

UNITED STATES OF AMERICA  
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

ANSWERS OF  
OFFICE OF CONSUMER ADVOCATE  
WITNESS: J. EDWARD SMITH TO INTERROGATORIES OF  
CAPITAL ONE SERVICES INC. (COS/OCA-T1-13-22)  
(January 21, 2003)

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The Office of the Consumer Advocate hereby submits the answers of J. Edward Smith to interrogatories COS/OCA-T1-13-22 of Capital One Services Inc., dated January 8, 2003. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

OFFICE OF THE CONSUMER ADVOCATE

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ANSWERS OF OCA WITNESS J. EDWARD SMITH  
TO INTERROGATORIES COS/OCA-T1-13-22

COS/OCA-T1-13. Please refer to your response to COS/OCA-T1-2(a) where you state, "Also, implicit in the procedure is that Capital One's Solicitation mail is not different from that of other workshared First-Class mail. This appears to be an unrealistic assumption in terms of Capital One's Solicitation mail and the Solicitation mail of other organizations." Please describe in what ways you believe Capital One's Solicitation mail is different than First-Class Solicitation mail sent by other organizations.

RESPONSE TO COS/OCA-T1-13.

The quality of the mailing list, the use of customer segmentation, and the total volume of Solicitation mail could result in Capital One's work-shared First-Class Solicitation mail being different from work-shared First-Class Solicitation mail sent by other organizations. The quality of the mailing list could impact the amount of UAA mail generated by the mailing, the number of potential customers reached per mailing, the speed with which customers are reached, and ultimately the response rates per thousand pieces. The use of customer segmentation could impact message content and customer response rates. Response rates can range from very low to 5% or more, depending on message, segmentation, and product. The volume of mail and how it is split between First-Class and Standard Mail could also be expected to be related to UAA, segmentation, and marketing strategy issues.

ANSWERS OF OCA WITNESS J. EDWARD SMITH  
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COS/OCA-T1-14. Do you believe that the own-price elasticity for solicitation mail in total is higher than or lower than the own-price elasticity of billing and customer communication mail in total? Please describe your reasoning fully.

RESPONSE TO COS/OCA-T1-14.

I don't know. Separate own-price elasticities for Solicitation and Customer communication First-Class mail are unavailable. Such elasticities in the case of Capital One would be a function of Capital One's marketing strategy and business operations, both of which are private undisclosed information.

ANSWERS OF OCA WITNESS J. EDWARD SMITH  
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COS/OCA-T1-15. Please refer to your response to COS/OCA-T1-2(a) where you state, "This approach appears to be based on the assumption that the two types of mail can be summed and, subsequently, a single elasticity for workshared First-Class mail can be used." Please confirm that in its calculation and use of a single elasticity for workshared First-Class Mail, the Postal Service also makes the assumption that the different types of workshared First-Class Mail can be summed and that the elasticity of that sum can be used for rate-setting purposes.

RESPONSE TO COS/OCA-T1-15.  
Confirmed.

ANSWERS OF OCA WITNESS J. EDWARD SMITH  
TO INTERROGATORIES COS/OCA-T1-13-22

COS/OCA-T1-16. Please refer to your response to COS/OCA-T1-7(a) where you state, "Insignificance of the time variables is sufficient to eliminate the equations from consideration."

- (a) Please confirm that a mail volume data series that is neither increasing nor decreasing over time is likely to produce regression results with time variables that are statistically insignificant. If not confirmed, please explain fully.
- (b) The above quoted statement from your response to COS/OCA-T1-7(a) implies that you would eliminate a regression equation from consideration for the mail volume data series described in subpart (a) of this interrogatory on the basis of its statistically insignificant time variables. Please explain whether this is the case.

RESPONSE TO COS/OCA-T1-16.

- (a) Confirmed. In such a case, the current year's volume could be used to predict the future year's volume.
- (b) Confirmed that this is the case for the equations that I have considered.

ANSWERS OF OCA WITNESS J. EDWARD SMITH  
TO INTERROGATORIES COS/OCA-T1-13-22

OCA/COS-T1-17. Please refer to your response to COS/OCA-T1-9(b). Please confirm that your projection uses a growth rate derived from volume data covering the period from October 2000 to September 2002.

RESPONSE TO COS/OCA-T1-17.

Confirmed. The number 1,501,567,386 is based on the total Solicitation mailings during the 12 months ending September 2002 multiplied by the growth rate of these total 12 month mailings over the time period 12 months ending September 2001 to 12 months ending September 2002. The Solicitation mailings during the 12 months ending September 2001 include the total of the monthly mailings for the months October 2000 through September 2001. Similarly, the number 721,943,126 is based on total Customer mailings during the 12 months ending September 2002 multiplied by the growth rate of these total 12 month mailings over the time period September 2001 to September 2002. The Customer mailings during the 12 months ending September 2001 include the total of the monthly mailings for the months October 2000 through September 2001.

