Postal Rate Commission
Submitted 4/4/2005 4:29 pm
Filing ID: 43188
Accepted 4/4/2005

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

RATE AND SERVICE CHANGES TO IMPLEMENT FUNCTIONALLY EQUIVALENT NEGOTIATED SERVICE AGREEMENT WITH HSBC NORTH AMERICA HOLDINGS INC.	Docket No. MC2005-2

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK (VP/USPS-T1-1-10)
(April 4. 2005)

The United States Postal Service hereby provides the responses of witness Dauer to the following interrogatories of Val-Pak: VP/USPS-T1-1-10, filed on March 25, 2005.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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April 4, 2005

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-1.

This question is a hypothetical. Please refer to your Appendix A, page 8. Assume that HSBC's marketing mail were twice as "dirty" as the rate shown on row 2 of page 8 of your Appendix A — *i.e.*, assume that HSBC's return rate were 9.5 percent instead of 4.75 percent — and confirm the following:

a. The return forecast for the volume of such "dirtier" marketing mail over the life of the negotiated service agreement ("NSA") would be as follows:

Year 1	15,032,073 returns
Year 2	23,293,163 returns
Year 3	28,430,485 returns
Total	66,755,721 returns

If you do not confirm, please provide the correct return forecast on the assumption that the return rate for HSBC's marketing mail is 9.5 percent.

b. The before rates return cost for such "dirtier" marketing mail over the life of the NSA would be as follows:

Year 1	$ 8,875,619
Year 2	$ 14,303,475
Year 3	$ 18,156,441
Total	$ 41,335,536

If you do not confirm, please provide the correct before rates return cost on the assumption that the return rate for HSBC's marketing mail is 9.5 percent.

c. The after rates return cost for such "dirtier" marketing mail over the life of the NSA would be as follows:

Year 1	$ 6,028,722
Year 2	$ 9,715,568
Year 3	$ 12,332,677
Total	$ 28,076,968

If you do not confirm, please provide the correct after rates return cost on the assumption that the return rate for HSBC's marketing mail is 9.5 percent.

d. The return cost savings over the life of the NSA would be as follows:

Year 1	$ 2,846,897
Year 2	$ 4,587,907
Year 3	$ 5,823,764
Total	$13,258,568

If you do not confirm, please provide the correct return cost savings on the assumption that the return rate for HSBC's marketing ma

Response

a-d.) Confirmed, though the use of the term "dirty" to describe to HSBC's marketing mail is an inaccurate pejorative similar to calling Standard Mail "junk" mail. And to the extent that this term is an implicit criticism of HSBC's mailing practices it is used most unfortunately in this setting. The use of this term is also inappropriate because, as required in the NSA, HSBC will be held to higher standards for address quality than obtain more generally. Moreover, return rates can

vary for a number of reasons that have nothing to do with the quality of a list. By using First-Class Mail as an advertising medium, customers like HSBC make a larger contribution to the Postal Service's institutional costs than a comparable mailer that uses Standard mail.

Also, the answers to these questions can be found by changing the 4.75 percent on the Assumption page (page 1) in USPS-T-1_Appendix.xls to 9.5 percent, and then looking on page 8 (UAA Calcs) to find the results of the change.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-2.

This question is also a hypothetical. Please refer to your Appendix A, page 8. Assume that HSBC's marketing mail were somewhat "cleaner" than it actually is and had a return rate of 1.5 percent, which is just under one-third of HSBC's actual return rate of the 4.75 percent — as shown on row 2 of page 8 of your Appendix A — and confirm the following:

a. The return forecast for such cleaner marketing mail over the life of the NSA would be as follows:

Year 1	2,373,485 returns
Year 2	3,677,868 returns
Year 3	4,489,024 returns
Total	10,540,377 returns

If you do not confirm, please provide the correct return forecast on the assumption that the return rate for HSBC's marketing mail is 1.5 percent.

b. The before rates return cost with such cleaner marketing mail over the life of the NSA would be as follows:

Year 1	$ 1,401,414
Year 2	$ 2,258,443
Year 3	$ 2,866,807
Total	$ 6,526,664

If you do not confirm, please provide the correct before rates return cost on the assumption that the return rate for HSBC's marketing mail is 1.5 percent.

