

**Before The
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268B0001**

**Rate and Service Changes to Implement
Baseline Negotiated Service Agreement
with Bookspan**

Docket No. MC2005-3

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

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AUTOBIOGRAPHICAL SKETCH

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2 My name is Michael K. Plunkett. I have worked for the Postal Service in various
3 capacities for 20 years. From 1984 to 1990 I held a number of positions in delivery and
4 customer service operations. In 1990 I entered the Postal Service's Management Intern
5 program, where I performed a series of short term assignments in several different
6 functional specialties, both in the field and at headquarters. Upon leaving the Intern
7 program I was hired as an economist in the office of Budget and Financial Analysis.
8 Subsequently I worked as an economist in the office of Pricing from 1998 through 2000.
9 After leaving the pricing organization I worked as the product manager for the Postal
10 Service's Mailing Online service, and later as the Associate VP of Business
11 Development. For the last three years I have been the Manager of Pricing Strategy.

12 I have testified before the PRC on several previous occasions. In Docket No.
13 MC97-1, I presented pricing testimony supporting an experimental packaging service.
14 In Docket No. MC 98-1, I provided pricing testimony in support of Mailing Online, and in
15 Docket No. MC 2000-2, I was the pricing witness in the Mailing Online experiment case.
16 I also provided policy testimony in the same docket. In previous omnibus cases I have
17 presented pricing testimony supporting parcel post, Express Mail, and various special
18 services. I have also been a witness in two previous NSAs; Capital One MC2002-2,
19 and Bank One MC2003-3.

20 I have an honors degree in economics and a bachelor's degree in finance from
21 Pennsylvania State University. I also have a master's degree in business administration
22 from the Wharton School at the University of Pennsylvania.

1 **I. PURPOSE OF TESTIMONY**

2 The purpose of my testimony is to describe the policy considerations that support
3 the Postal Service's baseline negotiated service agreement (NSA) with Bookspan. My
4 testimony describes the business objectives and strategy of NSAs generally, and how
5 the Bookspan agreement fits into this context. In doing so I provide background on the
6 Postal Service's NSA experience to date, and explain how this experience has helped
7 the Postal Service refine and develop its approach to negotiated pricing. There are no
8 library references or workpapers associated with my testimony.

9 **II. THE IMPORTANCE OF NEGOTIATED SERVICE AGREEMENTS**

10 In my role as Manager, Pricing Strategy, I have been personally involved in all of
11 the Postal Service's NSAs to date. During this relatively brief history, important
12 progress has been made, and useful precedents have been established. Thanks to a
13 continuing spirit of cooperation among the relevant participants, the series of NSAs that
14 have been filed thus far demonstrate that negotiated pricing can work in the Postal
15 Service's regulatory environment. They also demonstrate that declining block rates are
16 a useful tool for stimulating additional use of the mail for customers that advertise and
17 exercise discretion over how much mail to send. Most importantly, the first year results
18 of the first NSA with Capital One show that the business impact of NSAs can be
19 meaningful to both the customer and the Postal Service.

20 Since that initial filing, there have been many important developments. The
21 Postal Service has filed and litigated three functionally equivalent NSAs using the same
22 basic framework. Though the basic structure was unchanged, each successive
23 agreement included features designed to build upon a solid foundation. With the benefit

1 of experience and the collaboration of some innovative customers, we have been able
2 to craft contract terms that better manage risk and improve the quality of the
3 agreements for all parties. As was documented in the first year's data collection report
4 in the Capital One case, that agreement stimulated dozens of inquiries from customers
5 interested in discussing NSAs. Simultaneously, the Postal Service has worked to
6 develop internal processes to facilitate the effective management of NSAs as an
7 ongoing business activity.¹ As the manager responsible for NSA development, I have
8 been personally involved in all of these efforts, and believe strongly that they clearly
9 indicate that NSAs have tremendous potential to improve the Postal Service's ability to
10 price its products, provide greater value to our customers, and help to maintain the long-
11 term viability of the Postal Service as an institution committed to universal service.

