

**BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001**

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

Docket No. MC2002-2

**REBUTTAL TESTIMONY
OF
MICHAEL K. PLUNKETT
ON BEHALF OF
UNITED STATES POSTAL SERVICE**

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AUTOBIOGRAPHICAL SKETCH

My autobiographical sketch and qualifications are listed in my direct testimony, USPS-T-2, p. ii.

1 **I. Purpose of Testimony**

2 The purpose of my testimony is to demonstrate why the criticisms that have been
3 leveled regarding the Postal Service's proposal and the alternatives to it that have been
4 proposed are not valid.

5 As has been clear throughout the instant proceeding, Capital One's business model
6 constitutes a unique use of postal services because of its greater use of First-Class Mail to
7 advertise than any other mailer. Thus, despite exemplary use of address management
8 practices that far exceed existing requirements (Tr. 3/664-65), Capital One generates
9 proportionally more returned, undeliverable-as-addressed (UAA) mail when compared to
10 more traditional First-Class mailers. Because these pieces were sent by First-Class Mail,
11 average return costs are incorporated into the applicable rate, and additional fees are not
12 charged for the return of UAA mail. As witness Crum testified, if the Postal Service did not
13 have to process this UAA mail, approximately \$13.2M in test year costs would be avoided
14 (USPS-T3, p.4). I believe, and the Postal Service as an institution agrees that, the NSA—
15 as proposed—constitutes a wonderful opportunity to reduce the costs of handling Capital
16 One's mail that would otherwise be borne by all users of First-Class Mail, while retaining
17 and growing Capital One's First-Class Mail volume.

18 **II. Even With a High UAA Rate, Capital One's Solicitations Are More Beneficial**
19 **to the Postal Service as First-Class Mail than as Standard Mail.**

20
21 The NSA has been mis-characterized as a reward for bad mailer behavior. For
22 example, witness Kent decries the inequity of giving "free eACS to a high-cost entity, while
23 mailers that engage in better address hygiene do not get a discount (NAA-T-1, 5)." He
24 therefore concludes that "some mailers could look to this proposed NSA and see engaging

1 in high cost behavior as a way to get a better deal with the Postal Service (NAA-T-1, 5).”
2 Similarly, in interrogatory NAA/USPS-T-1-13, NAA asked witness Bizzotto: “If 10 percent
3 of the addresses in a particular mailing list are UAA and cannot be forwarded, would you
4 consider mail using that mailing list to be of poor quality or ‘dirty’?”

5 The idea that Capital One’s mailing practices harm the Postal Service is
6 demonstrably false and illogical. Capital One is not a bad mailer; it is a very good mailer.
7 Its extensive use of First-Class Mail, rather than Standard Mail, for solicitations generates
8 far greater net benefit to the Postal Service via its higher contribution, even accounting for
9 costs owing to a greater proportion of UAA mail. In the absence of the NSA, the only way
10 to address the situation witness Kent raises would be for Capital One to shift its First-Class
11 Mail to Standard Mail, with its less costly treatment of UAA mail. Neither the Postal
12 Service nor other mailers would be better off if that were to happen. Evaluation of the net
13 contribution impact of such a shift shows that it would be a substantial financial mistake. In
14 Table 1, I present an illustration of what would happen if Capital One’s solicitation volume
15 were to migrate to Standard Mail.

1

TABLE 1

Estimated Test Year Contribution Impact From Conversion of Acquisition Mail to Standard Mail Capital One Services			
	Projected test year		
	Volume (millions) (a)	Unit Contribution (cents) ¹ (b)	Total Contribution (\$ millions) (a X b)
First-Class Mail	768	0.1550	\$ 119.04
Standard Mail	0	0.0861	\$ -
Total	768		\$ 119.04
Effect of conversion to Standard			
	Volume (millions) (a)	Unit Contribution (cents) (b)	Total Contribution (\$ millions) (a X b)
First-Class Mail	0	0.1550	\$ -
Standard Mail	768	0.0861	\$ 66.12
Total	768		\$ 66.12
Net Change	0		\$ 52.92
1. First-Class contribution is derived from USPS-T3, Attachment A pages 1&2 by limiting the analysis to solicitation mail only. Standard Mail contribution is estimated by comparing unit costs from R2001: LR-J-58, Table 4 with R2001-1 revenue per piece adjusted to reflect Capital One's FY 2001 Standard Mail volume profile.			

2

3

4 As expected, the costs of handling Capital One's solicitation mail would decrease if

5 it were sent Standard Mail. This is not surprising, since UAA Standard Mail pieces would

6 be disposed of at the intended delivery unit. However, the loss in contribution is alarming.

7 As is shown in column (b), the average per-piece contribution from Standard Mail is lower

8 than the comparable contribution from First-Class Mail, even when the proposed declining

9 block rates are in force. At Capital One's original before rates volume forecast, the effect

10 of a 100 percent conversion of solicitation mail to Standard Mail in the test year would be

1 to reduce Capital One's overall contribution to the Postal Service's institutional costs by
2 approximately \$53 million.

