

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

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

Docket No. MC2004-3

RESPONSES OF THE UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE
(OCA/USPS-T1-24-27)
(August 5, 2004)

The United States Postal Service hereby provides its responses to the following interrogatories of the Office of Consumer Advocate: OCA/USPS-T1-24-27, filed on July 22, 2004. The response to Interrogatory 24 has been partially redirected to Bank One witness Buc.

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 THE UNITED STATES POSTAL SERVICE WITNESS PLUNKETT TO
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OCA/USPS-T1-24. Please refer to your testimony at VI. Discount Cap, pages 15-17, and PRC Op. MC2002-2, page 154, footnote 83, which states:

This excludes any potential increased contribution as a result of Capital One responding to the declining block rate structure by increasing its volume of First-Class Mail. The commission is excluding this potential contribution because the record does not provide an adequate basis for evaluating the response of Capital One (and its competitors) to the declining block rates. See Chapter V, Section M, for the analysis leading to this conclusion.

Please expand on your testimony and address the Commission's concern with respect to unknown before rates volumes and the unknown response to discounts.

Response:

The record in this case addresses the Commission's concerns on several levels. First, it shows that Before Rates First-Class marketing letter volume—the only type of First-Class mail volume over which Bank One appears to have significant discretion—would have to increase by nearly *300 percent* over Bank One's current marketing letter volume before the resulting "leakage" from the NSA rate discounts outweighed the ACS cost savings potential generated by the Before Rates volume. See my response to Presiding Officer's Information Request No. 1, Question 7 (filed July 26, 2004).

Also, the record shows that an unanticipated increase in Before Rates volume of this magnitude is extremely unlikely. Bank One's historical volumes, in contrast to those of Capital One, have been quite stable in recent years. See USPS-T-1 (Plunkett Direct), App. A, p. 2. Moreover, the terms of the NSA establishing an annual threshold adjustment and merger adjustments provide structural safeguards against the risk that Bank One could obtain volume-related discounts for increases in First-Class Mail volume caused by a merger or an organic increase in the scale of Bank One's business. See NSA ¶¶ III.F (annual threshold adjustment) and IV (merger adjustments).

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Moreover, the co-proponents of the NSA in this case have submitted a more sophisticated and thorough analysis of the anticipated financial effects of the proposed block discount schedule, including the effects of leakage, new contribution and ACS savings, than the proponents submitted to the Commission in the Capital One case. See Plunkett Direct (USPS-T-1), App. A; response of USPS witness Plunkett to OCA interrogatory OCA-USPS-T1-15; Buc Direct (BOC-T-2). In particular, Mr. Buc's testimony provides a sophisticated model of the optimization analysis used by credit card marketers to choose between Standard Mail and First-Class Mail solicitations. Relying on publicly available data, Mr. Buc shows that the proposed discount blocks will, under a range of plausible assumptions, elicit enough additional First Class Mail volume to generate a positive contribution to the Postal Service. Buc Direct (BOC-T-2).

The record shows that a stop-loss provision (or cap) would not eliminate financial risk for the Postal Service, but would substitute one risk for another. This is because a cap on total discounts creates the risk of choking off volumes that an incentive otherwise would induce. This is particularly true for the Bank One NSA: losses in contribution from the choked-off volume could be very large. Thus, imposing a cap would replace an insignificant risk with a substantial one. Bank One witness Buc has prepared an analysis based upon his the model presented in Mr. Buc's testimony (BOC-T-2), which shows an 80 percent chance that imposing an annual \$2.5 million cap would reduce the contribution made by Bank One's mail to institutional costs by \$9 million per year. Over the three year term of the NSA, the lost contribution could approach \$40 million. Witness Buc today will provide this analysis in a partially redirected response to this interrogatory.

