

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

**RATE AND SERVICE CHANGES TO IMPLEMENT  
FUNCTIONALLY EQUIVALENT NEGOTIATED  
SERVICE AGREEMENT WITH HSBC NORTH  
AMERICA HOLDINGS INC.**

**Docket No. MC2005-2**

**DIRECT TESTIMONY  
OF  
JESSICA A. DAUER  
ON BEHALF OF THE  
UNITED STATES POSTAL SERVICE**

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## **AUTOBIOGRAPHICAL SKETCH**

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My name is Jessica Ann Dauer. I joined the Postal Service in 2003 and am currently an Economist in the Pricing Strategy group. I provided financial analysis support for the Bank One Corporation Negotiated Service Agreement (NSA) filing, Docket No. MC2004-3, and the Discover Financial Services NSA filing, Docket No. MC2004-4. I am also responsible for the beginning process stages for NSAs.

I was part of the Postal Service's negotiating team that developed the NSA with HSBC North American Holdings Inc. and am responsible for all financial analyses presented in the Postal Service filing. In addition, I provided negotiation and financial analysis support for both the Bank One NSA and Discover NSA. This is my first appearance before the Commission.

I earned a Bachelor's Degree in Marketing and Economics from Lynchburg College and a Master's of Business Administration (MBA) from the Strayer University with honors. While pursuing my MBA, I worked full time with the Postal Service.

1 **I. PURPOSE AND SCOPE OF TESTIMONY**

2 The purpose of my testimony is to describe and analyze the policy and business  
3 considerations that support the Postal Service's negotiated service agreement (NSA)  
4 with the subsidiaries of HSBC North America Holdings Inc. In this testimony, I refer to  
5 the subsidiaries of HSBC North America Holdings Inc. that operate in the United States  
6 as HSBC. The HSBC NSA is submitted as functionally equivalent to the Docket No.  
7 MC2002-2 baseline NSA with Capital One. Thus, in accordance with 39 C.F.R. §  
8 3001.196, my testimony will include a detailed explanation of how the HSBC NSA is  
9 functionally equivalent to the baseline agreement, and will describe the differences  
10 between the HSBC NSA and the baseline agreement. My testimony will also analyze  
11 the financial impact of the NSA on the Postal Service over the three-year duration of the  
12 agreement, the fairness and equity of the NSA in regard to other users of the mail, and  
13 the fairness and equity of the NSA in regard to the competitors of the parties to the  
14 NSA. Finally, I will explain why functionally equivalent NSAs are important to the  
15 business goals of the Postal Service.

16 My testimony will show that (1) the HSBC NSA primarily rests on the same  
17 substantive functional elements as the Capital One NSA and provides comparable  
18 benefits; (2) the HSBC NSA is functionally equivalent to Capital One, and therefore this  
19 NSA has a comparable competitive impact; and (3) the HSBC NSA conforms to the  
20 relevant pricing and classification criteria of the Postal Reorganization Act. My  
21 testimony will also explain how the HSBC NSA will improve the financial position of the  
22 Postal Service.

1 My testimony relies on the concurrently filed testimony of HSBC witness John H.  
2 Harvey (HSBC-T-1), which is similar to the testimony provided by Capital One in Docket  
3 No. MC2002-2. On behalf of the Postal Service, I have reviewed Mr. Harvey's  
4 testimony, and affirm that such testimony may be relied upon in presentation of the  
5 Postal Service's direct case.

6 Appendix A to my testimony presents the model that calculates the financial  
7 impacts of the NSA. This model reproduces the calculations provided in Attachments  
8 (1), (2), and (B) of Witness Crum's testimony (USPS-T-3) in Docket No. MC2002-2.  
9 Appendix B explains the similarities and differences between both models. It is  
10 important to note that the underlying principles for calculating Postal Service  
11 contribution in the new format remain the same. Appendix C contains the proposed  
12 Data Collection Plan, which is based on the Data Collection Plan for the baseline  
13 Docket No. MC2002-2.

## 14 **II. INTRODUCTION AND SUMMARY**

15 The HSBC NSA creates a win-win situation for both HSBC and the Postal  
16 Service by providing HSBC with a direct economic benefit of up to \$9 million in postage  
17 discounts, and allowing the Postal Service to capture costs savings and increased  
18 contribution, which minimizes any potential risk of harm to mailers not party to the  
19 agreement. This win-win situation is created by three similar but not identical elements:  
20 the address correction element, the declining block rate volume discount element, and  
21 the negotiated cap element.

1 **III. THE IMPORTANCE OF NSAS AND FUNCTIONALLY EQUIVALENT**  
2 **AGREEMENTS**

3  
4 **A. Background and Strategic Advantages of NSAs**

5 In Docket No. MC2002-2, the Commission found that, when the concepts  
6 underlying negotiated pricing and declining block rates are applied fairly, benefits can  
7 accrue, not only to the customer and to the Postal Service, but also to all other postal  
8 customers. As witness Bizzotto pointed out, the Postal Service considers negotiated  
9 pricing a natural extension of its long-standing practice of seeking innovations in pricing.  
10 (MC2002-2) USPS-T-1 at 2-5. Used appropriately, negotiated pricing facilitates  
11 incentives for additional mail volume that benefits the Postal Service, its business  
12 partner, and all users of the Postal Service, through the resulting additional contribution  
13 to institutional costs. Given the economic pressures described below, NSAs represent  
14 one tool that can help to mitigate the risk that continued erosion of existing First-Class  
15 Mail volume will lead to higher than necessary rate and fee increases in the future.

16 In its opinion in Docket No. MC2002-2, the Commission also concluded that the  
17 “Postal Service should ensure that ‘[t]he negotiated rate-and-service package is made  
18 available on the same terms to other potential users willing to meet the same conditions  
19 of service.” PRC Op., Docket No. MC2002-2, ¶ 7004, p. 136. To address this concern  
20 in the Capital One case, the Postal Service, Capital One, the Office of Consumer  
21 Advocate (OCA), and many intervenors entered into a stipulation and agreement that  
22 identified the terms and conditions that must be included for an agreement to be  
23 considered comparable to Capital One. The Postal Service codified these elements in  
24 DMM G911. The HSBC NSA meets these criteria and affirms the Postal Service’s  
25 commitment to extend the Capital One NSA’s terms and conditions to other mailers.

1           **B.    The Importance of Functionally Equivalent NSAs to the Postal**  
2           **Service**

3  
4           Functionally equivalent NSAs are important to the Postal Service because they  
5 extend the benefits of baseline agreements to other customers. The Commission's  
6 procedural framework for functionally equivalent cases promises to ensure that this  
7 objective can be achieved efficiently in an expedited proceeding, where unnecessary  
8 controversy and duplication of effort can be minimized. These procedural goals, in turn,  
9 support the related objectives of minimizing the transaction costs involved in pursuing  
10 NSAs, reinforcing the financial incentives embodied in NSAs, and thereby promoting a  
11 viable and productive NSA process.

12           Expedited litigation and subsequent implementation of the adjustments proposed  
13 in this case would benefit both the Postal Service and HSBC under the specific terms of  
14 the HSBC NSA. If the proposed adjustments are recommended and approved, the  
15 Postal Service would realize immediate benefit from the agreement in terms of ACS  
16 savings. If this case, however, were to be litigated as a baseline NSA under the  
17 Commission's rules, the protracted proceedings would delay the Postal Service's ability  
18 to capture the ACS savings. From the customer's perspective, furthermore, lengthy  
19 litigation would result in higher costs as well as delayed business benefits. For smaller  
20 mailers this cost can become prohibitive, in effect lowering the customer's valuation of  
21 the NSA, perhaps making it economically undesirable. Moreover, lengthy proceedings  
22 would add to the risk that the business environment might change in such a way that  
23 neither the Postal Service nor HSBC could take advantage of the NSA.

24           In Docket No. MC2002-2, considerable attention was focused on the risks  
25 associated with declining block rates. Witness Panzar addressed the technical risks

1 associated with non-linear pricing, and the OCA focused on the risks inherent in  
2 providing volume-based incentives in a future period. A number of participants  
3 suggested various mechanisms for mitigating these risks, implying that the risk of  
4 change might be greater than the risk of doing nothing.

5 Competition from electronic alternatives, increasing cost pressure on business  
6 customers, and a recent period of economic sluggishness have contributed to a  
7 stagnating of demand for First-Class Mail over the last several years. At the same time,  
8 household growth continues to lead to expansion of the Postal Service's delivery  
9 network. While recent productivity gains have been remarkable, there continues to be  
10 pressure on the Postal Service to define ways to continue to fund its large and growing  
11 universal service obligation. In the absence of new ways for the Postal Service to  
12 generate additional volumes and revenues, USPS customers will likely be asked to  
13 absorb price increases in the future.

14 In this environment, the Postal Service considers to be of critical important the  
15 ability to negotiate individual price agreements that are consistent with the Act, and to  
16 implement them through rate and classification changes. Procedures linking baseline  
17 agreements with their functionally equivalent offspring will help ensure that the benefits  
18 of the baseline agreements can be efficiently extended to similar, but distinct,  
19 relationships with other mailers. Promoting functionally equivalent NSAs will also  
20 mitigate the concern that a baseline NSA might have adverse competitive impacts.

#### 21 **IV. THE HSBC NSA IS FUNCTIONALLY EQUIVALENT TO THE CAPITAL ONE NSA**

22  
23 The HSBC NSA fully meets the guidelines outlined in the Commission's Order  
24 No. 1391 (RM2003-5) for functionally equivalent NSAs. The HSBC NSA contains the

1 same functional elements as the Capital One baseline NSA (e.g., declining block rates  
 2 and address correction elements, Order 1391 at 50), and will produce comparable  
 3 benefits for the Postal Service. Any differences between the HSBC NSA and the  
 4 Capital One NSA do not detract from HSBC's status as functionally equivalent.

