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

**EXPERIMENTAL CHANGES TO
IMPLEMENT CAPITAL ONE NSA**

DOCKET No. MC2002-2

**DIRECT TESTIMONY
OF
DONALD JEAN
ON BEHALF OF
CAPITAL ONE SERVICES, INC**

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Counsel for Capital One Services, Inc.

September 19, 2002

1 **INTRODUCTION**

2 My name is Donald Jean, Senior Vice President of Capital One Services, Inc. (Capital One). I
3 earned two degrees from the University of Michigan: Bachelor of Arts in Economics in 1987 and
4 Masters in Business Administration in 1990. Since 1990, I have worked in the credit card
5 industry, both at American Express and Capital One. My team is responsible for the procurement
6 of goods and services, including mailing services, that support Capital One's business.

7
8 The purpose of my testimony is to provide descriptions of Capital One's mailing practices, some
9 of the factors that influence our choice of mail products and other marketing media, forecasts of
10 Capital One mail volume for the Test Year, before and after rates, and the benefits to Capital
11 One and other postal stakeholders that would flow from the implementation of the Service
12 Agreement Capital One has negotiated with USPS.

13
14 Capital One is the country's sixth-largest credit card issuer. The dollar value of managed loans
15 has more than quadrupled since 1995, as have our earnings. In that time frame, Capital One has
16 become one of the country's largest consumer franchises, with nearly 50 million accounts, and
17 has been cited nationally for its innovative information technology strategies. Capital One also is
18 perennially on Fortune magazine's Top 100 Places to Work in the U.S.

19 Capital One entered into discussions with the Postal Service regarding a potential customized
20 agreement in hopes of finding a mutually-beneficial arrangement that would help reduce costs
21 and motivate growth. Capital One believes the proposal that has been filed with the Commission
22 offers such an opportunity, as it will reduce the Postal Service's costs in handling undeliverable
23 mail and help the company continue to mail large volumes of First-Class Mail.

1 **I. MAIL PLAYS A VITAL ROLE IN CAPITAL ONE’S MARKETING**

2 Mail reaches all consumer segments in the U.S., regardless of demographic, socioeconomic, or
3 credit class. Using direct mail to deliver messages directly to people who demonstrate credit-
4 worthiness has been at the heart of Capital One’s success. Unlike most direct marketers, who
5 rely primarily on Standard Mail, Capital One has found value in using a combination of First-
6 Class Mail and Standard Mail to better target those credit-worthy consumers. This is, in part,
7 due to the higher level of service provided by First-Class Mail (including speed of delivery,
8 provision of forwarding service, and return of undeliverable mail). In fact, I understand that
9 Capital One is now the top originator of First-Class Mail in the U.S.

10 Capital One utilizes direct mail, along with telemarketing and the Internet, for its direct
11 marketing. Direct mail has played a key role in the success of our business by allowing us the
12 opportunity to quickly and relatively inexpensively test and customize different marketing
13 approaches, capture information about consumer reaction to these approaches, and test
14 innovations in marketing. Rather than “one size fits all” marketing, Capital One has been able to
15 develop what we call “mass customization,” which allows us to provide the right financial
16 services and products to the right customer at the right time and at the right price.

17

18 **II. STRATEGY BEHIND DIRECT MAIL CAMPAIGNS**

19 Capital One continually monitors competitive and market conditions in order to take advantage
20 of potential opportunities. Then, the company employs proprietary risk and response models and
21 analyses to determine to whom it will send marketing offers.

1 **A. Benefits of First-Class Mail**

2 Price, forwarding, and return mail information for First-Class Mail are three of the key factors
3 that help Capital One determine which class of mail to use for a given marketing campaign. Due
4 to the fact that the American public is increasingly mobile, First-Class Mail's forwarding feature
5 can be of great benefit to our business. In addition, speed to market is an important consideration
6 in many campaigns. Consequently, for some of our marketing campaigns, First-Class Mail is the
7 appropriate channel. Return mail information also enhances the effectiveness of our future
8 marketing campaigns.

9 In recent years, Capital One has generally been moving its solicitation volume from First-Class
10 Mail to Standard Mail. Due to the unique market and environmental conditions in the post-9/11
11 period, including the anthrax attacks, Capital One utilized First-Class Mail more heavily in the
12 fourth quarter of calendar year 2001 and the first quarter of calendar year 2002. Capital One has
13 since returned to its historical mailing patterns, which place less emphasis on First-Class Mail.

14 This return to baseline is confirmed by Capital One's recent announcements regarding its
15 strategic emphases in the coming months, which highlight the fact that Q4 2001 and Q1 2002
16 represented a unique, one-time opportunity.

17 **B. The Proposed Agreement Holds the Potential for Greater First-Class Mail Volume**

18 Because price is only one of the factors in the mail channel decision, we don't believe the
19 proposed discounts will cause Capital One to significantly switch our Standard Mail solicitations
20 to First-Class Mail. However, postage is one of the inputs into our models for determining to
21 whom we should send a particular solicitation. While the company has not developed specific
22 mailing plans utilizing the proposed discount structure, we are aware of a price elasticity study

1 performed by SLS Consulting indicating a volume response to the proposed agreement between
2 15 and 53 million pieces annually. The company believes that this range is reasonable if all
3 other factors in the mailing decision are controlled. The use of First-Class Mail and Standard
4 Mail price elasticities to define the range seems reasonable given that Capital One uses First-
5 Class Mail and Standard Mail for similar marketing purposes.

