental volume consists of solicitation mail, then a volume of 616.6 million pieces would produce ACS savings for letters under the NSA of approximately \$3.2 million with a combined ACS savings for letters and flats of \$9.5 million.” Please provide all calculations showing the derivation of the figures used in your example.

**RESPONSE:**

The figures in my response to OCA/USPS-T1-19 should be \$3.7 million and \$10 million. (Please see the errata to the Response of witness Plunkett to OCA/USPS-T1-19.) To calculate these figures, I changed the Before Rates marketing mail letter volume in Appendix A, Page 1 for each of Years 1 through 3 to 74,907,000 (616,600,000-506,650,000-35,043,000). I then applied the model in Appendix A. The \$3.7 million cost savings from returns for letters is set forth in the “Total” column of row (2) of Appendix A, Page 10. The \$10 million combined ACS savings can be calculated by adding the totals in row (2) and row (3) of the same page.

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**OCA/USPS-T1-38.** This is a hypothetical question. Please make the following assumptions. (1) Unit cost saving for solicitation letters is \$0.0159. (2) Unit cost saving for solicitation flats is \$0.0573. (3) Pre-NSA customer volume is 506,650,000. (4) Pre-NSA solicitation letter-shaped volume is 29,387,000. (5) Pre-NSA solicitation flat-shaped volume is 35,043,000. (6) The difference in contribution between Bank One's First Class and Standard Mail is \$0.07. (7) There is no quarterly settlement of discounts earned by Bank One. (8) Discount-induced volume does not appear until Bank One mails 103,368,725 solicitation pieces.

- a. Do you agree that if Bank One enters 500,000,000 customer pieces in Year One, it will receive no discounts and generate no cost savings? If you do not agree, please explain.
- b. Do you agree that if Bank One enters, in addition to the above 500,000,000 pieces, 35,000,000 solicitation flats, it will receive no discounts but will generate cost savings of \$2,005,500? If you do not agree, please explain.
- c. Do you agree that if Bank One enters, in addition to the above 535,000,000 pieces, 43,000 solicitation flats, it will receive discounts of \$1,075 ( $43,000 * \$0.025$ ) because the threshold has been exceeded and up to 35,000,000 flats are eligible for discounts? Do you also agree that the 43,000 solicitation flats will generate additional cost savings of \$2,464, for a net total benefit to the Postal Service of \$2,006,889? If you do not agree, please explain.
- d. Do you agree that if Bank One enters, in addition to the above 535,043,000 pieces, 6,650,000 customer pieces, it will receive additional discounts of \$166,250 ( $6,650,000 * \$0.025$ ) and generate no additional cost savings, for a net total benefit to the Postal Service of \$1,840,639? If you do not agree, please explain.
- e. Do you agree that if Bank One enters, in addition to the above 541,693,000 pieces, 18,307,000 solicitation letter-shaped pieces, it will receive additional discounts of \$467,675 ( $18,307,000 * \$0.025$ ) and generate additional cost savings of \$291,081, for a net total benefit to the Postal Service of \$1,674,045? If you do not agree, please explain.
- f. Do you agree that if Bank One enters, in addition to the above 560,000,000 pieces, 11,080,000 solicitation letter-shaped pieces, it will receive additional discounts of \$332,400 ( $11,080,000 * \$0.030$ ) and generate additional cost savings of \$176,172, for a net total benefit to the Postal Service of \$1,517,817? If you do not agree, please explain.
- g. Do you agree that if Bank One enters, in addition to the above 571,080,000 pieces, 13,920,000 exogenously-generated solicitation letter-shaped pieces, it will receive additional discounts of \$417,600 ( $13,920,000 * \$0.030$ ) and generate additional cost savings of \$221,328, for a net total benefit to the Postal Service of \$1,321,545? If you do not agree, please explain.
- h. Do you agree that if Bank One enters, in addition to the above 585,000,000 pieces, 25,000,000 exogenously-generated solicitation letter-

