Postal Rate Commission
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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON DC 20268-0001

Rate and Service Changes To Implement Functionally Equivalent Negotiated Service Agreement with Bank One Corporation	)))	Docket No. MC2004-3

ANSWER OF BANK ONE CORPORATION TO OFFICE OF CONSUMER ADVOCATE INTERROGATORY OCA-BOC-T1-24 (PARTIALLY REDIRECTED FROM USPS WITNESS PLUNKETT) (July 26, 2004)

Bank One Corporation ("Bank One") hereby submits the answer of its witness Lawrence G. Buc to Office of Consumer Advocate interrogatory OCA-USPS-T1-24 (filed July 22, 2004), as partially redirected from USPS witness Michael Plunkett. The interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

/s/

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August 2, 2004

**RESPONSE OF BANK ONE WITNESS BUC
TO OCA INTERROGATORY OCA-USPS-T1-24
(PARTIALLY REDIRECTED FROM USPS WITNESS PLUNKETT)**

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.

ANSWER TO OCA-USPS-T1-24:

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 over which Bank One appears to have significant discretion over volume—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 generated by the discounts. *See* response of USPS witness Michael Plunkett to Presiding Officer's information Request No. 1, Question 7 (filed July 26, 2004).

Second, 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).

Third, the proponents of the NSA in this case have submitted a far 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, my testimony provides a 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, I show that the proposed discount blocks will, under an extraordinarily robust range of assumptions, elicit enough additional First Class volume to generate an enormous positive contribution to the Postal Service. Buc Direct (BOC-T-2).

Fourth, the record shows that a "stop-loss" provision (i.e., cap on the total discounts available to Bank One) 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. To document this fact, I attach an analysis, based on the model presented in my direct 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 over $8 million per year—or approximately $25 million over the three year term of the NSA. And there is a ten percent chance that the lost contribution to institutional costs could exceed $12.5 million per year, or nearly $37.5 million over the three-year term of the NSA. *See* Attachment OCA-USPS-T1-24 (Excel spreadsheet).

As the Commission is aware, my direct testimony includes a Monte Carlo analysis of the amount of mail that could switch from Standard Mail to First-Class Mail under a broad set of assumptions. The same model can also be used to show the potentially "switched" volumes for each decile in my Monte Carlo analysis. One can calculate the contribution from the switched volume, as well as the net contribution after considering the incentive necessary to induce that switch. The analysis shows that, although annual losses in contribution resulting from a cap would be relatively modest at the 10th percentile volume estimate—about $0.6 million annually—they would increase to $8.3 million annually at the 20th percentile estimate, and $12.5 million at the 90th percentile estimate:

Effect of $2.5 million annual cap on total discounts offered under Bank One NSA	
Foregone annual contribution to USPS institutional costs	**Probability of Occurrence**
$8,297,435	80%
$9,416,975	70%
$9,821,916	60%
$10,183,998	50%
$10,553,403	40%
$11,140,696	30%
$11,604,061	20%
$12,469,210	10%

Source: Attachment OCA-USPS-T1-24.

Fifth, 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. Very few (if any) other banks currently send enough First-Class Mail 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.

BANK ONE ANNUAL CONTRIBUTION FROM NEW VOLUME SENSITIVITY ANALYSIS

I. INPUT DATA

ROW	DESCRIPTION	VALUE	SOURCE
1	Annual Before Rates Volumes	571,080,000	USPS-T-1, Appendix A, page 2
2	Contribution Per Piece -- First-Class Mail Marketing Letter	$ 0.166	USPS-T-1, Appendix A, Year 1, page 10
3	Contribution Per Piece -- Standard Mail Letter	$ 0.093	USPS-T-1, Appendix A, Year 1, page 10

II. VOLUME BLOCKS

Source: Docket No. MC2004-3 Request For Recommended Decision, Attachment F, page 4

ROW	FROM	TO	DISCOUNT		CUMULATIVE DISCOUNTS
4	535,000,001	560,000,000	$ 0.025	per piece	625,000
5	560,000,001	585,000,000	$ 0.030	per piece	1,375,000
6	585,000,001	610,000,000	$ 0.035	per piece	2,250,000
7	610,000,001	645,000,000	$ 0.040	per piece	3,650,000
8	645,000,001	680,000,000	$ 0.045	per piece	5,225,000
9	680,000,001	and above	$ 0.050	per piece	n/a

III. SENSITIVITY ANALYSIS USING MONTE CARLO SIMULATION PERCENTILES

	col. 1	col. 2	col. 3	col. 4	col. 5	col. 6	col. 7
ROW	PERCENTILE	VOLUME SWITCH	AFTER RATES VOLUME	EARNED DISCOUNT	CONTRIBUTION FROM VOLUME SWITCH	INCREASE IN CONTRIBUTION	NET LOSS DUE TO CAP
10	10%	64,212,441	635,292,441	$ 3,261,698	$ 4,687,508	$ 1,425,811	$ 628,401
11	20%	385,819,339	956,899,339	$ 19,069,967	$ 28,164,812	$ 9,094,845	$ 8,297,435
12	30%	434,494,982	1,005,574,982	$ 21,503,749	$ 31,718,134	$ 10,214,385	$ 9,416,975
13	40%	452,101,126	1,023,181,126	$ 22,384,056	$ 33,003,382	$ 10,619,326	$ 9,821,916
14	50%	467,843,824	1,038,923,824	$ 23,171,191	$ 34,152,599	$ 10,981,408	$ 10,183,998
15	60%	483,904,930	1,054,984,930	$ 23,974,247	$ 35,325,060	$ 11,350,813	$ 10,553,403
16	70%	509,439,387	1,080,519,387	$ 25,250,969	$ 37,189,075	$ 11,938,106	$ 11,140,696
17	80%	529,585,693	1,100,665,693	$ 26,258,285	$ 38,659,756	$ 12,401,471	$ 11,604,061
18	90%	567,200,871	1,138,280,871	$ 28,139,044	$ 41,405,664	$ 13,266,620	$ 12,469,210
19	100%	753,451,075	1,324,531,075	$ 37,451,554	$ 55,001,929	$ 17,550,375	$ 16,752,965
20							
21	Discount cap of $2.5 million		616,250,000	$ 2,500,000	3,297,410	$ 797,410	

Notes:

- Col 1 BOC-T-2, Buc Direct--Att. 3.xls, page 2
- Col 2 BOC-T-2, Buc Direct--Att. 3.xls, page 2
- Col 3 = col 2 + row 1
- Col 4 Calculation based upon volume blocks and incremental discounts
- Col 5 = col 2 * (row 2 - row 3)
- Col 6 = col 5 - col 4

CERTIFICATE OF SERVICE

I hereby certify that I have today caused the foregoing document to be served in accordance with Section 12 of the Commission's Rules of Practice

/s/

David M. Levy

August 2, 2004