c. The after rates return cost with such cleaner marketing mail over the life of the NSA would be as follows (note: total does not add due to rounding):

Year 1	$ 951,904
Year 2	$ 1,534,037
Year 3	$ 1,947,265
Total	$ 4,433,205

If you do not confirm, please provide the correct after rates return cost on the assumption that the return rate for HSBC's marketing mail is 1.5 percent.

d. The return cost savings with such cleaner marketing mail over the life of the NSA would be as follows:

Year 1	$ 449,510
Year 2	$ 724,406
Year 3	$ 919,542
Total	$ 2,093,458

If you do not confirm, please provide the correct return cost savings on the assumption that the return rate for HSBC's marketing mail is 1.5 percent.

Response

a-d.) Confirmed. See also my response to VP/USPS-T1-1 regarding use of the pejorative

"dirty," and for how such results can be automatically derived using my worksheets.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-3.

This question is also a hypothetical. Please refer to your Appendix A, page 8. Assume that HSBC's marketing mail somehow were "cleaner" than its operational mail — *i.e.*, the return rate for HSBC's marketing mail were only 0.25 percent instead of 4.75 percent — as shown on row 2 of page 8 of your Appendix A, and confirm the following:

a. The return forecast for such very clean marketing mail would be as follows:

Year 1	395,581 returns
Year 2	612,978 returns
Year 3	748,171 returns
Total	1,756,730 returns

If you do not confirm, please provide the correct return forecast on the assumption that the return rate for HSBC's marketing mail is only 0.25 percent.

b. The before rates return cost for such very clean marketing mail over the life of the NSA would be as follows:

Year 1	$ 233,569
Year 2	$ 376,407
Year 3	$ 477,801
Total	$1,087,777

If you do not confirm, please provide the correct before rates return cost on the assumption that the return rate for HSBC's marketing mail is only 0.25 percent.

c. The after rates return cost for such very clean marketing mail over the life of the NSA would be as follows:

Year 1	$ 158,651
Year 2	$ 255,673
Year 3	$ 324,544
Total	$ 738,868

If you do not confirm, please provide the correct after rates return cost on the assumption that the return rate for HSBC's marketing mail is only 0.25 percent.

d. The return cost savings over the life of the NSA would be as follows:

Year 1	$ 74,918
Year 2	$ 120,734
Year 3	$ 153,257
Total	$ 348,910

If you do not confirm, please provide the correct return cost savings on the assumption that the return rate for HSBC's marketing mail is only 0.25 percent.

Response

a-d.) Confirmed. As I mentioned in my response to VP/USPS-T1-1, referring to HSBC's marketing mail as "clean" or "dirty" is inappropriate.

The answers to these questions can be found by changing the 4.75 percent on the Assumption page (page 1) in USPS-T-1_Appendix.xls to .25 percent, and then looking on page 8 (UAA Calcs) to find the results of the change.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-4.

Please refer to your testimony, page 16, lines 6-14, where you estimate the net benefit to the Postal Service over the life of the proposed NSA with HSBC.

a. Please confirm that a change in the assumed return rate of 4.75 percent for marketing mail does not affect the "increased contribution (less incremental discounts)" of $4.1 million, shown on line 9. If you do not confirm, please explain fully, and indicate the extent of the change in net contribution if the assumed return rate is 9.5 percent.

b. Please confirm that a change in the assumed return rate of 4.75 percent for marketing mail does not affect the Postal Service's "discount exposure" of ($4.4) million, shown on line 10. If you do not confirm, please explain fully, and indicate the extent of the change in discount exposure if the assumed return rate is 9.5 percent.

c. Please refer to your response to VP/USPS-T1-1, part d, and confirm that if HSBC's return rate for marketing mail were 9.5 percent, then over the life of the NSA the Postal Service would derive a net benefit of $13.0 million, computed as follows:

ACS cost savings:	$13.3 million
Increased contribution (less incremental discounts):	$ 4.1 million
Discount exposure:	($4.4) million

If you do not confirm, please provide the net benefit over the life of the NSA on the assumption that HSBC's return rate for marketing mail were 9.5 percent.

d. If you confirm preceding part c, or if you do not confirm but provide an alternate net benefit for the NSA over the life of the agreement that is somewhat greater than the $6.3 million shown on line 12 of your testimony, would you agree that, *ceteris paribus,* the dirtier the existing marketing mail the greater is the net benefit to the Postal Service under the proposed NSA? If you fail to agree, please explain fully why not.

e. Could a higher amount of return cost savings and a larger computed net benefit to the Postal Service (*e.g.*, $12.8 million instead of $6.3 million) be a basis for justifying greater discount exposure, either in the form of lower volume thresholds for existing discounts, or higher discounts at existing volume thresholds? Please explain fully any answer that is not an unqualified affirmative.

