

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 NEWSPAPER ASSOCIATION OF AMERICA
WITNESS CHRISTOPHER D. KENT TO INTERROGATORIES OF
CAPITAL ONE SERVICES, INC. (COS/NAA-T1-30-33)
January 24, 2003**

The Newspaper Association of America hereby provides submits the answers of
Christopher D. Kent to interrogatories of Capital One Services, Inc., filed January 10,
2003.

Respectfully submitted,

NEWSPAPER ASSOCIATION OF AMERICA

By:

William B. Baker
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CERTIFICATE OF SERVICE

I hereby certify that I have this date served the instant document on all
participants requesting such service in this proceeding in accordance with section 12 of
the Rules of Practice and the Presiding Officer's Rulings.

January 24, 2003

William B. Baker

**ANSWERS OF NEWSPAPER ASSOCIATION OF AMERICA
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CAPITAL ONE SERVICES, INC.**

COS/NAA-T1-30. Please refer to your response to COS/NAA-T1-1 where you state, "Confirmed. However, none of the USPS sensitivities included consideration of the amount of the waived fees." Please refer further to your response to COS/NAA-T1-6. Finally, please refer to USPS-T-3, Appendices A and B where witness Crum calculates the Test Year financial impacts of the NSA. Please also assume that Capital One does not currently pay for or receive electronic "returns" and, in the absence of the NSA, would not pay for or receive electronic "returns" during the period that the NSA would have been in effect.

- (a) Please provide modified versions of USPS-T-3, Appendices A and B that include consideration of the amount of the waived fees.
- (b) Please explain fully why waived fees should be included in the calculation of the Test Year financial impact of the NSA.
- (c) Please explain fully why including waived fees as well as the costs for electronic "returns" in the calculation of the Test Year financial impact of the NSA does not double count the Test Year impact of receiving no-fee electronic "returns."

ANSWER:

- a) Attached are two modified versions of USPS-T-3, Appendix B (Appendix A does not need to be modified). *T3_AttB Modified 1.96.xls* uses a COS solicitation mail forwarding rate of 1.96%, as assumed by the USPS, to calculate the amount of the waived fees and *T3_AttB Modified 15.3.xls* uses a forwarding rate of 15.3%. I would like to reiterate that the 15.3% rate is simply a possible rate, based on COS's high return rate for solicitation mail.
- b) The waived fees should be included because they are potential lost revenue.

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- c) The waived fees are lost revenue and they must be considered separately from the costs, just as witness Crum considered cost savings from electronic returns, revenue leakage, and additional contribution separately.

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CAPITAL ONE SERVICES, INC.**

COS/NAA-T1-31. Please refer to your response to COS/NAA-T1-2 where you state, "I have not examined the costing of every mail class and special service in Docket No. R2001-1 and thus cannot confirm."

- (a) Please list all mail classes for which you have analyzed Docket No. R2001-1 costing methods.
- (b) Please indicate whether or not FY 2000 IOCS data were used to distribute costs in Docket No. R2001-1 to each of the mail classes listed in your response to subpart (a) of this interrogatory.

ANSWER:

- a) First-Class UAA mail and Standard Enhanced Carrier Route mail.
- b) The USPS has recently stated that FY2000 IOCS data were used for First-Class UAA mail (see USPS Response to Oral Request of Chairman Omas at Tr. 2/342), although this is not apparent from Library Reference LR-J-69. Although I have not reviewed for purposes of this case the Standard ECR data from R2001-1, I would not be surprised if FY2000 IOCS data were used for Standard ECR in that case.

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COS/NAA-T1-32. Please refer to your response to COS/NAA-T1-5 where you state, “use of NCOA presumably should reduce the forwarding rate somewhat.” Please provide your best estimate of the extent to which use of NCOA should reduce the forwarding rate, provide all underlying calculations, and describe your reasoning fully.

ANSWER:

Based on the testimony of witness Wilson, NCOA catches about 25% of possible changes of address (see transcript Volume 3 - Hearing Held on December 4, 2002, Testimony of Witnesses Bizzotto (USPS-T-1) and Wilson (USPS-T-4), page 639). Thus, use of NCOA might reduce COS’s forwarding rate by up to 25%.