5 **A. The HSBC NSA Contains the Same Functional Elements as in the**  
 6 **Capital One NSA**

7  
 8 The HSBC NSA rests on the same substantive functional elements as the Capital  
 9 One NSA. First, as in the Capital One agreement, the Postal Service's agreement with  
 10 HSBC calls for the implementation of incentives in the form of declining block rates,  
 11 according to the schedule outlined below. The incentives are applied only to incremental  
 12 volume above the negotiated threshold. In other words, no incentive would be applied  
 13 to the first 615 million pieces in the initial year; an incentive of 2.5 cents would be  
 14 applied to the next 40 million pieces, then 20 million pieces, etc.:

	<u>Year 1 Volume Block</u>	<u>Incremental Incentives</u>
16	615,000,001 – 655,000,000	2.5¢
17	655,000,001 – 675,000,000	3.0¢
18	675,000,001 – 695,000,000	3.5¢
19	695,000,001 – 715,000,000	4.0¢
20	715,000,001 – 735,000,000	4.5¢
21	735,000,0001 – above	5.0¢
22		
23	<u>Year 2 Volume Block</u>	<u>Incremental Incentives</u>
24	725,000,001 – 765,000,000	2.5¢
25	765,000,001 – 785,000,000	3.0¢

1	785,000,001 – 805,000,000	3.5¢
2	805,000,001 – 825,000,000	4.0¢
3	825,000,001 – 845,000,000	4.5¢
4	845,000,0001 – above	5.0¢
5	<u>Year 3 Volume Block</u>	<u>Incremental Incentives</u>
6	810,000,001 – 850,000,000	2.5¢
7	850,000,001 – 870,000,000	3.0¢
8	870,000,001 – 890,000,000	3.5¢
9	890,000,001 – 910,000,000	4.0¢
10	910,000,001 – 930,000,000	4.5¢
11	930,000,0001 – above	5.0¢

12 Considering these incentives and the testimony of witness Harvey (HSBC-T-1)  
 13 regarding the volume response of HSBC to the proposed incentive structure, the Postal  
 14 Service expects HSBC’s use of First-Class Mail to increase as a result of the incentives,  
 15 providing additional net contribution to the Postal Service.

16 Second, as with the Capital One NSA, the HSBC agreement contains an address  
 17 correction element, which creates further cost savings for the Postal Service. HSBC  
 18 has agreed that the Postal Service can convert the physical return of its undeliverable-  
 19 as-addressed (UAA) marketing mailpieces into electronic address correction information  
 20 through the computerized ACS system. It is the same ACS system that was described  
 21 more fully in the testimony of witness Wilson in Docket No. MC2002-2. USPS-T-4 at 2-  
 22 7. For discussion of the negotiated cap, see Section VII, *infra*.

23

1 **B. The HSBC NSA Provides the Postal Service a Comparable Benefit**

2 In discussing the NSA rules governing functionally equivalent agreements, Order  
3 No. 1391 stated that the Commission would go beyond an evaluation of the functional  
4 elements and examine whether the agreement provides a comparable benefit to the  
5 Postal Service. Order 1391 at 51. For example, the Commission stated that an  
6 agreement that is functionally equivalent to Capital One would need to have ACS cost  
7 savings. The ACS cost savings that will result from the HSBC NSA are significant  
8 since over 4.75 percent of HSBC's First-Class Mail solicitation volume is currently  
9 physically returned. See Appendix A, p. 1. Also, as in Capital One, the HSBC NSA will  
10 generate contribution from new First-Class Mail volume. *Id.* at 1, 10, 11.

11 **C. Other Terms and Conditions of the HSBC NSA**

12 The HSBC NSA incorporates other terms and conditions found in the Capital  
13 One NSA. The agreement waives the seal against postal inspection of mail; requires  
14 HSBC to prepare mail under applicable standards and to enhance its address  
15 management practices; includes a transaction penalty; and contains a provision for  
16 HSBC to make necessary records and data available to the Postal Service to facilitate  
17 and monitor compliance. It also enables the Postal Service to cancel for failure by the  
18 mailer to provide accurate data, to present properly prepared and paid mailings, to  
19 comply with a material term of the NSA, or to use the NSA. See Request, Attachment  
20 F.

21 **D. New Terms and Conditions in the HSBC NSA**

22 By their nature, individual service relationships with the Postal Service reflect the  
23 inherent differences among mailers. The ability to develop a customer-specific NSA

1 allows the Postal Service to address these differences directly, and to develop an  
2 agreement that best satisfies the needs of an individual customer and the Postal  
3 Service. By improving overall revenue contribution to the Postal Service, such  
4 agreements in turn benefit all postal customers.

5 The exact declining block rates in the HSBC NSA do not match those in the  
6 Capital One NSA, although they are similar. The thresholds, incremental blocks, and  
7 starting incentives are unique to the HSBC NSA. However, the incentive structure  
8 remains the same as in the Capital One NSA, and is the result of a negotiated  
9 agreement between the customer and the Postal Service.

10 In addition, the HSBC NSA incorporates three customer-specific terms not found  
11 in the Capital One NSA: negotiated out-year thresholds, an annual adjustment  
12 mechanism to the negotiated threshold, and a negotiated cap. As explained below,  
13 none of the terms alters the functionally equivalent status of the HSBC NSA.

14 The first customer-specific term is the set of negotiated thresholds in the out-  
15 years. The Postal Service and HSBC negotiated individual thresholds and incentives  
16 for each of the three years of the NSA. These enabled the Postal Service to minimize  
17 its discount exposure (leakage) against HSBC's high growth rates, while retaining the  
18 ability to give HSBC incentives to stretch its First-Class Mail volumes above what they  
19 otherwise might be. In previous agreements, the thresholds remained essentially  
20 constant throughout the agreement, but in this NSA the negotiated individual thresholds  
21 were needed to satisfy both the Postal Service's needs and HSBC's circumstances.

22 The second customer-specific term is the annual threshold adjustment. As  
23 noted, among other objectives, this NSA is intended to create incentives for HSBC to

1 increase First-Class Mail marketing volumes over the duration of the agreement.  
2 However, because HSBC's forecasts reflect high growth rates for both statement and  
3 marketing volume, it is possible that actual volumes levels in any given year could  
4 materially deviate, having an unintended consequence of diminishing the incentives for  
5 new marketing mail volume. For example, if there were a substantial volume shortfall in  
6 an early year of the agreement, HSBC may find it exceedingly difficult in later years  
7 even to approach the lowest volume threshold set for discounts in those years. If HSBC  
8 has no chance to qualify for discounts, those discounts cannot act to encourage volume  
9 growth. Alternatively, if volume levels increase in early years beyond what has been  
10 forecasted, HSBC might not have to stretch in later years to obtain the higher discounts  
11 levels, and the Postal Service would be facing increased discount exposure. In either  
12 circumstance, the multi-tiered threshold/discount structure would be unlikely to achieve  
13 its intended purpose: to provide an incentive for increasing First-Class Mail volume.

14         The annual threshold adjustment serves to protect against deviations from the  
15 forecasts by including provisions for either upward or downward threshold adjustments  
16 in the years following the first year of the agreement (the out-years). The downward  
17 adjustment operates such that, if HSBC's total First-Class Mail volume in either the first  
18 or second year ( $YR_n$ ) of the agreement is more than 15 percent below the before rates  
19 forecast of that year, then the next year's threshold ( $YR_{n+1}$ ) would be decreased by a  
20 percentage amount equal to the amount by which the volume shortfall exceeds 15  
21 percent. For example, under the HSBC mechanism, if the Year 1 actual volume was 18  
22 percent below the before rates forecast, then the Year 2 thresholds would be decreased  
23 by 3 percent (18 -15) to 703 million. Since the adjustment is intended to address only

1 major volume differences, the trigger point for any downward adjustment is a 15 percent  
2 deviation from the forecast.

3         The same type of mechanism works for increasing the thresholds, when  
4 appropriate. If HSBC's First-Class Mail volume in either the first or second year ( $YR_n$ )  
5 of the agreement is more than 20 percent greater than the before rates forecast of that  
6 year, and HSBC's Standard Mail volume for  $YR_n$  exceeds its forecast by 5 percent or  
7 greater, then the next year's threshold ( $YR_{n+1}$ ) would be increased by the percentage  
8 difference between the actual First-Class Mail volume and the before rates forecast,  
9 minus 15 percent. For example, if HSBC's actual First-Class Mail volume is 23 percent  
10 greater than the before rates forecast in Year 1, and the Standard Mail volume  
11 simultaneously exceeded its forecast by 5 percent or more, then in Year 2, the base  
12 threshold would increase by 8 percent ( $23 - 15$ ) to 783 million.

13         The purpose of including Standard Mail volume performance in the trigger  
14 mechanism for the upward adjustment is to attempt to distinguish situations in which  
15 the observed growth in First-Class Mail volume is primarily a response to the  
16 incentives of the NSA from those situations in which the observed growth is primarily  
17 due to other factors. Stated alternatively, the intent is to separate variances in the  
18 after rates forecasts from variances in the before rates forecast. Since the  
19 expectation is that additional pieces of First-Class Mail resulting from the discounts  
20 would be pieces converting from Standard Mail, observations of higher than expected  
21 First-Class Mail volume, if caused exclusively by better than anticipated response to  
22 the after rates discounts, would be accompanied by observed shortfalls in Standard  
23 Mail volumes. On the other hand, if both First-Class and Standard Mail volumes were

1 substantially exceeding forecasts, the natural conclusion would be that exogenous  
2 (before rates) factors were behind the surge in volume, and higher threshold levels  
3 would therefore be warranted.

4           To return to the example, if First-Class Mail volumes exceeded the forecast by  
5 23 percent, and Standard Mail volumes also exceeded forecast by a comparable  
6 amount, then it would be difficult to believe that the higher First-Class volumes were  
7 the result of a hugely successful response to the discounts shifting larger portions of  
8 Standard Mail to First-Class Mail. Alternatively, if the Standard Mail volume under the  
9 same circumstances were well below the forecast, it would be much more difficult to  
10 reject the hypothesis that the additional First-Class Mail volumes were, in fact, shifting  
11 from Standard Mail in exactly the fashion that the NSA was intended to encourage.  
12 While the logic of this mechanism might suggest that any unexpected increase in  
13 Standard Mail volumes could potentially negate the inference that unanticipated  
14 First-Class Mail increases were exclusively the result of the incentives performing as  
15 desired to convert more pieces from First-Class to Standard, the parties negotiated a  
16 five percent cushion on the Standard Mail portion of the trigger so that upward  
17 threshold adjustments would occur only when there was truly unambiguous evidence  
18 of a rising tide lifting all boats.

