

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

RATE AND SERVICE CHANGES TO IMPLEMENT
FUNCTIONALLY EQUIVALENT NEGOTIATED
SERVICE AGREEMENT WITH BANK ONE
CORPORATION

Docket No. MC2004-3

RESPONSES OF THE UNITED STATES POSTAL SERVICE WITNESS PLUNKETT
TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE
(OCA/USPS-T1-28-30)
(August 5, 2004)

The United States Postal Service hereby provides its responses to the following interrogatories of the Office of Consumer Advocate: OCA/USPS-T1-28-30, filed on July 26, 2004.

Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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August 5, 2004

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS PLUNKETT TO
INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T1-28. Please refer to PRC Op. MC2002-2, pages 152-156, and the attachment to this interrogatory.

- (a) Please confirm that in Table 3, the calculated stop-loss estimate for Bank One is consistent with the Commission's calculation of the stop-loss estimate with respect to Capital One. If you do not confirm, please explain and provide the correct stop loss estimate. Please show all calculations.
- (b) Refer to Table 2 in Year 1. Please confirm that the equilibrium Before Rates (BR) volume of 616,600,577 would permit Bank One to mail 81,600,576 (616,600,577 – 535,000,001) additional pieces in Year 1, more than 4.3 (81,600,576 / 19,055,000) times Bank One's Year 1 estimated volume response of 19 million pieces. If you do not confirm, please explain.
- (c) Refer to Table 2 in Year 2. Please confirm that the equilibrium BR volume of 619,172,944 would permit Bank One to mail 84,172,943 (619,172,944 – 535,000,001) additional pieces in Year 2, or 0.8 (84,172,943 / 99,055,000) times Bank One's Year 2 estimated volume response of 99 million pieces. If you do not confirm, please explain.
- (d) Refer to Table 2 in Year 3. Please confirm that the equilibrium BR volume of 621,853,081 would permit Bank One to mail 86,853,080 (621,853,081 – 535,000,001) additional pieces in Year 2, or 0.9 (86,853,080 / 99,055,000) times Bank One's Year 3 estimated volume response of 99 million pieces. If you do not confirm, please explain.

RESPONSE:

- a. Confirmed.
- b. Not confirmed. While the calculations appear to be correct, the "equilibrium" Before Rates volume of 616,600,577 would only permit (i.e., incent) Bank One to mail 45,520,577 (616,600,577 minus 571,080,000) additional pieces (above Bank One's Before Rates volume figure) in Year 1, approximately 2.4 (45,520,577 / 19,055,000) times Bank One's Year 1 estimated volume response of 19 million pieces. Also, I note that, as discussed by witness Buc (BOC-T-2), Bank One's volume response could be much larger than 19 million pieces. See also my response to OCA/USPS-T-1-19. Moreover, use

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS PLUNKETT TO
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continued

- c. of the term equilibrium – which could generally be interpreted as stable or normal – is inherently problematic as it mistakenly suggests a normative relationship between the earned discounts and ACS cost savings.
- d. Not confirmed. The “equilibrium” Before Rates volume of 619,172,944 would only permit (i.e., incent) Bank One to mail 48,092,944 (619,172,944 minus 571,080,000) additional pieces (above Bank One’s Before Rates volume figure) in Year 2, approximately 0.5 (48,092,944 / 99,055,000) times Bank One’s Year 1 estimated volume response of 99 million pieces. Also, note that, as discussed by witness Buc (BOC-T-2), Bank One’s volume response could be much larger than 99 million pieces. See also my response to part b.
- e. Not confirmed. The “equilibrium” Before Rates volume of 621,853,081 would only permit (i.e., incent) Bank One to mail 50,773,081 (621,853,081 minus 571,080,000) additional pieces (above Bank One’s Before Rates volume figure) in Year 3, approximately 0.5 (50,773,081 / 99,055,000) times Bank One’s Year 3 estimated volume response of 99 million pieces. Also, I note that, as discussed by witness Buc (BOC-T-2), Bank One’s volume response could be much larger than 99 million pieces. See also my response to part b.

