

OFFICIAL TRANSCRIPT OF PROCEEDINGS BEFORE THE POSTAL RATE COMMISSION

In the Matter of:)

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

Docket No. MC2002-2

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POSTAL RATE COMMISSION

In the Matter of:)
)
EXPERIMENTAL RATE AND)
SERVICE CHANGES TO) Docket No. MC2002-2
IMPLEMENT NEGOTIATED)
SERVICE AGREEMENT WITH)
CAPITAL ONE SERVICES, INC.)

Room 300
Postal Rate Commission
1333 H Street, N.W.
Washington, D.C.

Volume 9
Thursday, March 6, 2003

The above-entitled matter came on for hearing
pursuant to notice, at 9:30 a.m.

BEFORE:

HON. GEORGE A. OMAS, CHAIRMAN
HON. DANA B. COVINGTON, VICE-CHAIRMAN
HON. RUTH Y. GOLDWAY, COMMISSIONER
HON. TONY HAMMOND, COMMISSIONER

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C O N T E N T S

REBUTTAL WITNESSES APPEARING:

ROBERT SHIPPEE
 STUART ELLIOTT
 MICHAEL K. PLUNKETT

<u>WITNESSES:</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>	<u>VOIR DIRE</u>
Robert Shippee	1797	1805	1834	--	--
Stuart Elliott	1836	1847	--	--	--
Michael Plunkett					
by Mr. Baker	--	1873	--	--	--
by Ms. Dreifuss	--	1899	--	--	--
by Mr. May	--	1957	--	--	--
by Mr. Reiter	1857	--	--	--	--

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P R O C E E D I N G S

(9:30 a.m.)

CHAIRMAN OMAS: Good morning. Today we begin hearings to receive testimony filed as rebuttal to the evidence presented in response to the proposed negotiated service agreement between the Postal Service and Capital One Services, Inc.

This morning we will hear testimony from Capital One witnesses Robert Shippee and Stuart Elliott. We will also hear testimony from Postal Service witness Michael Plunkett.

I hope to be able to close the evidentiary record in this case shortly after the conclusion of this round of hearings. If any participant has material they think should be added to the record, I urge them to take appropriate steps to do so at tomorrow's hearing.

Does any participant here today have any procedural matters to raise before we begin?

(No response.)

CHAIRMAN OMAS: Mr. May, that brings us to you. Would you please introduce your first witness?

MR. MAY: He hasn't been sworn.

CHAIRMAN OMAS: I know. Introduce him first.

1 MR. MAY: You are Robert Shippee, group
2 manager of Capital One Services, Inc.?

3 MR. SHIPPEE: Yes, I am.

4 MR. MAY: You have to turn the mike on.

5 MR. SHIPPEE: That's right.

6 MR. MAY: And in that capacity you are
7 responsible for the relationship with the Postal
8 Service?

9 MR. SHIPPEE: Yes, sir.

10 MR. MAY: I think at this point you should
11 be sworn.

12 CHAIRMAN OMAS: Mr. Shippee, would you raise
13 your right hand, please?

14 Whereupon,

15 ROBERT SHIPPEE

16 having been duly sworn, was called as a
17 rebuttal witness and was examined and testified in
18 rebuttal as follows:

19 CHAIRMAN OMAS: Please be seated.

20 (The document referred to was
21 marked for identification as
22 Exhibit No. COS-RT-1.)

23 DIRECT EXAMINATION

24 BY MR. MAY:

25 Q Mr. Shippee, I'm going to hand you two

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1 copies of a document captioned Rebuttal Testimony of
2 Robert Shippee on behalf of Capital One Services,
3 Inc., and it is labeled as COS-RT-1.

4 I'm going to ask you to examine these
5 documents. Is that the testimony you prepared for
6 this proceeding?

7 A Yes, it is.

8 Q And if you were to testify fully today,
9 would that be the testimony you would offer?

10 A Yes, it is.

11 MR. MAY: Mr. Chairman, I'm going to hand
12 two copies of this document to the reporter. I ask
13 that it be transcribed into the record and moved into
14 evidence.

15 CHAIRMAN OMAS: Is there any objection?

16 (No response.)

17 CHAIRMAN OMAS: Hearing none, I will direct
18 counsel to provide the reporter with two copies of the
19 corrected rebuttal testimony of Robert Shippee. The
20 testimony is received into evidence and will
21 transcribed into evidence.

22 (The document referred to,
23 previously identified as
24 Exhibit No. COS-RT-1, was
25 received in evidence.)

**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

**REBUTTAL TESTIMONY
OF
ROBERT SHIPPEE
ON BEHALF OF
CAPITAL ONE SERVICES, INC**

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Counsel for Capital One Services, Inc.

February 24, 200

1 **INTRODUCTION.**

2
3 My name is Robert Shippee, Group Manager of Capital One Services, Inc. ("Capital One"). I
4 earned two degrees from Syracuse University in 1985, Bachelor of Arts in Economics and
5 Bachelor of Science in Industrial Engineering and Operations Research, and two degrees from
6 Cornell University in 1987, Master of Industrial and Labor Relations and Master of Business
7 Administration. Since 1987, I have worked in the financial services industry, at Fleet Bank
8 (including responsibility for merger and acquisition negotiations) and Capital One. I am
9 currently responsible for the company's relationship with the United States Postal Service.

10
11 The purpose of my testimony is to respond to criticisms that the NSA grants discounts for mail
12 that is not "new" volume; to respond to criticisms leveled at Capital One's address management
13 practices; to clarify the Company's expectations regarding returns and forwarding under the
14 NSA; and to offer my opinion on the NSA's alleged adverse effects on others, including
15 competitors.

16
17 **1. THE COMPANY'S "BEFORE RATES" TEST YEAR VOLUME FORECAST**
18 **MAY HAVE BEEN OPTIMISTIC.**

19
20 There have been criticisms by other parties, even questions by a Commissioner, about the NSA
21 volume discount threshold, which is set more than 100 million pieces below Capital One's Test
22 Year volume forecast. According to some NSA opponents, this has created a so-called "free
23 rider" problem--volume discounts granted to First Class Mail that would have been mailed in any

1 event, rather than for volume induced by the NSA. To the contrary, we were concerned during
2 negotiations that the discount volume threshold might be set so high that we would not be able to
3 meet it. Capital One does not normally make specific annual First Class Mail volume forecasts,
4 so the Company had no established methodology to make the specific Test Year forecast that
5 was required for this case. Additionally, as we surveyed our business managers last summer in
6 order to produce a "Before Rates" volume forecast, we were concerned that such a forecast,
7 given the recent public announcement concerning the change in our marketing strategy, might be
8 optimistic. As it turns out, based on our October, November and December 2002 numbers, our
9 concerns have been validated. We have provided actual mail volumes for October, November
10 and December to SLS Consulting and have asked them to include these data in calculating a new
11 Test Year volume forecast. Irrespective of what the SLS forecast may show, including a below-
12 threshold Test Year volume, Capital One values the volume discounts that are at the heart of this
13 deal. It is of real value to us to have the potential to earn these volume discounts throughout the
14 three-year term of the NSA.

15
16 **2. CAPITAL ONE'S ADDRESS MANAGEMENT PRACTICES ARE FAR BETTER**
17 **THAN REQUIRED BY USPS AND WILL IMPROVE FURTHER UNDER THE**
18 **NSA.**

- 19
20 a) As previously testified, the Company runs NCOA far more frequently than USPS
21 requirements of every 180 days, and commits under the NSA to run NCOA every 30 days
22 for customer addresses and 60 days for prospect mailing lists.

1 b) Upon approval of the NSA, the Company has further committed to incorporating
2 electronic ACS in its solicitation campaigns. Since this information is expected to be
3 received more quickly, and include additional data not received today (thereby improving
4 the Company's ability to determine which returns are unlikely to be delivered on
5 subsequent attempts), returns are very likely to be reduced.

6
7 c) Contrary to statements made before this body (Tr.6/1169-71), the Company's obligation
8 to run NCOA updates and utilize electronic ACS information extends to any lists that are
9 purchased or rented from third-party providers. In fact, Capital One employs vigorous
10 address hygiene practices on all solicitations no matter the source of the data.

11
12 **3. THE COMPANY EXPECTS "REPEAT FORWARDS" TO DECREASE UNDER**
13 **THE NSA.**

14
15 a) While Capital One has no way to measure so-called "repeat forwards" today, it is certain
16 that the Company's commitment to incorporate electronically-received forwarding
17 information will reduce such occurrences, perhaps dramatically. The net benefit this will
18 bring to the Postal Service could be quite significant, and it has not been included in its
19 already-favorable cost-benefit analysis.

20
21 b) The Company plans to diligently use electronic ACS information for both returns and
22 forwards because, quite simply, it is in the Company's best interests to maximize the
23 probability that a particular mailpiece will reach its intended recipient.

1 **4. THE NSA IS FAIR TO ALL STAKEHOLDERS, INCLUDING COMPETITORS.**

2
3 Assertions have been made during these hearings that the NSA gives more to Capital One than
4 necessary to make the deal; that, for example, Capital One would, or should, have agreed to
5 substitute free eACS for physical returns without the added benefit of volume discounts.
6

7 a) The negotiations leading to this agreement were among the most difficult and lengthy in
8 my experience. Each party bargained in good faith for the provisions it viewed as critical
9 to make the deal worthwhile. On more than one occasion, one or both parties appeared to
10 be ready to terminate discussions. This is not unusual in negotiations, but it underlines
11 how inappropriate it is for a third party to assess whether either party got the “best” deal
12 they could get. Further, speculation as to whether either party would accept a part of the
13 deal is moot, as both parties made it abundantly clear during negotiations that there was
14 no interest in pursuing such a path, and that the only acceptable agreement is that which
15 is presently before this body.
16

17 b) At various times in these proceedings, comments have been offered regarding the
18 potential effects of this NSA on the Company’s competitors. Indeed, Dr. Panzar raised
19 the potential for deleterious competitive effects as his chief concern in this case. In my
20 experience, including direct conversations with those who make marketing decisions at
21 the Company, I am aware of no meaningful linkage between one company’s mail
22 volumes and competitors’ volume. We compete, often rabidly, on product offerings and
23 features, but competitor mail volumes typically do not lead Capital One to change its

1 mailing plans. Nor is Capital One's planning affected by the likelihood that, even today,
2 some of our competitors (due to greater work-sharing and/or density discounts) may
3 enjoy lower average postal rates. The competitive concern, which is admittedly plausible
4 using purely theoretical economic logic, simply does not appear to exist in practice in the
5 credit card industry.

1 CHAIRMAN OMAS: This brings us to oral
2 cross-examination. One party, the Office of Consumer
3 Advocate, has requested oral cross-examination.

4 Ms. Dreifuss?

5 MS. DREIFUSS: Thank you, Mr. Chairman.

6 CROSS-EXAMINATION

7 BY MS. DREIFUSS:

8 Q Good morning, Mr. Shippee.

9 A Good morning.

10 Q I'm Shelley Dreifuss from the Office of the
11 Consumer Advocate.

12 A Nice to meet you.

13 Q Nice to meet you, too. Most of my questions
14 this morning concern Dr. Elliott's volume estimates.

15 Dr. Elliott is a Capital One Services
16 witness. He was a witness in the initial round, and
17 he's also a rebuttal witness, isn't he?

18 A That's right.

19 Q Have you read his testimony?

20 A Yes, I have.

21 Q Could you turn to page 2 of your testimony,
22 please, Lines 8 through 14?

23 A Yes.

24 Q You say there that you use the word, "We
25 have provided actual mail volumes for October,

1 November and December to SLS Consulting and have asked
2 them to include these data in calculating a new test
3 year volume forecast." Do you see that?

4 A That's right. Yes.

5 Q You're aware, are you not, that Dr. Elliott
6 used these three months of data and earlier filed data
7 to generate new forecasts for Capital One different
8 from the forecasts he presented in the initial round
9 of this proceeding?

10 A That's right.

11 Q Do you have a copy of Dr. Elliott's
12 testimony with you today?

13 A I don't.

14 MS. DREIFUSS: I have extra copies with me.
15 Would it be all right if I give a copy to Mr. Shippee?

16 MR. MAY: Sure.

17 MS. DREIFUSS: Do you have a copy, Mr. May?
18 I imagine you would.

19 MR. MAY: I do.

20 MS. DREIFUSS: I have a few extras in this
21 folder if anybody needs one.

22 BY MS. DREIFUSS:

23 Q Could you turn to Table 3 of Dr. Elliott's
24 testimony? That's at page 7.

25 A Yes.

1 Q There he presents the initial test year
2 before rates volume estimate of approximately 1.4
3 billion pieces. That's the first line in the table,
4 is it not?

5 A That's right.

6 Q And then he also presents a revised volume
7 estimate of approximately 1.21 billion pieces. Is
8 that correct?

9 A That's correct.

10 Q I'm not sure if you can recall his initial
11 testimony. In his initial testimony he presented
12 separate volume figures for first class customer mail
13 and first class solicitations mail. Are you aware
14 that he did that?

15 A Yes.

16 Q In his initial testimony he presented a
17 volume estimate of 640 million pieces of first class
18 customer mail. Does that sound right?

19 A That's right.

20 Q And he also presented a test year before
21 rates estimate of 768 million pieces of first class
22 solicitations mail. Does that also sound correct?

23 A Yes.

24 Q There's a difference, as I understand it,
25 from reading both Dr. Elliott's initial testimony and

1 his rebuttal testimony.

2 I'm under the impression that there's a
3 difference in the way these estimates were developed.
4 In his initial testimony, I believe he was presenting
5 the estimates that were given him by Capital One.
6 Does that sound right to you?

7 A I think that's largely correct. You may
8 have to ask Dr. Elliott the detailed methodology that
9 he used, but we did provide him with in particular our
10 solicitation volume and our customer expectations for
11 the test year.

12 Q In the current case he appears to be
13 developing estimates on his own of Capital One's test
14 year before rates volume. Is that your impression
15 also?

16 A I would characterize it as developing them
17 on his own in that we supplied him with several months
18 of actual figures on which to base the new forecast.

19 Q Did you or anyone else in Capital One
20 actually provide to him the revised test year before
21 rates volume estimate of 1.21 billion pieces?

22 A No. No, ma'am.

23 Q Do you know how he arrived at that figure?

24 A I really think that he would have to answer
25 that in detail. I believe he used the models that

1 were developed in the earlier phase of this case to do
2 that.

3 Q Okay. You have the impression, I believe,
4 that Dr. Elliott developed the 1.21 billion test year
5 before rates volume estimate from his models based on
6 data that were given him by Cap One?

7 A That's right.

8 Q Is it fair to say that the 1.21 billion
9 piece test year before rates estimate reflects the
10 current thinking of Capital One's management at this
11 time?

12 A We certainly view the 1.21 billion forecast
13 as reasonable. Dr. Elliott had taken into account not
14 only the three years of actual data that we supplied
15 him directly, but also a fairly in-depth understanding
16 of our long-term trends in mailing patterns. The
17 seasonality he spoke to in his testimony as well, so
18 we're comfortable with that estimate.

19 Q So Capital One at this point would actually
20 endorse the revised estimate of 1.21 billion pieces
21 over the initially presented estimate of 1.4 billion
22 pieces? Is that a fair statement?

23 A Yes. I think that's a more accurate
24 estimate.

25 Q Can you explain generally why there is a

1 difference of roughly 15 percent between the estimates
2 presented on September 19 by Dr. Elliott and the 1.21
3 billion piece estimate that was presented in the
4 rebuttal testimony? What happened to cause a change
5 in that estimate?

6 A I think there were two or three factors
7 there. One is that the new forecast again has the
8 benefit of at least three months of actual data, so
9 you're always going to get a more accurate and
10 different forecast if you are able to incorporate
11 actual volumes.

12 The second factor is that our business
13 strategy change that we announced in July of last year
14 hadn't really become implemented at the point that we
15 developed the first forecast that led to the 1.4
16 billion. In the subsequent months it has come to
17 fruition, and, therefore, we have a little better idea
18 of what our volumes look like going forward.

19 Thirdly, we're just new to the first class
20 mail forecasting process. That's not a standardized
21 process in the company and so the estimates that we
22 provided Dr. Elliott initially were reached by
23 discussions with business managers who are not used to
24 providing specific first class mail forecasts, and so
25 we knew there was some room for error there.

1 I think those are all factors that led to a
2 relatively less accurate initial projection versus the
3 1.21 billion.

4 Q You mentioned at the beginning of this
5 answer that Capital One changed its business strategy
6 in July. Can you describe what its business strategy
7 was before that point in July that you referenced and
8 how --

9 MR. MAY: Let me interpose an objection
10 unless the witness is comfortable answering that
11 question in light of what may be proprietary
12 information for the company.

13 I'll have to let the witness advise me about
14 that. If it's proprietary, I would object to the
15 question.

16 CHAIRMAN OMAS: Mr. Shippee?

17 THE WITNESS: I can give a very broad answer
18 to the question.

19 CHAIRMAN OMAS: Please. Thank you.

20 MS. DREIFUSS: That's a good start. Let me
21 just hear what he's comfortable saying and see if I
22 need to go further.

23 THE WITNESS: Sure. The shift in strategy
24 relates primarily to segments of the population as
25 defined by regulators and others. Prior to the shift

1 I would characterize our strategy as cutting across
2 all segments, all credit segments in the country,
3 whereas after the July announcement there's been a bit
4 of a shift to, as the regulators would define, higher
5 credit scoring prospects.

6 That is essentially the business shift that
7 happened, and because each business line uses a
8 different mix of first and standard class mail that
9 had ramifications for our volume.

10 BY MS. DREIFUSS:

11 Q From what you just said, I believe I
12 understand your answer to be that you are not
13 targeting -- you used the word higher prime. You were
14 targeting the higher prime. Am I correct in that?

15 A I don't think I said prime.

16 Q What word did you use? I don't want to
17 mis-state. You're now targeting what segment more
18 than you used to? What did you say in your answer?

19 MR. MAY: Again, Mr. Chairman, I would leave
20 it to the witness, but I object. To the extent that
21 that request divulges proprietary information, I
22 object. Again, the witness will --

23 CHAIRMAN OMAS: I think we should leave it
24 up to Mr. Shippee --

25 MR. MAY: Yes.

1 CHAIRMAN OMAS: -- to see what he can do
2 with it.

3 MS. DREIFUSS: Also, the pending question is
4 simply what did he say before? What terms did he use
5 before? That's obviously something he feels
6 comfortable stating publicly.

7 THE WITNESS: The regulators have made some
8 new distinctions with regard to credit scoring that
9 you or I might receive in a credit analysis than
10 existed before, and so I think I stated that there was
11 a relatively greater emphasis on higher credit scoring
12 prospects than previous.

13 BY MS. DREIFUSS:

14 Q Okay. So the difference between Capital
15 One's pre July strategy and its post July strategy is
16 that it is now targeting the higher scoring credit
17 segment more in the latter half of calendar year 2002
18 than it did in the first half of 2002? Is that a
19 correct statement?

20 A I think that's true.

21 Q And that for at least the time being and as
22 it would be reflected in the test year, that would
23 continue to be the strategy to target higher scoring,
24 higher credit scores than customers who would present
25 lower credit scores? Is that correct?

1 A That I can't really comment on in terms of
2 what years two and -- I trust you're talking about
3 years two and three of the agreement?

4 Q No. Actually for right now I'm just talking
5 about the test year.

6 A Okay.

7 Q That would be the first year of the
8 agreement.

9 A Yes. I think that's safe to say for the
10 test year that that's our strategy, but again I think
11 that I don't want to overemphasize a linkage between
12 that and mail class decisions. Those are happening
13 all the time across all business lines in the company.
14 Those can change, and they have changed as Dr. Elliott
15 has observed.

16 Q Are you familiar with the negotiated service
17 agreement itself that Capital One entered into with
18 the Postal Service?