19           The third customer-specific term is a negotiated cap. The HSBC NSA stipulates  
20 a negotiated cap of \$9 million over the life of the NSA. This cap is the maximum amount  
21 of discounts that HSBC can receive from the Postal Service over the life of the  
22 agreement. The Postal Service accepted the cap negotiated with HSBC, and agreed  
23 that it reinforces the goals of the NSA approach.

1           The Postal Service evaluated the proposed cap using Commission's logic of the  
2 Docket MC2004-4 to establish its position while in negotiations with HSBC. The Postal  
3 Service used a 100 percent pass through of the ACS cost savings of \$8.1 million plus  
4 the competitive adjustment given in Docket MC2004-04 of 10.09 percent. This equals  
5 \$8.9 million (\$8.1 million + \$.8 million).

6           While the Postal Service accepts the cap in the instant proceeding, and the cap  
7 is the result of arms-length negotiations, the Postal Service continues to believe that  
8 caps for any purpose will not necessarily benefit either the customer or the Postal  
9 Service. This is especially so in this case, where the Postal Service mitigated its risk by  
10 negotiating an annual adjustment mechanism to the threshold and specified out-year  
11 thresholds. Regarding the Capital One type of "stop-loss" cap, it is unlikely the Postal  
12 Service's exposure from misestimating could exceed the expected ACS savings from  
13 the HSBC NSA. Therefore, imposition of a "stop-loss" cap, in the context of the HSBC  
14 NSA, is not necessary to mitigate this specific form of risk.

## 15           **V. Financial Impacts**

### 16           **A. Value Factors/Elements**

17           As with the Capital One NSA, the HSBC NSA has three factors affecting the  
18 value: ACS cost savings, new volume contribution, and discount exposure (leakage).  
19 The first value driver, ACS cost savings, are the savings that accrue to the Postal  
20 Service from eliminating the physical return of First-Class Mail marketing pieces with an  
21 electronic return notice. Rather than having its undeliverable-as-addressed (UAA)  
22 marketing pieces physically returned, HSBC has agreed to receive most address  
23 correction information electronically through the computerized ACS system. This is the

1 same ACS system that was described more fully in the testimony of witness Wilson  
2 (USPS-T4) in Docket No. MC2002-2. (MC2002-2) USPS-T-4 at 3-4. Conversion to  
3 ACS would save the Postal Service the costs of returning UAA mail through the mail  
4 stream to the location where HSBC would have processed return mail.

5 The second value driver for the Postal Service is the volume contribution from  
6 any new volume generated by the NSA. This contribution is calculated using the  
7 following inputs: per piece contribution of First-Class Mail, per piece contribution of  
8 Standard Mail, and the percent of new First-Class marketing mail converted from  
9 Standard to First-Class.

10 As HSBC Witness Harvey explains, the price incentives in the NSA are expected  
11 to produce a First-Class Mail volume response of 16 million pieces in Year 1, and 20  
12 million pieces in each of Year 2 and Year 3. The new contribution must offset any  
13 substitution leakage that would result from the loss of contribution from Standard Mail  
14 pieces which might be converted to incremental First-Class Mail marketing pieces. To  
15 be conservative, HSBC has estimated that 100 percent of incremental volume would be  
16 converted from Standard Mail. HSBC-T-1 at 9. Both the Postal Service and HSBC  
17 believe that the incremental volumes could very well exceed the forecast. *Id.* (See Part  
18 C., Conservatism of Assumptions, below.)

19 The final value driver is the expected discount exposure. The discount exposure  
20 lowers the value of the NSA and is the result of price incentives applied to any volume  
21 that would have occurred without a price incentive. As described by witness Eakin,  
22 setting a threshold below forecast volume is economically efficient because it reduces  
23 the mailer's marginal price of First-Class Mail relative to other forms of solicitation, and

1 reduces the gap between marginal price and marginal cost of the mailer's First-Class  
2 Mail. (MC2002-2,USPS-RT-2 at 4-5, Tr. 10/2069-70).

3 I estimate the value to the Postal Service of the HSBC agreement, when  
4 considering all three value drivers, over the three years of the NSA, as follows:

5 ACS Cost savings:	\$6.6 million
6 Increased contribution (less incremental discounts):	\$3.9 million
7 Discount exposure:	(\$4.4) million

8  
9 The agreement therefore would result in a net benefit to the Postal Service of \$6.1  
10 million over the life of the NSA. A detailed analysis of the financial impact is provided in  
11 Appendix A.

## 12 **B. Financial Model**

13 I believe that the analysis provided in the valuation model of the HSBC NSA  
14 complies with the guidelines established by the Commission in Rule 193(e). The model  
15 follows witness Crum's methodology in Docket No. MC2002-2, except in instances  
16 where a change allows it to conform more closely to the requirements of Rule 193(e).  
17 The features of the model are described below; the model is in Appendix A and any  
18 changes are discussed in Appendix B.

19 In order to comply with Rule 193(e)(2), the Postal Service and HSBC have  
20 provided more data than in Docket No. MC2002-2 in order to present a more  
21 representative estimate of the cost and volume effects of the NSA in Years 2 and 3 of  
22 the agreement. See Appendix B at 2-3. In witness Harvey's testimony, HSBC has

1 provided estimates of After Rate mail volume forecasts in Years 2 and 3 of the  
2 agreement, which are minimum forecasts, as Mr. Harvey notes. HSBC-T-1 at 7-8.

3 In Appendix A, a contingency factor of 3 percent has been applied to all per piece  
4 cost calculations, including First-Class Mail, Standard Mail, and the physical and  
5 electronic costs of ACS. This adjustment is needed to gain certification from the Chief  
6 Financial Office of the Postal Service.

7 In addition, as described in Appendix B, the Postal Service applies a 4 percent  
8 annual inflationary cost adjustment factor to estimate unit costs in the each year of the  
9 agreement and to account for cost increases since litigation of the Capital One NSA  
10 agreement. This cost adjustment factor will provide a better estimate of the value of the  
11 NSA in the out-years of the agreement as requested by the Commission.<sup>1</sup> In other  
12 respects, the cost assumptions for the HSBC mail pieces are based on Docket No.  
13 MC2002-2.<sup>2</sup>

#### 14 **C. Conservatism of Estimated Value**

15 The After Rates (AR) forecast provided by HSBC is, in the opinion of the Postal  
16 Service, a conservative estimate of the potential volume response to the price  
17 incentives.

18 In fact, there are reasons why these forecasts would generally tend toward  
19 conservatism. Non-linear pricing of First-Class Mail is relatively new to the Postal  
20 Service. Consequently, postal customers have no direct experience in planning

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<sup>1</sup> There remains a possibility of a rate increase during the term of the agreement; such an increase has not been accounted for in the revenue calculations. To the extent that revenues in the out-years have been undercounted, greater credence is lent to the conservatism of any assumption.

<sup>2</sup> Just as in the Capital One case, the Postal Service is not providing estimates of forwarded mail.

1 postage expenditures, nor in adjusting budgets when – as may happen if HSBC  
2 reaches its initial declining block threshold – the cost of customer acquisition declines.  
3 If customers use traditional modeling techniques out of necessity, forecast volume  
4 effects are likely to understate the result of sudden and substantial price reductions.  
5 Moreover, banks work in a highly regulated and extensively analyzed industry, where  
6 public pronouncements can have significant consequences. This is also likely to act as  
7 a check against unwarranted optimism in projecting future outcomes.

8           One of the difficulties that arise in forecasting volumes in Years 1, 2, and 3 of the  
9 agreement is that, in complex mailing environments, postage is not the only variable  
10 that determines future mailing strategies. The customer and the Postal Service believe  
11 – and universally accepted principles of economics confirm – that, keeping all other  
12 business variables constant, lower postage costs will provide an incentive for greater  
13 mail volumes. Yet, most companies do not currently forecast the impact of declining  
14 postage rates, and it is difficult to predict the full impact on mail volumes. Thus, the  
15 point estimates provided are conservative and the Postal Service anticipates that the  
16 volume response could very well be higher.

## 17 **VI. COMPETITIVE IMPACT ANALYSIS**

18           The impact of the Capital One NSA on the competitors of the contracting parties  
19 was discussed and evaluated extensively in the baseline proceeding. (MC 2002-2,  
20 JCP-T-1 at 11-12 and USPS-RT-2 at 11-14.) In the end, the Commission concluded  
21 that the impact on competition would be minor. In this regard, the Commission found it  
22 significant that no competitors of Capital One opposed the NSA.

1 I estimate that the impact on competition of the HSBC NSA – which is  
2 functionally equivalent to the Capital One NSA – should be even less, since HSBC and  
3 Capital One are similarly situated, *i.e.*, direct competitors. Further, the pool of  
4 competitors which may be disadvantaged because they do not have an NSA decreases  
5 as the number of functionally equivalent agreements increase. For functionally  
6 equivalent agreements of direct competitors of the baseline agreement, any industry  
7 competitive impacts have been addressed in the baseline filing. More importantly,  
8 approving functionally equivalent NSAs provides competitors of Capital One the same  
9 incentives to grow their mail volumes. This is not to suggest that postage prices are the  
10 sole - or even the primary - dimension along which all competitors in an industry may  
11 compete. Indeed, there may be circumstances when it would be impracticable or  
12 otherwise inappropriate to provide NSAs to all competitors within an industry.

## 13 **VII. NEGOTIATED CAP**

14 A "stop-loss provision" or discount cap of \$40 million over three years was  
15 incorporated in the rate and classification changes implementing the Capital One NSA.  
16 This was not a condition that was negotiated between the Postal Service and Capital  
17 One, but was added by the Commission (PRC Op., MC2002-2, ¶ 5061).

18 The Commission explained that it instituted the stop-loss provision because of  
19 the variability inherent in the volume history of Capital One. The concern over "discount  
20 leakage" exceeding cost savings thus influenced the decision to limit the total value of  
21 incentives Capital One could earn (PRC Op., MC2002-2, ¶ 8024). In setting the cap,  
22 the Commission found that there would be no impact on new volume contribution  
23 because the thresholds were above the revised forecast. However, a cap based on

1 either cost savings or exposure (leakage) unnecessarily hinders the ultimate objective  
2 of utilizing NSAs as a tool to increase net contribution. Basing the "stop-loss provision"  
3 solely on cost savings would tend to limit participation in the NSA process to only large  
4 volume mailers who can offer significant cost savings opportunities. This would place  
5 customers who do not impose added costs on the Postal Service at a disadvantage.