BANK ONE NSA
Stop Loss Estimate

TABLE 1
Year 1 - ACS Related Savings

| | | |
|------|--|--------------------|
| [1] | Manual Letter Returns Unit Cost | \$0.55 |
| [2] | Manual Flat Returns Unit Cost | \$1.06 |
| [3] | Electronic Letter Returns Unit Cost | \$0.34 |
| [4] | Electronic Flat Returns Unit Cost | \$0.45 |
| [5] | BOC Return Rate - Solicitation Letters | 9% |
| [6] | BOC Return Rate - Solicitation Flats | 11% |
| [7] | Address Change Service (ACS) Success Rate | 85% |
| [8] | BOC BR Customer Mail Volume | 506,650,000 |
| [9] | BOC BR Solicitation Letter Volume | 29,387,000 |
| [10] | BOC BR Solicitation Flats Volume | 35,043,000 |
| [11] | Solicitation Letters % of BR Letter Volume | 5.4823% |
| [12] | Solicitation Flats % | 100% |
| [13] | BOC ACS Unit Cost Savings - Letters | \$0.00087234 |
| [14] | BOC ACS Unit Cost Savings - Flats | \$0.05726308 |
| [15] | BOC BR Equilibrium Letter Volume | 581,600,577 |
| [16] | Total ASC Cost Savings - Letters | \$507,353 |
| [17] | Total ASC Cost Savings - Flats | \$2,006,670 |
| [18] | Total ASC Savings | \$2,514,023 |

TABLE 2
Year 1 - Discount Leakage

| <u>Volume Block</u> | | <u>Incremental</u> | <u>Discount</u> | <u>Discount</u> |
|---|-----------------------|--------------------|-----------------|--------------------|
| [a] | [1] | <u>Volume</u> | [3] | <u>Leakage</u> |
| | | [2] = [1b] - [1a] | | [4] = [2] * [3] |
| 535,000,001 | to 560,000,000 | 24,999,999 | \$0.025 | \$625,000 |
| 560,000,001 | to 585,000,000 | 24,999,999 | \$0.030 | \$750,000 |
| 585,000,001 | to 610,000,000 | 24,999,999 | \$0.035 | \$875,000 |
| 610,000,001 | to 616,600,577 | 6,600,576 | \$0.040 | \$264,023 |
| 645,000,001 | to | | \$0.045 | \$0 |
| 680,000,001 | to | | \$0.050 | \$0 |
| Total | | | | \$2,514,023 |
| Difference - ACS Savings and Discount Leakage | | | | \$0.053747 |

BANK ONE NSA
Stop Loss Estimate

TABLE 1
Year 2 - ACS Related Savings

| | | |
|------|--|--------------------|
| [1] | Manual Letter Returns Unit Cost | \$0.57 |
| [2] | Manual Flat Returns Unit Cost | \$1.10 |
| [3] | Electronic Letter Returns Unit Cost | \$0.36 |
| [4] | Electronic Flat Returns Unit Cost | \$0.47 |
| [5] | BOC Return Rate - Solicitation Letters | 9% |
| [6] | BOC Return Rate - Solicitation Flats | 11% |
| [7] | Address Change Service (ACS) Success Rate | 85% |
| [8] | BOC BR Customer Mail Volume | 506,650,000 |
| [9] | BOC BR Solicitation Letter Volume | 29,387,000 |
| [10] | BOC BR Solicitation Flats Volume | 35,043,000 |
| [11] | Solicitation Letters % of BR Letter Volume | 5.4823% |
| [12] | Solicitation Flats % | 100% |
| [13] | BOC ACS Unit Cost Savings - Letters | \$0.00090723 |
| [14] | BOC ACS Unit Cost Savings - Flats | \$0.05955361 |
| [15] | BOC BR Equilibrium Letter Volume | 584,172,944 |
| [16] | Total ASC Cost Savings - Letters | \$529,981 |
| [17] | Total ASC Cost Savings - Flats | \$2,086,937 |
| [18] | Total ASC Savings | \$2,616,918 |

TABLE 2
Year 2 - Discount Leakage

| <u>Volume Block</u> | | <u>Incremental</u> | <u>Discount</u> | <u>Discount</u> |
|---|-----------------------|--------------------|-----------------|--------------------|
| [a] | [1] | <u>Volume</u> | [3] | <u>Leakage</u> |
| | | [2] = [1b] - [1a] | | [4] = [2] * [3] |
| | [b] | | | |
| 535,000,001 | to 560,000,000 | 24,999,999 | \$0.025 | \$625,000 |
| 560,000,001 | to 585,000,000 | 24,999,999 | \$0.030 | \$750,000 |
| 585,000,001 | to 610,000,000 | 24,999,999 | \$0.035 | \$875,000 |
| 610,000,001 | to 619,172,944 | 9,172,943 | \$0.040 | \$366,918 |
| 645,000,001 | to | | \$0.045 | \$0 |
| 680,000,001 | to | | \$0.050 | \$0 |
| Total | | | | \$2,616,918 |
| Difference - ACS Savings and Discount Leakage | | | | \$0.028813 |