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Additionally, the risks to the Postal Service from capping discounts transcend this case, particularly if the cap is limited to ACS cost savings. Many other banks have large quantities of Standard Mail solicitations. An appropriate discount incentive could enable the Postal Service to induce a large share of this volume to migrate to First-Class Mail, benefiting the Postal Service, banks, and other mailers. Limiting the discounts to the costs savings generated by solicitations currently mailed as First-Class Mail, however, would have a chilling effect on future functionally equivalent NSAs of this kind. Few other banks currently send enough First-Class Mail solicitations to justify the energy, time, and money needed to obtain a functionally equivalent NSA with discounts capped at ACS savings on Before Rates First-Class volumes.

Finally, the volume forecasts in the Capital One NSA case were revised mid-case to show that the TYBR and TYAR volume forecasts were the same, since the revised TYBR forecast was below the discount threshold. The lack of expected growth in that case limited the potential gain in contribution. However, in the instant case, the volume forecasts demonstrate a robust response to the proposed discount structure.

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OCA/USPS-T1-25. Please refer to your testimony at VI. Discount Cap, pages 15-17, and PRC Op. MC2002-2, page 154, para. [8025], which states:

Third party mailers will be unharmed by the NSA so long as the dollar amount of the volume discounts the Postal Service makes available to Capital One is not greater than the costs it avoids as a result of the return mail feature of the agreement.

Please explain how the Postal Service has protected third party mailers from harm should the dollar amount of the volume discounts provided to Bank One exceed the costs avoided as a result of the return mail feature of the Bank One NSA.

Response:

Please see my response to OCA/USPS-T1-24.

Furthermore, any meaningful risk analysis must recognize that the financial risks run in both directions. As explained in response to interrogatory OCA-USPS-T1-24, the risk of not pursuing an NSA is not zero. Ignoring the cost savings on existing volume, the Postal Service would lose without the NSA 19 million pieces in Year 1 and 99 million pieces in Years 2 and 3 of the agreement. The potential lost opportunity to the Postal Service is, at minimum, identified below.

	<u>YEAR 1</u>	<u>YEAR 2</u>	<u>YEAR 3</u>
Volume	19,055,000	99,055,000	99,055,000
Contribution *	\$0.163	\$0.157	\$0.152
Lost Opportunity	\$3,096,946	\$15,586,528	\$15,053,473

*MC2004-3 USPST-1-Appendix A page 10 line 9

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The chart above illustrates that no NSA, at a minimum, means an opportunity cost of \$33.7 million in additional contribution over the term of the NSA. Moreover, this new contribution is an important component that helps to protect third party mailers.

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OCA/USPS-T1-26. Please refer to your testimony Appendix A, pages 3, 4 and 5.

- (a) Please confirm that the “WEIGHTED AVERAGE/TOTAL” of 498,514,731 and 59,603,231 in column 11 on pages 4 and 5, respectively, sum to 558,117,962, the “Total Pieces” in column (3) on page 3. If you do not confirm, please explain.
- (b) On page 4, please explain how the “WEIGHTED AVERAGE/TOTAL” of 498,514,731 in column 11 was derived. Show all calculations.
- (c) On page 5, please explain how the “WEIGHTED AVERAGE/TOTAL” of 59,603,231 in column 11 was derived. Show all calculations.
- (d) Please confirm that the volumes for the specified Nonautomation Presort Letters and Automation Presort Letters rate categories in column 11 on pages 4 and 5 sum to the volumes of the same Nonautomation Presort Letters and Automation Presort Letters rate categories on page 3, column 1. If you do not confirm, please explain.
- (e) On page 4, please explain how the volumes of Nonautomation Presort Letters and Automation Presort Letters in column 11 were derived. Show all calculations.
- (f) On page 4, please provide all calculations that show the derivation of the percentages in column 12 associated with Nonautomation Presort Letters and Automation Presort Letters.
- (g) On page 5, please explain how the volumes of Nonautomation Presort Letters and Automation Presort Letters in column 11 were derived. Show all calculations.
- (h) On page 5, please provide all calculations that show the derivation of the percentages in column 12 associated with Nonautomation Presort Letters and Automation Presort Letters.