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- shaped pieces, it will receive additional discounts of \$875,000 ( $25,000,000 * \$0.035$ ) and generate additional cost savings of \$397,500, for a net total benefit to the Postal Service of \$844,045? If you do not agree, please explain.
- i. Do you agree that if Bank One enters, in addition to the above 610,000,000 pieces, 35,000,000 exogenously-generated solicitation letter-shaped pieces, it will receive additional discounts of \$1,400,000 ( $35,000,000 * \$0.040$ ) and generate additional cost savings of \$556,500, for a net total benefit to the Postal Service of \$545? If you do not agree, please explain.
  - j. Do you agree that if Bank One enters, in addition to the above 610,000,000 pieces, 18,725 exogenously-generated solicitation letter-shaped pieces, it will receive additional discounts of \$843 ( $18,725 * \$0.045$ ) and generate additional cost savings of \$298, for a net total benefit to the Postal Service of \$0? If you do not agree, please explain.
  - k. Do you agree that the financial consequences to the Postal Service of Bank One's entering the above 610,018,725 pieces are independent of the order in which the various types of mail are entered? If you do not agree, please explain.
  - l. Do you agree that so long as (1) total Bank One customer volume in Year One is 506,650,000 pieces and (2) total Bank One solicitation volume in Year One is less than 103,368,725 pieces, the Postal Service makes money on the NSA **even if** no discount-induced volume appears? If you do not agree, please explain.
  - m. Do you agree that if the NSA discounts induce Bank One to mail one new piece of solicitation mail, in addition to the above 103,368,725 pieces, the Postal Service obtains \$0.07 in new contribution while paying \$0.045 in discounts, for a net gain of \$0.025? If you do not agree, please explain.
  - n. Do you agree that if, in addition to the above 103,368,725 pieces, Bank One mails 1.2 discount-induced pieces for every exogenously-generated piece, the Postal Service obtains \$0.084 in new contribution and \$0.0159 in cost savings while paying \$0.099 in discounts, for a net gain of \$0.0009? If you do not agree, please explain.
  - o. Do you agree that if Bank One mails 103,368,726 pieces of exogenously-generated solicitation mail and only 1.2 pieces of discount-induced solicitation mail, the Postal Service makes money? If you do not agree, please explain.
  - p. What is the probability that the Postal Service loses money on the Bank One NSA?

**ANSWER:**

a-j. I'm not sure what is meant by "exogenously generated" mail pieces. When viewed in isolation, these calculations appear to be correct, if one assumes that the period under consideration is one in which the thresholds have not been

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adjusted for some reason. But considering one component of the NSA in isolation, as has been done in this interrogatory, creates an implicit assumption that I regard to be implausible: that the creation of price incentives will have no effect whatsoever. I would also point out that the calculation in part e appears to be incorrect. In part e, the cost savings from the additional 18,307,000 pieces equals \$457,675 ( $18,307,000 * \$0.025$ ). The calculated net total benefit to the Postal Service appears to be correct.

k. Theoretically, the Postal Service ought to be indifferent if one views the year in its entirety. Of course Bank One can not arbitrarily decide to send all of its customer mail before sending any of its acquisition mail. Presumably Bank One will retain the conventional practice of sending one statement per month to its active customers irrespective of the incentives in this agreement.

l. I agree, however I regard this scenario as highly improbable.

m. I disagree. If the piece of mail is new we would generally not include cost savings in the benefit. Moreover, I disagree with the use of the term “pay” as it suggests that the Postal Service will incur an expense. In fact there is no payout by the Postal Service, but a reduction in net contribution.

n. With the caveat described in my response to part m this calculation appears to have been done in a manner consistent with the approach used in my testimony. Similarly, if Bank One were to be prevented from sending these pieces – for example through the imposition of an arbitrarily constructed cap on incentives – then the Postal Service would forego the same net gain.

o. Yes.

p. While it is possible to construct hypothetical sets of assumptions that result in small net losses, the agreement with Bank One has been consciously structured to insulate the Postal Service from the possibility of a net loss in contribution under any plausible scenario.

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**OCA/USPS-T1-39.** The following interrogatory concerns Bank One's "free rider" volumes.

- a. Please confirm that in PRC Op. MC2002-2, para. 8016, the Commission described "free riders" as "mail that would have been sent even absent the NSA . . . ." If you do not confirm, then explain why not.
- b. Using the definition cited in part a., please confirm that the Bank One NSA contains 36,080,000 "free riders," determined as follows;
  - i. The NSA (§III.D.) provides for a threshold for the first year of 535 million, at which point discounts of 2.5 cents will be paid; these discounts continue to be paid up to 560 million pieces.
  - ii. The Before Rates volume forecast is 571,080,000 (Attachment A, page 6 (USPS-T- 1)). Discounts of 3 cents are paid up to the 571 million-piece level (and beyond).
  - iii. The Before Rates volume forecast of 571,080, 000 falls within the Commission's description of "volume that would have been sent even absent the NSA."
  - iv. If you do not confirm, then state the number of "free riders" in the Bank One NSA. Show all calculations and provide all source documents.
- c. Please confirm that the Commission concluded that, absent a stop-loss provision, "there is a serious risk that discounts given to 'free riders' will exceed savings to the Postal Service and that other mailers will be worse off because of the NSA."