6 More importantly, a stop-loss provision similar to Capital One's could foreclose  
7 the potential contribution from increased volume. It also would impose a competitive  
8 disadvantage on HSBC, because its potential cost savings are not nearly as large as  
9 the potential cost savings for Capital One, which is a larger originator of First-Class Mail  
10 marketing solicitations than HSBC.

11 Accordingly, a cap could actually cause harm because it would limit the upside  
12 potential of the NSA. As discussed previously, the HSBC forecasts are conservative,  
13 and it is quite possible that the incremental volume may be higher than predicted. A  
14 "stop-loss" cap hinders this possibility. Nevertheless, according to the recent Bank One  
15 Corporation decision, a cap is recommended by the Commission to ". . . preserve the  
16 win-win situations . . ." and ". . . holds significance in the review of this [MC2004-3]  
17 request under the functional equivalency rules, with the Capital One Negotiated Service  
18 Agreement as the baseline" (PRC Op., MC2004-3 ¶ 1010 -1011). To lessen the degree  
19 of complexity in determining the functional equivalency of HSBC, both parties have  
20 negotiated a cap to keep within the expedited procedures and thereby reducing the  
21 litigation costs to HSBC and the Postal Service.

1 **VIII. PROPOSED PRICES ARE CONSISTENT WITH THE CRITERIA OF THE ACT**

2 Title 39, Section 3623 requires that the Commission evaluate proposed changes  
3 in the classification schedule in accordance with the policies of the Title and the  
4 following factors:

- 5 1. the establishment and maintenance of a fair and equitable classification  
6 system for all mail;
- 7 2. the relative value to the people of the kinds of mail matter entered into the  
8 postal system and the desirability and justification for special classifications  
9 and services of mail;
- 10 3. the importance of providing classifications with extremely high degrees of  
11 reliability and speed of delivery;
- 12 4. the importance of providing classifications which do not require an extremely  
13 high degree of reliability and speed of delivery;
- 14 5. the desirability of special classifications from the point of view of both the user  
15 and of the Postal Service; and
- 16 6. such other factors as the Commission may deem appropriate.

17  
18 Section 3622(b) requires that postal rates and fees reflect the policies of the  
19 Postal Reorganization Act, and accord with the following factors:

- 20 1. the establishment and maintenance of a fair and equitable schedule;
- 21 2. the value of the mail service actually provided each class or type of mail  
22 service to both the sender and the recipient, including but not limited to, the  
23 collection, mode of transportation, and priority of delivery;
- 24 3. the requirement that each class of mail or type of mail service bear the direct  
25 and indirect postal costs attributable to that class or type plus that portion of  
26 all other costs of the Postal Service reasonably assignable to such class or  
27 type;
- 28 4. the effect of rate increases upon the general public, business mail users, and  
29 enterprises in the private sector of the economy engaged in the delivery of  
30 mail matter other than letters;
- 31 5. the available alternative means of sending and receiving letters and other  
32 mail matter at reasonable costs;
- 33 6. the degree of preparation of mail for delivery into the postal system performed  
34 by the mailer and its effect upon reducing costs to the Postal Service;
- 35 7. simplicity of structure for the entire schedule and simple, identifiable  
36 relationships between the rates or fees charged the various classes of mail  
37 for postal services;
- 38 8. the educational, cultural, scientific, and informational value to the recipient of  
39 mail matter; and
- 40 9. such other factors as the Commission deems appropriate.

1  
2 The arguments presented by witness Plunkett in the Capital One NSA are also  
3 applicable to the HSBC NSA:

4 ...the Postal Service believes that by negotiating directly with  
5 individual customers, it may be possible, through negotiated service  
6 agreements such as the one submitted here, to more accurately present  
7 prices that represent the value that the user places on the service being  
8 provided (pricing criterion 2) for mail classifications that are desirable to  
9 the mailer and the Postal Service (classification criterion 5). In this case,  
10 the Postal Service has directly negotiated with the sender of the mail to  
11 arrive at classifications and prices that the Postal Service considers to be  
12 fair and equitable (classification criterion 1 and pricing criterion 1). As  
13 indicated in the testimony of witness Crum, there can be no doubt that the  
14 prices presented in this case will cover the costs of providing the service  
15 (price criterion 3). In fact, the address improvement steps that Capital  
16 One has agreed to will serve to lower the costs currently borne by other  
17 customers (pricing criterion 6). For this reason, the classifications and  
18 prices presented in this agreement confer beneficial effects on the general  
19 public and other ratepayers (classification criterion 1 and pricing criterion  
20 1). The proposed rates do not have an adverse impact on the rates paid  
21 by the general public, or other business mail users (pricing criterion 4).  
22 The proposed declining block rate structure is relatively simple and  
23 maintains a transparent, identifiable relationship between volume levels  
24 and applicable rates and fees (pricing criterion 7). (MC2002-2, USPS-T-2,  
25 page 9, line 36 – page 10, line 15).  
26

27 I believe that these pricing and policy issues were comprehensively addressed in  
28 the Capital One NSA docket, and that the logic of functional equivalence enables  
29 reliance on the findings in that case. In this instance, the close comparability of the  
30 structure and elements of the HSBC and Capital One NSAs, the similarity of their  
31 situations as mailers, and their status as competitors, warrant full reliance on the  
32 Commission's findings to justify recommending the proposed changes based on the  
33 HSBC NSA. Further, the customer-specific rates offered to HSBC more than cover the  
34 costs associated with HSBC's mail, thus meeting pricing criterion 1, which concerns

1 fairness and equity, as well as pricing criterion 3, which addresses the requirement to  
2 cover all costs.

### 3 **IX. SUMMARY AND CONCLUSIONS**

4 This testimony has described and discussed the similarities and differences  
5 between the HSBC NSA and the Capital One NSA. The HSBC NSA has the same  
6 substantive functional elements of the Capital One NSA, comparable benefits, other  
7 material terms and conditions that were included in the Capital One NSA, and some  
8 additional provisions. The additional provisions in the HSBC NSA reflect the differences  
9 between the companies that are inherent in their status as individual mailers. HSBC is  
10 functionally equivalent to Capital One, and the fact that it is a direct competitor makes  
11 expeditious treatment of this filing under the Commission's specialized procedures  
12 especially important.

13 Accordingly, I conclude that the HSBC NSA meets the standards for functional  
14 equivalency. The financial model developed to support the HSBC NSA is based on the  
15 model submitted in Docket MC2002-2, with analytical enhancements as recommended  
16 by the Commission in Rule 193(e). The HSBC NSA also meets the terms and  
17 conditions that must be included for an agreement to be considered comparable to  
18 Capital One, as codified in DMM G911.

19 Finally, based on the Commission's findings and conclusions in its review of the  
20 baseline NSA, the HSBC NSA meets the criteria outlined for classifications in Title 39,  
21 Section 3623 of the Postal Reorganization Act as well as the criteria for postal rates and  
22 fees as outlined in Section 3622(b) of the Act.

1           For these reasons, I submit that the Commission should determine that the  
2   HSBC NSA is functionally equivalent to the Capital One baseline NSA and, in light of  
3   the expected benefits, should recommend the implementation of the HSBC NSA, as  
4   proposed by the parties.

1  
2  
3  
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5  
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7

**DATA AND APPENDICES**

- Appendix A: FINANCIAL MODEL**
- Appendix B: EXPLANATION OF FINANCIAL MODEL**
- Appendix C: HSBC FINANCIAL SERVICES NSA PROPOSED DATA COLLECTION PLAN**

# HSBC North America Holdings Inc. Model

## Negotiated Service Agreement

### Appendix A, page 1

	Year 1	Year 2	Year 3
<b>Return Forecast</b>			
(1) Operational Mail (Ops)	0.3%	0.3%	0.3%
(2) Marketing Mail (Mktg)	4.75%	4.75%	4.75%
(3) USPS FCM average return rates	1.23%	1.23%	1.23%
<b>Unit cost assumptions</b>			
(4) Inflation cost adjustment factor	4.0%	4.0%	4.0%
(5) Manual Letter Returns Unit Cost	\$ 0.59	\$ 0.61	\$ 0.64
(6) Electronic Letter Returns Unit Cost	\$ 0.37	\$ 0.38	\$ 0.40
(7) Address Change Service (ACS) Success Rate	85.0%	85.0%	85.0%
(8) Percent of new marketing mail switched from Standard Mail (SM) or Conversion Rate	100.0%	100.0%	100.0%
(9) Contingency Factor	1.03		
(1) Harvey (HSBC-T-1)			
(2) Harvey (HSBC-T-1)			
(3) USPS-LR-1/MC2002-2			
(4) Dauer (USPS-T-1)			
(5) USPS-LR-1/MC2002-2 * (1 + (4)) * (1 + (4)) * (9)			
(6) USPS-LR-1/MC2002-2 * (1 + (4)) * (1 + (4)) * (9)			
(7) USPS witness Wilson, T4/MC2002-2			
(8) Harvey (HSBC-T-1)			
(9) USPS-LR-1/MC2002-2			

# HSBC North America Holdings Inc. Model

## Negotiated Service Agreement

Appendix A, page 2

	2002	2003	2004	Year 1	Year 2	Year 3
<b>(1) First-Class Mail Volume calculations</b>						
<b>Before Rates</b>						
Operational mail	407,693,861	409,784,484	439,597,836	483,021,271	518,407,521	556,469,938
Marketing mail letter	107,741,060	89,141,274	95,685,915	158,232,348	245,191,188	299,268,268
<b>Total</b>	<b>515,434,921</b>	<b>498,925,758</b>	<b>535,283,751</b>	<b>641,253,619</b>	<b>763,598,709</b>	<b>855,738,206</b>
<b>After Rates</b>						
Operational mail	407,693,861	409,784,484	439,597,836	483,021,271	518,407,521	556,469,938
Marketing mail letter	107,741,060	89,141,274	95,685,915	174,232,348	265,191,188	319,268,268
<b>Total</b>	<b>515,434,921</b>	<b>498,925,758</b>	<b>535,283,751</b>	<b>657,253,619</b>	<b>783,598,709</b>	<b>875,738,206</b>

(1) Harvey (HSBC-T-1)