Response:

(a) Confirmed.

(b) The total of 498,514,731 is the total sum of the Bank One’s statement volume at the different rate categories. These values are the reconciled volume numbers from the USPS Permit system and Bank One, as shown below:

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FIRST-CLASS MAIL LETTERS

	Volume (Column 11)
Nonautomation Presort Letters	16,896,034
Automation Presort Letters	
Automation Mixed AADC	3,462,228
Automation AADC	5,935,849
Automation 3-Digit	321,218,301
Automation 5-Digit	150,886,728
Automation Carrier Route	115,591
WEIGHTED AVERAGE / TOTAL	498,514,731

(c) The total 59,603,231 is the total sum of the Bank One's marketing volume at the different rate categories. These values are the reconciled volume numbers from the USPS Permit system and Bank One, as shown below:

FIRST-CLASS MAIL LETTERS	Volume (Column 11)
Nonautomation Presort Letters	5,469
Automation Presort Letters	
Automation Mixed AADC	159,789
Automation AADC	157,854
Automation 3-Digit	20,459,211
Automation 5-Digit	38,358,545
Automation Carrier Route	462,363
WEIGHTED AVERAGE / TOTAL	59,603,231

(d) Confirmed.

(e) The volumes of Nonautomation Presort Letter and Automation Presort Letter in column 11 are actual Bank One volumes broken into rate categories. The only calculations used were to sum specific rate categories across all permits.

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(f) Please see the following chart:

Rate Category	Volume /	Total Volume =	Percentage
Nonautomation Presort Letters	16,896,034	498,514,731	3.39%
Automation Presort Letters			
Automation Mixed AADC	3,462,228	498,514,731	0.69%
Automation AADC	5,935,849	498,514,731	1.19%
Automation 3-Digit	321,218,301	498,514,731	64.44%
Automation 5-Digit	150,886,728	498,514,731	30.27%
Automation Carrier Route	115,591	498,514,731	0.02%
WEIGHTED AVERAGE / TOTAL	498,514,731		100.00%

The percentages are calculated by dividing the “Volume” for each rate category column by the “Total Volume”. This is reflected in footnote (12) on page 4 of Appendix A.

(g) Please see answer (e) above.

(h) Please see the following chart:

Rate Category	Volume /	Total Volume =	Percentage
Nonautomation Presort Letters	5,469	59,603,231	0.01%
Automation Presort Letters			
Automation Mixed AADC	159,789	59,603,231	0.27%
Automation AADC	157,854	59,603,231	0.26%
Automation 3-Digit	20,459,211	59,603,231	34.33%
Automation 5-Digit	38,358,545	59,603,231	64.36%
Automation Carrier Route	462,363	59,603,231	0.78%
WEIGHTED AVERAGE / TOTAL	59,603,231		100.00%

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OCA/USPS-T1-27. Please refer to your testimony Appendix A, pages 4 and 5.

- (a) On page 4, in columns (14) and (16), please confirm that the “Total Unit Cost Estimates, Including Contingency” of 0.107 and 0.107, respectively, are not used anywhere in Appendix A. If you do not confirm, please explain.
- (b) On page 5, in columns (14) and (16), please confirm that the “Total Unit Cost Estimates, Including Contingency” of 0.146 and 0.129, respectively, are not used anywhere in Appendix A. If you do not confirm, please explain.
- (c) Please explain the rationale for calculating, and intended use of, the figures referred to in parts (a) and (b) of this interrogatory.

Response:

(a) Please see the Errata that the Postal Service will be filing this week concerning the Contingency.

(b) Please see the Errata that the Postal Service will be filing this week concerning the Contingency.

(c) Please see the Errata that the Postal Service will be filing this week concerning the Contingency.

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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