Response

a.) Not confirmed. The increased contribution is reduced to $3.0 million, because the return rate is used in calculating the Marketing Unit Cost (page 6), Column 13 and 15. Increasing the return rate to 9.5 percent would increase the Current and After Rates Return Adjustment Unit Costs by 2.7 cents and 1.8 cents respectively, thus reducing the average contribution for Before and After Rates FCM (page. 11).

b.) Confirmed.

c.) Not confirmed. See response to part a in regards to the Increased Contribution.

ACS Cost Savings	$13.3 million
Increased Contribution	$ 3.0 million
Discount exposure	$(4.4) million
Total	$11.9 million

d.) One of the effects of the NSA is that HSBC will adopt electronic ACS. Therefore it is a mathematical truism that any assumption that increases the "before-NSA UAA rate – irrespective of how unfounded or realistic it may be – would increase the calculated benefits of the NSA to the Postal Service, *ceteris paribus*.

e.) The Postal Service does not link greater or lesser ACS Cost Savings to greater or lesser exposure. The discounts are not justified by the amount of cost savings (i.e. return rate), but how a customer responds to price incentives based upon its marketing model. The Postal Service sees the largest potential value coming from the volume response of a customer, rather than a trade between ACS cost savings and discounts given. The Commission, through the use of a cap, has created a link between the two features that was not considered when we negotiated with HSBC. The Postal Service still sees them as two different benefit streams that can be combined into a single contract for administrative and litigation purposes.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-5.

a. Please refer to your response to VP/USPS-T1-2, part d, and confirm that if HSBC's return rate for marketing mail were 1.5 percent, then over the life of the NSA the Postal Service would derive a net benefit of $1.8 million, computed as follows:

Address Change Service ("ACS") cost savings:	$ 2.1 million
Increased contribution (less incremental discounts):	$ 4.1 million
Discount exposure:	($ 4.4) million

If you do not confirm, please provide the net benefit over the life of the NSA on the assumption that HSBC's return rate for marketing mail is only 1.5 percent.

b. If you confirm preceding part a, or if you do not confirm but provide an alternate net benefit for the NSA over the life of the agreement that is somewhat less than the $6.3 million shown on line 12 of your testimony, would you agree that, *ceteris paribus,* the cleaner the existing marketing mail the smaller is the net benefit to the Postal Service under the proposed NSA? If you do not agree, please explain why not.

c. Could a lower amount of return cost savings and a resulting reduction in the net benefit to the Postal Service (*e.g.*, $1.8 million instead of $6.3 million) require a reduction in the amount of discount exposure, either in the form of higher volume thresholds for existing discounts, or lower discounts at existing volume thresholds? Please explain fully any answer that is not an unqualified affirmative.

Response

a.) Not confirmed. The increased contribution is higher because the return rate is used in calculating the Marketing Unit Cost (page 6), Column 13 and 15. Decreasing the return rate to 1.5 percent would decrease the Current and After Rates Return Adjustment Unit Costs, thus increasing the average contribution for Before and After Rates FCM (page 11).

ACS Cost Savings	$2.1 million
Increased Contribution	$4.8 million
Discount/exposure	$(4.4) million
Total	$2.5 million

b.) The alternate net benefit, as described in the hypothetical situation, does have a "somewhat less than $6.3 million" value because of the lowered return rate that was suggested. As I previously discussed, the constant use of "clean" or "dirty in these questions implies HSBC is using or is not using certain mailing practices which is unfounded.

c.) Please see my response to VP/USPS-T1-4(e).