# HSBC North America Holdings Inc. Model

Negotiated Service Agreement  
Appendix A, page 3

	(1) Volume	(2) Rates	(3) Revenue
<b>Rate Category</b>			
Single-Piece Letters			
First Ounces, except QBRM	-	0.370	\$ -
Qualified Business Reply Mail	-	0.340	-
Additional Ounces	-	0.230	-
Nonmachinable Pieces	-	0.120	-
Single-Piece revenue			-
Revenue Adjustment Factor (a)			1.000
(4) Total Single-Piece Postage Revenue			-
Nonautomated Presorted Letters			
First Ounce	9,805,861	0.352	3,451,663
Additional Ounces	-	0.225	-
Nonmachinable Pieces	-	0.055	-
Heavy Piece Deduction	-	(0.041)	-
Nonautomated Presorted Revenue			3,451,663
Revenue Adjustment Factor (a)			1.000
(5) Total Nonautomated Presorted Letters Revenue			3,451,663
Automation Presort Letters			
Mixed AADC Letters	31,387,770	0.309	9,698,821
AADC Letters	41,768,164	0.301	12,572,217
3-Digit Letters	264,042,110	0.292	77,100,296
5-Digit Letters	78,242,286	0.278	21,751,356
Additional Ounces	-	0.225	-
Heavy Piece Deduction	-	(0.041)	-
Automation Presort Letter Revenue			121,122,690
Revenue Adjustment Factor (a)			1.000
(6) Total Automation Presort Letters Revenue			121,122,690
Automation Carrier Route Letters			
First Ounce	14,351,645	0.275	3,946,702
Additional Ounces	-	0.225	-
Heavy Piece Deduction	-	(0.041)	-
Automation Carrier Route Revenue			3,946,702
Revenue Adjustment Factor (a)			1.000
(7) Automation Carrier Route Letters Revenue			3,946,702
(8) Total Company Letters Subclass			\$ 128,521,055
Total pieces			439,597,836
(9) <b>Revenue per piece</b>			<b>0.292</b>

(a) Revenue Adjustment Factor not required because customer specific revenue is presented

(1) CBCIS 2004 HSBC Volume Data

(2) Rate Schedule

(3) (1) \* (2)

(4) Single Piece Revenue \* Revenue Adjustment Factor

(5) Nonautomated Presorted Revenue \* Revenue Adjustment Factor

(6) Automation Presort Letter Revenue \* Revenue Adjustment Factor

(7) Automation Carrier Route Revenue \* Revenue Adjustment Factor

(8) (4) + (5) + (6) + (7)

(9) (8) / Total pieces

# HSBC North America Holdings Inc. Model

Negotiated Service Agreement  
Appendix A, page 4

	(1) Volume	(2) Rates	(3) Revenue
<b>Rate Category</b>			
Single-Piece Letters			
First Ounces, except QBRM	-	0.370	\$ -
Qualified Business Reply Mail	-	0.340	-
Additional Ounces	-	0.230	-
Nonmachinable Pieces	-	0.120	-
Single-Piece revenue			-
Revenue Adjustment Factor (a)			1.000
(4) Total Single-Piece Postage Revenue			-
Nonautomated Presorted Letters			
First Ounce	61,007	0.352	21,474
Additional Ounces	-	0.225	-
Nonmachinable Pieces	-	0.055	-
Heavy Piece Deduction	-	(0.041)	-
Nonautomated Presorted Revenue			21,474
Revenue Adjustment Factor (a)			1.000
(5) Total Nonautomated Presorted Letters Revenue			21,474
Automation Presort Letters			
Mixed AADC Letters	11,944,126	0.309	3,690,735
AADC Letters	18,498,424	0.301	5,568,026
3-Digit Letters	59,695,294	0.292	17,431,026
5-Digit Letters	5,313,665	0.278	1,477,199
Additional Ounces	-	0.225	-
Heavy Piece Deduction	-	(0.041)	-
Automation Presort Letter Revenue			28,166,985
Revenue Adjustment Factor (a)			1.000
(6) Total Automation Presort Letters Revenue			28,166,985
Automation Carrier Route Letters			
First Ounce	173,399	0.275	47,685
Additional Ounces	-	0.225	-
Heavy Piece Deduction	-	(0.041)	-
Automation Carrier Route Revenue			47,685
Revenue Adjustment Factor (a)			1.000
(7) Automation Carrier Route Letters Revenue			47,685
(8) Total Company Letters Subclass			\$ 28,236,144
Total pieces			95,685,915
(9) <b>Revenue per piece</b>			<b>0.295</b>

(a) Revenue Adjustment Factor not required because customer specific revenue is presented

(1) CBCIS 2004 HSBC Volume Data

(2) Rate Schedule

(3) (1) \* (2)

(4) Single Piece Revenue \* Revenue Adjustment Factor

(5) Nonautomated Presorted Revenue \* Revenue Adjustment Factor

(6) Automation Presort Letter Revenue \* Revenue Adjustment Factor

(7) Automation Carrier Route Revenue \* Revenue Adjustment Factor

(8) (4) + (5) + (6) + (7)

(9) (8) / Total pieces

**HSBC North America Holdings Inc. Model**

Negotiated Service Agreement  
Appendix A, page 5

Rate Category	DOCKET NO. R2001-1 PRC FIGURES - NATIONWIDE MAIL MIX									HSBC MAIL MIX						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
	TYBR 2003 Total Unit Cost (Dollars)	TYBR 2003 Mail Proc Unit Cost (Dollars)	TYBR 2003 Delivery Unit Cost (Dollars)	TYBR 2003 Other Unit Cost (Dollars)	TYBR 2003 Total Unit Cost (Dollars)	FY 2005 Total Unit Cost Dollars	BY 2000 Mail Volume (Pieces)	FY 2003 Mail Volume (Pieces)	FY 2003 Mail Volume (Percent)	TY 2005 Total Unit Cost (Dollars)	FY 2004 Mail Volume (Pieces)	FY 2004 Mail Volume (Percent)	Current Returns Adjustment Unit Cost (Dollars)	Current w/Rets Adj Total Unit Cost (Dollars)	After Rates Returns Adjustment Unit Cost (Dollars)	After Rates w/Rets Adj Total Unit Cost (Dollars)
FIRST-CLASS MAIL LETTERS																
Nonautomation Presort Letters		0.163	0.063	0.021	0.247	0.267	3,748,977,000	2,673,332,468	5.8%	0.267	9,805,861	2.2%				
Automation Presort Letters																
Automation Mixed AADC		0.055	0.045	0.021	0.121	0.130	2,504,846,824	2,820,696,002	6.1%	0.130	31,387,770	7.1%				
Automation AADC		0.046	0.044	0.021	0.110	0.119	2,680,656,176	2,636,650,800	5.7%	0.119	41,768,164	9.5%				
Automation 3-Digit		0.042	0.043	0.021	0.106	0.115	21,832,339,000	22,571,247,888	48.6%	0.115	264,042,110	60.1%				
Automation 5-Digit		0.032	0.041	0.021	0.093	0.101	12,720,447,000	14,911,024,110	32.1%	0.101	78,242,286	17.8%				
Automation Carrier Route		0.021	0.064	0.021	0.105	0.114	1,075,333,000	802,292,628	1.7%	0.114	14,351,645	3.3%				
<b>WEIGHTED AVERAGE / TOTAL</b>	<b>\$0.115</b>	<b>0.050</b>	<b>0.045</b>	<b>0.021</b>	<b>0.111</b>	<b>0.120</b>	<b>44,562,599,000</b>	<b>46,415,243,896</b>	<b>100.0%</b>	<b>0.117</b>	<b>439,597,836</b>	<b>100.0%</b>	<b>\$ (0.0055)</b>	<b>0.112</b>	<b>\$ (0.0055)</b>	<b>0.112</b>
														(17)		(18)
										<b>Total Unit Cost Estimates, Including Contingency =</b>				<b>0.115</b>		<b>0.115</b>

(1) Docket No. R2001-1, PRC LR-2, Volume 4, "TYBR", page 3

(2) Docket No. R2001-1, PRC LR-4, "FCLETPRCFA.XLS", page 1

(3) Docket No. R2001-1, PRC LR-7, Page 2

(4) (1) - Weighted Average(2) - Weighted Average(3)

(5) (2) + (3) + (4)

(6) (5) \* (1 + inflation cost adjustment factor) \* (1 + inflation cost adjustment factor)

(7) Docket No. R2001, PRC, LR-4, FCM base year volumes from FCM letter model.

(8) Revenue, Pieces, and Weight (RPW) Report.

(9) (8) / [Sum (8)]

(10) Line Item (6), Weighted Average weighted by percentages in (12).

(11) CBCIS 2004 HSBC Volume Data

(12) (11) / [Sum (11)]

(13) (Manual Letter Returns Unit Cost \* After Rates Statement Mail) \* (Statement Mail Return Forecast - USPS FCM Avg. Return Rate) / After Rates Statement Mail

(14) (10) + (13)

(15) (Manual Letter Returns Unit Cost \* After Rates Statement Mail) \* (Statement Mail Return Forecast - USPS FCM Avg. Return Rate) / After Rates Statement Mail

(16) (10) + (15)

(17) (14) \* Contingency Factor (Assumptions)

(18) (16) \* Contingency Factor (Assumptions)

