

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

EXPERIMENTAL RATE AND SERVICE CHANGES
TO IMPLEMENT NEGOTIATED SERVICE AGREEMENT
WITH CAPITAL ONE SERVICES, INC.

Docket No. MC2002-2

RESPONSE OF UNITED STATES POSTAL SERVICE TO INTERROGATORY OF THE
OFFICE OF THE CONSUMER ADVOCATE, REDIRECTED FROM WITNESS CRUM
(OCA/USPS-T3-14)

The United States Postal Service hereby provides the responses of witness
Crum to the following interrogatories of Office of the Consumer Advocate: OCA/USPS-
T3-14, filed on October 25, 2002. This interrogatory was redirected from witness Crum.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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OCA/USPS-T3-14. Please refer to pages 1-2, "Background," of your prefiled testimony. Please explain the relationship, if any, between the NSA's provisions for address correction savings and the NSA's provisions for volume-related discounts. In your response, describe and quantify the rate relationship if any between the NSA's proposed volume discounts and postal cost savings associated with address correction changes.

RESPONSE:

There is no quantifiable rate relationship between the address element cost savings of the Capital One NSA and the volume discount element, as the question suggests. However, the linkage of the elements within the NSA makes good economic and business sense for the Postal Service, Capital One, and all mailers.

The current heightened interest in NSA's as a pricing approach arises from a business and economic environment in which the Postal Service faces unprecedented challenges to its ability to maintain levels of volume and revenue from all services for the benefit of all mailers. Particularized arrangements with customers are seen in many industries, not just the Postal Service, as one way to maintain and promote growth during the adverse economic conditions currently faced by all businesses, as well as by their customers.

In this respect, Capital One is, and has been, a high-volume First-Class Mail user that has shown both a willingness and ability to capitalize on the particular advantages of First-Class Mail service for its own business model. In fact, this past fiscal year, Capital One's mail volumes have increased beyond Postal Service expectations. This has occurred at a time when First-Class Mail volume -- as well as mail volume for almost all other classifications -- declined or was stagnant at best. In this context, the Postal Service regards the Capital One NSA as presenting a unique opportunity to

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experiment with measures that could influence increased volume and contribution for the benefit of all mailers. Particularly, the Postal Service cannot take for granted that Capital One will continue to grow at previous rates, or even remain at its historically high volume levels. The Capital One NSA would create conditions favoring volume and revenue growth by meeting Capital One's relatively distinct needs as a user of First-Class Mail, while resulting in reduced costs and more efficient Postal Service operations.

With this as a backdrop, the Postal Service worked to develop an agreement with Capital One that encompassed more than the reduction of physical returns of undeliverable mail, and that created an incentive package encouraging Capital One both to continue its high level of mail usage, and to contribute additional mail volume growth. The proposed rate incentives evolved out of this effort. Perhaps the Postal Service could have proposed providing Capital One some type of fee incentive only for using electronic address correction service, in lieu of physical returns. However, it determined that it could accomplish more by constructing a proposal that would combine addressing and operational advantages to both Capital One and the Postal Service, with volume incentives linked to the successful implementation of the address correction element of the agreement.

The proposed Negotiated Service Agreement thus ties the address-related savings to volume incentives in a way that provides some insurance or offset to the risk that would be presented by the declining block approach to volume discounts, had it been offered independently. In this respect, while there is no quantifiable rate

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relationship between the address correction element of the agreement and the volume discounts, the two are logically related as part of the overall strategy and benefits of the NSA. In other words, unbundling the arrangement into its component parts would eliminate the incentive to maintain or increase volume, and would potentially allow Capital One to use any financial benefits from the proposed NSA, as a result of improving Capital One's operations and business, to fund non-mail activities that might not make an additional contribution to Postal Service institutional costs.

As indicated in the testimony of witness Crum, the Postal Service evaluated the net contribution change from the proposed NSA in its entirety in determining whether to enter into the agreement. The address management terms, including those related to address correction, are intertwined with the declining block discounts in a number of ways and are only available if Capital One complies with the address management terms. For example, the company's use of ACS for its solicitation mail determines whether mail will be counted towards the threshold for the discounts, or if it will be eligible to receive an additional discount.

The Postal Service acknowledges that this agreement does not "fit" the standard worksharing/cost avoidance/discount mold that underlies the more familiar presortation, automation, and dropshipment discounts. However, this agreement does present a customer-responsive approach to postal ratemaking that provides a new opportunity to increase contribution to the institutional costs of the Postal Service. Ignoring these possibilities would limit the Postal Service's ability to be more responsive to its

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customers' needs, and to develop opportunities that could help maintain the Postal Service's financial viability in a rapidly evolving market place.

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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