3 This analysis of costs and contributions also illustrates that Capital One's mail more
4 than covers its costs. While it is true that above average UAA rates have the effect of
5 causing costs that are ultimately shared by all users of First-Class Mail, this effect is
6 dwarfed by the substantial contribution that Capital One's discretionary use of First-Class
7 Mail as an advertising medium has on other mailers. As this Table clearly demonstrates, if
8 Capital One were to shift its direct mail out of First-Class Mail, the overall effect on users of
9 First-Class Mail would be decidedly negative.

10 Conversely, the Table illustrates why this agreement is extremely unlikely to induce
11 other customers to cause high UAA rates in order to improve their opportunities for an
12 NSA. For a Standard Mail user considering conversion to First-Class Mail—even at the
13 discounts in the Capital One agreement—the increase in postage costs would be
14 substantial.

15 **III. Other Proposals in this Docket Are Impractical.**

16 **A. Witness Callow's Proposed Classifications Present Insurmountable**
17 **Practical Obstacles.**

18
19 Witness Callow's proposes to establish two new classifications in lieu of the NSA.
20 Given the costs of returning UAA mail, attracting more customers to First-Class Mail
21 appears to increase the savings potential for CSR Option 2. However, witness Callow's
22 proposal neglects several fundamental provisions underlying the NSA that make extending
23 its terms problematic. These provisions would be difficult to extend to a large number of
24 additional customers.

- 1 • The Capital One agreement permits use of ACS Option 2 only on Capital One's
2 solicitation volume. This is an important distinction, because, under witness
3 Callow's proposal, UAA pieces would be destroyed by the Postal Service, if they
4 are not returned. Witness Callow's proposal, however, does not provide an
5 effective way to distinguish between mail containing advertising and mail—such
6 as bills and financial statements—that might contain personal or sensitive
7 information. Immediate widespread conversion to ACS Option 2 would thus
8 likely necessitate additional measures to distinguish the character of the
9 communications,¹ and would require enhanced procedures to maintain the
10 security of sensitive information if it is to be disposed. Failing to take such
11 measures could increase the risks of identity theft and fraud as First-Class Mail
12 users elect to forgo return of UAA mail pieces. In the long run, failure to incur the
13 added expense of extra security would tend to undermine mailer and public
14 confidence in the mail as a reliable and secure means of communications,
15 resulting in increasing loss of volume.
- 16 • Witness Callow is incorrect that only a limited number of mailers could
17 participate because of the NCOA requirement. Thousands of mailers process
18 less than 25,000 addresses a year through NCOA. Because declining block
19 rates would be so attractive to First-Class Mail users (especially at the terms
20 proffered in witness Callow's proposal), the Postal Service estimates that tens

¹ At a minimum, it might be necessary to obtain from the mailers waiver of the prohibition against breaking the seal on First-Class Mail.

1 of thousands of mailers would want to take advantage of the proposed
2 experimental classifications.

- 3 • Witness Callow's proposal would cause significant compliance issues with the
4 requirement that mailers update their databases with the address the
5 requirement that mailers update their databases with the address correction
6 information. Capital One is required to update address information within two
7 days of receipt. The Postal Service must monitor compliance through post-
8 mailing reviews on an ongoing basis. This is a realistic objective for a single
9 customer, but monitoring compliance with this requirement would represent a
10 significant Postal Service resource commitment for a large number of customers
11 that could convert. .
- 12 • By waiving the current electronic ACS fee, the Postal Service would lose a
13 price-induced incentive for mailers to correct databases to avoid a subsequent
14 20-cent charge. Along with the expressed desire for expedition, this realization
15 was one reason that the Postal Service elected to file this case as an
16 experiment in order to understand the effects of implementing this change by
17 limiting participation to a single customer. Witness Callow is incorrect that only
18 a limited number of mailers could participate because of the NCOA
19 requirement. This case has brought to light important issues relating to the
20 pricing of address correction services, and the associated operational impacts.
21 These issues warrant careful consideration, in light of the total rate and fee
22 structure, but they are not amenable to comprehensive resolution in this case.

1 Similar obstacles arise when it comes to offering alternative tariffs on a large scale.
2 Arriving at an appropriate set of thresholds for Capital One took several months, and
3 required consideration of a large number of variables. The thresholds established by
4 negotiations between the Postal Service and Capital One incorporate a wealth of
5 information about the Postal Service's operational practices, Capital One's mailing profile,
6 business model, and other factors that cannot be easily converted into the automated
7 process that witness Callow envisions.

8 For example, witness Smith considered Capital One's original volume forecast to
9 be at the lower end of plausibility. Several months later, actual results have proven witness
10 Smith's conclusion to be well off the mark. (See witness Elliott's testimony, COS-RT-2).
11 Had the Postal Service and Capital One not explicitly allowed for the volatility in Capital
12 One's volume history, thresholds might have been set at a level too high to produce the
13 desired incentives for participation. While some might conclude that pushing thresholds
14 higher confers some measure of safety, this is not necessarily the case. A formulaic
15 extrapolation of volume trends that does not attempt to account for changing business
16 conditions could just as easily result in thresholds that are well below the level that a
17 customer would have mailed in the absence of an agreement. Moreover, embedding such
18 a technique into the DMCS would almost certainly expose the Postal Service to the
19 dangers of adverse selection: The customers most likely to want to execute an agreement
20 would be those most able to exploit the methodology for establishing the threshold.