19 A Yes.

20 Q From your smile it sounds like you're very
21 familiar with that agreement.

22 A Yes.

23 Q Are you aware that under Article 3,
24 paragraph D, if Capital One mails fewer than 1.225
25 billion pieces in the test year that no discounts will

1 be paid?

2 A Yes.

3 Q Do you understand that in Dr. Elliott's
4 Table 3, which you have before you, that he projects
5 the same after rates volume estimate as his before
6 rates volume estimate?

7 That is, he projects 1.21 billion pieces of
8 Capital One's first class mail whether or not there is
9 an NSA. Is that your understanding?

10 A Yes. I believe that's the conclusion he's
11 drawn.

12 Q And he makes no change for what we call the
13 after rates estimate because in fact if Capital One's
14 volume estimate does come about, the 1.21 billion
15 pieces that he projects, in fact Capital One will get
16 no discounts in the test year, will it?

17 A That would be true.

18 Q Furthermore, under the agreement if Capital
19 One's first class mail volumes remain at the 1.21
20 billion level or lower there won't be any discounts in
21 years two or three, will there?

22 A That would be true. However, in a three
23 year time frame, as we've seen in recent years, enough
24 changes occur in a business climate that we feel
25 there's a very strong chance of actually achieving the

1 threshold in years two and three. In fact, there's a
2 fairly good chance we'll reach it in year one, in the
3 company's opinion.

4 Q Could you look at Dr. Elliott's testimony
5 again for a moment, please? He has a chart in there.
6 It's his Chart 1. That appears at page 4 of his
7 testimony.

8 In Chart 1, he seems to be presenting a
9 declining trend for Capital One in first class mail
10 solicitation volumes. Do you believe that that's an
11 accurate reflection of Capital One's solicitation
12 volume trend?

13 A Yes, it is.

14 Q If the trend were to continue; that is, that
15 Capital One would mail fewer first class solicitation
16 pieces in year two than it did in year one and even
17 less in year three than it did in year two, then
18 Capital One would never be paid any discounts under
19 the NSA, would it?

20 A That's possible, although it depends on what
21 happens with customer mail and other factors that
22 might impact our mailing decisions.

23 Q Well, earlier in the case it appeared that,
24 and I'm afraid I just don't recall who made the
25 statement, but if this sounds right to you let me

1 know. If it sounds wrong, we'll go further with it.

2 That there is a close connection between
3 Capital One's solicitation of new business and the
4 customer mail that's generated -- actually, it came
5 back. It was Dr. Elliott, I believe. Mr. May or Dr.
6 Elliott himself can correct me when he takes the stand
7 if I'm wrong on this.

8 There's a close relationship, so, generally
9 speaking, if Capital One mails out fewer solicitations
10 in future years because of that close connection there
11 would likely also be lower customer mail volumes
12 unless other forms of attracting new customers are
13 used. Does that sound right?

14 A That sounds right, but I want to be careful
15 with a distinction that needs to be made here. The
16 trend that's shown here is in first class mail
17 solicitations.

18 We mail a great deal of solicitations by a
19 standard class, and that generates a great deal of
20 customer account activity so we need to be careful
21 about talking about overall solicitations versus first
22 class mail solicitation trends.

23 Q Well, at least with respect to the way
24 Capital One uses first class mail solicitations, if
25 the first class mail solicitations have a downward

1 trend, and let's assume for a moment that the trend in
2 standard, whatever that is, continues.

3 Then having a downward trend in first class
4 mail solicitations will lead to a downward trend in
5 customer mail with respect to any potential new
6 account that might have been attracted through first
7 class solicitations. Does that sound right?

8 A Yes. That would be true, barring a change
9 in response rates from the first class mail
10 solicitations that could mitigate the customer
11 generation trend that you're talking about. In other
12 words, if response rates were to increase we could
13 generate the same or more accounts from lower first
14 class solicitations.

15 Q Okay. But if response rate didn't change
16 then the effect that I described a moment ago would
17 arise?

18 A That's right.

19 Q Under paragraph F, Article 3, of the
20 negotiated service agreement, and I've got copies of
21 that with me if you'd like to have one in front of
22 you.

23 A I'm comfortable answering the questions --

24 Q Okay.

25 A -- if you give me a little bit of content.

1 MS. DREIFUSS: Mr. May, would you like a
2 copy of the agreement?

3 MR. MAY: No, thank you.

4 BY MS. DREIFUSS:

5 Q Okay. Under Article 3, paragraph F, Capital
6 One's volume threshold -- I'm sorry. If Capital One's
7 volumes are less than 1.025 billion first class pieces
8 in the test year, then the threshold may be reset at a
9 lower level. Does that sound right?

10 A That sounds right.

11 Q But for volumes that fall between 1.025
12 billion and 1.225 billion that triggers no discounts?

13 A That's my understanding.

14 Q I want to get back for a moment to what we
15 started to talk about earlier that Mr. May was
16 concerned might be proprietary.

17 What I'm going to do is I'm going to ask you
18 a question based on something that is in the public
19 domain, so I won't be probing you, at least to begin
20 with, about anything that was not already put in the
21 public domain by Capital One.

22 A Sure.

23 Q Let me tell you what it is I'm going to ask
24 you about. I looked over an article that was
25 published about Capital One in *Business Week*. It's

1 the October 4, 2002, issue of *Business Week*. The
2 article is entitled A Slower Growing, But Safe For
3 Capital One. It was written by David Shook. Does
4 that ring a bell for you?

5 A I haven't read the article, but there have
6 been a lot of articles about our change in strategy,
7 so go ahead.

8 Q In that article, Capital One provides a
9 spokesperson to *Business Week*. The spokesperson's
10 name is Tatiana Stead. I'll spell it for the record.
11 T-A-T-I-A-N-A is the first name. S-T-E-A-D is the
12 second name. Do you know Tatiana Stead?

13 A Yes, I know her. Yes.

14 Q As far as you know, she is sometimes a
15 spokesperson for Capital One?

16 A That's right.

17 Q In the article she is quoted as saying that
18 Capital One will grow its prime and super prime
19 accounts at a faster rate than the subprime accounts.
20 Does that sound right?

21 A Yes.

22 MR. MAY: Just so the record is clear, there
23 is no foundation laid that that is actually a quote
24 that she made. That is simply what a magazine said,
25 and some of them are notoriously inaccurate. I think

1 we've all had that experience.

2 I just don't want the record to mislead and
3 suggest that this witness is vouching for the fact
4 that she said that.

5 MS. DREIFUSS: It might facilitate what I'm
6 about to do if I actually make as a cross-examination
7 exhibit -- not evidence -- the article that I was
8 referring to.

9 I'll give a copy to Mr. Shippee and to Mr.
10 May. I've got copies for anybody else who might like
11 one. Since I'm focusing on a quoted statement, I'll
12 bring to your attention exactly what she said and
13 where she said it in the article. I'm going to mark
14 this OCA-XE-1/Shippee, MC2002-2.

15 (The document referred to was
16 marked for identification as
17 Exhibit No. OCA-XE-1/
18 Shippee.)

19 MR. MAY: Mr. Chairman, I will have a
20 continuing objection to any question that presupposes
21 that any quote from this magazine is an accurate
22 quote.

23 I won't have any objection on those grounds
24 if the witness is asked if she said this do you agree
25 with it or what do you know about it if she said it,

1 but all such questions have to be predicated on that
2 because otherwise there's an assumption that somebody
3 actually said something, and there's no evidence that
4 she did.

5 MS. DREIFUSS: I feel comfortable with that
6 predicate.

7 CHAIRMAN OMAS: Thank you. Proceed.

8 MS. DREIFUSS: I'm going to mark two copies
9 of this article and give them to the reporter as OCA's
10 cross-examination exhibit.

11 (Pause.)

12 MS. DREIFUSS: They were printed from
13 *Business Week* on line. For each of you who want to
14 follow what I'm doing, in the lower left-hand corner
15 of each copy there's a page number. I'm going to go
16 to page 3 of this four-page document.

17 BY MS. DREIFUSS:

18 Q In the second full paragraph in quotes there
19 appears the phrase, "No concern." Just following
20 that, there's a quoted statement by Tatiana Stead.

21 Keeping in mind Mr. May's condition, which I
22 do accept, Tatiana Stead told *Business Week* that, we
23 meaning Capital One, planned to grow our lower risk,
24 prime and super prime credit card lending at a faster
25 rate than the subprime portion.

1 Does that sound like the business strategy
2 that we were talking about at the beginning of your
3 cross-examination?

4 A It's consistent with our strategy shift. As
5 Mr. May said, if Tatiana said this, and she does speak
6 for the company, then I would agree with her
7 statement.

8 Q Okay. In the next sentence she states that,
9 "In addition, we plan to diversify by focusing more on
10 personal installment loans, auto loans and consumer
11 lending internationally."

12 Does that also comport with what you
13 understand Capital One's business strategy to be at
14 the present time?

15 A Yes, although that really is just a
16 continuation of our previous strategy of
17 diversification both in these lines, as well as in the
18 international scene as well.

19 Q With respect to first class mail volume,
20 does Capital One use first class mail solicitations to
21 any significant extent to attract new business for
22 personal installment loans, auto loans or
23 international consumer loans?

24 A I'm not familiar with the specific mailing
25 patterns by its business line level. International I

1 guess is not relevant for this proceeding, but on the
2 other business lines you're talking about I'm not sure
3 what their patterns have been.

4 Q At least with respect to the international
5 consumer loans, Capital One wouldn't use first class
6 mail domestically to try to attract new customers for
7 that purpose, would it?

8 A I don't think we can.

9 Q I wouldn't think so either.

10 A Those are other countries.

11 Q I wouldn't think so either. I can't think
12 of a way anyway.

13 Are you at all familiar with the auto loan
14 part of the business?

15 A I'm familiar in their high growth and their
16 strategy of using the internet as well as mail, but
17 beyond that, no.

18 Q You don't know whether they use first class
19 mail solicitations?

20 A I don't. I'm sorry.

21 Q Are you aware that Capital One does use
22 first class mail solicitations to attract new credit
23 card customers?

24 A Yes.

25 Q If Capital One refocuses more away from

1 credit card customers and puts greater emphasis in
2 some of these other areas, is it your opinion that it
3 will likely use fewer first class mail solicitation
4 pieces to generate new business in those areas than it
5 would to attract new credit card customers?

6 A I can't draw any conclusions there, and I
7 also would not agree that we're shifting away from
8 credit cards in general.

9 Q Okay.

10 A There happens to be a higher rate of growth
11 in some of the non-credit card businesses, but the
12 dominant share of our business is still credit cards.

13 Q But simply you're refocusing within the
14 credit card segments, moving more toward the higher
15 scoring credit risks --

16 A That's fair.

17 Q -- and not the lower scoring?

18 MS. DREIFUSS: Thank you very much. I have
19 no further questions.

20 CHAIRMAN OMAS: Is there any follow up
21 cross-examination?

22 (No response.)

23 CHAIRMAN OMAS: Are there any questions from
24 the bench for Mr. Shippee? Mr. Covington?

25 COMMISSIONER COVINGTON: I have one, Mr.

1 Chairman.

2 Good morning, Mr. Shippee.

3 THE WITNESS: Good morning, Commissioner.

4 COMMISSIONER COVINGTON: I think in direct
5 questioning from Ms. Dreifuss from the Office of
6 Consumer Advocate you stated that you were pretty much
7 instrumental with negotiations of this agreement. Is
8 that correct?

9 THE WITNESS: That's true, yes.

10 COMMISSIONER COVINGTON: Okay. Can you give
11 me an estimation or can you tell me exactly how long
12 it took you, being Capital One, and parties from the
13 United States Postal Service to put together this
14 agreement that's before us now?

15 THE WITNESS: It was a multi-phase process
16 which started with idea generation by both parties to
17 talk about what might benefit each. That took a
18 period of months, and then once we decided on the
19 basic elements it took several more months to actually
20 reach an agreement, so from beginning to end probably
21 on the order of nine months give or take.

22 COMMISSIONER COVINGTON: Okay. So you're
23 saying nine months during the calendar year 2002?

24 THE WITNESS: The initial discussions
25 actually began in late 2001, I believe.

1 COMMISSIONER COVINGTON: Okay. One other
2 question. I noticed on page 4 of your testimony where
3 you say, "The negotiations leading to this agreement
4 were among the most difficult and lengthy in my
5 experience."

6 Now, how long have you been at Cap One, and
7 did you immediately leave Fleet to go to Capital One,
8 and were your responsibilities the same when you were
9 with Fleet?

10 THE WITNESS: I've been with Capital One
11 about seven and a half years. I did come directly to
12 Capital One from Fleet.

13 My responsibilities at Fleet Bank did not
14 relate to the postal world as it were, but they did
15 involve negotiating mergers and acquisitions of other
16 banks and other entities, so that's what I'm comparing
17 this negotiation to.

18 COMMISSIONER COVINGTON: Okay. Well, when
19 were you told by Capital One that you were going to be
20 I guess the go-to man with the United States Postal
21 Service as far as this experiment is concerned?

22 THE WITNESS: I don't think I was ever told
23 that I was going to be the go-to person for this
24 experiment. I took responsibility for the
25 relationship with the Postal Service about two years

1 ago.

2 COMMISSIONER COVINGTON: Okay. Now, I was
3 just going to point that out because in the first
4 paragraph of your testimony you say, "I am currently
5 responsible for the company's relationship with the
6 United States Postal Service."

7 Prior to the great concept of this
8 negotiated service agreement, what were your
9 responsibilities with the United States Postal
10 Service?

11 THE WITNESS: As with any large mailer, you
12 know, we have day-to-day conversations with our
13 national account manager and others that are
14 responsible for insuring that our mail is received and
15 delivered across the country.

16 We have conversations about many different
17 products and services that the Postal Service offers
18 such as confirm and, you know, every other -- product
19 redesign conversations were very active. You know, we
20 wanted to establish a high level contact with the
21 Postal Service since we're one of their largest
22 customers.

23 Those were a lot of the activities that took
24 place in the first year that I was responsible for the
25 relationship.

1 COMMISSIONER COVINGTON: Okay. How much
2 time do you actually spend in Richmond, Virginia?

3 THE WITNESS: I spend most of my time in
4 Richmond, Virginia. That's where my office is, so
5 probably 80 percent of my time.

6 COMMISSIONER COVINGTON: Okay. That's
7 comforting to know because a lot of the prior
8 witnesses that have appeared here before the
9 Commission don't spend any time down there at all, so
10 it's a little comforting to know that someone from
11 Capital One knows what's going on.

12 Back to page 4 of your testimony, that same
13 paragraph. It says, "Each party bargained in good
14 faith for the provisions it viewed as critical to make
15 the deal worthwhile."

16 THE WITNESS: Right.

17 COMMISSIONER COVINGTON: Okay. "On more
18 than one occasion, one or both parties appeared to be
19 ready to terminate discussions."

20 I don't think you want to tell me what the
21 hang ups were, do you?

22 THE WITNESS: I think I want to respect the
23 parties that were in the negotiating room and not go
24 into too much detail, but I think you can imagine the
25 key provisions in the agreement were very sensitive to

1 both parties. We have talked a lot about this
2 threshold.

3 COMMISSIONER COVINGTON: The threshold.

4 THE WITNESS: Clearly, that was one of the
5 provisions that caused some angst. This was new to
6 the Postal Service, and it was new for us as well. It
7 was not an easy, smooth process to reach an agreement
8 that both parties felt met their needs.

9 COMMISSIONER COVINGTON: Okay. Another
10 question, Mr. Shippee. You know, you're here for
11 rebuttal purposes. You stated that SLS Consulting,
12 and I'm familiar with some of the principals in that
13 firm, particularly with Mr. Larry Buck. Where are
14 they at with looking at your test year volumes?

15 I think in your testimony you state that
16 because you knew that the United States Postal Service
17 and Capital One were going to be coming to the PRC,
18 you felt it might be advisable to have somebody start
19 looking at volumes. I think you specifically stated
20 that in October, November and December 2002 this task
21 was relegated to SLS Consulting. Is that correct?

22 THE WITNESS: Well, we've used SLS
23 Consulting as an expert economic adviser in this case.
24 The company doesn't forecast mail volumes specific to
25 first class or standard class typically, and we knew

1 that was called for in this case and so we knew that
2 SLS could help us in that regard.

3 The specific data that you're talking about,
4 October, November and December, was supplied to them
5 since it was information that we had that could help
6 us determine whether the volume projections that we
7 had provided earlier were valid or whether they should
8 be subject to some revision, so we felt they would be
9 helpful in determining that.

10 COMMISSIONER COVINGTON: Okay. Now, one
11 last area that I wanted to touch on. UAAs. I think
12 you're familiar with that.

13 THE WITNESS: Yes.

14 COMMISSIONER COVINGTON: Can you honestly
15 tell me what is Capital One's UAA rate percentage
16 wise? I don't mean pieces of mail.

17 THE WITNESS: Right. It varies by line of
18 business due to demographic differences and even
19 geographic differences. It runs from, you know, five
20 or six percent with some business lines into the
21 double digits with others.

22 COMMISSIONER COVINGTON: Meaning 10 percent
23 or higher?

24 THE WITNESS: Meaning 10 or 12 percent in
25 some business lines.

1 COMMISSIONER COVINGTON: Okay. So
2 conceivably the address management portion of this
3 case is something that the Commission should actually
4 look at very closely too, right?

5 THE WITNESS: I think the Commission should
6 look at the address management portion of this
7 agreement as a huge opportunity because we are going
8 to get so much more information about why a piece of
9 mail is not deliverable than we have today that it's
10 going to help us make much more intelligent decisions,
11 I hope, about who to mail to and why certain pieces
12 don't get to the intended recipient. I think that
13 there's a huge opportunity in this agreement.

14 COMMISSIONER COVINGTON: All right. One
15 last question for Witness Shippee. Are you going to
16 continue to do that on your timetable, or are you
17 going to use the time specified by the United States
18 Postal Service?

19 In your testimony you said you more
20 frequently deal with your address management problems,
21 as opposed to what the United States Postal Service
22 required.

23 THE WITNESS: Oh, yes. We cleanse our
24 address databases much more frequently than the Postal
25 Service requires, but this agreement calls for a

1 number of additional address hygiene practices that
2 we'll certainly adhere to.

3 Again, I think that the receipt of this
4 electronic return and forwarding information will be
5 something of great value to us. It will end up saving
6 the Postal Service a great deal as well.

7 COMMISSIONER COVINGTON: Now, would that
8 mean every 30 days, every 60 days, or you still don't
9 know?

10 THE WITNESS: We know. We have committed to
11 cleansing our customer address list at least every 30
12 days and our prospect list at least every 60 days, but
13 in addition this electronic information is going to be
14 received virtually every day, as I understand, and
15 that will be incorporated into our databases
16 immediately upon receipt.

17 COMMISSIONER COVINGTON: Okay. Thanks, Mr.
18 Shippee.

19 That's all I have, Chairman Omas.

20 CHAIRMAN OMAS: If there are no other
21 further questions from the bench, Mr. May, would you
22 like some time with your witness?

23 MR. MAY: Just a moment. Just one second.

24 CHAIRMAN OMAS: All right. Fine.

25 (Pause.)

1 CHAIRMAN OMAS: Mr. May?

2 MR. MAY: Just very briefly, Mr. Chairman.

3 REDIRECT EXAMINATION

4 BY MR. MAY:

5 Q Mr. Shippee, OCA asked you about the SLS
6 estimate, which is reflected in their table, and noted
7 that it was under the threshold in this case. You had
8 I believe answered her question by saying that you
9 were comfortable with those estimates.

