

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

RATE AND SERVICE CHANGES TO IMPLEMENT  
FUNCTIONALLY EQUIVALENT NEGOTIATED  
SERVICE AGREEMENT WITH HSBC NORTH  
AMERICA HOLDINGS INC.

Docket No. MC2005-2

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS DAUER TO  
INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE  
(OCA/USPS-T1-6-9)  
(April 8, 2005)

The United States Postal Service hereby provides the responses of  
witness Dauer to the following interrogatories of the Office of Consumer  
Advocate: OCA/USPS-T1-6-9, filed on March 29, 2005.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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April 8, 2005

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**OCA/USPS-T1-6.** Please confirm that your Appendix A, page 1, line 3 incorporates an average First-Class Mail return rate of 1.23%. If you do not confirm, then please explain.

**Response**

Confirmed.

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**OCA/USPS-T1-7.** In March 2005, at the Nashville, TN, National Postal Forum, Postal Service witness (Docket No. MC2002-2) Jim Wilson made a presentation on the National Change of Address (NCOA) service. Data from an "average" 20-million-piece mailing for which the Postal Service had utilized NCOA service and Address Change Service (ACS) were disclosed. The data showed that 5.94% of such an "average" First-Class mailing was returned, as opposed to the 1.23% figure that you use in Appendix A. Assume for purposes of this interrogatory that the 5.94% figure, rather than the 1.23% figure, is correct.

- a. What is the effect on a Commission-style savings cap of a return rate that is nearly 5 times the return rate that you use? Provide all calculations and cite/provide all sources used to answer this question.
- b. What is the effect of a return rate that is nearly 5 times the return rate that you use on the contribution that you have estimated? Provide all calculations and cite/provide all sources used to answer this question.
- c. If the average return rate for First Class is 5.94%, then please confirm that HSBC's return rate is below the average. If you do not confirm, then please explain.

### **Response**

I understand that you are asking me to assume (rather than confirm as fact) that the correct return rate for First-Class Mail overall is 5.94 percent, in contrast to the 1.23 percent upon which my analysis is predicated, along with the analysis in all previous NSA cases. Furthermore, I understand that posing such hypothetical questions can on occasion provide a useful means to explore otherwise cumbersome issues. I do not, however, believe that to be the case in this instance. It is my understanding, in contrast with the implication of your question, that Mr. Wilson had no intention of representing the return rate of the single mailing (by a single mailer) that he was using for illustrative purposes as average or typical of the totality of First-Class Mail. See the response of the Postal Service to OCA/USPS-1. In reality, the return rate for any single mailer is not indicative of the return rate experienced by all mailers in the same class of mail, and I have been told by Mr. Wilson that it was not presented as such by him at the Forum. His purpose, rather, was simply to point out that there is a connection between the quality of address data and return rates for mailers, which attendees could use as a

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point of reference to understand the value of improving their address information. Lastly, I need to note my understanding that, even with respect to the one mailing by the one mailer discussed at the Forum, the reported return rate of 5.94 percent applied only to the portion of the mailing that was ZIP+4 coded, not the entire mailing. This distinction further underscores why the 5.94 percent figure simply cannot be assumed to apply to all First-Class Mail.

Because I believe that your entire line of questions is premised on a misinterpretation of one number presented at the Forum, I believe that accepting your assumption would foster misunderstanding of the relevant issues, rather than a better understanding. The assumption that the correct return rate for First-Class Mail overall is 5.94 percent rather than 1.23 percent appears quite implausible. As your question acknowledges, a return rate so high would suggest that the Postal Service has been underestimating the overall return rate for First-Class Mail by a factor of nearly five. My concerns are addressed more fully in response to the specific subparts of this question, and OCA/USPS-T1-8.

a.-b.) If I were to limit my response to making the adjustments in my model that relate to the single model input which you are requesting be changed in this question, the value of the NSA calculated by my model increases. This is because, with a lower than average return rate, HSBC's pieces converting from Standard Mail to First-Class would contribute more than the average piece of First-Class Mail, thereby escalating the estimated additional contribution from those converted pieces. Specifically, by changing the 1.23% on the Assumptions (page 1) of HSBC North America Holdings Inc Model, the effects would appear in Columns 13-18 on pages 5 and 6 (Ops and Mktg unit cost), on page 11 (Contrib Inputs) Line 3-10, and finally on page 12 (USPS Value) Line 4. On the other hand, because no change is made on page 8 where the ACS savings are

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calculated, there would be no change in the discount cap calculations and the associated breakeven volume.

As evident from your question OCA/USPS-T1-8, this result appears contrary to your expectations. Your apparent view is that an increase in the return rate should lead to a reduction in the estimated cost of manual returns, and a decrease in the overall value of the NSA. In this question, however, you have not asked me to assume a different value for the manual return unit cost input (Page 1, Line 5).

To summarize, when the only change in my model is an increase in the overall First-Class Mail return rate, the calculated net benefit from the NSA increases. The results for any particular change in this input – whether realistic or not -- can easily be generated using my model. In my opinion, the change you are suggesting is not realistic. Please also see my answer to OCA/USPS-T1-8.

c.) I confirm that, as noted above, if one implausibly assumes that the average return rate for First-Class Mail is 5.94 percent, then HSBC's return rate of 4.75 percent for marketing mail would be lower than the assumed average.