BANK ONE NSA
 Stop Loss Estimate

TABLE 1
Year 3 - ACS Related Savings

| | | |
|------|--|--------------------|
| [1] | Manual Letter Returns Unit Cost | \$0.60 |
| [2] | Manual Flat Returns Unit Cost | \$1.15 |
| [3] | Electronic Letter Returns Unit Cost | \$0.37 |
| [4] | Electronic Flat Returns Unit Cost | \$0.48 |
| [5] | BOC Return Rate - Solicitation Letters | 9% |
| [6] | BOC Return Rate - Solicitation Flats | 11% |
| [7] | Address Change Service (ACS) Success Rate | 85% |
| [8] | BOC BR Customer Mail Volume | 506,650,000 |
| [9] | BOC BR Solicitation Letter Volume | 29,387,000 |
| [10] | BOC BR Solicitation Flats Volume | 35,043,000 |
| [11] | Solicitation Letters % of BR Letter Volume | 5.4823% |
| [12] | Solicitation Flats % | 100% |
| [13] | BOC ACS Unit Cost Savings - Letters | \$0.00094352 |
| [14] | BOC ACS Unit Cost Savings - Flats | \$0.06193575 |
| [15] | BOC BR Equilibrium Letter Volume | 586,853,081 |
| [16] | Total ASC Cost Savings - Letters | \$553,709 |
| [17] | Total ASC Cost Savings - Flats | \$2,170,414 |
| [18] | Total ASC Savings | \$2,724,123 |

TABLE 2
Year 3 - Discount Leakage

| <u>Volume Block</u> | | <u>Incremental</u> | <u>Discount</u> | <u>Discount</u> |
|---|-----------------------|--------------------|-----------------|--------------------|
| [a] | [1] | <u>Volume</u> | [3] | <u>Leakage</u> |
| | | [2] = [1b] - [1a] | | [4] = [2] * [3] |
| [a] | [b] | | | |
| 535,000,001 | to 560,000,000 | 24,999,999 | \$0.025 | \$625,000 |
| 560,000,001 | to 585,000,000 | 24,999,999 | \$0.030 | \$750,000 |
| 585,000,001 | to 610,000,000 | 24,999,999 | \$0.035 | \$875,000 |
| 610,000,001 | to 621,853,081 | 11,853,080 | \$0.040 | \$474,123 |
| 645,000,001 | to | | \$0.045 | \$0 |
| 680,000,001 | to | | \$0.050 | \$0 |
| Total | | | | \$2,724,123 |
| Difference - ACS Savings and Discount Leakage | | | | \$0.022822 |

TABLE 1

Notes & Sources

- [1] USPS-T-1 (Plunkett), Appendix A, page 1
- [2] USPS-T-1 (Plunkett), Appendix A, page 1
- [3] USPS-T-1 (Plunkett), Appendix A, page 1
- [4] USPS-T-1 (Plunkett), Appendix A, page 1
- [5] USPS-T-1 (Plunkett), Appendix A, page 1
- [6] USPS-T-1 (Plunkett), Appendix A, page 1
- [7] USPS-T-1 (Plunkett), Appendix A, page 1
- [8] USPS-T-1 (Plunkett), Appendix A, page 2
- [9] USPS-T-1 (Plunkett), Appendix A, page 2
- [10] USPS-T-1 (Plunkett), Appendix A, page 2
- [11] = [9] / ([8] + [9])
- [12] Percent of solicitation flats eligible for ACS
- [13] = ([1] - [3]) * [5] * [7] * [11]
- [14] = ([2] - [4]) * [6] * [7] * [12]
- [15] = Table 2 [1b] - ([10] - 43,000)
- [16] = [13] * [15]
- [17] = [14] * [10]
- [18] = [16] + [17]

TABLE 2

Notes and Sources:

- [1] Request, Attachment B
- [3] Request, Attachment B

BANK ONE NSA

TABLE 3
Calculation of Total Stop Loss Estimate

| | <u>Volume</u> [1] | <u>Discount</u> <u>Leakage</u> [2] | <u>Return</u> <u>Cost</u> <u>Savings</u> [3] |
|---------------------|----------------------|--|---|
| Year 1 | 616,600,577 | \$2,514,023 | \$2,514,023 |
| Year 2 | 619,172,944 | \$2,616,918 | \$2,616,918 |
| Year 3 | 621,853,081 | \$2,724,123 | <u>\$2,724,123</u> |
| | | | \$7,855,064 |
| Passthrough Percent | | | 95% |
| STOP LOSS ESTIMATE | | | \$7,462,311 |

Notes and Sources

[1] & [2] TABLE 2, for the year indicated

[3] TABLE 1, for the year indicated

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS PLUNKETT TO
INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T1-29. Please refer to your testimony at Appendix A, page 1.

