

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
WITNESS CRUM TO PRESIDING OFFICER'S
INFORMATION REQUEST No. 2, QUESTION 7
(POIR-2, Q7)
November 21, 2002

The United States Postal Service hereby provides the response of witness Crum's response to Presiding Officer's Information Request No. 2, question 7, issued on November 8, 2002. The question is stated verbatim, followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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POIR-2, Q7: Under the terms of the NSA, the Postal Service will provide electronic address correction information for Capital One's First-Class solicitations that are forwarded under CSR option 2. In the response to NAA/USPS-T3-11 witness Crum provides an estimate of 6.6 cents for the cost of providing electronic address correction information for one forwarded piece of First-Class [M]ail. Witness Crum goes on to assert that the costs of notification "would likely be more than offset by the cost savings accruing to the Postal Service from the reduction of forwarded Capital One mail."

- (a) Please provide the estimate of the Postal Service's *total* (as opposed to unit) TYAR cost of providing electronic address correction information to Capital One for forwarded First-Class solicitation mail upon which witness Crum's assertion is based. If no quantitative estimate is available, please develop one. Please show all calculations and explain any assumptions.
- (b) Please provide the estimate of *total* TYAR savings from the reduction of forwarded mail upon which witness Crum's assertion is based. If no quantitative estimate is available, please develop one. Please show all calculations and explain any assumptions.

RESPONSE:

Estimating the total costs of providing electronic address correction to Capital One and the total savings from avoided forwarding requires a number of simplifying assumptions. By choosing conservative assumptions, I can explain why I believe the savings will more than offset the costs. The starting point is an estimate of the volume of Capital One solicitation mail that would be forwarded without the Capital One NSA. Currently, no means for estimating Capital One's own forwarding ratio is known.

Development of a TYAR estimate accordingly begins with application of the First-Class Mail forwarding percentage of 1.96 percent (response to APWU/USPS-T3-4(e)) to the portion of Capital One's volume that would be forwarded through CFS units. This calculation embeds two assumptions, the first

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of which is conservative and the other of which has no alternatives. First, witness Wilson expects that Capital One's forwarding rate is equal to or less than the First-Class Mail average (see the response to APWU/USPS-T2-8), so the 1.96 percent is conservative. Second, the only available estimate for the percentage of UAA mail that is directed to CFS units, 85 percent, is witness Wilson's estimate of the proportion of ACS-endorsed mail sent to CFS units. USPS-T-4, at 7.

Thus the theoretical maximum number of pieces forwarded through CFS units for Capital One First-Class Mail solicitations would be: number of test year solicitations multiplied by both the average forwarding rate and the percentage handled by CFS units ($768,000,000 * 0.0196 * 0.85 = 12,794,880$ pieces).

This estimate is too high for the test year, after rates, because it fails to account for the fact that pursuant to the NSA, Capital One receives corrected address information frequently and must act on it almost immediately (within two days). Capital One's forwarding rate should accordingly decline substantially during the test year. Capital One now has a comparatively high rate of repeat forwards, so each electronic notice is likely to save multiple forwards from the same address, thus reducing the forwarding rate in the test year.

The next step is to develop a TYAR, or "after NSA", estimate that accounts for the impact of Capital One's incorporation into mailing lists of electronic address corrections. This can be accomplished by projecting Capital One's annual solicitation volume over the number of domestic delivery points and making a few more assumptions.

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Witness Elliot's estimate of 768 million solicitations in the test year (COS-T-2, Exhibit 1) projected to 137,682,000 domestic delivery points (Postal Service 2001 Annual Report) implies an average of 5.6 (or 5.578071208) pieces per delivery point. While Capital One does not actually mail to all domestic delivery points in a given year, use of this assumption constitutes a conservative approach because this number would be higher if Capital One mails only to, for example, two thirds of such delivery points.

Based on the 5.6 pieces per delivery point, the 12,794,880 Capital One mailpieces that would have been forwarded in the test year, would go to 2,293,782 delivery points ($12,794,880 / 5.578071208 = 2,293,782$). At a cost of \$0.066 per electronic notice, the TYAR cost of providing each of these delivery points one notice would be \$151,390 ($2,293,782 * 0.066 = 151,389.61$). If, for purposes of being conservative, one were to assume that two electronic notices were sent before the first was made effective in Capital One's address list, this number would double to \$302,779 ($2 * 151,389.61 = 302,779.22$). Or, for still greater conservatism, one could assume that all but one piece per address would generate an electronic notice, and only one electronic address correction would be avoided; the TYAR cost would be \$696,392 ($(5.6 - 1) * 151,389.61 = 696392.21$).

A similar set of assumptions can also be made to develop estimates of avoided forwarding costs. On average, forwarding a mailpiece costs the Postal Service \$0.307 per piece. Table 5.1.1 of USPS-LR-J-69/R2001-1. If the first electronic address correction notice is effective in precluding further forwarding,

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the avoided cost would equal \$3,23,837 $((12,794,880 - 2,293,782) * 0.307 = 3,223,837)$. Offset by the \$151,390 cost of providing the one address correction notice would yield a net cost avoidance of \$3,072,447 $(3,223,837 - 151,390 = 3,072,447)$.

If two electronic notices were required for each delivery point before forwarding costs were avoided, the TYAR avoided costs would equal \$2,519,646 $((12,794,880 - (2 * 2,293,782)) * 0.307 = 2,519,646)$. The cost of electronic address correction would be \$302,780 (from above). The net avoidance would then be \$2,216,866 $(2,519,646 - 302,780 = 2,216,866)$.

Finally, if one makes the exceptionally conservative assumption that the forwarding of only one mailpiece per delivery point with an active forwarding order is avoided, the avoided cost is \$704,191 $(2,293,782 * 0.307 = 704,191)$. The cost of electronic address correction notices would be \$696,392 (from above). Only by making a variety of conservative – even ridiculous – assumptions can one get the costs of providing electronic address corrections to Capital One to approximate the avoided costs. However, by its own terms, the Capital One NSA precludes this occurrence since the required address updating would be inconsistent with over four electronic notices to one delivery point.

The waiver of ACS fees is specifically conditioned on Capital One updating its address list(s) within two days. Agreement, section II(C). So if no forwarding savings were realized and 12,794,880 electronic address correction notices were provided to Capital One at an estimated cost of \$0.066 each, the

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\$844,462 in electronic address correction costs would be offset by \$2,588,976 in address correction fees ($12,794,880 * 0.20 = 2,588,976$).

This discussion explains why, in response to NAA/USPS-T3-11, I stated that the costs of notification would likely be more than offset by the cost savings from avoided forwarding. Finally, as I have added here, if the cost of notification approaches the cost savings from avoided forwarding, the terms of the Agreement require payment of address correction service fees which will preserve for the Postal Service a net positive outcome.

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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