**RESPONSE:**

- a. Confirmed that the Commission described "free riders" as "mail that would have been sent even absent the NSA." I used the term "exposure" in my testimony to refer to the situation where the threshold is set below forecasted Before-Rates volume and discounts are given for mail volume that would have been mailed even without a price incentive. The term "free riders" is a misleading concept in the NSA context because the cost of litigating an NSA for a customer carries a significant transaction cost. This transaction cost may offset a large share of—or may actually exceed—the discounts earned on the "free riders." Thus, such mail pieces are not actually "free". Please also note that all pieces characterized as "free-riders" at all times make a positive contribution to the Postal Service.
- b. (i)-(iv) Generally confirmed.

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- c. Confirmed that the interrogatory accurately quotes the Commission's Docket No. MC2002-2 Opinion and Recommended Decision. Given the stability of Bank One's First-Class Mail volumes and the additional cost savings that would be generated by higher Before-Rates solicitation volumes, I don't believe that "there is a serious risk that discounts given to 'free riders' will exceed savings to the Postal Service" in the Bank One NSA.

A cost-savings cap would likely choke off First-Class Mail solicitation letter volumes that would have been mailed with a discount incentive in place, thereby limiting the increase in Bank One's contribution to institutional costs which would make other customers worse off.

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**OCA/USPS-T1-40.** For Bank One, please provide an analysis equivalent to that submitted by witness Crum at Tr. 2/318-22 (Docket No. MC2002-2), in response to POIR 2, question 7.

- a. In your analysis, address specifically the fact that Bank One's estimated First-Class Mail (FCM) solicitation volumes in Year One of the NSA are approximately 11% of Capital One's FCM solicitation volumes.
- b. Also, address specifically the fact that in contrast to Capital One, which had an obligation to update its address lists within two days of receipt of electronic ACS notices (Tr. 2/321), Bank One is given a longer period of time – 7 days – to update its address lists.
- c. Isn't it generally correct that dividing Capital One's annual volumes of FCM solicitations – 768 million – by the number of delivery points in the United States (witness Crum used a figure of 137,682,00, from the Postal Service's 2001 Annual Report; Tr. 2/320) yielded an implied average number of pieces per delivery point of 5.6? If you do not agree, please explain.
- d. Isn't it generally correct that dividing Bank One's estimated annual volumes of First-Class Mail solicitations (for Year One of the NSA) – 83.5 million – yields an implied average number of pieces per delivery point of 0.62? If you do not agree, please explain.
- e. Doesn't a comparison of the figures set forth in parts c. and d., *i.e.*, 5.6 versus 0.62, suggest that the Postal Service is much less likely to benefit from avoided forwards in the case of Bank One than it does in the case of Capital One? If you do not agree, please explain.
- f. Please provide discussions comparable to those requested in parts d. and e. for Year Two and Year Three of the Bank One NSA.
- g. Please confirm that an obligation to update address lists within 7 days (Bank One) compared to 2 days (Capital One) is likely to result in higher costs for the Postal Service for forwarding and returning Bank One's UAA mail as compared to Capital One. If you do not confirm, please explain.

**RESPONSE:**

Witness Crum's analysis at Tr. 2/318-22 (Docket No. MC2002-2) in response to Presiding Officer's information Request (POIR) No. 2, Question 7 was presented to provide a minimum estimate of the effect of the costs and cost savings of providing ACS forwarding notices to Capital One as part of its NSA. However, I believe that, with one adjustment, witness Crum's bounding analysis can be applied to Bank One (as well as his general conclusion that cost savings from reducing repeat forwards will significantly exceed the cost of providing ACS notices).

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The adjustment is as follows: In his analysis in POIR No 2, Question 7, Witness Crum estimated the minimum number of First-Class Mail solicitations sent by Capital One to each delivery point by dividing Capital One's total First-Class Mail solicitations by the total number of delivery points in the United States. As pointed out in this interrogatory, Bank One's First-Class Mail solicitation volumes make clear that Bank One does not mail to every delivery point in the United States. Therefore, witness Crum's "bounding" assumption for estimating the number of pieces sent to each delivery point is not appropriate for Bank One.