10 Dr. Elliott makes two alternate estimates,
11 does he not, in his testimony?

12 A Yes, he does.

13 Q And both of those estimates are slightly
14 above the threshold, are they not?

15 A That's right.

16 Q Are you comfortable with those alternate
17 estimates as reasonable estimates?

18 A Yes, I am. They're certainly in the
19 reasonable range.

20 Just as a point of information, our January
21 figures are in, and our first class mail in January
22 was 105 million, so I think if I do my math correctly
23 that's about 1.26 billion as a run rate if that were
24 to continue, so it's certainly in a reasonable range.

25 Q And if indeed the alternate estimates were

1 to eventuate then there would be some discounts
2 available under the agreement, would there not?

3 A There would be some. I think it's worth
4 noting that the existence of the incentives are very
5 likely to prompt us to try to meet and exceed the
6 1.225 billion, especially since we're so close in the
7 before rates.

8 MR. MAY: Thank you, Mr. Chairman.

9 CHAIRMAN OMAS: Mr. Shippee, that completes
10 your testimony here today. We appreciate your
11 appearance and your contribution to our record, and
12 you are now excused. Thank you.

13 THE WITNESS: Thank you.

14 (Witness excused.)

15 CHAIRMAN OMAS: Mr. May, would you please
16 introduce your next witness?

17 MR. MAY: Yes. Dr. Elliott, please.

18 CHAIRMAN OMAS: Mr. May, your mike please?
19 Thank you.

20 Dr. Elliott, you have already been sworn, so
21 we can proceed. Thank you.

22 //

23 //

24 //

25 //

1 Whereupon,

2 STUART ELLIOTT

3 having been previously duly sworn, was
4 recalled as a rebuttal witness herein and was examined
5 and testified in rebuttal further as follows:

6 (The documents referred to
7 were marked for
8 identification as Exhibit
9 Nos. COS-RT-2 and COS-LR-4.)

10 DIRECT EXAMINATION

11 BY MR. MAY:

12 Q Dr. Elliott, I'm going to hand you a
13 document, two copies of a document captioned Rebuttal
14 Testimony of Stuart Elliott on behalf of Capital One
15 Services, Inc., labeled COS-RT-2, and also two copies
16 of a library reference, Library Reference No. 4, and
17 I'm going to ask that you examine these documents.

18 CHAIRMAN OMAS: Mr. May, would you turn the
19 mike on, please?

20 MR. MAY: It is on, Your Honor.

21 CHAIRMAN OMAS: Okay.

22 BY MR. MAY:

23 Q I'm going to ask that you examine these
24 documents and see if they were prepared under your
25 direction.

1 A Yes, they were.

2 Q If you were to testify fully today, would
3 this be your testimony that you would adopt in this
4 proceeding?

5 A Yes, it would be.

6 MR. MAY: Mr. Chairman, I ask that the
7 rebuttal testimony of Dr. Elliott on behalf of Capital
8 One, COS-RT-2, and the library reference, COS-LR-4, be
9 received into evidence and that the testimony be
10 printed in the record.

11 CHAIRMAN OMAS: Is there any objection?

12 (No response.)

13 CHAIRMAN OMAS: Hearing none, I will direct
14 counsel to provide the reporter with two copies of the
15 corrected rebuttal testimony of Stuart Elliott. That
16 testimony is received and is to be transcribed into
17 evidence.

18 (The documents referred to,
19 previously identified as
20 Exhibit Nos. COS-RT-2 and
21 COS-LR-4, were received in
22 evidence.)

23 //

24 //

25 //

**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

**REBUTTAL TESTIMONY
OF
STUART ELLIOTT
ON BEHALF OF
CAPITAL ONE SERVICES, INC**

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February 25, 2003

1 **Autobiographical Sketch**

2

3 My name is Stuart W. Elliott. I am a Vice President at SLS Consulting, a
4 consulting firm located in Washington, DC. SLS specializes in economic,
5 operational, and environmental analyses on behalf of the mailing community. I
6 have a B.A. in Economics from Columbia University and a Ph.D. in Economics
7 from the Massachusetts Institute of Technology. After my formal education, I
8 was a Research Fellow at Carnegie Mellon University, a Senior Analyst at
9 Project Performance Corporation (PPC), and a Senior Associate at
10 PricewaterhouseCoopers. While at PPC, I presented testimony in Docket No.
11 R2000-1 on behalf of the National Newspaper Association, the Recording
12 Industry Association of America, and Magazine Publishers of America. I also
13 presented direct testimony regarding Capital One's FY 2003 mail volumes in this
14 docket.

15

16 **1. Purpose and Scope of Testimony**

17

18 The purpose of this testimony is threefold. First, the testimony rebuts the
19 testimony of OCA witness Smith regarding Capital One's FY 2003 Before Rates
20 volume forecast. Second, it shows, based upon recent volume data, that Capital
21 One's FY 2003 Before Rates First-Class Mail volume is likely to be less than
22 originally estimated, not more (as suggested by witness Smith). Third, it
23 calculates the increase in contribution that would result from the negotiated
24 service agreement (NSA) based upon a lower FY 2003 First-Class Mail volume.

1 **2. Neither of Witness Smith's Extrapolation Approaches for Forecasting**
2 **Capital One's FY 2003 First-Class Mail Volumes Are Accurate. Therefore,**
3 **His Assessment of Capital One's FY 2003 Before Rates First-Class Mail**
4 **Volume Is Baseless.**
5

6 During cross examination, witness Smith admitted that his extrapolation
7 approach rendered a mail volume "number that lacks credibility in the
8 neighborhood of 2.2 billion." Tr. 7/1310. He further conceded that this
9 extrapolation approach will not "generate accurate mail volume forecasts under
10 the following circumstances: 1) if future growth rates do not resemble past growth
11 rates; 2) base year mail volumes are unusually low or high; or 3) marketing
12 strategies of the firm change." Tr. 7/1304.
13

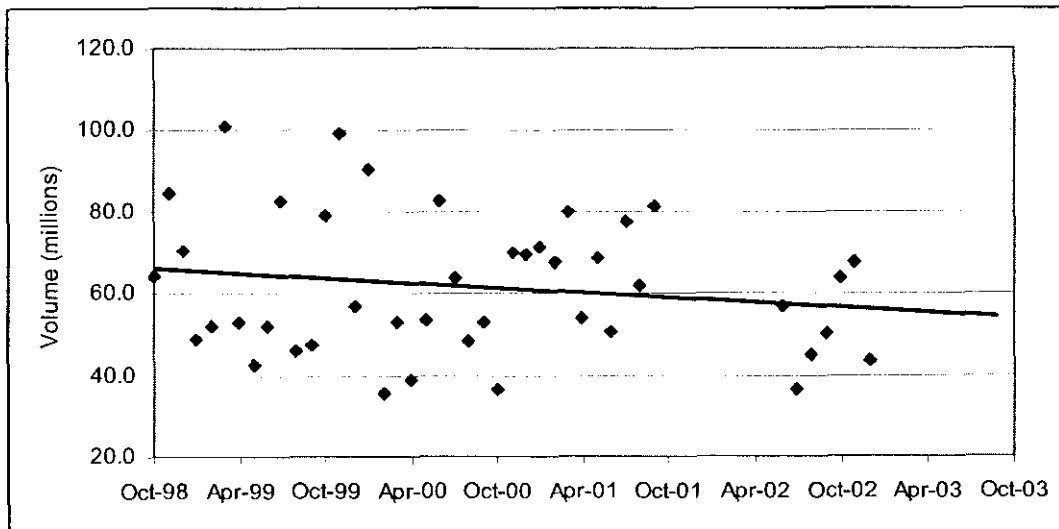
14 However, Smith asserted that using an earlier base year (FY 2001) for
15 solicitation volumes, but otherwise using his extrapolation approach, somehow
16 solves these problems. Tr. 7/1313. He is wrong. His "alternative projection,"
17 which was based partially upon an earlier base year, is inaccurate because it
18 does not resolve the issue that "future growth rates do not resemble past growth
19 rates." Therefore, his assessment that Capital One's volume is at the "lower
20 range of possible outcomes," which he noted during cross examination was
21 based upon his alternative volume projection, is baseless. Tr. 7/1244, 1312.
22
23

1 Specifically, in both of his approaches, OCA witness Smith used a significant
2 annual growth rate to project future customer mail volumes. Tr. 7/1257. The
3 annual growth rate for FY 2003, however, appears to be much lower. While the
4 actual growth rate from FY 2001 to FY 2002 was 24 percent, the annual growth
5 rate from calendar year (CY) 2001 to CY 2002 dropped to 17 percent. See
6 Exhibit 1. In fact, Exhibit 1 shows that Capital One's volume of customer mail
7 actually dropped from the first half of CY 2002 to the second half, which includes
8 the first quarter of FY 2003.

9
10 To forecast solicitation mail volumes in his alternative approach, witness Smith
11 applies an annual growth rate of 4.7 percent (the growth rate from FY 2000 to FY
12 2001) to FY 2001 volumes. Tr. 7/1284, 1290. This completely ignores the fact
13 that, as shown in Chart 1, the historical trend is, if anything, one of gradual
14 decline in First-Class Mail solicitation volumes.¹

¹ Note that the chart excludes the anomalous months following 9/11 discussed by witness Jean (Tr. 2/39) and in my direct testimony (Tr. 2/203-204)

**Chart 1. Capital One First-Class Mail Solicitation Volume by Month
(Excluding Anomalous Post-9/11 Period)**



Source: Exhibit 1

Another indication of the inaccuracy of witness Smith's forecasting approach is that his forecast of Capital One's October, November, and December First-Class Mail volumes overstated Capital One's actual volumes by 66 percent. Specifically, in response to a Postal Service interrogatory, witness Smith estimated that Capital One had mailed 527 million pieces of First-Class Mail in October, November, and December of 2002 (Tr. 7/1289-1290), two-thirds more than the 317 million First-Class Mail pieces that Capital One actually sent. As shown in Table 1 below, his estimates significantly overstated both customer mail (76 percent) and solicitation mail (58 percent). As witness Smith conceded, if his forecasts for October, November, and December of 2002 were off by an extreme degree, "it would suggest that this [forecasting] approach has failed." Tr. 7/1323-1324.

Table 1. Comparison of Actual FY 2003 October, November, and December First-Class Mail Volume With Those Projected by Witness Smith

Category	Actual [1]	Smith [2]	Difference (%) [3]
Customer	141,681,662	249,985,213	76.4%
Solicitation	175,437,720	277,227,649	58.0%
Total	317,119,382	527,212,862	66.3%

[1] Exhibit 1

[2] Tr. 7/1290

[3]= [2]/[1]-1

3. Capital One's First-Class Mail Volumes for the First Quarter of FY 2003 Imply a Before Rates First-Class Volume for FY 2003 of 1.210 Billion Pieces in the Absence of the Agreement.

As shown in Table 2, in the first quarter of FY 2003, Capital One mailed an average of 105.7 million First-Class Mail pieces per month. If Capital One continues at this pace for the rest of the fiscal year, its Test Year Before Rates First-Class Mail volume will be 1.268 billion pieces, significantly less than its initial FY 2003 Before Rates mail volume estimate of 1.408 billion pieces. Tr. 2/206. This suggests that Capital One's initial estimate was optimistic.

In fact, an analysis of historical volumes suggests that FY 2003 mail volumes are likely to be less than 1.268 billion pieces. Specifically, since the beginning of FY 1999, Capital One's monthly First-Class Mail volumes were higher in the first quarter than during the remainder of the fiscal year. In other words, as shown in Exhibit 2, Capital One has mailed more than 25 percent of its fiscal year volumes in October, November, and December.² Therefore, assuming that Capital One's

² Note that this holds true regardless of whether the anomalously high volumes of early FY 2002 are included or not.

1 mail volume will continue at Quarter 1 levels is likely to slightly overstate volume
 2 for the entire fiscal year, thereby generating a conservatively high FY 2003
 3 Before Rates volume forecast. Table 2 shows a FY 2003 forecast based on
 4 Quarter 1 volumes and the historical percentage of Quarter 1 volumes of 26.2
 5 percent for the years FY 1999 to FY 2001.³

6 **Table 2. FY 2003 Before Rates First-Class Mail Volume**

Category	FY 2003 Average Q1 Monthly [1]	FY 2003 Forecast Total [2]
First-Class Mail Volume	105,706,461	1,210,249,622

8 [1] Actual Volumes from Table 1 divided by 3

9 [2] Exhibit 3, cells (4) and (5)

10

11 Finally, it is important to recognize that the FY 2003 forecast in Table 2 uses an
 12 estimate of the Quarter 1 volume percentage that was calculated using data from
 13 FY 1999 to FY 2001, a period of high growth in customer mail. This high growth
 14 would have increased customer mail volume in the later quarters of each fiscal
 15 year, thereby lowering the percentage of mail volume sent in Quarter 1. Since
 16 customer mail growth has slowed, Quarter 1's percentage of the full FY 2003
 17 volume is likely to be greater than 26.2 percent, implying that this forecast of FY
 18 2003 First-Class Mail volume in Table 2 is somewhat overstated.

19

20

³ Other possible versions of this same general approach result in similar projections. For example, an approach that uses the same historical period but calculates separate percentages for customer and solicitation mail results in total projected FY 2003 mail volume of 1.245 billion.

4. If Capital One's Test Year Before Rates First-Class Mail Volume Is 1.210 Billion Pieces, Then the NSA Will Increase Capital One's Contribution to Institutional Costs by \$11.4 Million, \$3.2 Million More Than the \$8.2 Million Estimated by Witness Crum.

Table 3 calculates the increase in contribution that will result from the NSA if Capital One's FY 2003 Before Rates mail volume is 1.210 billion First-Class Mail pieces. At this volume, the NSA would result in no mail above the threshold of 1.225 billion pieces in FY 2003, which would result in no discount being paid to Capital One and therefore no After-Rates increase in mail volume.⁴ In Exhibit 3, I use the cost model presented by witness Crum (USPS-T-3, Attachment A, Page 2) to calculate that the NSA will reduce Capital One's FY 2003 unit cost by 0.94 cents per piece, translating into an increase in Capital One's contribution of \$11.4 million.⁵

Table 3. Test Year Contribution from NSA Based Upon Initial and Revised Volumes

Category	TYBR Volume	TYAR Volume	NSA Contribution
Initial [1]	1,408,000,000	1,423,458,969	\$8.2 million
Revised [2]	1,210,249,622	1,210,249,622	\$11.4 million

[1] Tr. 2/211; USPS-T-3, Attachment B

[2] Table 2; Volume * ((24)-(25)) from Exhibit 3

⁴ Note that the projected mail volume of 1.210 billion is only 1.2 percent less than the threshold of 1.225 billion. Given the uncertainty in any mail volume projection, there is some chance that actual volume will turn out to be above the threshold, resulting in a discount being paid on some mail pieces and an After-Rates increase in mail volume.

⁵ Note that the only differences between Exhibit 3 and USPS-T-3, Attachment, Page 2 are the Before Rates volume figures. Electronic versions of my exhibits have been filed as COS-LR-4.

1 **5. CONCLUSION**

2
3 Of course, we cannot forecast with certainty Capital One's Test Year volumes.
4 The real import of our new analysis, based on new volume data, is that the
5 established threshold of 1.225 billion in the NSA is a reasonable one -- one that
6 may or may not be met; and that predictions of volumes greatly in excess of that
7 threshold are devoid of any practical or theoretical substance.
8

1 CHAIRMAN OMAS: This now brings us to oral
2 cross-examination. One party, the Office of Consumer
3 Advocate, has requested oral cross-examination.

4 Is there any other party here today who
5 wishes to cross-examine Witness Elliott?

6 (No response.)

7 CHAIRMAN OMAS: Ms. Dreifuss, that brings us
8 to you.

9 CROSS-EXAMINATION

10 BY MS. DREIFUSS:

11 Q Good morning, Dr. Elliott.

12 A Good morning, Ms. Dreifuss.

13 Q You were the subject of discussion, as you
14 know, with Mr. Shippee, so I might as well go to the
15 source and ask a little bit more about the volume
16 estimates that you present in your rebuttal testimony
17 and also that you presented initially.

18 Could you turn to Table 3 of your testimony?
19 That's at page 7.

20 A I have it.

21 Q In that table you present estimates you
22 developed, I believe, for Capital One's total first
23 class mail volumes both for the test year before rates
24 and the test year after rates. Is that correct?

25 A That's correct, yes, in the revised line.

1 Q Yes. That's the second line, the revised
2 line.

3 The 1.21 billion piece figure that you
4 present, the revised figure, is that the result of
5 separate estimations for first class customer mail and
6 for first class solicitation mail?

7 A That particular estimate is the result of a
8 combined estimation using the overall totals for the
9 three months.

10 Q So when you developed that estimate you
11 incorporated data both for customer and for
12 solicitation mail in the model?

13 A Incorporated both, yes, and essentially
14 treated them together.

15 Q You were able in your model to generate
16 separate customer mail volume estimates and separate
17 solicitation mail volume estimates, were you not?

18 A In a mechanical way, yes.

19 Q In Exhibit 3 of Library Reference 4 -- do
20 you happen to have that with you?

21 A Yes, I do.

22 Q Okay. You present a before rate customer
23 mail volume estimate -- that's Line 4 -- of 540.7
24 million pieces. Is that correct?

25 A That is correct.

1 Q And you present a before rate solicitation
2 mail volume figure of 669.5 million pieces at Line 5,
3 do you not?

4 A Right. Yes. That's correct.

5 Q Let's compare for a moment the current pair
6 of estimates for customer mail and solicitation mail
7 with your earlier estimates. I've got copies of your
8 initial testimony with me if you need them. If you
9 can rely on memory or subject to check --

10 A I have what is sufficient here.

11 Q Okay. That's fine. In your initial
12 testimony, you had presented Capital One's projection
13 of first class solicitations volume at 768 million
14 pieces. Is that correct?

15 A For the solicitation, yes.

16 Q For solicitation, yes. And the revised
17 figure that I just cited in Exhibit 3 is 669.5 million
18 pieces, correct?

19 A That is correct.

20 Q So that's approximately a 100 million piece
21 decline between the initial figure and the rebuttal
22 figure. Is that correct?

23 A Right. Yes. That is correct.

24 Q The initial customer volume figure you
25 presented was 640 million pieces, but the rebuttal

1 figure that you present is 540.7 million pieces. Is
2 that correct?

3 A Yes, that is correct.

4 Q Again, that's a decline of approximately 100
5 million pieces, is it not?

6 A Yes.

7 Q I discussed this with Mr. Shippee, and I'll
8 just take a moment to go over it with you again since
9 you were involved in projecting volumes both at the
10 initial round and the rebuttal round of this case.

11 The test year before rates volume figures
12 you presented in your initial testimony were provided
13 to you by Capital One, were they not?

14 A Yes, that is correct.

15 Q And by contrast, you estimated volumes from
16 data they gave you in the rebuttal phase?

17 A Yes, that's correct.

18 Q At page 3, Lines 13 through 14 of your
19 rebuttal testimony, you indicate that Capital One
20 exhibits an historical trend of gradual decline in
21 first class mail solicitation volume. Is that
22 correct?

23 A Yes, that is correct.

24 Q Have you projected an historical trend for
25 customer volume?

1 A No, I have not. I did note in the testimony
2 that -- well, I believe in my direct testimony I
3 provided some figures on past growth, and I did note
4 that there has been a drop during the second quarter
5 of 2002 in this rebuttal testimony.

6 Q Right. In fact, you project a downward
7 change from actual calendar year 2002 customer mail
8 figures to test year customer mail estimates, do you
9 not? That is, calendar year customer mail figures,
10 the actual figures, you expect will be higher than the
11 test year customer mail figures. Is that correct?

12 A If you're comparing that with the 540
13 million, although you've gone down this line. I just
14 want to clarify that I made several estimates, and the
15 estimate that you are using was derived in a combined
16 way and wasn't meant to be broken apart. It's a ball
17 park way of arriving at a figure.