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COS/NAA-T1-33. Please refer to your response to COS/NAA-T1-7(a) where you state, "I advise [clients] on strategic matters during negotiations." Please assume that one of your clients asked for your advice on a negotiation and told you, "one of our largest customers is using a product on which we currently make \$100 million in profit. Over the last year, this client has started making significant use of one of our lower-profit products and is considering shifting entirely to the use of the lower-profit product. If they shift entirely from using our higher-profit product to the use of our lower-profit product, it will reduce our profitability by \$50 million. (Also, it's important to note that we can't legally stop this customer from moving to the use of this other product or increase our price for the lower-profit product.) During negotiations, the customer told us that it probably would not shift to the use of the lower-profit product if we give his company a discount of \$7 million on the higher-profit product. Based upon this, the customer proposed an agreement where we offer him a \$7 million discount on the higher-profit product. The customer further agreed that if his company does shift a percentage of their high-profit volume to the lower-profit product, we can reduce the discount more than proportionately. Finally, in exchange for receiving this discount, the customer agreed to change its operations in a way that we are certain will reduce our costs by more than \$10 million." Assuming that there is no opportunity to modify the deal, would you advise your client to accept it? If not, please explain your reasoning fully. In particular, explain why it would be good for your client to reject the deal and take the risk of reducing its profitability by \$50 million.

ANSWER:

I would advise my client to accept the deal posited in this hypothetical.

ATTACHMENT B, PAGE 1

Increased Contribution from New Mail Volume

$$\begin{aligned} \text{New Mail Volume Contribution} &= (\$.2910 \text{ (1)} - \$.1266 \text{ (2)} - \$.045 \text{ (3)}) * 15,458,969 \text{ (4)} \\ &= \quad \quad \quad \mathbf{\$1,846,000} \end{aligned}$$

- (1) Test year estimated Capital One FCM presort revenue per piece (Attachment A, page 1)
- (2) Test year after rates estimated Capital One FCM presort cost per piece (Attachment A, page 2)
- (3) Applicable discount from declining block table tier 1.375 B - 1.450 B (Attachment B, page 5)
- (4) New Mail Volume (Bottom range estimate of test year after rates Capital One FCM volume minus test year before rates FCM volume from testimony of witness Elliot (COS-T-2)).

Response to COS/NAA-T1-30, Page 2 of 5
Source: USPS-T-3, Attachment B

ATTACHMENT B, PAGE 2

Address Change Service (ACS) Return Cost Savings

$$\begin{aligned} \text{Return Cost Savings} &= (\$.1359 \text{ (1)} - \$.1266 \text{ (2)}) * 1,408,000,000 \\ &= \$ \quad \mathbf{13,094,000} \end{aligned}$$

- (1) Test year before rates estimated Capital One FCM presort cost per piece (Attachment A, page 2)
- (2) Test year after rates estimated Capital One FCM presort cost per piece (Attachment A, page 2)
- (3) Test year before rates forecasted Capital One FCM presort volume (COS-T-1, page 5)

ATTACHMENT B, PAGE 3

Discount Leakage

Discount leakage equals the estimated revenue foregone from discounts provided on mail volume that would have been sent even in the absence of the Negotiated Service Agreement (NSA). Since Capital One's test year before rates volume forecast equals 1.408 billion pieces, the discount leakage can be calculated as below:

$$\begin{aligned}
 \text{Discount Leakage} = & (1,275,000,000 - 1,225,000,001) * \$0.03 + \\
 & (1,325,000,000 - 1,275,000,001) * \$0.035 + \\
 & (1,375,000,000 - 1,325,000,001) * \$0.040 + \\
 & (1,408,000,000 - 1,375,000,001) * \$0.045 \\
 = & \boxed{\$ \quad 6,735,000}
 \end{aligned}$$

Declining Block Discount Table

First-Class Mail Presort Volume Range		Discount
0	to 1,225,000,000	\$ -
1,225,000,001	to 1,275,000,000	\$ 0.030
1,275,000,001	to 1,325,000,000	\$ 0.035
1,325,000,001	to 1,375,000,000	\$ 0.040
1,375,000,001	to 1,450,000,000	\$ 0.045
1,450,000,001	to 1,525,000,000	\$ 0.050
1,525,000,001	to 1,600,000,000	\$ 0.055
1,600,000,001	to above	\$ 0.060

1,408,000,000 Test year before rates Capital One FCM volume (COS-T-1)

ATTACHMENT B, PAGE 4

Address Change Service (ACS) Return Fee Leakage

Solicitation Fee Leakage = \$.20 (1) * (9.6% (2) * 85% (3) + **1.96%** (4) * 95% (5))* 768,000,000 (6)