ANSWERS OF OCA WITNESS J. EDWARD SMITH  
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OCA/COS-T1-18. Please refer to your response to COS/OCA-T1-10(c). Please confirm that your alternative projection uses a growth rate derived from volume data covering the period October 1999 to September 2001.

RESPONSE TO COS/OCA-T1-18.

Confirmed. The number 864,590,059 is based on total Solicitation mail pieces for the 12 months ending September 2001 and the growth rate of the total 12 month mailings over the time period September 2000 through September 2001, extrapolated through 2003. The Solicitation mailings during the 12 months ending September 2000 include the total of the monthly mailings for the months October 1999 through September 2000.

ANSWERS OF OCA WITNESS J. EDWARD SMITH  
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OCA/COS-T1-19.

On page 3 of your testimony, you state that the payment of incentives at a lower than forecasted volume creates a significant free-rider problem, that is, the payment of an incentive where none is necessary, because the mail would have been sent even absent an incentive. I ask you to assume that the payment of the discount is not for the purpose of incenting First-Class volume but rather to incent the mailer, in this case Capital One, to enter into an agreement which has significant cost-savings opportunities for the Postal Service. On that assumption, would the payment of a discount for volume which would materialize in any event create the "free-rider" problem to which you allude. Please explain any affirmative answer.

RESPONSE TO COS/OCA-T1-19.

On the basis of the requested assumption, the answer is "yes". The free-rider problem does not go away. It merely changes appearance. Under your requested assumption, instead of paying discounts on volume that would have been mailed anyway, the Postal Service would be paying money to induce behavior that would have occurred anyway. Witness Jean has testified that Capital One will save money by accepting electronic returns in lieu of physical returns. Thus, there should be no need for the Postal Service to pay anything to get Capital One to accept electronic returns.



ANSWERS OF OCA WITNESS J. EDWARD SMITH  
TO INTERROGATORIES COS/OCA-T1-13-22

OCA/COS-T1-20.

I direct your attention to your testimony at page 11, where you state that the number of Capital One customer mailings is a near-deterministic function of the number of existing credit cards, and to the testimony of Capital One witness Jean that the company has made a decision to convert substantial numbers of its statement mail to electronic statements over the next three years. (Tr. 2/40). If that statement turns out to be correct, is it not the case that the number of customer mailings will not be a "near-deterministic function of the number of existing credit cards," but, in fact, the growth of customer mail will slow, and, possibly, cause a reduction in the gross volume of customer mail?

RESPONSE TO COS/OCA-T1-20.

On a *ceteris paribus* basis--an assumption which appears to be inappropriate--the assertion that "the growth of customer mail will slow, and, possibly, cause a reduction in the gross volume of customer mail" may possibly be true.

ANSWERS OF OCA WITNESS J. EDWARD SMITH  
TO INTERROGATORIES COS/OCA-T1-13-22

OCA/COS-T1-21. Please refer to your testimony on page 17 where you say that: "Although one can obtain a trend analysis for customer mailings, a trend analysis for solicitation mailings appears to be meaningless." I take it that you imply that a trend analysis for customer mailings is meaningful and valuable. If that is your view, please explain whether your trend analysis took account of the Company's testimony that it was already engaged in and intended to accelerate its conversion of customer mail to electronic communications over the term of the Negotiated Service Agreement. If the answer is in the negative, please explain why your trend analysis of customer mail has any value, given the fact that it does not take account of uncontroverted statements by the Company as to its future behavior.

RESPONSE TO COS/OCA-T1-21.

Capital One's private undisclosed information on its marketing programs would be needed in order to improve, modify, and upgrade the trend analysis. Thus there has been no opportunity for significant analysis. The available data provide the level of mailings; also provided is an unverifiable assertion that there will be a conversion of customer mail to electronic communications over the term of the Negotiated Service Agreement. The OCA analysis was performed based on the best available data. Capital One's statements about its future behavior are speculative. The data report what actually occurred, and the trend reports the implications.

ANSWERS OF OCA WITNESS J. EDWARD SMITH  
TO INTERROGATORIES COS/OCA-T1-13-22

OCA/COS-T1-22. On page 17 of your testimony you state that: "It is not surprising that regression analysis has not provided strong results. If one had access to Capital One's private undisclosed information, one might, of course, obtain better results." Is it not the case that, even though you did have access to the Company's disclosed information that they intended to convert in an aggressive manner to electronic communications with their customers, as opposed to First-Class mail communications, that your regression analyses failed to take account of that fact in your calculations?

RESPONSE TO COS/OCA-T1-22.

Please see my response to OCA/COS-T1-21. Again, Capital One's statement of possible future actions is speculative. We must remember that Capital One's market planning process has generally been in terms of a six-month time horizon, requiring special efforts by managers in generating longer-term forecasts. Accordingly, incorporation of the qualitative and unsubstantiated information is of questionable value.