

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

RATE AND SERVICE CHANGES TO IMPLEMENT  
FUNCTIONALLY EQUIVALENT NEGOTIATED  
SERVICE AGREEMENT WITH DISCOVER  
FINANCIAL SERVICES, INC.

Docket No. MC2004-4

UNITED STATES POSTAL SERVICE NOTICE OF SECOND ERRATA TO  
DIRECT TESTIMONY OF ALI AYUB (ERRATA)  
(September 3, 2004)

The United States Postal Service hereby provides notice that it is filing a second set of errata to witness Ayub's testimony. Two revised pages are attached for inclusion in the text of witness Ayub's Testimony, as well as one revised page in Appendix A and two revised pages in Appendix B.

In the first errata, filed on September 2, 2004, revisions to Appendix A were prompted by the Presiding Officer Information Requests, No. 4 and 5, in Docket No. MC2004-3, and are described in that notice.

The changes filed with this errata all reflect the changes that were made to Appendix A on September 2, 2004. On page 12 of witness Ayub's testimony, the estimated value of the agreement has been revised to reflect the changes in Appendix A. On page 17 of the testimony, the estimated value of a hypothetical example has been revised in a similar fashion. As to page 10 of Appendix A, a pdf copy is being filed herein of changes that were made in the spreadsheets on September 2, 2004, which should have been included in that earlier filing. On

pages 5 and 6 of Appendix B, sentences have been added to clarify when the contingency is applied.

Respectfully submitted,  
UNITED STATES POSTAL SERVICE

By its attorneys:

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1 Eakin, setting a threshold below forecast volume is economically efficient because it  
2 reduces the mailer's marginal price of First-Class Mail relative to other forms of  
3 solicitation, and reduces the gap between marginal price and marginal cost of the  
4 mailer's First-Class Mail. (MC2002-2,USPS-RT-2 at 4-5, Tr. 10/2069-70).

5 I estimate the value to the Postal Service of the DFS agreement, when  
6 considering all three value drivers, over the three years of the NSA, as follows:

7 ACS Cost savings:	\$8.2 million
8 Increased contribution (less incremental discounts):	\$2.1 million
9 Discount exposure:	(\$3.2) million

10

11 The agreement therefore would result in net benefit to the Postal Service of \$7.1 million  
12 over the life of the NSA. A detailed analysis of the financial impact is provided in  
13 Appendix A.

#### 14 **B. Financial Model**

15 I believe that the analysis provided in the valuation model of the Discover NSA  
16 complies with the guidelines established by the Commission in Rule 193(e). The model  
17 follows witness Crum's methodology in Docket No. MC2002-2, except in instances  
18 where a change allows it to conform more closely to the requirements of Rule 193(e).  
19 The features of the model are described below; the model is in Appendix A and any  
20 changes relative to the Capital One model are discussed in Appendix B.

21 In order to comply with Rule 193(e)(2), the Postal Service and Discover have  
22 provided more data than in Docket No. MC2002-2 in order to present a more  
23 representative estimate of the cost and volume effects of the NSA in Years 2 and 3 of

1 in exposure, the NSA would be contribution-positive because of ACS savings. Under  
2 the situation described above, the Postal Service would have underestimated the  
3 savings from ACS and, in absolute terms, the savings at 209 million marketing pieces  
4 would have been \$11.0 million (as opposed to the \$8.2 million presented above in  
5 Financial Impacts, part A). This means that the NSA would still generate \$2.8 million in  
6 additional contribution for the Postal Service.

7 Accordingly, a cap could actually cause harm because it would limit the upside  
8 potential of the NSA. As discussed previously, the Discover forecasts are conservative,  
9 and it is quite possible that the incremental volume may be higher than predicted. A  
10 cap would obviate this possibility.

## 11 **VII PROPOSED PRICES ARE CONSISTENT WITH THE CRITERIA OF THE ACT**

12 Title 39, Section 3623 requires that the Commission evaluate proposed changes  
13 in the classification schedule in accordance with the policies of the Title and the  
14 following factors:

- 15 1. the establishment and maintenance of a fair and equitable classification  
16 system for all mail;
- 17 2. the relative value to the people of the kinds of mail matter entered into the  
18 postal system and the desirability and justification for special classifications  
19 and services of mail;
- 20 3. the importance of providing classifications with extremely high degrees of  
21 reliability and speed of delivery;
- 22 4. the importance of providing classifications which do not require an extremely  
23 high degree of reliability and speed of delivery;
- 24 5. the desirability of special classifications from the point of view of both the user  
25 and of the Postal Service; and
- 26 6. such other factors as the Commission may deem appropriate.