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**OCA/USPS-T1-8.** In the Spring 2003 issue of a Pitney Bowes publication, *PostInsight*, Pitney Bowes reported that the Postal Service incurs approximately \$1.9 billion of UAA costs each year. Please confirm that this figure is correct or provide the correct figure. Cite/provide the source for any corrected figure.

a. If the \$1.9 billion figure is approximately correct, and the return rate for First-Class Mail is 5.94%, not 1.23%, then doesn't it follow that the unit cost of physically returning mail is far lower than estimated by witness Crum, i.e., because the \$1.9 billion will be spread over the much larger volume figure implied by a 5.94% return rate? If you do not confirm, then please explain.

b. If the unit cost of physically returning mail is far lower than estimated by witness Crum, then doesn't it follow that the Postal Service might be worse off in providing electronic return service in lieu of the physical return of HSBC's mail? If you do not agree, then please explain.

c. If \$1.9 billion and 5.94 percent are correct figures, then doesn't it follow that the unit cost of a physical return is more like \$0.12 than \$0.57? If you do not confirm, please explain.

d. If 5.94 percent and \$0.12 are used in your testimony at Appendix A, Page 1, is it not the case that the results in the table below will appear at Appendix A, Page 12? If you do not confirm, please explain.

**HSBC North America Holdings Inc. Model**

**Negotiated Service Agreement**

**Appendix A, page 12**

		Year 1	Year 2	Year 3	Total
<b>ACS Savings</b>					
(1)	Statement Mail	\$ -	\$ -	\$ -	-
(2)	Marketing Mail Letter	\$ (1,559,055)	\$ (2,512,490)	\$ (3,189,286)	<b>(7,260,831)</b>
<b>Contribution from New Volume</b>					
(3)	Statement Mail	\$ -	\$ -	\$ -	-
(4)	Marketing Mail Letter	\$ 1,245,336	\$ 1,528,773	\$ 1,499,761	<b>4,273,869</b>
<b>(5) Total Exposure</b>		\$ 656,340	\$ 964,968	\$ 1,172,146	<b>2,793,454</b>
<b>(6) Total Incremental Discounts</b>		\$ 411,268	\$ 592,994	\$ 628,691	<b>1,632,953</b>
<b>(7) Total USPS Value</b>		<b>\$ (1,381,328)</b>	<b>\$ (2,541,678)</b>	<b>\$ (3,490,363)</b>	<b>(7,413,369)</b>

**Response**

It is believed that the ultimate source of the \$1.9 billion estimate quoted by Pitney Bowes is the analysis contained in USPS-LR-J-69 (Docket No. R2001-1), Section C Table 5.1, Line 7. The \$1.9 billion includes the costs associated with all handlings, forwarding, return, and disposal of UAA mail, across all classes of mail. It would be erroneous to

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distribute the \$1.9 billion to only return processing of First-Class Mail. Importantly, the return rate employed in this and all previous NSA cases also comes from USPS-LR-J-69 as well. See Tables 4.2 and 4.3.3. Therefore, the return rate and the unit cost estimates I use in my model are closely intertwined.

a.) Not confirmed. As noted in response to OCA/USPS-T1-7, I believe that using the 5.94 percent number as the average return rate for all First-Class Mail would not be credible. Moreover, as described above, the \$1.9 billion figure relates to all types of UAA costs for all classes of mail, and can not appropriately be “spread over” return volumes of First-Class Mail to obtain the unit cost of returned UAA First-Class Mail.

b.) Obviously, one could always hypothetically assume a manual return unit cost so low that it would be lower than the accepted estimate of electronic return unit cost. Such an assumption, however, would not be meaningful.

c.) As noted in response to subpart a., your question is attempting to apply the 5.94 percent number and the \$1.9 billion number in ways that are not appropriate.

d.) For the reasons set forth above and in my response to OCA/USPS-T1-7, the exercise you have requested would not be meaningful.

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**OCA/USPS-T1-9.** Please refer to your testimony at Appendix A, Page 6.

a. Please confirm that the formula in column (13) is:  $= (\$0.57 * 95,685,915) * (0.0475 - 0.0123) / 95,685,915$ . If you do not confirm, please explain.

b. Please confirm that the formula in column (13) can be written as:  $= - (\$0.57 * 0.0123) + (\$0.57 * 0.0475)$ . If you do not confirm, please explain.

c. Please confirm that the formula in column (15) is:  $= ((0.85 * \$0.36 + (1 - 0.85) * \$0.57) * (95,685,915 * (0.0475 - 0.0123))) / 95,685,915 - 0.0123 * (\$0.57 - \$0.36) * 0.85$ . If you do not confirm, please explain.

d. Please confirm that the formula in column (15) can be written as:  $= - (\$0.57 * 0.0123) + (0.85 * \$0.36 + (1 - 0.85) * \$0.57) * 0.0475$ . If you do not confirm, please explain.

**Response**

a.) Confirmed, although the spreadsheet in my model does the actual calculation using inputs with more decimal places, which changes the results slightly relative to what you would obtain merely using the values you have specified.

b.) Confirmed, although the spreadsheet in my model does the actual calculation using inputs with more decimal places, which changes the results slightly relative to what you would obtain merely using the values you have specified.

c.) Confirmed, although the spreadsheet in my model does the actual calculation using inputs with more decimal places, which changes the results slightly relative to what you would obtain merely using the values you have specified.

d.) Confirmed, although the spreadsheet in my model does the actual calculation using inputs with more decimal places, which changes the results slightly relative to what you would obtain merely using the values you have specified.

## CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice and Procedure.

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