Since this assumption is inappropriate, I asked Bank One how many First-Class Mail solicitations it sends to delivery points for First-Class Mail. Bank One indicated that, on average, it sends several First-Class Mail solicitations to each delivery point. Given that Bank One sends several First-Class Mail solicitations to each "First-Class Mail delivery point", witness Crum's conclusion that cost savings from reduced forwards exceed the cost of providing ACS notices should hold true for Bank One as well.

Finally, witness Crum's analysis shows that even if address lists were not updated by the time the next solicitation (or even the third or fourth solicitation) is sent to the address, the cost savings from reduced forwards would still exceed the cost of providing ACS notices. Therefore, I do not think that allowing Bank One seven days to update its address lists would change witness Crum's conclusion.

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**OCA/USPS-T1-41.** For J.P. Morgan Chase, please provide an analysis equivalent to that submitted by witness Crum at Tr. 2/318-22 (Docket No. MC2002-2), in response to POIR 2, question 7.

**RESPONSE:**

Please see my response to OCA/USPS-T1-40. Also, note that adding J. P. Morgan Chase's First-Class Mail solicitation volumes to Bank One's volumes should increase the number of pieces per delivery point, thereby increasing cost savings from reducing forwards.

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**OCA/USPS-T1-42.** Please confirm that Capital One has an obligation to process its customer account mail addresses against CASS/NCOA within 30 days prior to mailing. (§II.H.1). If you do not confirm, please explain why not.

- a. Also confirm that Bank One has an obligation to process its customer account mail addresses against CASS/NCOA much less often than Capital One, *i.e.*, within 90 days prior to mailing. (§II.G.1). If you do not confirm, please explain why not.
- b. Isn't it correct that Capital One's processing of customer account mail addresses against CASS/NCOA 3 times more frequently than Bank One is more likely to result in fewer forwards for Capital One customer mail as compared to Bank One customer mail? If you do not agree, please explain why not.

**RESPONSE:**

Confirmed.

- a. Confirmed.
- b. Holding all else equal and assuming that Capital One will process its customer mail addresses more frequently than Bank One, I confirm. However, even if Bank One's customer mail forwarding rate were higher than Capital One's, this would not affect the estimated value of the NSA to the Postal Service. This is because I have not included any savings or new contribution related to Bank One customer account mail in my calculations of the value of the NSA.

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**OCA/USPS-T1-43.** Please confirm that Capital One has an obligation to process its solicitation mail addresses against CASS/NCOA within 60 days prior to mailing. (§II.H.2). If you do not confirm, please explain why not.

- a. Also confirm that Bank One has an obligation to process its solicitation mail addresses against CASS/NCOA less often than Capital One, i.e., within 90 days prior to mailing. (§II.G.2). If you do not confirm, please explain why not.
- b. Isn't it correct that Capital One's processing of solicitation mail addresses against CASS/NCOA more frequently than Bank One is more likely to result in fewer forwards for Capital One solicitation mail as compared to Bank One solicitation mail? If you do not agree, please explain why not.

**RESPONSE:**

Confirmed.

- a. Confirmed.
- b. Holding all else equal, processing solicitation mail addresses more frequently might result in fewer forwards. I disagree, however, that that Bank One's processing interval will be substantially longer than 60 days. My understanding is that, even though the NSA allows a processing cycle as long as 90 days, some of Bank One's solicitations are already being processed within a 60-day cycle, and Bank One is changing its internal process shortly to have most of its solicitations processed within a 60 day cycle prior to mailing. Furthermore, I understand that these internal processes will apply to Standard Mail solicitations in addition to First-Class Mail solicitations.

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**OCA/USPS-T1-44.** Please reproduce Appendix A of USPS-T-1 for J.P. Morgan Chase.

At this time a complete reconstruction of Appendix A for JP Morgan Chase is not possible, as there is not yet an integration schedule. See also witness Rappaport's response to OCA/BOS-T1-14.

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**OCA/USPS-T1-45.** Please reproduce Appendix B of USPS-T-1 for J.P. Morgan Chase.

**ANSWER:**

See my response to OCA/USPS-T1-44. As appendix B merely describes the content of Appendix A, it can not be written in the absence of Appendix A.

## **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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Nan K. McKenzie

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