**HSBC North America Holdings Inc. Model**

Negotiated Service Agreement  
Appendix A, page 6

Rate Category	DOCKET NO. R2001-1 PRC FIGURES - NATIONWIDE MAIL MIX									HSBC MAIL MIX							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	
	TYBR 2003 Total Unit Cost (Dollars)	TYBR 2003 Mail Proc Unit Cost (Dollars)	TYBR 2003 Delivery Unit Cost (Dollars)	TYBR 2003 Other Unit Cost (Dollars)	TYBR 2003 Total Unit Cost (Dollars)	FY 2005 Total Unit Cost Dollars	BY 2000 Mail Volume (Pieces)	FY 2003 Mail Volume (Pieces)	FY 2003 Mail Volume (Percent)	TY 2005 Total Unit Cost (Dollars)	FY 2004 Mail Volume (Pieces)	FY 2004 Mail Volume (Percent)	Current Returns Adjustment Unit Cost (Dollars)	Current w/Rets Adj Total Unit Cost (Dollars)	After Rates Returns Adjustment Unit Cost (Dollars)	After Rates w/Rets Adj Total Unit Cost (Dollars)	
FIRST-CLASS MAIL LETTERS																	
Nonautomation Presort Letters		0.163	0.063	0.021	0.247	0.267	3,748,977,000	2,673,332,468	5.8%	0.267	61,007	0.1%					
Automation Presort Letters																	
Automation Mixed AADC		0.055	0.045	0.021	0.121	0.130	2,504,846,824	2,820,696,002	6.1%	0.130	11,944,126	12.5%					
Automation AADC		0.046	0.044	0.021	0.110	0.119	2,680,656,176	2,636,650,800	5.7%	0.119	18,498,424	19.3%					
Automation 3-Digit		0.042	0.043	0.021	0.106	0.115	21,832,339,000	22,571,247,888	48.6%	0.115	59,695,294	62.4%					
Automation 5-Digit		0.032	0.041	0.021	0.093	0.101	12,720,447,000	14,911,024,110	32.1%	0.101	5,313,665	5.6%					
Automation Carrier Route		0.021	0.064	0.021	0.105	0.114	1,075,333,000	802,292,628	1.7%	0.114	173,399	0.2%					
WEIGHTED AVERAGE / TOTAL	\$0.115	0.050	0.045	0.021	0.111	0.120	44,562,599,000	46,415,243,896	100.0%	0.117	95,685,915	100.0%	0.0208	0.138	0.0118	0.129	
														(17)		(18)	
										Total Unit Cost Estimates, including Contingency =			0.142			0.132	

- (1) Docket No. R2001-1, PRC LR-2, Volume 4, "TYBR", page 3.
- (2) Docket No. R2001-1, PRC LR-4, "FCLETPRCFA.XLS".
- (3) Docket No. R2001-1, PRC LR-7, Page 2.
- (4) (1) - Weighted Average(2) - Weighted Average(3)
- (5) (2) + (3) + (4)
- (6) (5) \* (1 + inflation cost adjustment factor) \* (1 + inflation cost adjustment factor)
- (7) Docket No. R2001, PRC, LR-4, FCM base year volumes from FCM letter model.
- (8) Revenue, Pieces, and Weight (RPW) Report.
- (9) (8) / [Sum (8)]
- (10) Line Item (6), Weighted Average weighted by percentages in (12).
- (11) CBCIS 2004 HSBC Volume Data
- (12) (11) / [Sum (11)]
- (13) ((Manual Letter Returns Unit Cost \* After Rates Statement Mail) \* (Statement Mail Return Forecast - USPS FCM Avg. Return Rate) / After Rates Statement Mail
- (14) (10) + (13)
- (15) ((ACS Success Rate \* Electronic Letter Returns Unit Cost + (1 - ACS Success Rate) \* Manual Letter Returns Unit Cost) \* After Rates Statement Mail \* (Statement Mail Return Forecast - USPS FCM Avg. Return Rate)) / After Rates Statement Mail - USPS FCM Avg. Return Rate \* (Manual Letter Returns Unit Cost - Electronics Letter Returns Unit Cost) \* ACS Success Rate
- (16) (10) + (15)
- (17) (14) \* Contingency Factor (Assumptions)
- (18) (16) \* Contingency Factor (Assumptions)

# HSBC North America Holdings Inc. Model

Negotiated Service Agreement

Appendix A, page 7

Year 1

Year 2

Year 3

## Agreement Structure

Year 1		Year 2				Year 3					
Threshold		Discount		Threshold		Discount		Threshold		Discount	
615,000,000	655,000,000	\$	0.025	725,000,000	765,000,000	\$	0.025	810,000,000	850,000,000	\$	0.025
655,000,000	675,000,000	\$	0.030	765,000,000	785,000,000	\$	0.030	850,000,000	870,000,000	\$	0.030
675,000,000	695,000,000	\$	0.035	785,000,000	805,000,000	\$	0.035	870,000,000	890,000,000	\$	0.035
695,000,000	715,000,000	\$	0.040	805,000,000	825,000,000	\$	0.040	890,000,000	910,000,000	\$	0.040
715,000,000	735,000,000	\$	0.045	825,000,000	845,000,000	\$	0.045	910,000,000	930,000,000	\$	0.045
735,000,000		\$	0.050	845,000,000		\$	0.050	930,000,000		\$	0.050

### Discount on volume above threshold

(1) Before Rates Forecast	641,253,619	763,598,709	855,738,206
(2) After Rates Forecast	657,253,619	783,598,709	875,738,206
Discount in first tier	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000
Discount in second tier	\$ 67,609	\$ 557,961	\$ 600,000
Discount in third tier	\$ -	\$ -	\$ 200,837
Discount in fourth tier	\$ -	\$ -	\$ -
Discount in fifth tier	\$ -	\$ -	\$ -
Discount in sixth tier	\$ -	\$ -	\$ -
(3) <b>Discount Earned</b>	<b>\$ 1,067,609</b>	<b>\$ 1,557,961</b>	<b>\$ 1,800,837</b>

### Exposure on volume above threshold

(4) Threshold	615,000,000	725,000,000	810,000,000
(5) Before Rates Forecast	641,253,619	763,598,709	855,738,206
(6) Exposed Pieces	26,253,619	38,598,709	45,738,206
(7) After Rates Forecast	657,253,619	783,598,709	875,738,206
Exposure in first tier	\$ 656,340	\$ 964,968	\$ 1,000,000
Exposure in second tier	\$ -	\$ -	\$ 172,146
Exposure in third tier	\$ -	\$ -	\$ -
Exposure in fourth tier	\$ -	\$ -	\$ -
Discount in fifth tier	\$ -	\$ -	\$ -
Discount in sixth tier	\$ -	\$ -	\$ -
(8) <b>Total Exposure</b>	<b>\$ 656,340</b>	<b>\$ 964,968</b>	<b>\$ 1,172,146</b>

- (1) Before Rates Total Volume (Volume calcs)
- (2) After Rates Total Volume (Volume calcs)
- (3) Sum of discounts earned in first tier to sixth tier
- (4) Agreement Structure Beginning Threshold
- (5) (1)
- (6) Before rates - Threshold: The number of total pieces on which Exposure occurs
- (7) (2)
- (8) Sum of Exposure in first tier to sixth tier

## HSBC North America Holdings Inc. Model

Negotiated Service Agreement

Appendix A, page 8

Year 1      Year 2      Year 3

### Return Costs

UAA Rate		Year 1	Year 2	Year 3
(1)	Statement mail	0.3%	0.3%	0.3%
(2)	Marketing mail	4.75%	4.75%	4.75%

### Before Rates Forecast

(3)	Statement mail	483,021,271	518,407,521	556,469,938
(4)	Marketing mail	158,232,348	245,191,188	299,268,268

### Return Forecast

(5)	Statement mail	1,449,064	1,555,223	1,669,410
(6)	Marketing mail	7,516,037	11,646,581	14,215,243

### Return Costs

(7)	Statement mail	\$ 855,593	\$ 955,005	\$ 1,066,128
(8)	Marketing mail	\$ 4,437,809	\$ 7,151,738	\$ 9,078,221
(9)	Total	\$ 5,293,403	\$ 8,106,743	\$ 10,144,349

### After Rates Return Costs

(10)	Statement mail	\$ 855,593	\$ 955,005	\$ 1,066,128
(11)	Marketing mail	\$ 3,014,361	\$ 4,857,784	\$ 6,166,339
(12)	Total	\$ 3,869,954	\$ 5,812,789	\$ 7,232,467

### (13) Return Cost Savings

**\$ 1,423,448    \$ 2,293,954    \$ 2,911,882**

- (1) Harvey (HSBC-T-1)
- (2) Harvey (HSBC-T-1)
- (3) Harvey (HSBC-T-1)
- (4) Harvey (HSBC-T-1)
- (5) (1) \* (3)
- (6) (2) \* (4)
- (7) (5) \* Manual Letter Returns Unit Cost (Assumptions)
- (8) (6) \* Manual Letter Returns Unit Cost (Assumptions)
- (9) (7) + (8)
- (10) (5) \* Manual Letter Returns Unit Cost (Assumptions)
- (11) ((6) \* ACS Success Rate \* Electronic Letter Returns Unit Cost) + ((1 - ACS Success Rate) \* Manual Letter Returns Unit Cost \* (6))
- (12) (10) + (11)
- (13) (9) - (12)

## HSBC North America Holdings Inc. Model

Negotiated Service Agreement

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### (1) Standard Mail Regular Revenue per piece

Mail Category	Revenue per piece	Volume	Weighted Avg.
Mixed AADC Auto	\$ 0.214	7,219,345	1,543,496
AADC Auto	\$ 0.206	20,311,073	4,177,988
3-Digit Auto	\$ 0.188	182,672,355	34,305,868
5-Digit Auto	\$ 0.169	101,052,532	17,057,667
Basic Nonauto	\$ 0.253	1,197,363	302,813
3/5 Digit Nonauto	\$ 0.227	469,903	106,621
Total Volume		312,922,571	57,494,453
Revenue per piece			\$ 0.184

### (2) Standard Mail ECR Revenue per piece

Mail Category	Revenue per piece	Volume	Weighted Avg.
Basic Nonauto Letters	\$ 0.172	20,947	3,607
Basic Auto Letters	\$ 0.149	12,494,212	1,857,889
Saturation Letters	\$ 0.126	-	-
Total Volume		12,515,159	1,861,496
Revenue per piece			\$ 0.149

### (3) Average Revenue per piece

**\$ 0.182**

- (1) 2004 Standard Mail Regular Billing Determinants
- (2) 2004 Standard Mail ECR Billing Determinants
- (3) (Standard Mail Regular Revenue + Standard Mail ECR Revenue) /  
(Standard Mail Regular Total Volume + Standard Mail ECR Total Volume)