18 In one of the footnotes of the testimony I
19 also refer to projection that's actually based on
20 separate projections for customer and solicitation
21 mail.

22 Q Could you direct my attention to that
23 footnote, please?

24 A That footnote is Footnote No. 3 on page 6.

25 Q Have you provided those estimates?

1 A The full -- no. The full broken apart
2 figure is not on the record.

3 Q Okay. Do you have the figures with you?

4 A Yes, I do.

5 Q Could you tell me what they are?

6 A The figure for customer mail volume is 608
7 million, and the figure for solicitation mail volume
8 is 637 million.

9 Q I guess the customer figure that you just
10 gave me is somewhat higher than I see on Line 4 of
11 Exhibit 3. Is that correct?

12 A Yes. Yes. What happens is that the mix
13 changes. The total goes up a little bit, but the mix
14 changes towards the customer and away from the
15 solicitation.

16 Q Right. Do you recall what the calendar year
17 2002 customer mail figure was? Do you recall the
18 total?

19 A No.

20 Q Do you know if the 608 million is less than
21 2002, the calendar year 2002 actual figure?

22 A On Exhibit 1 there is --

23 CHAIRMAN OMAS: Dr. Elliott, would you
24 please bring the mike closer?

25 THE WITNESS: Oh, okay. Sorry. I believe

1 the total is in the ball park of 580 million for
2 calendar year.

3 BY MS. DREIFUSS:

4 Q I'm looking at Exhibit 1 now, and I see also
5 that --

6 A Right.

7 Q -- it's less than 600 million. So you're
8 actually projecting a slight increase? You separately
9 project a slight increase in customer mail over
10 calendar year 2002?

11 A Right. Yes. That's correct.

12 Q And because of the simultaneity of your
13 total projection, that I suppose causes an even
14 greater decline in the solicitation mail volume figure
15 for the test year than we originally discussed a few
16 minutes ago?

17 A Right. Yes. That's correct.

18 Q Okay. In Table 3 that I discussed just a
19 little earlier with Mr. Shippee, you show that test
20 year after rates volumes will be the same as test year
21 before rates volumes, do you not?

22 A Yes, that is correct.

23 Q And the reason for that is if volumes do
24 turn out to be 1.21 billion pieces in the test year
25 then no discounts will be paid to Capital One?

1 A Yes. That would be correct.

2 MS. DREIFUSS: I have no further questions,
3 Mr. Chairman.

4 CHAIRMAN OMAS: Thank you, Ms. Dreifuss.

5 Is there anyone else in the room who would
6 like to cross-examine Mr. Elliott?

7 (No response.)

8 CHAIRMAN OMAS: Any questions from the
9 bench? Mrs. Goldway?

10 COMMISSIONER GOLDWAY: I just have one
11 question. Thank you, Mr. Chairman.

12 I just wanted to clarify for the record a
13 comment that you make in your testimony regarding
14 Chart No. 1 on page 4.

15 THE WITNESS: Uh-huh.

16 COMMISSIONER GOLDWAY: You make the comment
17 actually on page 3 previous to the chart. You
18 indicate that the chart shows with historical trends
19 that, if anything, there is a decline in first class
20 mail volume solicitation from the period of October
21 1998 --

22 THE WITNESS: That's correct.

23 COMMISSIONER GOLDWAY: -- through October 3,
24 but have you done any statistical tests to determine
25 that the slope of that line is in fact significantly

1 different from zero?

2 THE WITNESS: I have checked to see whether
3 or not one would want to say the trend is negative or
4 positive, and if one were to say that the trend is
5 negative you'd have an 89 percent chance of being
6 right.

7 The customary figure of 95 percent
8 confidence isn't met, but I feel more comfortable
9 being in the 89 percent end of things rather than the
10 corresponding 11 percent end of trying to say that
11 there is a positive trend.

12 COMMISSIONER GOLDWAY: But one can see that
13 there is a certain equanimity in that trend line over
14 time if you average it out in spite of very different
15 business models and mailing patterns in various
16 months.

17 THE WITNESS: Do you mean it's possible to
18 imagine that it's zero?

19 COMMISSIONER GOLDWAY: Yes.

20 THE WITNESS: Yes, it is possible to imagine
21 that it's zero, although that would not be the best
22 guess if you were trying to minimize your error.

23 COMMISSIONER GOLDWAY: Okay. Thank you for
24 clarifying that for the record.

25 CHAIRMAN OMAS: Mr. May, would you like time

1 with the witness to determine whether you need cross-
2 examination?

3 MR. MAY: No, Mr. Chairman.

4 CHAIRMAN OMAS: Thank you. Dr. Elliott,
5 that completes your testimony here today. We
6 appreciate your appearance and your contribution to
7 the record, and you are now excused. Thank you.

8 THE WITNESS: Thank you.

9 (Witness excused.)

10 CHAIRMAN OMAS: We have several people to
11 cross-examine our next witness, so why don't we take a
12 brief say 10 minute break before we start with Mr.
13 Plunkett?

14 (Whereupon, a short recess was taken.)

15 CHAIRMAN OMAS: Mr. Reiter, would you please
16 introduce your next witness?

17 MR. REITER: Yes, Mr. Chairman. Our next
18 witness is Michael Plunkett.

19 CHAIRMAN OMAS: Thank you. Mr. Plunkett, as
20 you know, you've already been sworn in for this
21 proceeding.

22 MR. PLUNKETT: Yes.

23 //

24 //

25 //

1 Whereupon,

2 MICHAEL K. PLUNKETT

3 having been previously duly sworn, was
4 recalled as a rebuttal witness herein and was examined
5 and testified in rebuttal further as follows:

6 (The document referred to was
7 marked for identification as
8 Exhibit No. USPS-RT-1.)

9 DIRECT EXAMINATION

10 BY MR. REITER:

11 Q Mr. Plunkett, I'll hand you two copies of a
12 document entitled Rebuttal Testimony of Michael K.
13 Plunkett on behalf of the United States Postal
14 Service, USPS-RT-1. Was this testimony prepared by
15 you or under your direction?

16 A Yes, it was.

17 Q And do you have any changes or typos to
18 correct from the original filed version?

19 A I do have a somewhat embarrassing number of
20 typographical corrections to make.

21 On page 3 in the exhibit entitled Table No.
22 1 in the footnote on the first line where it says
23 "USPS-T3" it should say "USPS-T-3." On the third line
24 there is an extra I leading the word "estimated."
25 That should be deleted.

1 On page 4, Line 19, the sentence beginning,
2 "Witness Callow's proposes..." should read, "Witness
3 Callow...", no possessive. On page 5, there's an
4 inadvertent deletion of the word "of" on Line 10. The
5 sentence ending "...if it is to be disposed," should
6 end, "...if it is to be disposed of."

7 On page 6, Lines 4 and 5, the phrase "The
8 requirement that mailers update their databases with
9 the address," should be deleted. On Line 11 there is
10 an extraneous period that should be deleted. Lines 17
11 through 19, the sentence, "Witness Callow is incorrect
12 that only a limited number of mailers could
13 participate because of the NCOA requirement," can be
14 deleted as redundant.

15 On page 8, Line 8, the word "mail" should be
16 inserted after the words "first class," and Line 9 the
17 word "mailers" should be replaced by the two words
18 "mail users."

19 MR. REITER: Thank you, Mr. Plunkett.

20 Mr. Chairman, I will provide two copies of
21 the testimony containing all of those corrections to
22 the reporter and ask that they be entered into
23 evidence as Mr. Plunkett's rebuttal testimony and
24 transcribed in the record.

25 CHAIRMAN OMAS: I will direct counsel to

1 provide the reporter with two copies of the corrected
2 rebuttal testimony of Michael K. Plunkett. That
3 testimony is received into evidence and is to be
4 transcribed.

5 (The document referred to,
6 previously identified as
7 Exhibit No. USPS-RT-1, was
8 received in evidence.)

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USPS-RT-1

**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.

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1

TABLE 1

Estimated Test Year Contribution Impact From Conversion of Acquisition Mail to Standard Mail Capital One Services			
	Projected test year		
	Volume (millions)	Unit Contribution (cents) ¹	Total Contribution (\$ millions)
	(a)	(b)	(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)	Unit Contribution (cents)	Total Contribution (\$ millions)
	(a)	(b)	(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-T-3, 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

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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 Witness Callow proposes to establish two new classifications in lieu of the NSA.
19
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.

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- 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 of. 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.

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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 correction

5
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.

18
19 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.

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

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

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

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

1 CHAIRMAN OMAS: This now brings us to oral
2 cross-examination. Two parties have requested oral
3 cross, the Newspaper Association of America and the
4 Office of Consumer Advocate.

5 Mr. Baker?

6 MR. BAKER: Thank you, Mr. Chairman.

7 CROSS-EXAMINATION

8 BY MR. BAKER:

9 Q Good morning, Mr. Plunkett.

10 A Good morning.

11 Q Let's start by turning to page 6 of your
12 testimony and direct your attention to Line 19.

13 A Yes.

14 Q There you state that, "This case has brought
15 to life important issues relating to the pricing of
16 address correction services and the associated
17 operational impacts." Could you identify for me what
18 those important issues are?

19 A Well, I think as has been stated on the
20 record that the current pricing, which imposes a fee
21 on a per transaction basis, has the undesirable
22 consequence of keeping most of the largest users of
23 first class out of that service.

24 Let's use Capital One as an example. The
25 rate at which they generate UAA mail if they were

1 subscribing to that service today, they would incur
2 millions of dollars in additional cost. They have
3 been able to identify what is in their minds an
4 appropriate substitute at a much lower cost. I think
5 as has also been stated, that appears to be typical.

6 As has been discussed in my original
7 testimony and Witness Crum's testimony, the
8 operational consequences for the Postal Service of the
9 inability to keep the largest first class mailers as
10 users of ACS service is that the Postal Service incurs
11 tens of millions of dollars in additional costs
12 associated with handling undeliverable addressed mail
13 that is associated with first class advertising mail.

14 Q One thing you stated there was the current
15 fee for EACS. Are there any other important issues
16 related to the pricing of address correction services?

17 A Well, that was what was meant by my
18 testimony.

19 Q Were you also thinking of the implicit
20 marginal fee of zero for the physical returns as part
21 of that?

22 A Not explicitly, no.

23 Q And is that an important pricing issue, do
24 you think?

25 A One could consider that an important pricing

1 issue, but I don't consider that necessarily a pricing
2 issue that has a specific relevance to address
3 correction services. That has to do with the pricing
4 of first class mail more generally, and that is not
5 what I was referring to in this testimony.

6 Q So the fact that a large mailer may opt for
7 accepting physical returns for marginal cost of zero
8 rather than the lower cost electronic returns that
9 have a price of 20 cents is not what you meant by that
10 passage in your testimony?

11 A Not at all, and I wouldn't necessarily
12 characterize it as opting for acceptance of physical
13 returns. That is the default option on first class
14 mail, and it is something that all users receive as a
15 consequence of using first class mail.

16 Q Well, they do have the choice today of
17 taking electronic service ACS, don't they, electronic
18 address correction service today, do they not?

19 A I guess I was making a distinction between
20 on the one hand the requirement that a customer
21 actually make an effort to participate in ACS, as
22 opposed to the default option, which is in the absence
23 of any effort whatsoever all users of first class mail
24 are entitled to the physical return of pieces that are
25 not deliverable as addressed. I think that's a

1 worthwhile distinction to maintain.

2 Q All right. You go on to say in the next
3 line that these issues warrant careful consideration,
4 although not in this case.

5 As a postal pricing expert, are you going to
6 recommend internally within the Postal Service that
7 the pricing of EACS and physical returns should be
8 reviewed?

9 A It's being reviewed right now.

10 Q Are you part of that?

11 A Indirectly. I am not the expert on pricing
12 special services, but I work in the Pricing and
13 Classification organization so I am often party to
14 discussions of that kind. The decisions won't be made
15 by me.

16 Q All right. Now I'd like you to turn to page
17 1 of your testimony.

18 A Yes.

19 Q I direct your attention here to the sentence
20 beginning at Line 7 going on through Line 10 there.
21 You state, "Despite," and your word is "exemplary use
22 of address management practices that far exceed
23 existing requirements..." -- I'll skip the citation --
24 "...Capital One generates proportionately more return
25 undeliverable as addressed mail compared to more

1 traditional first class mailers."

2 My first question, and it's sort of a minor
3 point, was we were trying to decide whether the word
4 is proportionately or disproportionately. What were
5 you trying to convey with that word?

6 A That all other things being equal when
7 compared with -- for example, if you were comparing
8 Capital One to a mailer of comparable size that was
9 mailing solely statements or other kinds of customer
10 mail, Capital One's mail would produce more UAA or
11 undeliverable as addressed mail than a hypothetical
12 mailer of comparable size.

13 Q Now, I understand that you're here as a
14 pricing witness, not as a costing witness. Let me ask
15 you whether it is your understanding that the costs of
16 UAA first class mail are attributed to first class
17 mail as a class rather than as being specifically
18 charged to any particular mailer.

19 A I believe that to be the case, yes.

20 Q Okay. Now, here in this NSA one mailer has
21 agreed to reduce its physical returns by the efforts
22 it would undertake as part of the NSA, but on the
23 condition that it get some of the cost savings the
24 Postal Service would enjoy back in the form of volume
25 discounts and I would say fee waivers. Is that

1 correct?

2 A I'm slightly uncomfortable with the use of
3 the term condition.

4 Q That was a term of the agreement, wasn't it?

5 A Yes. To the extent they're embodied in the
6 same agreement they are related, but I'm not sure the
7 nexus is as direct as is implied by the word
8 condition.

9 Q And so although the cost of physical returns
10 are not attributed directly to Capital One, but rather
11 are spread among all first class mailers, the cost
12 savings from Capital One, the cost savings to the
13 Postal Service resulting from Capital One changing its
14 mailing practices to reduce the amount of UAA returned
15 mail, would be given in part to it. Is that correct?

16 A This is perhaps a good illustration of why I
17 was uncomfortable with the use of the term condition.

18 As I have explained in my testimony, the
19 savings to the Postal Service that will accrue as a
20 result of Capital One's agreement to convert to
21 electronic address correction service far exceeds the
22 expected amount of discounts to Capital One, so in
23 fact those savings benefit all users of first class
24 mail.

25 I wouldn't necessarily use the term can then

1 be attributed to all users because it's not an issue
2 of attribution, but they will cause an overall
3 reduction in institutional costs that renounce to the
4 benefit of all users of first class mail.

5 Q To the extent that Capital One is a first
6 class mailer it might see that itself, but it also
7 sees a more immediate and direct return to it in the
8 form of the discounts and, I would argue, the fee
9 waivers. Is that correct?

10 A Well, again I'm uncomfortable with implying
11 such a direct cause and effect relationship between
12 the agreement on Capital One's part to convert to
13 electronic address change service and the declining
14 block rates that are also embodied in this agreement.

15 They exist in the same agreement. That is
16 true, but it is not a quid pro quo in the sense that I
17 think is being implied.

18 Q They exist in the same agreement, but are
19 not part of a quid pro quo. Okay.

20 What you're saying here is the discounts in
21 charge for the change in business practice, you don't
22 consider that to be a reward for fixing bad mailing
23 behavior, do you?

24 A No, I don't.

25 Q Okay.

1 A If you want, I can maybe elaborate on why.

2 Q No, I don't really want you to, but Mr. May
3 or someone might.

4 Let me give you a hypothetical situation
5 here of a first class mailer that mails two ounce
6 flats and comes to the Postal Service and says gee,
7 I've come to realize that flats cost you more to
8 handle than first class and letters do.

9 You know, I can fold and put them in a
10 letter envelope so it costs you less to handle and
11 deliver, but I would want to share in the cost savings
12 that you would enjoy through that by some kind of rate
13 discount. Would that hypothetical mailer be a
14 candidate for an NSA?

15 A You know, when we enter into discussions
16 with a company about a potential NSA we generally
17 start with a much broader set of issues than something
18 that narrowly focused, but my initial reaction to that
19 would be they will get a much lower price per piece
20 because the rate on the letters will be much lower
21 than the rate on the flats.

22 Q In first class mail?

23 A No. If there's no surcharge I guess they
24 wouldn't be, but, on the other hand, we tend to look
25 at a much larger set of issues than that.

1 Q A much larger set of issues. So just saying
2 I can convert to a lower cost way of handling wouldn't
3 necessarily make them attractive to the Postal Service
4 as an NSA?

5 A Well, it's very unlikely we would be able to
6 isolate that single change from either the rest of
7 that mailer's use of postal services or the effect
8 that that change might have on other users of first
9 class mail.

10 In the absence of, you know, some kind of
11 additional contextual information it's hard for me to
12 know how we would respond to that. I can't find any
13 immediate fault with it, but it's difficult to
14 evaluate in isolate without an appropriate context.

15 Q Well, the hypothetical is an example of a
16 mailer who's willing to shift to a mailing practice
17 that's less costly to the Postal Service, but only if
18 it gets a rate incentive to do so. Do you regard that
19 hypothetical as different from this case?

20 A There are some obvious similarities, and
21 maybe I'm having difficulty because I can't help but
22 know so much more about what was going on in the
23 discussions with Capital One that it makes it
24 difficult for me to make a direct comparison.

25 As I said, I see nothing on the face of that

1 hypothetical situation that would cause us to reject
2 the idea out of hand, and we would probably consider
3 it. Does that necessarily mean that we would engage
4 in an agreement with that company? I don't really
5 know.

6 Q And if I amended the hypothetical to tell
7 you that this mailer would also mail 700 million
8 pieces of solicitation flats, would that affect your
9 answer?

10 A That they were not otherwise going to mail?

11 Q No. That they could mail as letters just as
12 well.

13 A My question, though, is is it mail that
14 they're already sending?

15 Q Yes.

16 A Well, it certainly increases the size of the
17 potential savings, and to the extent we're about
18 making sure that the expected benefits exceed the
19 transaction cost of negotiating and agreement and
20 litigating it that fact makes it perhaps more
21 appealing hypothetically.

22 Again that doesn't necessarily imply that we
23 would by necessity enter into an agreement with that
24 company because we would weigh a number of other
25 factors besides.

1 Q Changing the subject a little bit, a recent
2 issue of the *Business Mailers Review* reports that the
3 Postal Service I think later this month will be
4 rolling out a national move update initiative. Are
5 you familiar with that initiative?

6 A No, I'm not.

7 Q No, you're not. So I suppose I won't ask
8 you a whole lot of questions about that.

9 A It's unlikely I'd be able to answer them.

10 Q Okay. Could you turn to Table 1 of your
11 testimony on page 3?

12 A Yes.

13 Q On this table you present the simple
14 calculation of a net contribution change in the
15 unlikely event that Capital One would convert all of
16 its solicitation mail from first class to standard,
17 correct?

18 A That's correct.

19 Q You're not saying, are you, that Capital One
20 has threatened to do so?

21 A No, and I don't necessarily expect them to
22 do so either.

23 Q And the table assumes that standard and
24 first class mail are perfectly acceptable substitutes
25 for one another for purposes of the illustration,

1 correct?

2 A That is certainly an implied assumption,
3 yes.

4 Q And I notice that the unit contribution
5 difference per piece is roughly 6.89 cents unit
6 contribution between first and standard, right?

7 A That sounds about right. Yes.

8 Q If a shift of that nature had this magnitude
9 of consequence, might that suggest to you that perhaps
10 the Postal Service is overly reliant on the market for
11 first class mail?

12 A Not necessarily, because in your
13 introductory question you asked me to accept the
14 premise that in my hypothetical situation here the two
15 products are perfectly acceptable substitutes for one
16 another. That is certainly not true in the case of
17 most first class mail.

18 Q So when you go through the exercise of Table
19 1, it doesn't present a concern to you that the mark
20 up on first class mail may be excessive or troubling
21 high?