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-6.

a. Please refer to your response to VP/USPS-T1-3, part d, and confirm that if HSBC's return rate for very clean marketing mail were only 0.25 percent, then over the life of the NSA the net benefit to the Postal Service would be $0 million (rounded), computed as follows:

ACS cost savings:	$ 0.3 million
Increased contribution (less incremental discounts):	$ 4.1 million
Discount exposure:	($ 4.4) million

If you do not confirm, please provide the net benefit over the life of the NSA on the assumption that HSBC's return rate for marketing mail were 0.25 percent.

b. If you confirm preceding part a, or if you do not confirm but provide an alternate net benefit of the NSA over the life of the agreement that is not positive, please explain how, under such circumstances — *i.e.*, generating only very clean marketing mail — HSBC could qualify for an NSA that is functionally equivalent to the baseline (Capital One Services, Inc.) NSA? Would one sure-fire option for increasing the computed net benefit to the Postal Service be for HSBC to rent and use dirtier mailing lists prior to entering into an NSA?

c. If very clean Standard marketing mail results in very little ACS cost savings, but would give the Postal Service a higher per piece contribution if such mail were to upgrade to First-Class, what does (or could) the Postal Service offer to induce such mail to use First-Class?

Response

a-b.) Not confirmed. The increased contribution is higher because the return rate is used in calculating the Marketing Unit Cost (page 6), Column 13 and 15. Decreasing the return rate to 1.5 percent would decrease the Current and After Rates Return Adjustment Unit Costs, thus increasing the average contribution for Before and After Rates FCM (page 11).

ACS Cost Savings	$0.3 million
Increased Contribution	$5.1 million
Discount/exposure	$(4.4) million
Total	$1.0 million

I agree that, under the approach used by the Commission to date (i.e. capping cumulative discounts at cumulative ACS cost savings), it would be difficult to design a useful NSA with a mailer that has an extremely low return rate, and remain functionally equivalent to the Capital One NSA. I reject, however, the suggestion that such mailers should or would respond to these circumstances by trying to manipulate the process. It is improbable in the extreme that a

customer would attempt to increase the Postal Service's calculated NSA benefit by intentionally degrading the quality of their acquisition mail. To do so would require purchasing mail lists, paper stock, and printing services (or expending additional resources to perform similar functions in-house) and paying for postage for mail pieces believed to have no probability of reaching their intended recipients, all for the sake of possibly getting small incentives at the margin. Suggesting that this is a sound business strategy would indicate a fundamental misunderstanding of business practices and basic economics.

c.) As indicated above, the link between ACS cost savings and price incentives was artificially created through the imposition of a cap in the Capital One NSA. I believe that, independent of a cap, incentives of the type that exist in the HSBC NSA provide incentives for customers to convert from Standard Mail to First-Class Mail in some instances.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-7.

a. Does the Postal Service have any estimate for the percentage of HSBC's Standard Mail that was undeliverable as addressed ("UAA") in BY 2000, or any fiscal year subsequent to BY 2000? If so, please provide.

b. For the portion of its Standard Mail that HSBC expects to convert to First-Class, does the Postal Service have any estimates of the percentage that is expected to be (i) UAA, (ii) UAA and forwardable, and (iii) UAA and non-forwardable? If so, please provide.

Response

a-b.) The Postal Service does not have any estimate. The Postal Service generally disposes of UAA Standard Mail and does not track the amount by customer.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-8.

a. For the portion of HSBC's Standard Mail that it expects to convert to First-Class, do your computations of the net benefit to the Postal Service assume, either explicitly or implicitly, that the percentage of such converted Standard Mail that will be UAA and non-forwardable (*i.e.*, requiring either an electronic or manual return) will be the same as HSBC's existing First-Class marketing mail return rate of 4.5 percent? Please explain fully any response that is not an unqualified affirmative.

b. If your response to preceding part a is affirmative, please explain the basis for assuming that HSBC's Standard marketing mail is neither "cleaner" nor "dirtier" than its First-Class marketing mail.

c. Would you concur that the UAA rate of the NSA recipient's Standard marketing mail was not a relevant consideration in the baseline (Cap One) NSA, but is a relevant consideration in this NSA with HSBC? If you do not concur, please explain why.

d. Where in your testimony do you discuss the UAA rate of HSBC's Standard marketing mail?

e. Please assume that the Standard marketing mail that HSBC converts to First-Class turns out to be much "dirtier" than its existing First-Class marketing mail, and has a return rate of 9.5 percent. Over the life of the NSA, would that eventuality, by itself, tend to increase or decrease the $6.3 million net benefit to the Postal Service that is shown in your testimony at page 16, line 12? Please explain your answer.

f. Please assume that the Standard marketing mail that HSBC converts to First-Class turns out to be much "cleaner" than its existing First-Class marketing mail, and has a return rate of only 1.5 percent. Over the life of the NSA, would that eventuality, by itself, tend to increase or decrease the net $6.3 million benefit to the Postal Service that is shown in your testimony at page 16, lines 12-13? Please explain your answer.