**HSBC North America Holdings Inc. Model**

Negotiated Service Agreement  
Appendix A, page 10

**Standard Regular Unit Cost**

	From Docket No. R2001-1									HSBC		
	TYBR 2003 Total Unit Cost (Dollars) (1)	TYBR 2003 Mail Proc Unit Cost (Dollars) (2)	TYBR 2003 Delivery Unit Cost (Dollars) (3)	TYBR 2003 Other Unit Cost (Dollars) (4)	TYBR 2003 Total Unit Cost (Dollars) (5)	FY 2005 Total Unit Cost (Dollars) (6)	BY 2000 Mail Volume (Pieces) (7)	FY 2003 Mail Volume (Pieces) (8)	FY 2003 Mail Volume (Percent) (9)	TY 2005 Total Unit Cost (Dollars) (10)	FY 2004 Mail Volume (Pieces) (11)	FY 2004 Mail Volume (Percent) (12)
<b>LETTERS</b>												
Nonauto Basic		0.130	0.042	0.01	0.18	0.19	1,322,401,662	1,411,242,831	3.2%	0.19	1,197,363	0.4%
Nonauto 3/5-Digit		0.121	0.044	0.01	0.17	0.19	4,476,247,838	2,481,782,907	5.7%	0.19	469,903	0.2%
Auto Mixed AADC		0.050	0.039	0.01	0.10	0.10	2,354,963,527	2,687,599,740	6.1%	0.10	7,219,345	2.3%
Auto AADC		0.043	0.038	0.01	0.09	0.09	2,875,476,520	2,848,635,910	6.5%	0.09	20,311,073	6.5%
Auto 3-digit		0.040	0.038	0.01	0.08	0.09	15,600,801,986	17,815,958,778	40.6%	0.09	182,672,355	58.4%
Auto 5-digit		0.031	0.037	0.01	0.07	0.08	11,222,413,732	16,604,952,264	37.9%	0.08	101,052,532	32.3%
<b>Total/average</b>	<b>0.096</b>	<b>0.05</b>	<b>0.04</b>	<b>0.01</b>	<b>0.09</b>	<b>0.10</b>	<b>37,852,305,265</b>	<b>43,850,172,430</b>	<b>100.0%</b>	<b>0.09</b>	<b>312,922,571</b>	<b>100.0%</b>
Company average letter cost		\$ 0.089	(13)									
Company average letter cost, including Contingency		\$ 0.092	(14)									

**Standard ECR Unit Cost**

	TYBR Unit Costs		
	TY 2005 Delivery Unit Costs (17)	FY 2004 Mail Volume (18)	FY 2004 Mail Volume (19)
Total ECR letter unit cost	0.072	(15)	
Total ECR letter delivery unit cost	0.054	(16)	
ECR Basic Auto Letters	0.050	12,494,212	99.8%
ECR Basic Letters	0.069	20,947	0.2%
ECR High Density Letters	0.051	0	0.0%
ECR Saturation Letters	0.036	0	0.0%
<b>Total</b>		<b>12,515,159</b>	
Company Average letter ECR Unit Delivery Cost			0.050 (20)
Company Delivery Cost Adjustment			-0.004 (21)
Company ECR total letter unit cost			0.068 (22)
Company ECR total letter unit cost, including Contingency			0.070 (23)

Average Cost per piece **0.0910** (24)

- (1) Docket No. R2001-1, LR-J-58, LR58AREG.xls, total unit letter costs
- (2) Docket R2001-1, LR-J-60 Revised 11/15/01
- (3) Docket R2001-1, LR-J-60 Revised 11/15/01
- (4) (1) - average from (2) - average from (3)
- (5) (2) + (3) + (4)
- (6) (5) \* (1 + inflation cost adjustment factor) \* (1 + inflation cost adjustment factor)
- (7) Docket No. R2001, PRC, LR-4, SM base year volumes from SM letter model.
- (8) Revenue, Pieces, and Weight (RPW) Report.
- (9) Each row in (8) divided by total in (8)
- (10) (6)
- (11) CBCIS 2004 HSBC Volume Data
- (12) Each row in column (11) divided by total in column (11)
- (13) Weighted average costs calculated by multiplying column (10) by column (12)
- (14) (13) \* Contingency Factor (Assumptions)
- (15) Docket No. R2001-1, LR-J-58, LR58AEER.xls, total TY2003 ECR unit letter costs \* (1 + inflation cost adjustment factor) \* (1 + inflation cost adjustment factor)
- (16) Docket No. R2001-1, LR-J-58, LR58AEER.xls, sum of TY2003 ECR unit letter delivery costs  
(Cost segments 6, 7 and 10) \* (1 + inflation cost adjustment factor) \* (1 + inflation cost adjustment factor)
- (17) Docket No. R2001-1, LR-J-117, Revised 1/22/02, TY2003 unit delivery costs \* (1 + inflation cost adjustment factor) \* (1 + inflation cost adjustment factor)
- (18) CBCIS 2004 HSBC Volume Data
- (19) Percent of volume in each row of (18) divided by total in (18)
- (20) Weighted average of the unit costs in (17) weighted by the volume percents in (19)
- (21) (20) - (16)
- (22) (15) + (21)
- (23) (22) \* Contingency Factor (Assumptions)
- (24) ((14 \* 11) + (23 \* 18)) / (11 + 18)

# HSBC North America Holdings Inc. Model

Negotiated Service Agreement

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Year 1      (14)      (15)  
Year 2      Year 3

## First Class Letter

(1)	Avg Revenue First-Class Operational Letters	0.292	0.292	0.292
(2)	Avg Revenue First-Class Marketing Letters	0.295	0.295	0.295
(3)	First-Class Operational Letter cost per Piece Before Rates	0.115	0.120	0.124
(4)	First-Class Operational Letter cost per Piece After Rates	0.115	0.120	0.124
(5)	First-Class Operational Letter avg. Contribution Before Rates	0.177	0.173	0.168
(6)	First-Class Operational Letter avg. Contribution After Rates	0.177	0.173	0.168
(7)	First-Class Marketing Letter cost per Piece Before Rates	0.142	0.147	0.153
(8)	First-Class Marketing Letter cost per Piece After Rates	0.132	0.138	0.143
(9)	First-Class Marketing Letter avg. Contribution Before Rates	0.153	0.148	0.142
(10)	First-Class Marketing Letter avg. Contribution After Rates	0.163	0.157	0.152

## Standard Mail

(11)	Standard Revenue per Piece	0.182	0.182	0.182
(12)	Standard Cost per Piece	0.091	0.095	0.098
(13)	Standard Mail Contribution per Piece	0.091	0.088	0.084

- (1) Revenue per piece (Ops unit rev)
- (2) Revenue per piece (Mktg unit rev)
- (3) Current Total Unit Cost Estimates, Including Contingency (Stmt unit cost)
- (4) After Rates Total Unit Cost Estimates, Including Contingency (Stmt unit cost)
- (5) (1) - (3)
- (6) (1) - (4)
- (7) Current Total Unit Cost Estimates, Including Contingency (Mktg unit cost)
- (8) After Rates Total Unit Cost Estimates, Including Contingency (Mktg unit cost)
- (9) (2) - (7)
- (10) (2) - (8)
- (11) Average Revenue per Piece (SM rev calcs)
- (12) Average Cost per Piece (SM cost calcs)
- (13) (11) - (12)
- (14) Year 1 \* Inflation cost adjustment factor Year 2 (Assumptions)
- (15) Year 2 \* Inflation cost adjustment factor Year 3 (Assumptions)

## HSBC North America Holdings Inc. Model

Negotiated Service Agreement

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	Year 1	Year 2	Year 3	Total
<b>ACS Savings</b>				
(1) Statement Mail	\$ -	\$ -	\$ -	-
(2) Marketing Mail Letter	\$ 1,423,448	\$ 2,293,954	\$ 2,911,882	<b>6,629,284</b>
<b>Contribution from New Volume</b>				
(3) Statement Mail	\$ -	\$ -	\$ -	-
(4) Marketing Mail Letter	\$ 1,139,455	\$ 1,391,129	\$ 1,356,611	<b>3,887,194</b>
<b>(5) Total Exposure</b>	\$ 656,340	\$ 964,968	\$ 1,172,146	<b>2,793,454</b>
<b>(6) Total Incremental Discounts</b>	\$ 411,268	\$ 592,994	\$ 628,691	<b>1,632,953</b>
<b>(7) Total USPS Value</b>	<b>\$ 1,495,295</b>	<b>\$ 2,127,121</b>	<b>\$ 2,467,655</b>	<b>6,090,071</b>

(1) Statement Mail Return Costs - Statement Mail After Rates Return Costs (UAA calcs)

(2) Marketing Mail Return Costs - Marketing Mail After Rates Return Costs (UAA calcs)

(3) (Statement Mail After Rates - Statement Mail Before Rates) \* FCM Statement Letter avg. Contribution After Rates

(4) Conversion Rate \* (Marketing Mail After Rates - Marketing Mail Before Rates) \*

(FCM Marketing Letter avg. Contribution After Rates - Standard Mail Contribution per Piece) +

(1 - Conversion Rate) \* (Marketing Mail After Rates - Marketing Mail Before Rates) \* FCM Marketing Letter avg. Contribution After Rates

(5) Total Leakage (Disc&Leak)

(6) Discount Earned - Total Leakage (Disc&Leak)

(7) (1) + (2) + (3) + (4) - (5) - (6)

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## **Appendix B**

### **EXPLANATION OF FINANCIAL MODEL**

The HSBC Model incorporates all of the cost and revenue per piece information into one comprehensive workbook. It serves as a presentation mechanism for the customer-specific revenue and cost calculations. The model was built upon the same revenue and cost assumptions (discount, and exposure (leakage) calculations) as the Capital One NSA. The historical and forecasted volumes are provided by HSBC witness Harvey (HSBC-T-1). These inputs provide the basis for calculating the value of the NSA.

#### **Assumptions**

The assumptions contain the return rate for HSBC' mail mix as provided by witness Harvey (HSBC-T-1). The inflation cost adjustment factor, a weighted average of inflationary factors, represents the inflationary cost growth projected by the Postal Service. Currently, that factor is 4 percent. The Capital One manual and electronic return unit costs for letters serve as proxies in the HSBC Model (USPS-LR-1/MC2002-2). The manual and electronic return unit costs for flats are the adjusted subclass averages (USPS-LR-1). Costs for Years 1, 2, and 3 of the agreement are adjusted by the inflationary cost growth of 4 percent. The Address Change Service (ACS) success rate was explained by USPS witness Wilson (MC2002-2, USPS-T-4 at 7, Line 4) and is assumed to be constant throughout the life of the agreement. The HSBC model assumes 100 percent of the incremental mail volume growth will come from migrating Standard Mail to First-Class Mail for all marketing letters. The contingency is a

1 multiplicative factor applied uniformly to all forecasted postal costs, including First-Class  
2 Mail, Standard Mail, and the physical and electronic costs of ACS.<sup>1</sup>

### 3 **Volume Calculations**

4 The Volume Calculations contain HSBC' mailing mix, consisting of operational  
5 mail and marketing mail letters. The mailing mix for 2002 – 2004 provides a historical  
6 view of HSBC' past mailing profile. To illustrate the volume response to incentives,  
7 HSBC witness Harvey (HSBC-T-1) has provided the volume forecasts for HSBC, both in  
8 the absence of an agreement (BR) and in the presence of an agreement (AR).