1 **B. Witness Callow's Proposal Would Not Resolve the Competitive**
2 **Issues Raised by Witness Panzar.**

3
4 Witness Panzar asserts that fairness considerations ought to be the main concern
5 in implementing alternative tariffs (JCP-T-1, p. 20). He therefore recommends making
6 similar pricing schedules available to companies that compete in the same market as
7 Capital One. As has been pointed out, other mailers often rely primarily on Standard Mail,
8 rather than First-Class, for direct mail advertising. Extending the terms of the Capital One
9 agreement to all other First-Class Mailers will therefore do little to address the competitive
10 balance issue raised by Panzar. Similarly, by focusing on First-Class Mail, witness
11 Callow's proposed declining block rate classification ignores this factor altogether.

12 Having discussed NSAs with many credit card companies competing with Capital
13 One, I note that their interest in the instant proceeding is readily apparent. Their lack of
14 participation in these proceedings is not due to lack of interest. Indeed, it would not be in
15 their interests to prevent implementation of the Cap One NSA, or to alter its terms. Rather,
16 their interests lie in having the NSA with Capital One implemented, since it will serve as a
17 model on which subsequent agreements can be built. Such agreements could serve a
18 broad range of individual interests and, like the Capital One NSA, could benefit all mailers.

19 Ultimately, the customization inherent in NSAs in general will allow the Postal
20 Service to tailor subsequent proposals to other customers' unique business needs. By
21 contrast, despite his goal of promoting equity by making the elements of the Capital One
22 NSA available to a broad range of customers, witness Callow's proposals would not
23 address the particular business needs of actual customers, and would not serve as broad
24 a range of mailer interests as the NSA approach. In fact, to the extent that his proposals

1 might be viewed as a substitute for the Capital One NSA experiment, they may harm the
2 broader interests of all First-Class Mail customers by neglecting the unique characteristics
3 of Capital One that led to the proposed NSA agreement.

4 **C. The NSA Model, Combined with Effective, Efficient Review, Will**
5 **Ultimately Benefit All Mailers.**
6

7 By recommending the rate, fees and classifications as proposed by the Postal
8 Service and Capital One, the Commission would create an experiment capable of testing
9 the merits of the NSA approach in the context of a low-risk agreement likely to benefit both
10 the Postal Service and Capital One, as well as all First-Class mailers. A favorable
11 recommendation would also create a precedent for and encourage other advantageous
12 customer-specific agreements. In this regard, I would encourage the Commission to
13 consider and provide guidance on creation of a broader classification context and
14 procedures that would facilitate more expeditious review of future similar (but not identical)
15 agreements within an industry. This would go a long way toward solving the problem posed
16 by Dr. Panzar.

17 Without streamlined procedures, the number of agreements that can be executed
18 will remain small, thus limiting the ability of the Postal Service to enter into contribution-
19 enhancing, customer-specific agreements with overall contribution increases that benefit all
20 customers. Conversely, streamlined procedures capable of maintaining effective review
21 will encourage potential NSA participants and make possible potential gains in net
22 contribution.²

² More expeditious litigation would tend to reduce the amount of risk faced by both the Postal Service and other NSA partners. Given the current schedule, the Capital One
(continued...)

1 **IV. Witness Kent's Criticisms of ACS Cost Estimates are Unfounded and**
2 **Erroneous.**

3
4 In his recently filed response to an oral cross examination question posed by Mr.
5 May, witness Kent criticizes the application of ACS costs in LR-J-69 by witness Crum
6 (USPS-LR-1) to returns. He argues that electronic returns reflect the costs of Nixie
7 processing only, and thus are more costly than forwards. In fact, TAB 3 of USPS LR-J-69
8 does not attempt to isolate ACS costs based on whether pieces were returned or
9 forwarded. Contrary to witness Kent's argument, ACS COA notification applies to some
10 returns as well as forwards. For example, a COA notification of a forwarded address is
11 provided for pieces returned to sender when the forwarding order has expired, such as in
12 the period 13 to 18 months after the effective date of the forwarding order. Therefore it is
13 appropriate to use a weighted average of the two costs in Tab 3.

14 Moreover, it is my understanding that returns require fewer keystrokes than
15 forwards. Change of Address notification, unlike returns, requires additional keystrokes to
16 provide the forwarding address. The 14.5 cent cost is the best estimate available for the
17 cost of electronic "returns."

(...continued)

Agreement will not be implemented until more than eight months after the parties agreed to its terms. As the testimonies of witnesses Elliott (COS-RT-2) and Shippee (COS-RT-1) illustrate, conditions can change dramatically during such a span, such that companies might find themselves in a business environment that is substantially altered from that which existed at the time negotiations were conducted.