22 A No, it doesn't.

23 Q No, it doesn't. I don't suppose I can
24 expect a Postal Service pricing witness to say so, but
25 I thought I'd ask.

1 You discuss that table and continue on to
2 page 4 of your testimony. I'm looking now at the
3 paragraph beginning on Line 3 and in particular your
4 statements in Line 4. It goes on, and you mention
5 Capital One's use of first class mail for advertising
6 makes a substantial contribution to other mail. You
7 used the word I think dwarf. Cost of UAA is dwarfed
8 by the contribution from Capital One.

9 Is that saying that it's accurate to say
10 that Capital One may cost the Postal Service some
11 extra cost, but they're such a large volume user that
12 it's worth it?

13 A . I might say it slightly differently. I
14 mean, it might have taken me several pages to make
15 what I think is a very basic point. The point is in a
16 number of instances throughout these proceedings it
17 has been implied that the Postal Service might somehow
18 be better off if this mail just traveled as standard
19 mail, and, therefore, these issues didn't arise.

20 I was trying to illustrate why the overall
21 effect of such an outcome would be harmful not just to
22 the Postal Service, but to all of its customers.

23 Q If Capital One had only say one-quarter of
24 the first class volume that it now has, its
25 contribution would be less. Is that correct?

1 A That's correct.

2 Q Would it be less likely in that case that
3 the Postal Service would want to enter into an NSA
4 with it?

5 A No, I don't think so. We're in active
6 discussions with companies smaller than one-quarter
7 the size of Capital One in terms of overall Postal
8 Service spending, so there's certainly no floor of
9 that kind that's been established.

10 Q Well, that's an interesting question because
11 it leads to my next question. If this NSA were
12 approved by the Commission and were to take effect and
13 be implemented, is it your expectation that there
14 would be a lot more NSAs or only a few?

15 A Could you define what you mean by a lot?

16 Q Well, maybe I'll ask you. How many more
17 NSAs do you think we might be having? Ten? Twenty?
18 Thirty? Two? Three?

19 A To a very large extent that depends very
20 heavily on what is contained in the Commission's
21 decision, if it sets forth any determination about
22 what constitutes a similarly situated mailer, whether
23 or not some kind of rule making ensues that results in
24 a more expedited set of procedures. There are a lot
25 of variables that would affect the number and types of

1 agreements we would be able to enter into.

2 A point I would make, though, is since we've
3 done one up until now, one can consider two to be a
4 lot.

5 Q Well, let me explore this a little bit. On
6 page 6, the top bulleted paragraph on page 6 where
7 you're expressing a concern about Witness Callow's
8 proposal, at Lines 8 through 10 you state that the
9 compliance that would be required on the part of the
10 Postal Service, the monitoring of compliance that the
11 Postal Service would be required to do in your
12 understanding of Mr. Callow's proposal, would be a
13 realistic objective for a single customer, but
14 monitoring such compliance would represent a
15 significant Postal resource commitment for a large
16 number of customers that might convert to this sort of
17 NSA kind of agreement or arrangement proposed by Mr.
18 Callow.

19 That suggests to me that the Postal Service
20 at least at this point would not want a lot of NSAs or
21 at least a lot of NSAs that require it to monitor
22 address updates. Is that a fair characterization of
23 what you meant?

24 A Not exactly.

25 Q Okay.

1 A I'd put it this way. The Postal Service has
2 a significant amount of resources dedicated to
3 activities generally associated with rate making
4 because of its, I mean, 30 years of having filed
5 omnibus cases.

6 The Postal Service has not invested heavily
7 in the infrastructure needed to support the kinds of
8 monitoring and compliance that I think Witness
9 Callow's proposals would set up. I think that's
10 appropriate. The Postal Service is cautiously
11 optimistic, but is waiting to see the results of the
12 first case, and then we'll make decisions about
13 whether to devote resources to additional cases.

14 Certainly if we are successful in this one
15 and it produces the results we anticipate, we would
16 want to do more, but the fact is the infrastructure
17 necessary to support a much larger number of NSAs does
18 not yet exist, and any Postal Service decision to
19 invest in those kinds of infrastructures depends very
20 heavily on being assured that these agreements produce
21 the intended result.

22 Q Well, that sounds like you're not expecting
23 there to be many NSAs any time soon at least.

24 A I don't know what you mean by many. As I
25 said, since we've done one this year some people would

1 think if we did three or four next year that would be
2 a significant increase.

3 Q Well, let's ask about the word many because
4 you use it on page 8 of your testimony at Line 12 when
5 you say, "Having discussed NSAs with many credit card
6 companies competing with Capital One...", and you go
7 on to denote their interest in this proceeding is
8 apparent.

9 Further on you say their interests lie in
10 having the NSA implemented since it would be a model
11 perhaps for subsequent agreements for them. How many?

12 A The credit card industry is somewhat heavily
13 concentrated, and the vast majority of cards are
14 issued by a relatively small number of companies.

15 Considered in that light, I would say, and
16 we have done some work on the credit card industry as
17 a result of this case and subsequent analysis. I'm
18 aware of only one significant credit card company with
19 which we have not had any discussions pertaining to an
20 NSA.

21 Q Only one that you have not had discussions
22 with?

23 A Yes.

24 Q Okay. One out of how many?

25 A The top four or five companies account for

1 the vast majority of cards, but we've probably had
2 discussions with roughly eight to 10 financial
3 services companies. There were definitional problems.

4 Q Okay.

5 A I mean, there are some companies that issue
6 many credit cards, but also engage in many other kinds
7 of business. They wouldn't necessarily be considered
8 credit card companies or credit card banks.

9 Q So in the credit card industry, many you
10 took to mean eight to 10. Now, conceivably if
11 everything went swimmingly well you could have eight
12 to 10 NSAs with those companies conceivably, correct?

13 A Conceivably.

14 Q Okay. And you expect they would probably
15 have some variation among them?

16 A Oh, absolutely.

17 Q Absolutely. Okay. Is it possible that you
18 expect that the Postal Service would have to undertake
19 some monitoring in the course of each of those?

20 A I would expect so, yes.

21 Q Monitoring of something? Maybe not address
22 fees.

23 A Well, we would certainly want to ensure that
24 the terms of the agreement were complied with. We
25 are, of course, interested in analyzing the outcomes

1 and being assured that the actual results comport with
2 our expectations, so that implies some kind of
3 monitoring.

4 Q Okay. Now going back to page 6, and I'm
5 looking for my cite. Excuse me just a moment. I've
6 lost my place.

7 (Pause.)

8 Q Page 5. At the bottom of page 5, the bottom
9 bullet there, you are again offering a criticism of
10 Mr. Callow's proposal, but at the bottom of that
11 starting at Line 18 you state the declining block
12 rates would be so attractive to first class mail
13 users, especially at the terms proffered in Witness
14 Callow's testimony.

15 "The Postal Service estimates that tens of
16 thousands of mailers would want to take advantage of
17 the proposed experimental classifications." The way
18 you phrase that suggests that you think that would be
19 a bad thing.

20 A Well, as I've tried to elucidate, the Postal
21 Service isn't in a position to do that. We don't have
22 the necessary systems and structures in place to
23 implement NSAs on such a large scale.

24 It would be I think somewhat irresponsible
25 for us to make such a massive investment prior to

1 having determined that we can be successful with the
2 first one.

3 Q Are you suggesting that there might be tens
4 of thousands of first class mailers willing to use
5 electronic address correction services if they could
6 get a volume discount favorable to them?

7 A Since as I understand Witness Callow's
8 proposal the cost to those customers of doing so
9 approaches zero, I don't see why they wouldn't.

10 Q Okay. Do you understand whether Mr.
11 Callow's proposal, the discounts, would go to new
12 volume or not?

13 A That would be -- I think that's the
14 intention. However, as I tried to explain, a
15 relatively simple extrapolation of volume trends will
16 not necessarily result in appropriate thresholds and
17 in many cases would cause discounts to be paid on mail
18 that otherwise would have been presented to the Postal
19 Service anyway. Not in all cases certainly, but
20 certainly in a large number.

21 Q In general, would you regard new volume
22 coupled with electronic address correction to be a
23 desirable trade off for the Postal Service?

24 A All other things being equal, in general,
25 yes, I would.

1 Q But at this point the Postal Service would
2 not want to give a volume discount to tens of
3 thousands of mailers that might incent them to convert
4 to EACS. Is that correct?

5 A Well, under the terms that have been
6 presented that's correct because again there is no
7 infrastructure in place to ensure compliance to roll
8 out agreements of this kind on such a large scale. In
9 the absence of such an infrastructure or an ability to
10 do so, the possible risks are significant.

11 Q At this point, do you have any sense of the
12 costs that might be required to roll out that
13 infrastructure necessary to support such a proposal?

14 A I do not.

15 Q Would the cost of such an infrastructure be
16 a factor in the Postal Service decision whether to
17 make this proposed experimental classification a
18 permanent one?

19 A Could you say that again?

20 Q Well, would the cost of developing that
21 supporting infrastructure that you talked about be a
22 factor that the Postal Service will consider when it
23 decides whether to make the experimental
24 classification proposed in this case a permanent
25 classification?

1 A I mean, if a decision like that is
2 envisioned that would be several years from now.
3 There have been no discussions about creating a
4 permanent classification subsequent to this that I've
5 been party to.

6 Certainly we will take a look at the outcome
7 in this case, and we will consider other NSA
8 candidates and other options that the Commission's
9 decision makes available to the Postal Service. At
10 that time, we will weigh the possibility of developing
11 the capability to implement NSAs on a much larger
12 scale.

13 You know, those decisions I will certainly
14 contribute to the dialogue, but, you know, to the
15 extent they require any significant investments, I
16 mean, those discussions have not even begun yet.

17 Q Now I'd like you to turn to page 10 of your
18 testimony.

19 A Yes.

20 Q As you discuss it here, I assume you are
21 familiar with Tab 3 of Library Reference USPS-LR-J69?

22 A Yes.

23 Q And is it your understanding that that was
24 the source of Mr. Crum's figure of 14.5 cents that he
25 used as the weighted cost per piece of electronic

1 address correction services?

2 A That's correct. Yes.

3 Q You don't happen to have Tab 3 with you, do
4 you?

5 A I do have a copy with me, yes.

6 Q Do you? All right. That's helpful. I
7 would like to pass out a document which I am told is
8 Tab 3, although I am unable to get a Tab 3 notation on
9 my version of Excel.

10 Let me pass this out to you and give you a
11 chance to compare it to see if it looks like the real
12 thing.

13 A All right.

14 (Pause.)

15 MR. BAKER: For the record, I have
16 distributed a document. In the upper right-hand
17 corner appears page No. 4, and it's titled Special
18 Services Update Address Change Service ACS, which I
19 took from USPS-LR-J69.

20 BY MR. BAKER:

21 Q Has the witness had a chance to look at
22 that?

23 A Yes, I have.

24 Q Is that Tab 3?

25 A I believe so, yes.

1 Q Okay. It looks like it? Okay. I just
2 wanted to make sure I understand your point here,
3 which is that the top category -- what we have here is
4 a table that produces a total cost per piece for ACS,
5 and there are two parts to it.

6 There is ACS Change of Address Notification,
7 which has mechanized and non-mechanized terminal costs
8 associated with it, and ACS Nixie Processing, and then
9 there are costs for Nixie Quirk and ACS Nixie King as
10 well. Is that correct?

11 A That's correct, I believe.

12 Q Okay. The point of your testimony here at
13 Lines 9 to 10 is that the ACS COA notification, the
14 top part of that, includes both returns, as well as
15 forwards. Is that right?

16 A Yes, that's correct.

17 Q Okay. Do you have an understanding whether
18 the line ACS Nixie Processing includes both returns
19 and forwards, or is that only returns?

20 A I believe that is solely returns.

21 Q Now, I gather neither you nor the Postal
22 Service as an institution knows what proportion of the
23 ACS COA notifications are offer returns and offer
24 forwards. Is that correct?

25 A I don't know those proportions.

1 Q You don't know them?

2 A No.

3 Q And so in the bottom part of this table when
4 they take the cost figures for ACS COA notification
5 and ACS Nixie processing and then they weight them by
6 the percentage of the ACS volume, the weighting factor
7 of 58.03 percent for ACS COA notification consists of
8 both forwards and returns, correct?

9 A The 58 percent, which consists of the ACS
10 COA?

11 Q Yes.

12 A Yes, that includes both I understand.

13 Q And we don't know how much of which?

14 A I don't know.

15 Q Okay. And the cost per piece of the ACS COA
16 notification of .0997 cents is less than half of the
17 ACS Nixie processing cost of .2074, correct?

18 A Yes, that's correct.

19 Q Does the weighted average of 14.5 cents of
20 Tab 3 --

21 CHAIRMAN OMAS: Mr. Baker, excuse me. Would
22 you like a copy of this put into the transcript?

23 MR. BAKER: I will. I have two more
24 questions, and then I'll put that in if that's okay.

25 CHAIRMAN OMAS: Okay.

1 BY MR. BAKER:

2 Q So the weighted average of 14.5 cents, which
3 is the conclusion of this table, does not assume, does
4 it, that all of these ACS COA notifications are for
5 returns because there are some forwards in that
6 number. Is that correct?

7 A Could you say that again, please?

8 Q All right. Let me ask it a different way.
9 Does the weighted average of 14.5 cents at Tab 3 here
10 assume that all ACS COA notifications are for physical
11 returns?

12 A No. It assumes that there will be a mix of
13 pieces that are forwarded and pieces that would have
14 otherwise been returned in the absence of an ACS key
15 line on the piece.

16 Q When Mr. Crum used the same figure of 14.5
17 cents as an EACS cost for electronic return costs in
18 his Library Reference LR-1 in this case, page 2, did
19 that assume that all ACS notifications, ACS COA
20 notifications, are forward returns?

21 A I'm not prepared to discuss what Mr. Crum
22 was assuming. I mean, I can see how one might draw
23 that conclusion.

24 MR. BAKER: All right. Mr. Chairman, I have
25 no more questions, but I would like to mark this

1 document as I guess NAA Cross-Examination Exhibit 1.

2 The witness has said it looks to be Tab 3.

3 Therefore, I don't think we need to have it in as
4 evidence, but I think I'd like to submit it for
5 clarity of the record.

6 CHAIRMAN OMAS: Thank you.

7 (The document referred to was
8 marked for identification as
9 Exhibit No. NAA-1.)

10 MR. BAKER: With that, I have no more
11 questions.

12 CHAIRMAN OMAS: All right. Are there any
13 questions from the bench?

14 MS. DREIFUSS: Mr. Chairman, I'd be
15 delighted to defer to the bench if you'd like. I
16 could go ahead at this point or wait until --

17 CHAIRMAN OMAS: I'm jumping the gun. I'm
18 jumping the gun. I apologize to you, Ms. Dreifuss.
19 Please.

20 MS. DREIFUSS: Thank you, Mr. Chairman.

21 CROSS-EXAMINATION

22 BY MS. DREIFUSS:

23 Q Good morning, Mr. Plunkett.

24 A Good morning.

25 Q Could you turn to Table 1 of your rebuttal

1 testimony? That's found at page 3.

2 A I have it.

3 Q In that table you were trying to show how
4 much contribution would be lost if Capital One's first
5 class mail solicitation pieces were to shift to
6 standard mail, were you not?

7 A Yes.

8 Q Let me ask you. First, do you have any
9 reason to believe that that likelihood is imminent;
10 that if for some reason this NSA doesn't go through
11 that Capital One is likely to shift all of its first
12 class mail solicitations to standard mail
13 solicitations?

14 A Certainly not all in one fell swoop. I
15 think as has been discussed earlier today, there's
16 been a gradual, moderate downward trend in Capital
17 One's use of first class advertising mail, so there
18 does appear to be a trend toward substitution into
19 standard. I certainly wouldn't expect 768 million
20 pieces to disappear immediately.

21 Q Earlier today we established that there was
22 a downward trend in the first class mail solicitation
23 pieces. We did not establish that they were shifting
24 into standard mail, did we?

25 A I suppose not.

1 Q In Footnote 1 to the table you indicate that
2 you're going to limit the analysis to solicitation
3 mail. Is that correct?

4 A Yes.

5 Q And as I understand what you did to generate
6 the first class mail contribution figure of 15.5
7 cents, and that's in the second column under the line
8 First Class Mail. I believe what you did, and
9 according to this footnote, is you took the revenue
10 per piece figure from Witness Crum's Attachment A of
11 29.1 cents. Is that correct? Was that your stating
12 point?

13 A That's correct, yes.

14 Q And from that you subtracted the unit cost
15 that he presents on page 2 of his Attachment A, and
16 that unit cost was 13.59 cents per piece. Is that
17 correct?

18 A That's correct, yes.

19 Q Did you receive a copy of a cross-
20 examination exhibit that OCA sent to the Postal
21 Service? I think it was very late Tuesday night, so
22 you might not have seen it until yesterday morning.

23 A I've seen it, yes.

24 MS. DREIFUSS: Okay. Mr. Chairman, I have
25 copies of that cross-examination exhibit. There are a

1 number of calculations. I think it might be easier
2 for everyone to follow it if I distribute the copies
3 certainly to the bench and anyone else who's
4 interested.

5 THE WITNESS: I have one.

6 BY MS. DREIFUSS:

7 Q Mr. Plunkett, I'm giving you a copy because
8 I actually changed one word in the cross-examination
9 exhibit. I labeled it. The copy that I sent by
10 e-mail didn't have a label on it. That doesn't make
11 any difference. I'll tell you the one word that I
12 changed, which is not a significant change.

13 In our Question No. 1 to you, the second
14 line from the end, we had originally cited a Column 9.
15 It's actually Row 9. That was the only change I made,
16 just that one word from column to row.

17 A I see that.

18 Q I'm sure you found what we were talking
19 about anyway.

20 Now, the 13.59 cent figure used by Witness
21 Plunkett --

22 A Witness Crum do you mean?

23 Q I'm sorry. Witness Crum. -- was a weighted
24 average of the return cost of customer mail and
25 solicitation mail, was it not?

1 A I don't have his exhibit in front of me.

2 MS. DREIFUSS: Okay. I've got copies of
3 that, too. I'll go ahead and distribute those as
4 well.

5 (Pause.)

6 MS. DREIFUSS: While we're handing things
7 out, I might as well hand out one other thing that
8 I'll be talking about, and that is something that we
9 mention in the cross-examination exhibit.

10 That was an answer that Witness Crum
11 provided to an OCA interrogatory to him, and it
12 concerns a breakout or deaveraging of what we believe
13 to be a weighted average figure on page 2 of
14 Attachment A.

15 What we've done in this interrogatory is
16 we've tried to break out the average cost of returns
17 for presort letters from the specific return cost
18 presented by Capital One solicitation pieces. I'm
19 going to go ahead and hand that out, too.

20 THE WITNESS: I have it.

21 BY MS. DREIFUSS:

22 Q You now have page 2 of Attachment A in front
23 of you. Is the 13.59 cent figure presented on page 2
24 a weighted average --

25 A It appears to be.

1 Q -- of the returns?

2 A It appears to be.

3 Q Okay. Now to be precise, if we're looking
4 at the contribution of Capital One's mail, first class
5 solicitation mail, we should use the higher return
6 cost figure that it presents as compared to average
7 presorted first class mail, shouldn't we?

8 A You may be misinterpreting my intentions
9 here. I was not attempting to present an exhaustive
10 or precise estimate of these numbers; merely to
11 illustrate a much more general point that the overall
12 effect of this mail somehow converting to standard
13 mail would be, you know, however you calculate it
14 disastrous and so I relied solely on numbers that
15 existed on the record rather than conduct any
16 additional analysis where it wasn't necessary to do
17 so.

18 Admittedly, you could make a different set
19 of assumptions, so I used the average cost embedded in
20 Witness Crum's exhibit. The intention, though, was
21 not to produce a very detailed analysis of these
22 results, as you can see by the relatively small number
23 of lines and numbers presented in my exhibit.