Response

a.) That assumption is implicit.

b.) I do not make the assumption referenced in this question (i.e., that all of HSBC's Standard Mail has the same UAA profile as its First-Class marketing mail). I only assume that the pieces which convert would have that profile.

c.) I do not agree that the UAA rate of <u>all</u> of HSBC's Standard Mail is relevant. See also my response to part b.

d.) I do not discuss in my testimony the UAA rate of HSBC's Standard marketing mail.

e-f.) For the relatively small share of HSBC's Standard Mail that witness Harvey has projected will convert to First-Class Mail, if the UAA rate were lower, that would tend to increase the benefit to the Postal Service. Conversely, if the UAA rate were higher, it would tend to decrease the net benefit. However, the situation that this interrogatory implies – that a customer who

knew which share of its addresses were likely to produce a greater proportion of UAA pieces would be sending them via Standard rather than First-Class Mail – is highly unlikely. Since First-Class Mail pieces are forwardable and returnable free of charge, such a customer would see an immediate and automatic lift in response rates by sending such pieces via First-Class Mail and is therefore more likely to choose First-Class Mail rather than Standard. This implies that for a given customer who is using both First-Class Mail and Standard Mail for advertising, it is likely that the Standard Mail portion is even less likely than the First-Class Mail portion to generate UAA pieces.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-9.

Please refer to your response to Presiding Officer's Information Request No. 1, question 10.

a. Please explain why correction of the ACS pricing anomaly you discuss would "typically be addressed in an omnibus rate case."

b. What are the major reasons why correction of the ACS pricing anomaly you discuss could not be corrected in a mail classification case or a non-omnibus rate case?

c. Please confirm that correction of the ACS pricing anomaly you discuss would promote Postal Service efficiency. If you do not confirm, please explain why the pricing anomaly does not hamper or impede more efficient use of postal resources.

d. Please confirm that correction to the ACS pricing anomaly you discuss would result in the lowest combined cost for the Postal Service and the mailer. If you do not confirm, please explain how the pricing anomaly supports lowest combined cost.

Response

a-b.) It would "typically be addressed in an omnibus rate case" because the size and scope, particularly in terms of the range of potentially affected mailers, are so large. Interim cases tend to be focused on more discrete groups of mailers. Broader matters are usually left for an omnibus case when groups across the entire spectrum of mailers are already involved.

c.) I assume that ACS pricing would only change if it meant improved postal efficiency.

d.) The issues raised by ACS pricing are complicated. In my work, which focuses on NSAs, I have not been requested to consider broader ACS pricing in terms of lowest combined cost, and I have no opinion in that regard.

RESPONSE OF POSTAL SERVICE WITNESS DAUER TO INTERROGATORIES OF VAL-PAK

VP/USPS-T1-10.

On October 27, 2004, the Postal Service published a final rule seeking to clarify the eligibility requirements for First-Class Mail, particularly with respect to personalization of mailings, which will be effective on June 1, 2005 (69 Fed. Reg. 62578), as well as several related Customer Support Rulings. Is it your understanding that either the current or scheduled-to-be-amended Postal Service First-Class eligibility rules or Customer Support Rulings could require some or all of HSBC's current or planned marketing mail to be sent as First-Class Mail?

a. If so, how much of HSBC's current or planned marketing mail would be required to be sent as First-Class Mail?

b. If not, please explain in detail why not.

Response

a-b.) This final rule would not affect HSBC's marketing mail because the only mail would fall into this category are the "convenience checks" and they are currently being mailed as First-Class Mail, and are categorized as operational mail for the purpose of the NSA. Please see witness Harvey's response to OCA/HSBC-T1-7.

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice and Procedure.

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