\$15,394,000

- (1) Per piece fee for eACS (USPS-T-2, page 3)
- (2) COS solicitation mail return rate (COS-T-1, page 6)
- (3) eACS success rate (USPS-T-4, page 7)
- (4) USPS estimated COS solicitation mail forwarding rate (response to APWU/USPS-T-3-4)
- (5) Percent of forwards that are forwarding through CFS, thus generating an eACS notice (NAA-T-1, page 13)
- (6) Test year before rates forecasted COS First-Class solicitation mail volume (COS-T-1, page 5)

Response to COS/NAA-T1-30, Page 5 of 5
Source: USPS-T-3, Attachment B

ATTACHMENT B, PAGE 5

Summary USPS Financial Impact of NSA

Total New Contribution as a result of NSA = New Volume Contribution + Return Cost Savings - Discount Leakage
= **(\$7,189,000)**

ATTACHMENT B, PAGE 1

Increased Contribution from New Mail Volume

$$\begin{aligned} \text{New Mail Volume Contribution} &= (\$.2910 \text{ (1)} - \$.1266 \text{ (2)} - \$.045 \text{ (3)}) * 15,458,969 \text{ (4)} \\ &= \quad \quad \quad \mathbf{\$1,846,000} \end{aligned}$$

- (1) Test year estimated Capital One FCM presort revenue per piece (Attachment A, page 1)
- (2) Test year after rates estimated Capital One FCM presort cost per piece (Attachment A, page 2)
- (3) Applicable discount from declining block table tier 1.375 B - 1.450 B (Attachment B, page 5)
- (4) New Mail Volume (Bottom range estimate of test year after rates Capital One FCM volume minus test year before rates FCM volume from testimony of witness Elliot (COS-T-2)).

Response to COS/NAA-T1-30, Page 2 of 5
Source: USPS-T-3, Attachment B

ATTACHMENT B, PAGE 2

Address Change Service (ACS) Return Cost Savings

$$\begin{aligned} \text{Return Cost Savings} &= (\$.1359 \text{ (1)} - \$.1266 \text{ (2)}) * 1,408,000,000 \\ &= \$ \quad \mathbf{13,094,000} \end{aligned}$$

- (1) Test year before rates estimated Capital One FCM presort cost per piece (Attachment A, page 2)
- (2) Test year after rates estimated Capital One FCM presort cost per piece (Attachment A, page 2)
- (3) Test year before rates forecasted Capital One FCM presort volume (COS-T-1, page 5)

ATTACHMENT B, PAGE 3

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Discount leakage equals the estimated revenue foregone from discounts provided on mail volume that would have been sent even in the absence of the Negotiated Service Agreement (NSA). Since Capital One's test year before rates volume forecast equals 1.408 billion pieces, the discount leakage can be calculated as below:

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 & (1,375,000,000 - 1,325,000,001) * \$0.040 + \\
 & (1,408,000,000 - 1,375,000,001) * \$0.045 \\
 = & \boxed{\$ \quad 6,735,000}
 \end{aligned}$$

Declining Block Discount Table

<u>First-Class Mail Presort Volume Range</u>			<u>Discount</u>
0	to	1,225,000,000	\$ -
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1,325,000,001	to	1,375,000,000	\$ 0.040
1,375,000,001	to	1,450,000,000	\$ 0.045
1,450,000,001	to	1,525,000,000	\$ 0.050
1,525,000,001	to	1,600,000,000	\$ 0.055
1,600,000,001	to	above	\$ 0.060

1,408,000,000 Test year before rates Capital One FCM volume (COS-T-1)

ATTACHMENT B, PAGE 4

Address Change Service (ACS) Return Fee Leakage

Solicitation Fee Leakage = \$.20 (1) * (9.6% (2) * 85% (3) + 15.3% (4) * 95% (5)) * 768,000,000 (6)

\$34,860,000

- (1) Per piece fee for eACS (USPS-T-2, page 3)
- (2) COS solicitation mail return rate (COS-T-1, page 6)
- (3) eACS success rate (USPS-T-4, page 7)
- (4) Possible COS solicitation mail forwarding rate (NAA-T-1, page 12)
- (5) Percent of forwards that are forwarding through CFS, thus generating an eACS notice (NAA-T-1, page 13)
- (6) Test year before rates forecasted COS First-Class solicitation mail volume (COS-T-1, page 5)

Response to COS/NAA-T1-30, Page 5 of 5
Source: USPS-T-3, Attachment B

ATTACHMENT B, PAGE 5

Summary USPS Financial Impact of NSA

Total New Contribution as a result of NSA = New Volume Contribution + Return Cost Savings - Discount Leakage
= **(\$26,655,000)**