27  
28 Section 3622(b) requires that postal rates and fees reflect the policies of the  
29 Postal Reorganization Act, and accord with the following factors:

- 30 1. the establishment and maintenance of a fair and equitable schedule;

## Discover Model

### Negotiated Service Agreement

#### Appendix A, page 10

	(13)	(14)
Year 1	Year 2	Year 3

#### First Class Letter

(1) Avg Revenue First-Class Letters	0.292	0.292	0.292
(2) First-Class Statement Letter cost per Piece Before Rates	0.112	0.116	0.121
(3) First-Class Statement Letter cost per Piece After Rates	0.112	0.116	0.121
(4) First-Class Statement Letter avg. Contribution Before Rates	0.181	0.176	0.172
(5) First-Class Statement Letter avg. Contribution After Rates	0.181	0.176	0.172
(6) First-Class Marketing Letter cost per Piece Before Rates	0.154	0.160	0.167
(7) First-Class Marketing Letter cost per Piece After Rates	0.137	0.143	0.148
(8) First-Class Marketing Letter avg. Contribution Before Rates	0.138	0.132	0.126
(9) First-Class Marketing Letter avg. Contribution After Rates	0.155	0.150	0.144

#### Standard Mail

(10) Standard Revenue per Piece	0.175	0.175	0.175
(11) Standard Cost per Piece	0.085	0.088	0.091
(12) Standard Letter Contribution per Piece	0.091	0.088	0.084

- (1) Revenue per piece (FCM rev calc)
- (2) CurrentTotal Unit Cost Estimates, Including Contingency (Stmt unit cost)
- (3) After Rates Total Unit Cost Estimates, Including Contingency (Stmt unit cost)
- (4) (1) - (2)
- (5) (1) - (3)
- (6) CurrentTotal Unit Cost Estimates, Including Contingency (Mktg unit cost)
- (7) After Rates Total Unit Cost Estimates, Including Contingency (Mktg unit cost)
- (8) (1) - (6)
- (9) (1) - (7)
- (10) Average Revenue per Piece (SM rev calcs)
- (11) Average Cost per Piece (SM cost calcs)
- (12) Standard Revenue - Standard Cost
- (13) Year 1 \* Inflation cost adjustment factor Year 2 (Assumptions)
- (14) Year 2 \* Inflation cost adjustment factor Year 3 (Assumptions)

1

**2 UAA Calculations**

3 In lieu of receiving physical returns, DFS will accept electronic diversion of  
4 address changes or corrections, as Capital One does. This results in cost savings to  
5 the Postal Service by replacing costly physical returns with the less costly transmission  
6 of electronic information. The estimated Capital One physical and electronic return unit  
7 costs described in USPS-LR-1/MC2002-2 will be used in the DFS model. The total  
8 return costs savings vary from the Capital One model because of the different marketing  
9 mail volumes, and return rate forecasts (9.3 percent for marketing mail letters).

10 To calculate the cost savings, multiply the expected volume of Discover's UAA  
11 mail times unit costs savings for each piece processed through the ACS times the  
12 percentage of Discover's UAA mail that will be processed. The calculation relies upon  
13 the evidence in MC2002-2 for 1) the percentage of Discover's UAA mail that will be  
14 processed through the ACS system (85%) and 2) the unit savings for each UAA piece  
15 processed through the ACS system. The contingency is not applied until page 11.

16

**17 Standard Mail Revenue Calculations and Standard Mail Cost Calculations**

18 The Standard Mail Regular and Enhanced Carrier Route (ECR) Revenues are  
19 based on the Standard Mail Regular and ECR Billing Determinants of DFS. The  
20 revenue per piece for both Regular and ECR is a weighted average of the revenue per  
21 piece and DFS volume. The Standard Regular and ECR unit costs are based on  
22 Docket No. R2001-1 for TY 2003 unit costs (Docket No. R2001-1, USPS LR-J-58).  
23 These data are based on the USPS version of the cost models, due to the fact that a

1 PRC-version is not available for some of the data. Specifically, the total unit costs of  
2 Standard letters and Standard ECR letters are needed for this analysis. These data are  
3 found in the USPS Weight Study (Docket No. R2001-1 USPS LR-J-58), and there is no  
4 PRC version of this document. The format for 2004 unit costs follows the First-Class  
5 Mail unit cost estimates on pages 4 and 5. This provides the customer-specific revenue  
6 and cost data on DFS' Standard Mail. The standard mail cost is adjusted by the  
7 contingency, as was the First-Class Mail cost.

8

### 9 **Contribution Inputs**

10 The Contribution Inputs calculate the contribution per piece of DFS' operational  
11 mail and marketing mail letters. This per piece calculation provides the Postal Service  
12 with before and after rates revenue, cost, and contribution for First-Class Mail and  
13 Standard Mail on a customer-specific basis. It also allows for forecasting future  
14 contribution per piece in the out-years of the agreement by allowing the inflationary  
15 growth to be multiplied by the cost of each subclass. Unit revenue remains constant  
16 over the three-year agreement.

### 17 **USPS Value**

18 The total USPS value looks at the value determinants, less the discount and  
19 exposure associated with the declining block rate structure. "Contribution from New  
20 Volume" is any volume above the before rates forecast multiplied by the difference  
21 between the First-Class Mail and Standard Mail estimated contributions. This is so  
22 because Discover indicates that all of its new First-Class Mail volume will be switched  
23 from Standard Mail (100% conversion). (DFS-T-1 at 11).

## **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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September 3, 2004