24 Q Right. In your testimony, you're trying to
25 get the Commission to approve this particular NSA with

1 this particular mailer, are you not?

2 A Yes.

3 Q And you're warning of the consequences of
4 having this particular mail, shifted solicitation
5 mail, from first class to standard, are you not?

6 A No, I don't think I'm doing that at all.
7 I'm attempting to answer something that has been
8 suggested on numerous occasions in this case that
9 somehow a better solution rather than this NSA would
10 be to just, for example, allow this mail to become
11 standard, at which point the cost of delivering or
12 returning those undeliverable as addressed pieces
13 would vanish.

14 I'm merely presenting a hypothetical example
15 of what the consequences of that would be and how they
16 don't represent a good solution to that problem and a
17 much inferior solution to the one we presented in the
18 form of a negotiated service agreement.

19 Q Right.

20 A I'm not warning that this is a potential
21 consequence. As I said, I don't expect this to
22 happen.

23 Q Your Table 1 produces a figure of \$52.92
24 million of lost contribution to the Postal Service,
25 doesn't it?

1 A Yes, it does.

2 Q One of the important inputs in developing
3 that net change figure is going to be the unit cost
4 that is covered by an average first class revenue per
5 piece of 29.1 cents, isn't it?

6 A Well, that's certainly an input, yes.

7 Q Right. So we can make this a more realistic
8 projection by using the actual unit cost for Capital
9 One as opposed to the average unit cost of the average
10 presorted first class mail piece, can't we?

11 A I'd be wary of calling it more realistic.
12 You're substituting one way of calculating this or one
13 set of assumptions for another.

14 There are probably an enumerable number of
15 different ways this could be done, all of which,
16 though, are just estimates and would I think
17 inevitably produce the same overall result that the
18 consequence of this happening, if it were possible for
19 it to happen, would be losses in tens of millions of
20 dollars.

21 Now, whether that number is exactly 52.92 or
22 is it more like 43 or 63 or 163, we don't know the
23 answer to that question, but I think it would be hard
24 to prove other than the number is very large, and it
25 would be an overall enormous net loss to the Postal

1 Service and have a substantially negative effect on
2 all the Postal Service's customers.

3 Q Would the Postal Service have entered into
4 this NSA with Capital One if it had the average level
5 of returns in its solicitation mail?

6 A What do you mean by average? Average of all
7 of first class?

8 Q Yes. The average for first class presorted
9 letters.

10 A I don't know. I mean, that was certainly
11 never the case. When we began this, as Mr. Shippee or
12 Witness Shippee testified, we spent some time
13 identifying what the issues were, but from the outset
14 this situation was pretty clearly understood so we
15 never had an opportunity to consider that as an
16 option.

17 Q So the net contribution figure that Witness
18 Crum provided in his initial testimony we should now
19 consider to be hypothetical figures because we don't
20 really know what the unit costs are of Capital One?

21 Instead, we should view Capital One's costs
22 to be reflected by average unit costs of first class
23 presort, including the average return figures?

24 A What I believe Witness Crum has done, which
25 he's done every time the Postal Service puts forth a

1 rate or classification proposal, is provide expert
2 testimony on what he believes to be the best available
3 estimate of the cost relevant to the changes that are
4 being proposed. I wouldn't call those hypothetical.

5 He has presented himself as an expert
6 witness and has done his best analysis to arrive at
7 what he believes to be a reasonable result. In
8 crafting this hypothetical example, I've relied on his
9 testimony rather than conduct any separate analysis.

10 Q Do you know in Witness Crum's testimony
11 whether he used a higher return figure for Capital One
12 solicitation pieces than is found typically in first
13 class?

14 A He used I believe 9.6 percent as the return
15 rate on Capital One's solicitation mail, and I believe
16 somewhere in the record the overall average for first
17 class mail has been identified as being around one
18 percent.

19 Q All right. Have you had a chance to review
20 the figures set forth in OCA's cross-examination
21 exhibit?

22 A Yes, I have.

23 Q Do you understand that what OCA has done is
24 rely on Witness Crum's confirmation of calculations
25 that OCA presented to him in Interrogatory

1 OCA/USPS-T3-21, which is found at page 308 of
2 Transcript 2?

3 In that interrogatory OCA, has identified
4 the separate unit costs for Capital One, broken them
5 out from average first class mail. Do you understand
6 that that's what OCA did in Interrogatory 21?

7 Q I do, but I think it's important to note
8 that Witness Crum didn't confirm that that was an
9 appropriate way in which to estimate these costs. He
10 confirmed that the calculations appeared to be
11 correct.

12 While I acknowledge that he checked the
13 math, I don't think he is endorsing this as the
14 appropriate way to separate and isolate those costs,
15 and so I was reluctant to affirm that that produces a
16 better result than the one that I presented in my
17 exhibit.

18 Q Are you aware that generally the figures
19 that are presented in OCA's interrogatory came from
20 Witness Crum's testimony and exhibits?

21 A Yes, I am.

22 Q Are you now asking that everyone step back
23 from those figures that he presented in his testimony
24 and exhibits and view them as hypothetical?

25 A Not at all. I'm merely saying that Witness

1 Crum presented testimony as to what he believed to be
2 the most accurate costs available. My understanding
3 of this interrogatory is it sets forth a new way to
4 approach the same problem which produces at least
5 somewhat different results.

6 In confirming that these calculations are
7 correct, Witness Crum wasn't in my mind saying that
8 that was a superior way to estimate these costs. I
9 think he is acknowledging that it is a different way
10 and that in attempting to do that the calculations
11 that we used are correct and, yes, they are based on
12 the numbers presented in his testimony. As I said a
13 little while ago, undoubtedly one could come up with
14 many other ways to estimate the same cost. They're
15 all estimates.

16 I think it's important to point out that
17 even if I accept this as a preferred way of doing
18 this, you reach the same general result, which is that
19 the net loss to the Postal Service if this would have
20 happened in your estimation is about \$40 million. I
21 find it hard to believe anyone would think that \$40
22 million is okay if \$50 million isn't. They're both
23 very large numbers, and the overall consequence would
24 be decidedly negative.

25 Q Witness Crum's object in his Attachment A is

1 different than yours. He intended to generate a
2 weighted average unit cost for all of Capital One's
3 mail, whether it be customer mail or solicitation
4 mail. Isn't that correct? That was his object?

5 A I think that's fair to say, yes.

6 Q And your object, as you state on Table 1, is
7 to focus on the shift or the potential shift of
8 Capital One's solicitation mail to standard mail,
9 isn't it?

10 A I wouldn't say it that way. As I said, I
11 don't expect this to happen, and nowhere have I said
12 that I think the possibility that Capital One will
13 suddenly convert 750 some odd million pieces over to
14 standard is even a remote possibility.

15 My intention here was to respond to
16 suppositions and implications that have been made
17 throughout this proceeding that somehow if this mail
18 became standard this problem would be solved, and I am
19 just pointing out with I admit a somewhat simplistic
20 example that the result is not positive. It does not
21 produce a good solution to that problem. It produces
22 a solution that has very deleterious effects on the
23 Postal Service and on all of its customers.

24 I wasn't in any way attempting to portray
25 what I considered to be a plausible outcome at all;

1 merely responding to suppositions and implications
2 that have been made in this proceeding.

3 Q Okay. Do you understand OCA's cross-
4 examination exhibit to try to produce a figure that is
5 more representative of Capital One's particular return
6 level as compared to the average first class return
7 level?

8 A I understand that, but I don't think OCA's
9 -- I mean, maybe I misinterpreted this. I didn't
10 think, though, that OCA in any way thought that the
11 possibility for that mail to leave first class
12 entirely exists at all.

13 Q Well, the fact is I don't want to leave on
14 the record the figure of a potential shift of \$52.92
15 million if Capital One were to convert solicitation
16 pieces from first class to standard because that net
17 change that you present in Table 1 is based on a much
18 lower unit cost figure for average first class mail
19 and its level of returns as compared to Capital One's
20 specific level of returns.

21 A Let me give an example of something I
22 consciously made a decision not to do. Despite the
23 fact that it might have produced in some ways a more
24 realistic picture of what I'm trying to describe here,
25 when I talk about a possible or hypothetical

1 conversion of that many pieces from first class into
2 standard in no way have I attempted to estimate the
3 additional disposal cost that the Postal Service would
4 incur.

5 I have explicitly through the use of Witness
6 Crum's numbers attempted to account for the
7 differential in the UAA rate on first class, but
8 presumably if we're disposing of an additional nearly
9 800 million pieces of standard mail we incur
10 additional disposal cost. I've not made any attempt
11 to model that, so one could argue that I've in some
12 ways been conservative in estimating these costs.

13 The fact is I don't think in any way of this
14 as a realistic possibility, and the intent was not to
15 describe in a very precise or exhaustive way what the
16 financial impacts are. It's merely to illustrate that
17 some of the implications that have been made
18 throughout this case rest on just an utterly false
19 premise that somehow if this mail became standard
20 people would be better off, and that's clearly not the
21 case.

22 Q You just mentioned the additional cost of
23 disposal that would necessarily arise from entering
24 into this negotiated service agreement, didn't you?

25 A Uh-huh.

1 Q If there are costs additional to what --

2 A Well --

3 Q Hold on a second.

4 A I was talking about if that arose in my
5 hypothetical example, if somehow we had to disclose
6 800 million more pieces. That's not a feature of the
7 negotiated service agreement. That's a feature of my
8 hypothetical example, and that's all.

9 Q You were not talking about the additional
10 disposal cost that the Postal Service will have to
11 incur under this agreement?

12 A No. I was talking about what would happen
13 if suddenly we had 800 million more pieces of standard
14 mail to dispose of or whatever the number is, but I
15 wasn't in any way referring to the NSA. I was
16 referring to this hypothetical example.

17 Q But how is that relevant to Table 1, which
18 talks about existing Capital One mail and not a new
19 hypothetical 800 million pieces?

20 A Because in the hypothetical example that
21 mail leaves first class and becomes standard. As a
22 result, mail that could not be delivered would have to
23 be disposed of.

24 If there was undeliverable mail that is now
25 in first class and if it all converted to standard,

1 any mail that could not be delivered would have to be
2 disposed of and would cause additional disposal cost,
3 but that is purely in a hypothetical situation, and
4 that has nothing whatsoever to do with the terms of
5 the NSA.

6 Q Well, standard mail's unit cost, the average
7 unit cost of standard mail, must reflect, I imagine,
8 and I'm going to ask you about this in a minute. It
9 must reflect the cost of the Postal Service to dispose
10 of mail that is undeliverable, does it not?

11 A I don't know. I am not an expert on cost of
12 standard mail. I'm guessing, though, that if they do
13 they reflect disposable at an average rate and so I
14 guess if I wanted to be extra precise I would have to
15 find out how Capital One's UAA rate deviates from the
16 average UAA for standard mail, which I don't believe
17 we have any evidence of.

18 I don't think the Postal Service is in any
19 position to calculate the UAA rate on standard mail
20 not just for Capital One, but for all mail.

21 Q Well, it's possible that Capital One's
22 return rate is actually below the average in standard
23 mail, isn't it?

24 A Sure, it's possible. I have no idea.

25 Q At any rate, OCA's cross-examination exhibit

1 focused on information presented in the record of this
2 case, information that we do have before us and not on
3 the hypothetical information that you've alluded to.
4 Is that correct?

5 A Yes, I'd say that's correct.

6 Q Apart from the reservations that you've
7 expressed so far, do you challenge any of OCA's
8 calculations in this exhibit?

9 A They appear to have been done correctly, but
10 I have to stop short of saying that I believe that's a
11 better way to estimate this number because I've not
12 done an analysis on this methodology.

13 I did notice that Witness Crum affirmed that
14 the calculations appear to be correct, but I did note
15 that he stopped short of endorsing that methodology
16 and so since his is the evidence that's on record that
17 is what I relied on.

18 While I can acknowledge that the
19 calculations appear to have been done correctly, I
20 can't necessarily say that that's a superior result.

21 Q Please note on the cross-examination exhibit
22 that OCA in its attempt to isolate the higher unit
23 cost of Capital One's solicitation pieces as compared
24 to average first class mail pieces with respect to the
25 return rate, that our net change is \$36.79 million.

1 Do you see that?

2 A Yes, I do.

3 Q And in terms of the way we calculated it and
4 based on the reservation you just expressed, you don't
5 challenge that figure?

6 A No. It appears to have been calculated
7 correctly, but I would just note that it's just a
8 different number, but it produces the same result,
9 which is that however you estimate it the effect of
10 this kind of change would be disastrous.

11 That was the point I was trying to make. As
12 I've mentioned, there are probably dozens of ways one
13 could approach this problem, but I would propose that
14 inevitably you end up with the same result.

15 Q In Question 3 of our cross-examination
16 exhibit, which I guess is not anything concrete in and
17 of itself, but we did ask you to provide the
18 electronic spreadsheets used to calculate the standard
19 mail unit cost.

20 Also, I contacted Mr. Reiter by phone and
21 asked if it would be possible for you to present a
22 hard copy of those calculations today. Were you able
23 to get those ready for today?

24 A No. That will require some work. I mean, I
25 don't want people to misunderstand what we've done

1 here. I did not prepare work papers. While I've done
2 so in the past, I mean, I conducted a quick analysis
3 based on the available numbers, so in order to make it
4 clear enough for people to follow how it was done
5 there's some additional work that would be required
6 before it could be filed.

7 MS. DREIFUSS: All right. Mr. Chairman, I'm
8 going to ask that two things happen. I would like to
9 have OCA's cross-examination exhibit placed in the
10 transcript and entered into evidence, and I would also
11 ask you to ask the Postal Service to provide the
12 electronic spreadsheets that were used to calculate
13 the standard mail contribution that's presented in
14 Table 1.

15 CHAIRMAN OMAS: Mr. Reiter?

16 MR. REITER: Mr. Chairman, I'm going to
17 object to two out of three of those. I have no
18 objection to the cross-examination exhibit being
19 transcribed in the record. I don't think there's been
20 any foundation laid for it being put into evidence.
21 Mr. Plunkett didn't calculate it. He didn't agree to
22 the calculations other than being mathematically
23 correct.

24 For some reason Ms. Dreifuss wants to see
25 the electronic or hard copy worksheet that underlies

1 what Mr. Plunkett presented, but he hasn't had and we
2 haven't had the opportunity to see the same thing for
3 their calculations so I think there's some missing
4 foundation there.

5 I also don't really think that additional
6 information is necessary in light of the testimony
7 that we have today to support these figures. The
8 witness has said regardless of whether it's his number
9 or the OCA's number, it supports the point that he was
10 trying to make in his testimony. I really don't see
11 any reason to burden the record further with that.

12 MS. DREIFUSS: Mr. Chairman, if I can answer
13 a couple of the remarks made by Mr. Reiter?

14 First of all, OCA did provide the Postal
15 Service the electronic spreadsheets underlying our
16 calculations. When I sent it over by e-mail I made
17 note in the e-mail that the Postal Service need only
18 click on the table.

19 You see it as a revised table in the cross-
20 examination exhibit. They needed only have clicked on
21 the table, and the Excel spreadsheet would have opened
22 up. Perhaps there was a misunderstanding about that,
23 but you already have the electronic spreadsheet for
24 that.

25 MR. REITER: I guess I would ask one more

1 thing, Mr. Chairman. Since the OCA was able to
2 replicate what Mr. Plunkett did and substitute I guess
3 one or two numbers, is there any lack of understanding
4 here of what underlies the table that needs to be
5 elucidated?

6 MS. DREIFUSS: Well, there are a couple
7 points. One is we ask that Mr. Plunkett provide the
8 electronic spreadsheets that underlie his standard
9 mail, his calculation of the standard mail unit
10 contribution. We were not able to reproduce that, so
11 I would say we still need it or else we should really
12 disregard the entire table.

13 If he can't explain and support the unit
14 contribution figure for standard mail that's in the
15 table, then I say just strike the entire table because
16 that's one of the elements of calculating the ultimate
17 net change that he calculates there.

18 MR. REITER: Mr. Chairman?

19 CHAIRMAN OMAS: Mr. Reiter, I think if the
20 calculations exist, I don't see any reason why you
21 cannot supply us with that.

22 MR. REITER: All right. I will check on
23 what exists. My understanding was that it was just
24 based on what Witness Crum has presented, and we can
25 give whatever citations are necessary to make that

1 clear.

2 CHAIRMAN OMAS: Because he did provide
3 numbers, and there should be numbers available. I'd
4 like for you to provide that to us.

5 MR. REITER: We will provide that.

6 CHAIRMAN OMAS: Thank you.

7 MS. DREIFUSS: Mr. Chairman, with respect to
8 the other point that Mr. Reiter made, whether this
9 cross-examination should be entered into evidence, I
10 would argue based on Mr. Reiter's own statement that
11 whether or not one uses the OCA number or the net
12 change figure that Mr. Plunkett presents in his table,
13 the Postal Service still feels it's able to make its
14 point.

15 I would say go ahead and make available the
16 OCA figures since the Postal Service is seemingly
17 indifferent to whether we use the OCA's figure or the
18 Postal Service's.

19 CHAIRMAN OMAS: I think they should be
20 transcribed, but not put into the record.

21 Ms. Dreifuss?

22 MS. DREIFUSS: I think I have one more
23 matter to take up with you today, Mr. Plunkett.

24 CHAIRMAN OMAS: Ms. Dreifuss, can you tell
25 me about how much time you need?

1 MS. DREIFUSS: Well, I think everybody can
2 be eating a sandwich certainly by 12:15.

3 CHAIRMAN OMAS: All right.

4 MS. DREIFUSS: I just have a few more
5 minutes.

6 CHAIRMAN OMAS: We have a couple of other
7 things that are going to go on, so would you proceed
8 then?

9 MS. DREIFUSS: Sure.

10 BY MS. DREIFUSS:

11 Q Mr. Plunkett, this is going to feel like
12 deja vu because I'm going to quote to you a statement
13 that you made when you were last cross-examined, but
14 in this particular instance when you were examined on
15 redirect by Mr. Reiter.

16 At pages 847 and 848 of the transcript that
17 contained the redirect examination of you by Mr.
18 Reiter, Mr. Reiter asked you, and I've got copies of
19 this for you and for your counsel and for anybody else
20 who is interested. These are the two pages I just
21 cited, pages 847 and 848 of the transcript.

22 I'll give you a moment to look it over, but
23 in particular you might want to take a look at page
24 848 beginning with Line 10.

25 A All right.

1 Q Mr. Reiter asked you at Line 10:

2 "Q If the negotiated service agreement
3 had consisted simply of a waiver of ACS fees, but
4 still contained the other address hygiene
5 requirements, but no declining block rate, along the
6 lines of that initial classification that was
7 suggested earlier, do you know what the likely
8 reaction would have been to that on Capital One?"

9 You answered:

10 "A In fact, we presented that as an
11 option to Capital One. They were not interested."

12 You go down a little further. I'm skipping
13 the next sentence and part of the third. You go on to
14 say:

15 "A ...and they saw change of that kind as
16 producing at best limited benefits such that they were
17 not interested in pursuing or undertaking the effort
18 required to execute a negotiated service agreement for
19 what they considered to be marginal benefits."

20 What you were talking about there was that
21 it was your understanding that Capital One wouldn't be
22 interested in a negotiated service agreement that
23 didn't provide declining block rates to them. Is that
24 correct?

25 A Yes, that's correct.

1 Q And are you aware that based on Dr.
2 Elliott's testimony he is now projecting that in the
3 test year Capital One will not be mailing sufficient
4 volumes to reach the threshold specified in the
5 agreement?

6 A I want to be a little more precise. He had
7 presented an eight point estimate of one volume level
8 that is below the threshold. He's produced
9 alternative estimates that are above the threshold.