6 **III. FIRST-CLASS MAIL IS USED TO COMMUNICATE WITH EXISTING**
7 **CUSTOMERS**

8 The company also makes extensive use of First-Class Mail in its communications with existing
9 customers (statements, letters, etc.). Capital One expects account growth to slow somewhat,
10 which will moderate growth in First-Class Mail statement/letter volume. Capital One is also
11 actively pursuing the use of electronic statements. Currently, a small portion of our statements
12 are presented electronically to customers. The company expects this to increase over the course
13 of this agreement, and has set an aggressive target of 25% electronic statements by the end of
14 2005. Based upon all of these factors, we expect non-solicitation mail volume, in the absence of
15 this agreement, in fiscal 2003 to remain at approximately 2002 levels (640 million pieces).

16 **IV. CAPITAL ONE PROJECTS THAT IT WILL MAIL APPROXIMATELY 1.4**
17 **BILLION PIECES OF FIRST-CLASS MAIL IN FY 2003**

18 For the above reasons, in the absence of the proposed agreement, Capital One expects to mail
19 approximately 1.4 billion pieces of First-Class Mail in FY 2003, higher than our current First-
20 Class Mail volumes, but significantly lower than the one-time peak levels reached in the 4th
21 Quarter of calendar year 2001 and 1st Quarter of calendar year 2002. As discussed above, price
22 elasticity models performed by SLS Consulting indicate that, controlling for all other factors, the
23 proposed agreement could cut this projected decrease in First-Class Mail volume by 15 to 53
24 million pieces.

Table 1. Projection of FY 2003 Pre-NSA Mail Volume

Type	First-Class Mail
Solicitation Mail	768,000,000
Non-Solicitation Mail	640,000,000
Total	1,408,000,000

Table 1 summarizes our FY 2003 “Before Rates” forecast. While Capital One does not typically forecast solicitation volumes in detail more than 6 months into the future, we developed this forecast in the same way that we typically develop forecasts of solicitation volumes for planning purposes. This is done by asking business managers to provide estimates of their anticipated volumes.

V. CAPITAL ONE EXCEEDS POSTAL REQUIREMENTS FOR ADDRESS HYGIENE, AND ADOPTION OF AGREEMENT WILL GREATLY REDUCE PHYSICAL RETURNS

Capital One meets or exceeds postal requirements regarding address hygiene because, quite simply, doing so saves us money. Currently, Capital One runs National Change of Address on existing customer files every 30 days, and complies with all Postal Service address hygiene requirements. Solicitation mail address hygiene processing (typically around 60 days prior to mailing) exceeds the Postal Service’s requirement of 180 days. An additional indicator of Capital One’s mailpiece quality is its Richmond production site’s certification under the Mail Preparation Total Quality Management (MPTQM) program, the first U.S. list mailer to accomplish this. Under the agreement, Capital One is committing to maintain all above practices and will additionally seek MPTQM certification of its Seattle production site.

1 Due to our efforts, we believe that Capital One address databases are at least as accurate as those
2 of other marketers who utilize First-Class Mail to offer a full range of financial products.

3 Despite our significant efforts to ensure high address quality, some of our First-Class Mail pieces
4 must be returned. For non-solicitation First-Class Mail, including statements and letters, 1.2
5 percent are returned. For First-Class Mail solicitations, approximately 6-12 percent are returned,
6 depending on marketing campaign. In 2001, approximately 9.8 percent were returned. In 2002,
7 approximately 9.6 percent have been returned. While the company does not forecast return mail
8 rates, we expect return rates to be similar in the Test Year of this agreement, although, for
9 reasons discussed below, we hope that this agreement will contribute to improved return rates.

10 Currently, the Postal Service is obligated to physically return undeliverable First-Class Mail. In
11 addition to costing the Postal Service a significant amount of money, for Capital One this process
12 can take weeks and thereby limits our ability to use this information to improve our address
13 database.

14 The new process for transmitting return mail data electronically will improve timeliness, and we
15 expect the improved information to increase the quality of our address database and reduce our
16 return rate, due to enhanced address suppression on subsequent mailings. By relieving the Postal
17 Service of its obligation to physically return undeliverable mail, this agreement will also
18 substantially reduce postal costs.

19 Other requirements of the Agreement should improve the quality of Capital One addresses even
20 further. Capital One's obligations under the Agreement include several address quality
21 requirements that are greater than what is required of similarly-situated mailers. The Agreement
22 requires Capital One to implement or maintain the following procedures not required of other

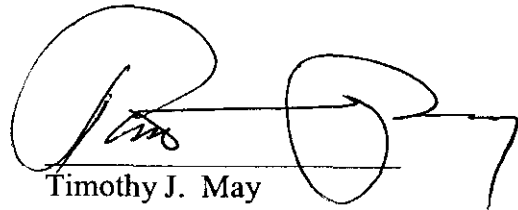
1 mailers: maintain MPTQM in its Richmond site, achieve MPTQM certification at its Seattle site,
2 cleanse address databases for its existing customers not more than 30 days prior to mailing,
3 cleanse solicitation address files no more than 60 days prior to mailing, and utilize electronic
4 Address Correction Service information in its marketing campaigns.

5 **VI. CONCLUSION**

6 This Agreement offers the potential for greater volume of First-Class Mail (through growth and
7 decreased attrition), which contributes to institutional costs at a far greater rate than Standard
8 Mail. Incremental First-Class Mail marketing volume has a multiplier effect by creating Business
9 Reply Mail and subsequent First-Class Mail statements and correspondence. This Agreement
10 will also make Capital One and the Postal Service more efficient and reduce costs.

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.



Timothy J. May

Dated: September 19, 2002