### 9 **First-Class Mail Revenue Calculations**

10 The Rate Category of the model shows the First-Class Mail profile of HSBC. It is  
11 similar to the profile in the Capital One NSA (MC2002-2, USPS-T-3). It provides a  
12 representation of the estimated revenue per piece for HSBC marketing and operational  
13 mail pieces.

### 14 **Operational Unit Cost and Marketing Unit Cost**

15 The cost estimates for Operational Unit Cost were built on the same assumptions  
16 of the First-Class Mail Presort Letters/Flats Unit Cost Estimate of witness Crum  
17 (MC2002-2, USPS-T-3 Atta2.xls) for the Capital One NSA. Estimates for the HSBC  
18 NSA differ from those of the Capital One NSA in the Test Year (TY) calculations, the  
19 HSBC volumes, and the total unit cost (columns 17 and 18). The TYBR 2003 unit cost

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<sup>1</sup> The contingency is applied to all forecasted postal costs to protect against unforeseen circumstances. It is applied as the very last step in development of the roll-forward costs. It needs to be incorporated in NSA calculations for two reasons. First, the existing rates from which the NSA rates or discounts are being derived include contingency. In the absence of an NSA, the rates that HSBC would be paying would have been set so as to recover the contingency. Furthermore, the NSA financial analyses are projections into the future, and the further into the future the projections are made, the more appropriate the application of the contingency.

1 is based on Docket No. R2001-1, with the weighted distributions calculated from Base  
2 Year (BY) 2000 FCM base year volumes from the FCM letter model from Docket No.  
3 R2001, PRC, LR-4. The TY 2005 cost estimates were derived by multiplying the TYBR  
4 2003 Total Unit Cost by the inflationary growth rate of 8.0 percent (4.0 percent x 2  
5 years).<sup>2</sup> FY 2003 Mail Volume for HSBC was used because it was the latest full year  
6 historical volume available. The Total Unit Cost Estimates, including Contingency  
7 (Attachment A, page 4, sources 17 and 18) are equal, based on the assumption that the  
8 before and after rates forecasts of operational mail remain the same.

9         The Marketing Unit Cost is built on the same assumptions as the Operational  
10 Unit Cost. The major difference is electronic diversion from ACS and the cost  
11 differential between manual and electronic returns for UAA mail. Operational mail does  
12 not receive the Change Service Requested (CSR) endorsement because it needs to be  
13 physically returned to HSBC. Marketing mail receives the endorsement, and  
14 information is returned from UAA mail electronically 85 per cent of the time. This  
15 explains why the Total Unit Cost, including Contingency, differ in sources 17 and 18  
16 (Pg. 5); the after-rates unit cost is 1.6 cents less than the before-rates unit cost.

### 17 **Discount and Exposure**

18         The declining block rate structure for the proposed NSA for Year 1 begins at  
19 615,000,000 pieces, with a discount of 2.5 cents per piece; for Year 2 begins at

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<sup>2</sup> Columns are labeled as "TYBR 2003" in these sheets because those figures are drawn from Docket No. R2001-1, in which FY 2003 was the test year. Columns are labeled as "TY 2005" because FY 2005 is the first of the three years in which the instant NSA is assumed to be in effect. Estimates for the last two years of the agreement, Years 2 and 3, are presented in the subsequent sheets. FY 2005 is not the exclusive "test year" in this proceeding in the sense that FY 2003 was the test year in the Capital One proceeding. It is, rather, one of three relevant years for which estimates are presented and evaluated.

1 725,000,000 with a discount of 2.5 cents per piece; and for Year 3 begins at  
2 810,000,000 with a discount of 2.5 cents per piece. Exposure (to the Postal Service)  
3 measures the discounted revenue associated with declining block rates for mail volume  
4 that HSBC would have mailed in the absence of the proposed NSA. HSBC's BR  
5 Forecast for Year 1 falls within the first tier of the discount structure. Total exposure is  
6 therefore calculated for Year 1 by subtracting the BR Forecast from the beginning  
7 threshold ( $641,253,619 - 615,000,000 = 26,253,619$ ), and the difference is multiplied by  
8 the corresponding incentive (2.5 cents). The first tier exposure and total exposure  
9 equals \$656,340 ( $26,253,619 \times .025$ ). This same formula is applied to the Year 2 and 3  
10 of the agreement, with the total exposure equaling \$964,968 and \$1,172,146  
11 respectively.

12 Based on the Y1AR Forecast, HSBC could achieve discounts in the first year of  
13 the agreement, equaling \$1,067,609, using the same formula as exposure. Discounts  
14 are given on pieces mailed above the threshold. Double counting of the 26,253,619  
15 (Y1BR – Beginning Threshold:  $641,253,619 - 615,000,000$ ) mail pieces occurs in the  
16 discount and exposure calculations, because the 26,253,619 pieces are the exposure  
17 calculation. The Y1AR of 656,253,619 is made up of the Y1BR plus the 16,000,000  
18 additional marketing pieces. To account for this double counting, the Postal Service  
19 subtracts the exposure from the discount, to get the incremental discount calculation of  
20 \$411,268 (Attachment A, page 12). This same formula is applied to the Year 2 and 3 of  
21 the agreement, with the total incremental discounts equaling \$592,994 and \$628,691  
22 respectively.

23

## 1 **UAA Calculations**

2           In lieu of receiving physical returns, HSBC will accept electronic information for  
3 address changes or corrections, as Capital One does. This results in cost savings to  
4 the Postal Service by replacing costly physical returns with the less costly transmission  
5 of electronic information. The estimated Capital One physical and electronic return unit  
6 costs described in USPS-LR-1/MC2002-2 will be used in the HSBC model. The total  
7 return costs savings vary from the Capital One model because of the different marketing  
8 mail volumes, and return rate forecasts (4.75 percent for marketing mail letters).

9           To calculate the cost savings, the expected volume of HSBC's UAA mail times  
10 unit costs savings for each piece processed through the ACS is multiplied by the  
11 percentage of HSBC's UAA mail that will be processed. The calculation relies upon the  
12 evidence in MC2002-2 for 1) the percentage of UAA mail that will be processed through  
13 the ACS system (85%) and 2) the unit savings for each UAA piece processed through  
14 the ACS system.

## 15 **Standard Mail Revenue Calculations and Standard Mail Cost Calculations**

16           The Standard Mail Regular and Enhanced Carrier Route (ECR) Revenues are  
17 based on the Standard Mail Regular and ECR Billing Determinants of HSBC. The  
18 revenue per piece for both Regular and ECR is a weighted average of the revenue per  
19 piece and HSBC volume. The Standard Regular and ECR unit costs are based on  
20 Docket No. R2001-1 for TY 2003 unit costs. The format for 2005 unit costs follows the  
21 First-Class Mail unit cost estimates on pages 4 and 5. This provides the customer-  
22 specific revenue and cost data on HSBC' Standard Mail.

## 1 **Contribution Inputs**

2           The Contribution Inputs calculate the contribution per piece of HSBC's  
3 operational mail and marketing mail letters. This per piece calculation provides the  
4 Postal Service with before and after rates revenue, cost, and contribution for First-Class  
5 Mail and Standard Mail on a customer-specific basis. It also allows for forecasting future  
6 contribution per piece in the out-years of the agreement by allowing the inflationary  
7 growth to be multiplied by the cost of each subclass. Unit revenue remains constant  
8 over the three-year agreement.

## 9 **USPS Value**

10           The total USPS value is derived from the value determinants, less the discount  
11 and exposure associated with the declining block rate structure. "Contribution from New  
12 Volume" is any volume above the before rates forecast multiplied by the difference  
13 between the First-Class Mail and Standard Mail estimated contributions. This is so  
14 because HSBC indicates that all of its new First-Class Mail volume will be switched from  
15 Standard Mail (100% conversion).

## Appendix C

### HSBC FINANCIAL SERVICES NSA PROPOSED DATA COLLECTION PLAN

The Postal Service plans to collect the following data pertaining to the NSA with HSBC Financial Services, Inc. (HSBC):

1. The volume of First-Class Mail solicitations by rate category in eligible HSBC permit accounts;
2. The volume of First-Class Mail customer mail by rate category in eligible HSBC permit accounts;
3. The amount of discounts paid to HSBC for First-Class Mail by incremental volume block;
4. The volume of First-Class Mail solicitations bearing the ACS endorsement that are physically returned to HSBC;
5. The number of electronic address correction notices provided to HSBC for forwarded solicitation mailpieces, including the number of notices processed by CFS units and separately for PARS (when fully operational).
6. The number of electronic address correction notices provided to HSBC for solicitation mailpieces that would otherwise be physically returned, including the number of notices processed by CFS units and separately for PARS (when fully operational).
7. Monthly estimate of the amount of time spent on compliance activity and a description of the activities performed.
8. For each First-Class Mail solicitation mailing list run against NCOA, HSBC will provide NCOA contractor reports that separately identify the number of address records checked and the number of corrections made.
9. For each Change of Address record that is used to forward a piece of HSBC solicitation mail through ACS under the Agreement, the Postal Service will provide the date the record was created, its move effective date, whether it was for a family or individual move, and each date that the record was used to forward a mail piece. No other information from the record would be provided.

As part of each data collection plan report, the Postal Service will provide an evaluation of the impact on contribution. It will also provide an assessment of trends of HSBC' First-Class Mail volume as compared to overall First-Class Mail volume.

- 1 Data collected under the plan shall be reported annually following the end of the fiscal
- 2 year, with the first report being made available at the end of FY2005. The Postal
- 3 Service shall provide the data in a PC-available format.