10 I think something that needs to be realized
11 is when one produces a point estimate like that it is
12 that. It is an estimate. There is a range of
13 outcomes well below and well above that estimate. If
14 you think of it as having a normal distribution,
15 Witness Elliott's point estimate, which is just barely
16 below the threshold, presumably produces a 50 percent
17 probability of volumes that will be above the
18 threshold.

19 I think Witness Shippee testified to the
20 fact that if Capital One were that one, they would see
21 sufficient incentive by the proximity to the existing
22 threshold that they would be very likely to take
23 additional mail so as to be able to avail themselves
24 of the declining block rates.

25 Q Right. As you point out, there's a point

1 estimate. There's a 50 percent probability that the
2 volumes might be higher than 1.21 billion, and there's
3 a 50 percent probability that they might be lower than
4 that. Isn't that correct?

5 A If those outcomes are normally distributed,
6 that would be correct.

7 Q In any event, at 1.21 billion pieces, if
8 that truly turns out to be the volume level mailed by
9 Capital One in the test year, they will not receive
10 any declining block rates, will they?

11 A I believe that's correct. Yes.

12 Q And in fact under the operation of the
13 negotiated service agreement unless they deviate in a
14 much greater downward direction to below 1.025 billion
15 pieces they're not ever likely, unless somehow they
16 can turn around what appears to be a downward trend I
17 know in the first class solicitation volumes, perhaps
18 overall in first class. I wasn't able to establish
19 that with Dr. Elliott.

20 At any rate, unless Capital One mails below
21 1.025 billion pieces then it's not likely ever to have
22 discounts in the three years of the agreement, is it?

23 A I'd be careful in saying not likely. As I
24 said, I mean, that estimate is so close to the
25 threshold that for all practical purposes one could

1 consider them to be at the threshold such that there
2 is a reasonable probability that they will go above
3 that threshold.

4 Capital One, I mean, they're a business.
5 They often make, you know, decisions about the future
6 that incorporate some amount of risk. They have shown
7 throughout this proceeding that they believe the
8 potential benefits to their organization are
9 sufficient that they are willing to incur the risk
10 that they may come in under the threshold for part or
11 all of the duration of the agreement.

12 Does that mean that's going to happen? I
13 think if it was a certainty, Capital One would have
14 abandoned this a long time ago. I think Witness
15 Shippee testified to that fact this morning that, you
16 know, they intend to grow their business. They intend
17 to use mail to grow their business, and they believe
18 that this agreement gives them an opportunity to do
19 just that under the terms that were negotiated between
20 Capital One and the Postal Service.

21 That point estimate is Witness Elliott's
22 best single number estimate of Capital One's test year
23 volume, but there is a wide range of outcomes around
24 that number that are possible. If Capital One is
25 satisfied that there is still sufficient reason for

1 them to participate in that agreement, I think that is
2 the most relevant point that can be made.

3 Q Is it your impression that Capital One would
4 have entered the negotiated service agreement as it is
5 currently drafted and with the volume levels that are
6 included in that agreement if it thought it likely at
7 the time it negotiated with the Postal Service that it
8 was only going to be mailing 1.21 billion pieces in
9 the test year?

10 A Well, it's very possible they might have
11 asked for other consideration or might have changed
12 their approach. I believe all in all they would have
13 still found this to be a valuable agreement.

14 I think, you know, Witness Shippee testified
15 to that fact this morning. He expressed what I would
16 consider to be a very high level of comfort with the
17 agreement as it stands even in the presence of Witness
18 Elliott's testimony, so I don't think there would be
19 an attempt to revise the agreement, or if they could
20 have predicted the future more accurately I don't
21 think you would see a big deviation from the agreement
22 that we have today.

23 Q Let's say the Commission were to recommend
24 the agreement as currently written. Do you think that
25 Capital One is likely to stick it out for three years

1 if they find themselves mailing first class volumes at
2 a low enough level that they're not likely to realize
3 any discounts from this agreement?

4 A Based on what I know today, I believe they
5 will stay in the agreement for its duration.

6 Q Why would they stay with it when you
7 testified at Transcript 848 that they were not really
8 interested in an agreement that didn't include I would
9 think a realistic shot at declining block rates?

10 A But I think Witness Shippee addressed that
11 point. They consider the way things stand today to be
12 a perfectly realistic shot that they will be able to
13 partake of the declining block rates such that while
14 it's not possible to precisely estimate to the degree
15 we might like that, if they're that close the
16 likelihood is that they will undertake the efforts
17 needed to get them above the threshold and to be able
18 to partake of the declining block rate.

19 Q Let's think for a moment about what Dr.
20 Elliott has testified to. As you say, he developed a
21 point estimate of 1.21 billion pieces for the test
22 year or for before rates, did he not?

23 A Among other estimates, yes.

24 Q And in fact based on that volume level he
25 actually projects no change in the test year after

1 rates. In other words, his projection right now is
2 that Capital One won't receive any discounts in the
3 test year, isn't it?

4 A Well, I think that's -- I mean, that's more
5 what I would consider to be a mathematical consequence
6 of the way the model is constructed. It's perhaps
7 somewhat anomalous, but the way the model is
8 constructed if the thresholds are not hit the prices
9 don't change, so they can't really be an after rate
10 effect because there's no change in the rate.

11 You know, it's very difficult to model
12 effectively the kind of business decision making that
13 Witness Shippee was describing this morning. You
14 know, if Witness Elliott could effectively model such
15 decision making I would be impressed, but, I mean, I
16 think what you're describing is really just a
17 mathematical feature of the model more than anything
18 else.

19 Q Do you recall that Dr. Elliott testified
20 that there is a downward trend in first class
21 solicitation mail volume levels?

22 A Well, I think he suggested that he did not
23 have sufficient confidence around the trend line to
24 call it a trend, but that one could note with some
25 degree of confidence that the direction of Capital

1 One's use of first class mail tends slightly toward
2 the negative.

3 Q Right. Let's say hypothetically that Dr.
4 Elliott has accurately estimated Capital One's use of
5 first class mail in the test year, and it turns out to
6 be 1.21 billion pieces.

7 A Uh-huh.

8 Q If the downward trend continues that Dr.
9 Elliott identified, then in year two Capital One's use
10 of first class mail is likely to be even less than it
11 was in the test year. Isn't that true?

12 A Well, I mean, inevitably if the trend is
13 downward then the farther out along that trend line
14 you go the lower the number. I think that's
15 inevitable.

16 Q I know you're very familiar with all the
17 terms of the NSA. I don't know whether I need to show
18 this to you or if you can just recall it.

19 There is a paragraph G -- it's the
20 cancellation paragraph -- of the NSA, and it states
21 that during the term of the agreement, Capital One may
22 cancel the agreement without cause by providing 30
23 business days' advance notice provided that it must
24 still comply with Section 2, paragraph E, and also
25 another condition is that it mailed more than 750

1 million first class mail pieces. Are you familiar
2 with that clause?

3 A Yes.

4 Q It sounds like if it turns out as the three
5 year period unfolds if it turns out that Capital One
6 is not realizing declining block rates and isn't
7 likely to, it can withdraw from the agreement with
8 relative ease, can't it?

9 A I'd be a little careful in saying relative
10 ease. I mean, to comply with this agreement Capital
11 One is going to have to take some pretty substantial
12 changes in its business modeling.

13 It's going to have to change the way it
14 prepares and presents first class mail. It's going to
15 have to change the way it receives information about
16 undeliverable mail and how it incorporates that
17 information into its existing databases.

18 So then at some point in the hypothetical
19 future suddenly to undo those things and convert back
20 to their old way of doing things is not a trivial
21 effort, and I don't think it's something they would
22 entertain without some serious internal discussions
23 and a somewhat exhaustive consideration of all the
24 potential impacts of that.

25 Q Well, at least with respect to any legal

1 impediment it can withdraw from the agreement
2 essentially after 30 days' notice has been given to
3 the Postal Service. Isn't that correct?

4 A Well, the legal impediments are minimal, but
5 the operational impediments I think are significant.

6 MS. DREIFUSS: I have no further questions.

7 CHAIRMAN OMAS: Thank you, Ms. Dreifuss.

8 Mr. Plunkett, it's my understanding that the
9 Postal Service is presently in discussion with mailers
10 about several classes of mail regarding possible NSAs.

11 Assume the Commission approves this NSA and
12 that the Postal Service is then approached by 10
13 different banks seeking similar agreements to enable
14 them to compete with Capital One. Would the Postal
15 Service put these competitors at the head of the line
16 for getting NSAs, or would they have to wait while the
17 current negotiations go on?

18 THE WITNESS: That's a hard question to
19 answer. I mean, certainly if we were approached by 10
20 comparable companies all seeking terms that were
21 virtually identical to those embodied in the Capital
22 One agreement and the Postal Service believed that we
23 could enter into those agreements much more quickly
24 than a somewhat more groundbreaking agreement with a
25 different product, we would certainly have a strong

1 incentive to do those things immediately. We have not
2 developed a plan for doing so.

3 I don't want my remarks to be
4 misinterpreted, though. Saying we're in discussions
5 with a large number of companies does not mean that
6 agreements are imminent with that many companies.

7 As Witness Shippee attested to this morning,
8 the Capital One discussions extended over a very long
9 period of time. I think his estimate was about nine
10 months. Now, obviously if we have in place a
11 framework that allowed comparable companies to sort of
12 mimic that agreement presumably it would not be nearly
13 as long, but I would have to think there's still going
14 to be some lead time associated with getting all the
15 way to the consummation of an agreement.

16 Certainly if the decision were written in
17 such a way that made activation of similar agreements
18 much easier, inevitably I think we would heighten the
19 priority on those kinds of discussions.

20 CHAIRMAN OMAS: Let me go a little further.
21 Would those agreements that you would consider, would
22 they be sent for review to the Commission?

23 THE WITNESS: I don't know that I can answer
24 that question. I think in large part that depends on
25 the outcome in this case. I'm not aware of any --

1 CHAIRMAN OMAS: I said let's presume that we
2 have approved this NSA, and let's say that some other
3 competitor of Capital One comes in, I mean, and you
4 see many similarities, and you can enter into
5 agreement.

6 Would you before entering into that
7 agreement send that agreement or the negotiated
8 service agreement to us for review as you have this
9 one?

10 THE WITNESS: I believe that would be
11 required, as far as I understand it, that we're
12 required to take any proposed changes in rates or
13 classification to the Commission for approval before
14 they can be implemented. We have not envisioned any
15 alternative to that that I know of.

16 CHAIRMAN OMAS: All right. Thank you.

17 COMMISSIONER GOLDWAY: I have a question.

18 CHAIRMAN OMAS: Commissioner Goldway?

19 COMMISSIONER GOLDWAY: We've had extensive
20 discussion today about the volume forecasts. Let me
21 summarize it as follows.

22 In your initial presentation we had been
23 told that volume was approximately 1.4 hundred
24 million, whatever it is. I don't remember the zeros.

25 THE WITNESS: I believe it was 1.408.

1 COMMISSIONER GOLDWAY: And now we're told
2 it's 1.21. The concern in the earlier discussions was
3 about the leakage between the threshold and the volume
4 where we were giving away existing volume -- you were
5 in your proposal -- at lower rates than you're now
6 processing that mail for.

7 THE WITNESS: Some people expressed that
8 concern, yes.

9 COMMISSIONER GOLDWAY: So now you've
10 answered that concern. You've come in and said well,
11 the threshold really is the threshold, and there won't
12 be any leakage, right?

13 THE WITNESS: Using Witness Elliott's new
14 point estimate, the leakage would drop to zero.
15 That's correct.

16 COMMISSIONER GOLDWAY: Okay. By doing that
17 do you know what you've done? You've taken away any
18 rationale for why these two parts of the agreement
19 have to be combined because if Capital One is willing
20 to accept this agreement when its forecast is at 1.25,
21 basically not getting the discount on mail up front,
22 but happy with the EACS part of the agreement, then
23 why can't it just have the EACS part of the agreement
24 and the volume as another agreement? Why did you need
25 to make this agreement so complicated?

1 THE WITNESS: Well, I have to go back to,
2 you know, where we were when we did this. It's now
3 nine months since we finished negotiations with
4 Capital One, and at the time we crafted what we all
5 considered to be the best possible agreement, given
6 what we knew about the future.

7 Now, at the time Capital One's point
8 estimate might have been at 1.4 billion pieces, but
9 I'm sure they knew, as we did, that a wide range of
10 outcomes was possible around that 1.4 number,
11 including some well below the threshold. Capital One
12 was willing to incur the risk that that might happen,
13 and the Postal Service was willing to incur the risk
14 that an alternative might happen, given the agreement
15 that was constructed as a whole.

16 I would say that now that we have a new
17 point estimate that is settled at 1.21 billion pieces,
18 there is still a range of outcomes possible, and
19 Witness Shippee I think, you know, very eloquently
20 this morning described why Capital One still believes
21 that the declining block rates are a beneficial
22 feature of the agreement.

23 From the Postal Service's point of view,
24 while most people I think have latched onto the notion
25 that the Postal Service likes the avoided cost and

1 Capital One likes the declining block rates, in fact
2 the Postal Service has important reasons for wanting
3 those declining block, rates to stay in this
4 agreement.

5 We want that incentive to exist for Capital
6 One to send more mail and believe very strongly that
7 the alternative tariff schedule that is embedded in
8 this agreement that Witness Akin discusses in his
9 testimony is a very important characteristic and
10 provides an important incentive to Capital One to stay
11 in first class mail and to send even more of it.

12 I don't want people to misconstrue this
13 agreement as a trade off between one thing that the
14 Postal Service likes and one thing that Capital One
15 likes. From the outset, the Postal Service has
16 believed very strongly that those declining block
17 rates produce an overall benefit to the Postal Service
18 that takes a number of forms.

19 COMMISSIONER GOLDWAY: But that's all the
20 more reason why they couldn't be two separate
21 agreements. That's all the more reason. You've just
22 explained why.

23 If you also believe that the declining block
24 grants are beneficial to the Postal Service and would
25 in some way stimulate the mail, why not just do those?

1 It seems to me that we've got this dilemma of these
2 two different -- very different -- kinds of
3 arrangements put in one agreement, and I'm not at this
4 moment willing to make a decision about that
5 conundrum, but it is a conundrum that you've presented
6 us with.

7 I have another question in another area. I
8 was a bit confused with your answers about the extent
9 and cost of the -- I've forgotten the terms you used,
10 but the notion was that the support and infrastructure
11 necessary to implement NSAs, monitor NSA, negotiate
12 NSAs, so I'm confused about the status of your
13 operations.

14 You are currently in discussion with eight
15 or 10 other possible banks, so some part of this cost
16 for doing NSAs is ongoing in your operation already.

17 THE WITNESS: Well, I have a very small
18 staff so they are working on discussions with a number
19 of other companies, but there's been no investment in
20 any larger infrastructure of the kind that generally
21 supports, you know, broader classification or price
22 changes.

23 For example, there's been no attempt yet to
24 invest in any kind of costing systems that could get
25 us better customer specific cost. There's been no

1 attempt to model demand at a customer level in the
2 same way that model is modeled at the subclass level
3 in a rate case.

4 We have a small group, and we're capable of
5 simultaneously engaging in discussions with a
6 reasonable number of companies, but we're not in a
7 position to simultaneously negotiate with dozens or
8 hundreds or thousands of companies because we would
9 have to have much more automated techniques and
10 systems in place than exist today.

11 COMMISSIONER GOLDWAY: Okay. Because you
12 were saying that you needed this one agreement in
13 place and the experience from it in order to determine
14 whether you should have any other NSAs; at least
15 that's what I understood in your testimony.

16 THE WITNESS: Well, certainly if this
17 produces a good result the Postal Service will believe
18 that repeating the process is worth doing. If it
19 produces a negative result, some people will conclude
20 that the Postal Service shouldn't do any more.

21 COMMISSIONER GOLDWAY: So should those other
22 NSA candidate understand that while it may take you a
23 few less months to agree upon the terms of an NSA if
24 in fact we agree upon one here that it might take you
25 longer to actually be willing to submit it to us

1 because you want to see whether this NSA works first?

2 THE WITNESS: I didn't mean to imply that we
3 would wait to file others until we've compiled
4 empirical data in the Capital One agreement.

5 What I think I meant to say was that it
6 would be easier for us to enter into agreements with
7 other companies if we knew the outcome of the case,
8 not that we had been able to accurately measure the
9 financial consequences after implementation. We
10 wouldn't necessarily wait until after we've
11 implemented or --

12 COMMISSIONER GOLDWAY: If you're negotiating
13 for NSAs that have different characteristics from the
14 characteristics you're presenting here, would the
15 decision that the Postal Rate Commission makes today
16 slow you down from those further negotiations with
17 other companies?

18 I mean, we have two very specific terms that
19 you've presented to us, and we can all imagine many
20 other kinds of terms that an NSA might take.

21 THE WITNESS: Yes.

22 COMMISSIONER GOLDWAY: So even if the Postal
23 Rate Commission were to disallow or advise against
24 this NSA, isn't it possible that you could have
25 discussions about different kinds of agreements that

1 were continuing?

2 THE WITNESS: It's possible, but one thing I
3 do not know is the tolerance that Postal Service
4 management would have for continuing to undertake such
5 discussions and invest in the time and resources
6 necessary to enter into agreements and litigate them
7 if the first time out the results aren't favorable.

8 Again, we're a newly created group. We have
9 a very limited amount of resources at our disposal,
10 and the organization is watching to see what happens.
11 I believe if we're successful the organization is
12 committed to continuing and extending comparable or
13 other kinds of agreements on a larger scale.

14 You know, the Postal Service doesn't commit
15 massive amounts of resources to new initiatives
16 without some reasonable expectation that that will
17 produce the desired result, and I think for many
18 people in the Postal Service the outcome of the first
19 agreement is going to be a very important factor in
20 considering, you know, how actively we pursue other
21 kinds of agreements and what kind of resources we're
22 willing to commit to doing future agreements.

23 CHAIRMAN OMAS: Can I interrupt here?

24 COMMISSIONER GOLDWAY: Yes.

25 CHAIRMAN OMAS: In the same line you're

1 saying well, how can you make decisions and submit
2 other negotiated service agreements without knowing or
3 having any empirical data from the one we're
4 considering here.

5 I mean, you're sort of saying one thing, and
6 then you're going back to another thing. I mean, in
7 one breath you're saying we are prepared and we're
8 preparing to submit other negotiated service
9 agreements depending on the outcome of whether we
10 agree to do this one or not, but then you're saying
11 that until you have empirical data you can't
12 determine. I'm totally confused at this point.

13 THE WITNESS: I'll try to clarify. We're in
14 active discussions with a number of companies, but we
15 do not have any signed agreements yet, so there's
16 nothing that is ready to be brought to the Board of
17 Governors for consideration.

18 All of those companies that we're in
19 discussions with know about the Capital One agreement
20 and remain informed about it as it proceeds through
21 litigation. A number of those companies would I think
22 -- well, without knowing exactly the outcome in this
23 case it's hard for me to speculate exactly on what
24 would happen, but I think pretty clearly --

25 CHAIRMAN OMAS: As I said to you earlier,

1 let's assume that we have approved this NSA and go
2 from there.

3 THE WITNESS: If the NSA is approved and
4 sets forth conditions for companies to be considered
5 similarly situated and sets forth a reasonable
6 expectation that the proceedings would go somewhat
7 smoothly, a number of companies would be willing I
8 think to sign on to agreements that mimic the Capital
9 One agreement, so at that point we would be prepared
10 to take some to the Board of Governors and then
11 presumably file them as experiments or whatever form
12 was necessary to implement them.

13 The alternative, though, if the outcome in
14 this case were not favorable, I think certainly one or
15 more of those companies would stop discussions
16 altogether. The Postal Service would certainly have
17 to reevaluate its thinking, but we're proceeding under
18 the assumption that things go as hoped and working
19 toward that end, but, you know, we're prepared to
20 moderate our approach to the extent necessary.