- (a) Please confirm that Bank One's first-year ACS unit cost saving for solicitation letters is $\$0.00087234 [(\$0.55 - 0.34) * 0.09 * 0.85 * 0.054823]$, where $(\$0.55 - 0.34)$ is the difference between manual return unit costs and electronic return unit costs, 0.09 is Bank One's physical return rate, 0.85 is the ACS success rate, and 0.054823 is the ratio of Bank One's BR solicitation letter volume to the sum of Bank One's BR customer mail and solicitation letter volume. If you do not confirm, please explain.
- (b) Please confirm that Bank One's first-year ACS unit cost saving for solicitation flats is $\$0.05726308 [(\$1.06 - 0.45) * 0.11 * 0.85 * 1.00]$, where $(\$1.06 - 0.45)$ is the difference between manual return unit costs and electronic return unit costs, 0.11 is Bank One's physical return rate, 0.85 is the ACS success rate, and 1.00 is the percentage of Bank One's BR solicitation flats volume eligible for ACS. If you do not confirm, please explain.

RESPONSE:

- a. Generally confirmed although I would state it differently. Bank One's first-year ACS cost savings for First-Class Mail solicitation letters divided by all Bank One First-Class Mail letters is $\$0.00087234$.
- b. Confirmed.

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS PLUNKETT TO
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OCA/USPS-T1-30. Please refer to your testimony at page 9, lines 12-19.

- (a) Please confirm that the annual threshold adjustment (see Bank One NSA, Article III.F., and proposed DMCS 612.33) provides a specific mechanism to address the risks of exogenous factors as they relate to *future* statement/operational mail volumes. If you do not confirm, please explain.
- (b) Please confirm that there are exogenous factors that can affect the BR volumes of marketing mail. If you do not confirm, please explain.
- (c) Please confirm that there are exogenous factors that can affect the AR volumes of marketing mail. If you do not confirm, please explain.
- (d) If your response to parts (b) and (c) of this interrogatory is in the affirmative, please identify and describe such exogenous factors.
- (e) Please identify and explain specific provisions of the Bank One NSA and proposed DMCS that explicitly recognize and attempt to mitigate the risks of the exogenous factors identified in part (d) above as they relate to *future* marketing mail volumes.

RESPONSE:

- a. Confirmed.
- b. Confirmed, although to the extent that one compares AR and BR volumes during the same period, exogenous impacts could be considered identical such that any difference between AR and BR volumes would be the result of a difference in postage prices.
- c. See my response to part b.
- d. A comprehensive list of all the exogenous factors that could affect mail volume is not possible, as it would have to include all possible macroeconomic and microeconomic variables that could be demonstrated to have an effect on credit card marketing. For example, the prices of paper and

continued

other inputs, consumer confidence, interest rates, competitive pressure, and customer response rates all affect mail volumes.

- e. It is not clear that any exogenous factors, including those listed in response to part (d), pose a risk to the success of the NSA. The relevant risks arise not from the possibility that before rate volumes will be higher or lower than projected, or that after rate volumes will be higher or lower than projected, but from the possibilities that the *differential* between after and before rate volume will be smaller than projected. If, in the unlikely circumstance that the Before Rates volumes will be materially higher than projected, it is probable that the exposure or 'discount leakage' has been underestimated. However, by that same token the projected ACS cost savings will also have been underestimated, thus mitigating the loss from the additional leakage.

The terms of the NSA establishing an annual threshold adjustment and merger adjustments provide structural safeguards against the risk that Bank One could obtain volume-related discounts for increases in First-Class mail volume caused by a merger or an organic increase in the scale of Bank One's business, rather than by the discounts. See NSA ¶¶ III.F (annual threshold adjustment) and IV (merger adjustments). Beyond that, it is not evident that any other exogenous factors would pose a risk to the profitability of the NSA for the Postal Service. While those factors may cause Bank One's actual before-rate volumes to vary from the projected before-rate volumes, the same factors would tend to cause Bank One's actual after-rate volumes to vary from projections in the same direction and approximately the

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continued

same magnitude. Moreover, the testimony of Bank One witness Buc (BOC-T-2) indicates that the differential between Bank One's before- and after-rate volume is likely to be even greater than the Postal Service's financial analysis has assumed.

Finally, it is important to emphasize that any risk analysis must also take account of the financial risks to the Postal Service from a rate cap. As explained in my answer to OCA-USPS-T1-24, and the partially redirected answer of Bank One witness Buc, a cap on total discounts would pose a greater risk to the Postal Service's contribution than does the absence of a cap.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

Nan K. McKenzie

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August 5, 2004