21 COMMISSIONER GOLDWAY: Then your earlier
22 testimony about needing to determine whether this NSA
23 was effective and had positive results, that you
24 needed to do that before you entered into other NSAs
25 because of the cost of implementing the infrastructure

1 for it was not correct. You're willing to go ahead if
2 we are?

3 THE WITNESS: We can do others on a
4 reasonable scale. We can't do them by the dozens or
5 hundreds.

6 I'll give one specific example of one of the
7 obstacles. In order to negotiate with a company for
8 the establishment of thresholds, and I'll use
9 declining block rates as an example of the kind of
10 agreement we might entertain. We have to be pretty
11 reasonably satisfied that we've got very accurate
12 volume and revenue estimates for that company going
13 back some period of time. We're using three years as
14 a starting point for the purposes of trying to
15 forecast out into the future.

16 The Postal Service's volume and revenue
17 measurement systems are not designed to produce those
18 kinds of estimates at a customer level because they're
19 generally designed to collect class and subclass
20 information.

21 In the case of a customer that may be
22 mailing in multiple cities using a number of
23 intermediaries to produce and presort their mail,
24 sometimes just collecting accurate volume and revenue
25 information can be a time consuming and daunting task.

1 With one company, whose name I won't mention, we have
2 been actively trying to reconcile volume and revenue
3 numbers for three months.

4 We can work with a reasonable number of
5 companies and are continuing to do so and will do so,
6 but the idea that we could go from one to 1,000
7 quickly, we just don't have the resources at our
8 disposal to do that. We can go from one to -- you
9 know, again I don't like to use the term many. We
10 could do a few more certainly, and we intend to.

11 To the extent they're similar to Capital One
12 it's somewhat easier because we've done a lot of work
13 already on this kind of agreement, but we certainly
14 couldn't go overnight from one to 1,000 or one to
15 10,000. We just don't have the resources, and the
16 Postal Service won't invest in them unless it's
17 assured that there's some possible benefit to doing
18 so.

19 COMMISSIONER GOLDWAY: Well, I hope that
20 clarifies it.

21 THE WITNESS: I hope so, too.

22 CHAIRMAN OMAS: Commissioner Covington?

23 COMMISSIONER COVINGTON: Good afternoon,
24 Witness Plunkett. I am going to follow up on some
25 areas that both of my colleagues touched on because I

1 feel quite sure that you understand what a precedent
2 our giving you approval to do this idea is going to
3 set.

4 THE WITNESS: I think I do.

5 COMMISSIONER COVINGTON: We want to make
6 sure that anything along these lines is going to cover
7 everything that's specific not only to where you're
8 concerned, but to the customer and the company as
9 well.

10 I just heard you say that there are roughly
11 10 other companies that are kind of like chomping at
12 the bit or hanging around your door.

13 THE WITNESS: That's a good estimate of the
14 number of credit card companies we've talked to.
15 We've talked to companies in other industries too,
16 maybe a similar number in some other areas, which, of
17 course, would have little relevance to this particular
18 agreement.

19 COMMISSIONER COVINGTON: To this particular
20 one. Well, let me ask you this, Witness Plunkett.
21 Have you ever visited the Capital One site, any of
22 them, or particularly the one down in Richmond?

23 THE WITNESS: I have not gone to Richmond,
24 no, but people on my staff have.

25 COMMISSIONER COVINGTON: Okay. Did you sit

1 in and participate with Vice President Carney when
2 most of the negotiations were going on with this
3 particular proposal?

4 THE WITNESS: Actually, I was in I think
5 every session. Mr. Carney, who was my boss, was not
6 present most of the time.

7 COMMISSIONER COVINGTON: Okay.

8 THE WITNESS: To the extent the Postal
9 Service had an equivalent role to Witness Shippee's, I
10 think you would say that was mine.

11 COMMISSIONER COVINGTON: Okay. All right.
12 In other words, it's fair to assume that you were the
13 lead man then?

14 THE WITNESS: Again, just like Witness
15 Shippee, I'm reluctant to call myself that.

16 COMMISSIONER COVINGTON: In other words,
17 your fingerprints are on this proposal?

18 THE WITNESS: Yes, they are.

19 COMMISSIONER COVINGTON: Okay. All right.
20 Now, the United States Postal Service has been out
21 asking and making it known that, you know, they need
22 pricing flexibility. Okay. I'm assuming that this
23 misclassification request would pretty much be in
24 line, you know, with that. Would you agree?

25 THE WITNESS: Well, I think certainly the

1 ability to set prices at a customer level, it would
2 certainly be a greater degree of flexibility than
3 currently exists.

4 COMMISSIONER COVINGTON: Okay.

5 THE WITNESS: I think this is an example,
6 and I think in our transformation plan we espouse NSAs
7 as one of the ways in which we attempt to, you know,
8 test the available flexibility as it exists today.

9 COMMISSIONER COVINGTON: Okay. To follow up
10 on what Chairman Omas and Commissioner Goldway raised,
11 Witness Plunkett, based on the success or non-success
12 of Capital One how are you going to know and how long
13 is it going to take you to figure it out?

14 THE WITNESS: Well, for the purposes of
15 understanding whether the agreement was a good one for
16 the Postal Service, we will never stop measuring that
17 throughout the three year duration.

18 I think, given the way our finances work,
19 we'll have a pretty good idea after at least a
20 quarter, maybe a half year, but we won't necessarily
21 wait until such period of time before entering into or
22 filing other agreements with comparable companies.

23 COMMISSIONER COVINGTON: Okay. In other
24 words, the number of agreements that is going to get
25 in the mix, it wouldn't really be a small amount then.

1 It could vary?

2 THE WITNESS: Well, it's always, though,
3 subject to the constraints we're currently operating
4 under and our ability to effectively measure customer
5 volumes, expend the resources necessary to negotiate
6 and litigate agreements, so there are some
7 constraints.

8 I don't know what the sort of upper limit is
9 right now. You know, we haven't really -- it's hard
10 for us to know that, but, you know, we can do more, I
11 think. I just don't know how many more.

12 COMMISSIONER COVINGTON: This initiative was
13 how you went into your new position. Is that correct?

14 THE WITNESS: Well, Steve Carney, the vice
15 president of Pricing and Classification, created a
16 small group within his organization to do what you
17 described, which is to try to figure out ways to test
18 some of the pricing flexibility that he believes are
19 available to us that we have not yet made use of. He
20 explicitly determined that one of those goals ought to
21 be to test the viability of negotiated service
22 agreements.

23 COMMISSIONER COVINGTON: Okay. You may not
24 be in a position to answer this, Witness Plunkett, but
25 if this initiative is, and I hate to use the term, a

1 flop, but if it's a failure, who's going to own up to
2 it over at the United States Postal Service?

3 THE WITNESS: Well, you talk about my
4 fingerprints. I don't want to mention any other body
5 parts, but, I mean, certainly all the people
6 associated with this feel some degree of
7 responsibility and commitment to the outcome, and so I
8 think to the extent there's blame or accountability it
9 will be spread among a number of people.

10 Certainly as one of the Postal Service's
11 main witnesses in this case and as the person with as
12 much as or more negotiation responsibility than
13 anybody else, certainly I guess I'm up for my share of
14 that and more, but, you know, the Postal Service, when
15 it files any kind of proposed rate or classification
16 change, it gets input from a large number of people.

17 I mean, I work for the Pricing organization.
18 We had contributions from people in our Finance group,
19 our Operations group, the Law Department certainly,
20 and, of course, anything before it is filed is
21 approved by the Board of Governors and by the
22 Executive Committee, so in a sense all of the senior
23 management of the Postal Service is ultimately
24 responsible for what has been presented in this case,
25 but to the extent people want to assign a name and a

1 face that's probably going to be mine.

2 COMMISSIONER COVINGTON: Okay. All right.
3 You know, we're talking about a duration, a period of
4 time. If the Commission were to rule favorably or
5 grant you your wish, my question would be if I'm
6 Capital One I'd want to go for the duration. I might
7 say well, the United States Postal Service actually
8 just really had a rope, and they had it around their
9 neck, and they kicked the bucket out from under
10 themselves.

11 I'm saying what's in here? Is there going
12 to be room for modification, or is Capital One going
13 to continue for the duration of this experiment to try
14 to, you know, meet those thresholds? It appears that
15 the thresholds are basically one of the primary things
16 with the overall concept.

17 I mean, what would you tell me about that,
18 Witness Plunkett? I mean, you know, if we say go and
19 Capital One says yes and then if things get kind of
20 murky or if the revenue is not there or if there are
21 some unforeseeables, even though we're not talking
22 about rate case, how are you going to deal with that?

23 THE WITNESS: Well, we've not yet and don't
24 plan any discussions to modify the terms of the
25 agreement. If you're asking whether we would be

1 willing to renegotiate with Capital One if conditions
2 changed somewhere in the future, as Witness Shippee
3 described we have ongoing discussions with Capital One
4 all the time.

5 I'm imagining that during the course of this
6 agreement to the extent conditions change and either
7 the Postal Service or Capital One sees reason for
8 possibly modifying the terms of the agreement, we
9 would certainly be willing to enter into those
10 discussions.

11 I'm not expert enough to know whether or not
12 or to what level of modification it would require us
13 to come back to the Commission and request a
14 recommended decision. Certainly there must be some
15 terms that would trigger that. Maybe there are some
16 that wouldn't.

17 I think, you know, Witness Shippee described
18 it perfectly. You know, they're one of the Postal
19 Service's largest customers. We're in ongoing
20 discussions with them all the time, not just about the
21 NSA, but on operational and technical issues, a number
22 of areas. Certainly we'll continue that throughout
23 the duration of an agreement.

24 You know, there may very well be situations
25 that arise that cause us to rethink things. Certainly

1 the Postal Service product mix changes periodically.
2 Technology enables different kinds of address
3 management practices. I would be very surprised if
4 over a three year period some things did not change
5 that might cause us to want to relook at some of the
6 features of the agreement.

7 COMMISSIONER COVINGTON: In other words,
8 it's safe for us to assume that if you see this ship
9 taking on water, you know, you're going to come
10 through before it's too late?

11 THE WITNESS: Well, to the extent we can
12 anticipate problems it's certainly in our interest to
13 do so, yes.

14 COMMISSIONER COVINGTON: Okay. One last
15 question. On page 7 of your testimony you talk about
16 a wealth of information that was incorporated into the
17 development of the volume thresholds in this proposal.

18 What you said, Witness Plunkett, and what I
19 would like to know, to the best of your knowledge, has
20 all of the information that went into setting these
21 thresholds been presented to us as a body in this case
22 up to this point?

23 THE WITNESS: Yes. To the extent that it's
24 possible to do so, yes. What I'm referring to here is
25 sort of what Witness Shippee describes when he talked

1 about the duration and some of the tension associated
2 with the negotiation.

3 During the course of discussions over such a
4 long period of time, it's inevitable that, you know,
5 information emerges all the time, and you attempt to
6 incorporate all of that information into your decision
7 making when considering different features of the
8 agreement.

9 To the extent it's been possible to do so,
10 we've tried to capture those things and present them
11 in the testimony. Obviously you don't record every
12 oral discussion that takes place between all the
13 people involved. It wouldn't necessarily be possible
14 to do so, but we've tried to reflect I think to the
15 extent practical all of that information in these
16 proceedings.

17 COMMISSIONER COVINGTON: Okay. As Chairman
18 Omas mentioned this morning, Witness Plunkett, this is
19 basically like the last hurrah as far as testimony is
20 concerned. My final question to you.

21 Is there anything that was relied upon, and
22 I mean covering the whole gamut -- leakage, declining
23 block grants, NCOA, UAA, I mean the whole gamut. Is
24 there anything that was relied upon that has not been
25 presented or that we don't have on the record so far?

1 THE WITNESS: I believe this record to be
2 exhaustive in every respect. I can't think of
3 anything that I'm aware of that hasn't been presented
4 sometimes several times over.

5 COMMISSIONER COVINGTON: Okay. Thank you,
6 Chairman Omas. Thank you, Mr. Plunkett.

7 CHAIRMAN OMAS: Mr. Plunkett, one final
8 thing before we go.

9 You mentioned a few seconds ago about how
10 you were going to be able to evaluate whether this NSA
11 is successful or not. Do you have a program, an
12 evaluating program set up? If so, would we as a
13 Commission be privy to your findings to see where and
14 how this experiment is going so that if for some
15 reason you were to bail out a sinking ship we would
16 know what happened and why it happened?

17 THE WITNESS: Well, to the extent we've done
18 anything it's already on the record. The way we
19 evaluate, and what we're really talking about here is
20 comparing the Postal Service's net contribution from
21 Capital One before the NSA versus the net contribution
22 after the NSA.

23 One form of that analysis exists in the work
24 papers of Witness Crum where we've attempted to model
25 the net contribution. As we go forward, we'll

1 continually update that calculation and compare it
2 against our expectation.

3 We presented a data collection plan where we
4 lay out how we are going to attempt to understand the
5 way we've avoided UAA costs by monitoring the number
6 of ACS records, and so that will inform that
7 discussion.

8 We haven't built the analysis or evaluation
9 tool yet because we're holding off until we get the
10 results of the recommendation decision to see exactly
11 what's required in the data collection plan, and then
12 at that point we'll sort of reopen those work papers
13 and then modify them to include the necessary
14 elements. In some form that will form the basis of
15 what we analyze and present.

16 CHAIRMAN OMAS: Okay. Mr. Reiter, would you
17 like some time with your witness?

18 MR. MAY: Mr. Chairman?

19 CHAIRMAN OMAS: Excuse me. I'm sorry. I'm
20 sorry. Is there anyone else wishing to cross-examine
21 this witness?

22 MR. MAY: Yes. At the risk of incurring the
23 wrath of those who are hungry, I do have a few
24 questions, which I'll try to be as brief as I can
25 about.

1 CROSS-EXAMINATION

2 BY MR. MAY:

3 Q Just very quickly, back to your Table 1,
4 which the OCA asked you so many questions and had
5 their own alternative presentation. Theirs showed a
6 \$36.79 million contribution loss, and yours shows
7 \$52.92 million.

8 The whole purpose of your exercise, as I
9 understand your testimony, was to explain the
10 consequences of a shift of all first class
11 solicitation mail to standard mail by Capital One as a
12 way of eliminating the 10 percent returns they have on
13 first class solicitation mail?

14 A That's correct.

15 Q Have you figured out any other way for
16 Capital One on their first class solicitation mail to
17 eliminate those 10 percent returns other than
18 converting it all to standard?

19 A No, and I think sometimes you can lose sight
20 of the fact that Capital One certainly doesn't want
21 any of their mail to go out undeliverable as
22 addressed. They have as much interest as the Postal
23 Service in minimizing that number, and that's why they
24 take such elaborate address management practices to
25 try to keep that number as low as possible.

1 It's I think an inevitable consequence of
2 using first class as an acquisition medium, as opposed
3 to a purely communication tool between an organization
4 and its existing customer base.

5 Q And if you were to agree that the OCA's
6 methodology were better than your methodology, would
7 it make you feel a lot better to know that you were
8 only going to lose almost \$37 million rather than \$53
9 million?

10 A I'd still think \$37 million was way too
11 much.

12 Q Okay. I'd like to follow up on Mr. Baker's
13 questions to you about page 10 of your testimony where
14 he gave you an excerpt from where the Nixie processing
15 costs came and all that.

16 A Yes.

17 Q That's Tab 3, I believe. It was all handed
18 out.

19 A Yes.

20 Q Let me ask you. The two costs you're
21 referring to in your sentence on page 10, Lines 12 and
22 13, the two costs you're referring to in that sentence
23 are the unit cost or ACS change of address
24 notification and the unit cost of the ACS Nixie
25 processing operation?

1 A That is how those are described in Tab 3,
2 yes, although that's perhaps not a very good
3 description of what those costs are.

4 Q Yes. I believe it was your testimony that
5 it was appropriate to take the weighted average of
6 those two costs to derive the EACS cost for Capital
7 One's electronic returns. I believe it was Postal
8 Service testimony.

9 A It's appropriate. In fact, in some ways it
10 might be conservative.

11 Q That's what I want to ask you about. The
12 ACS Nixie processing operation, which is a very high
13 cost, does that take place entirely or at least almost
14 entirely at non-mechanized terminals?

15 A That's correct. Yes. I believe in an
16 updated version of that library reference that is now
17 called ACS second generation Nixie processing,

18 Q On the other hand, does the ACS change of
19 address notification operation take place primarily at
20 mechanized terminals?

21 A Yes, that's correct.

22 Q And under the agreement, will Capital One's
23 electronic returns be processed primarily at
24 mechanized terminals and to a much lesser extent
25 non-mechanized terminals?

1 A Yes. I mean, mechanized terminals exist
2 primarily -- well, exclusively to process letter mail,
3 and Capital One's solicitation mail is letters.

4 Q Aren't we, therefore, justified in
5 concluding that using the 14.5 cent unit cost number
6 that the Postal Service has used greatly overstates
7 the unit cost for Capital One's electronic return?

8 A I think one could credibly argue that if one
9 had to choose that the .0997 cost is more
10 representative of what is likely to happen with
11 Capital One's volume than the weighted average of 14.5
12 cents.

13 We elected to do so for the purposes of
14 being conservative and because it's unlikely you will
15 have 100 percent on mechanized terminals. Some is
16 likely to go over into non-mech even if they are
17 letters.

18 Q But if you had used that, that would have
19 increased the net contribution from this deal, would
20 it not?

21 A Absolutely. Yes.

22 MR. MAY: That's all I have, Mr. Chairman.

23 CHAIRMAN OMAS: Thank you.

24 Mr. Reiter?

25 MR. REITER: Yes. We would like some time,

1 Mr. Chairman.

2 CHAIRMAN OMAS: How much time, sir?

3 MR. REITER: I think we could do it in 10
4 minutes.

5 CHAIRMAN OMAS: Ten minutes it is. We'll
6 come back at 1:00 p.m.

7 (Whereupon, a short recess was taken.)

8 CHAIRMAN OMAS: Mr. Reiter?

9 MR. REITER: Thank you, Mr. Chairman. We
10 have no further questions.

11 CHAIRMAN OMAS: Thank you, Mr. Reiter.

12 Mr. Plunkett, that completes your testimony
13 here today. We do appreciate your being here and your
14 contribution to our record. You are now excused.
15 Thanks.

16 THE WITNESS: Thank you, Mr. Chairman.

17 (Witness excused.)

18 CHAIRMAN OMAS: That concludes today's
19 hearing. We will reconvene tomorrow morning at 9:30
20 when we will receive testimony from Post Com et al.
21 witness Robert Pouche and Postal Service witness Akin.

22 Thank you, and have a nice afternoon.

23 (Whereupon, at 1:02 p.m. the hearing in the
24 above-entitled matter was concluded.)

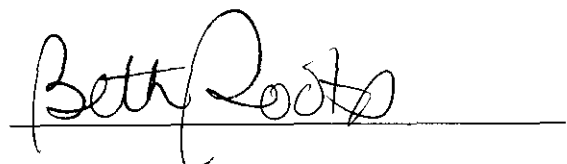
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REPORTER'S CERTIFICATE

DOCKET NO.: MC2002-2
CASE TITLE: Experimental Rate and Service Changes
to Implement Negotiated Service
Agreement with Capital One Services
HEARING DATE: March 6, 2003
LOCATION: Washington, D.C.

I hereby certify that the proceedings and
evidence are contained fully and accurately on the
tapes and notes reported by me at the hearing in the
above case before the United States Postal Rate
Commission.

Date: March 6, 2003

A handwritten signature in cursive script, reading "Beth Roots", is written over a horizontal line.

Beth Roots
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