12 In order for this potential to be fulfilled, it is important for NSAs to move beyond
13 the relatively narrow scope defined by the Capital One agreement. Not surprisingly, the
14 agreements that were patterned after the Capital One agreement were also with large
15 credit card banks. However, I can attest to the fact that Postal Service customers in
16 every subclass are interested in NSAs, and believe strongly that through the prudent
17 implementation of additional baseline agreements, NSAs can be viable for a much wider
18 range of postal customers of varying sizes.

19 **III. THE EVOLUTION OF NSAs**

20 In the Capital One case, witness Bizzotto (MC2002-2, USPS-T-1) referred to a
21 quiet revolution in Postal Services and described how Negotiated Service Agreements

¹ A detailed description of these processes is contained in the Postal Service's memorandum on reconsideration filed May 16, 2005 in Docket MC2004-3.

1 represented a logical continuation of a long standing trend toward greater and greater
2 customization over time. For that trend to continue, NSAs will also have to evolve and
3 improve over time as well.

4 **A. Extension to Standard Mail**

5 To date all of the Postal Service's NSAs have dealt with First-Class Mail.
6 Because First-Class Mail is the Postal Service's largest source of revenue, and often
7 viewed—wrongly—as a product not subject to competition, it was the natural product
8 with which to test NSAs. However, because First-Class Mail is generally used to reach
9 a defined customer base, demand is less likely to expand solely on the basis of a price
10 incentive. Therefore, the potential for expanding negotiated pricing beyond the few
11 NSAs already in effect is somewhat limited.

12 The logical progression from the established precedent is to employ a proven
13 technique in a new way. Consequently, in the Bookspan agreement, the Postal Service
14 is seeking to employ declining block pricing in Standard Mail. As described in the
15 testimony of witness Yorgey, the proposed pricing structure will result in increased
16 Standard Mail letter volume, and by virtue of the multiplier effect described in the
17 testimonies of Bookspan witnesses Posch and Epp, an increase in mail in other product
18 areas as well.

19 I believe the results demonstrated thus far by the Capital One NSA provide
20 strong empirical support for the application of declining block pricing for postal services.
21 While that baseline agreement also had cost savings, the declining block discounts
22 produced an increase in volume that alone improved contribution to institutional costs
23 by \$12.4 million. As was expected, and is apparent, there are limited opportunities to

1 use declining block pricing for First-Class Mail. As was discussed in my testimony in
2 Docket No. MC2002-2, the utility of declining block pricing in the Capital One agreement
3 is a consequence of the fact that Capital One makes atypically significant use of First-
4 Class Mail for discretionary purposes.² In contrast, one could argue that virtually all
5 Standard Mail is sent for discretionary purposes; thus, the prudent extension of
6 declining block rates into Standard Mail will enable greater use of this technique, and
7 create opportunities for further increases in contribution.

8 **B. Volume Generation in the Absence of Unrelated Cost Savings**

9 The Capital One NSA and its progeny were based on the combination of
10 (1) declining block rates to produce additional postal net revenue from the generation of
11 increased mail volume, and (2) postal cost savings resulting from changes in mailer
12 practices. At the time the Capital One case was filed, questions were raised about, and
13 indeed some confusion was originally engendered by, the combination of these two,
14 seemingly unrelated features. Ultimately, the Commission saw the value of both parts
15 and recommended the changes needed to implement them. It nevertheless
16 recommended capping total discounts at the amount of the unrelated cost savings, as a
17 way to address issues regarding the difficulties of single-company volume forecasting.
18 It has done so in each subsequent, functionally equivalent NSA.

19 The Bookspan NSA concerns only volume generation. There are no savings
20 involved³ and therefore no savings to cap. Given that, the agreement contains other

² Docket No. MC2002-2, USPS-T-2, pp 7-8.

³ In negotiating this agreement, the Postal Service and Bookspan examined the possibility for additional cost savings, but concluded that, based on our longstanding, successful business relationship, our mutual operations were such that there was no significant identifiable opportunity for further cost savings. It would indeed be ironic if

1 risk mitigation features, as summarize below and as are fully discussed by witness
2 Yorgey.

3 **C. Progress in Risk Mitigation**

4 Witness Yorgey's testimony describes the review and analysis that preceded this
5 filing, as well as the risk mitigation features incorporated into the agreement. The
6 volume commitments, the level of those commitments relative to the before-rates
7 forecast and the discount thresholds, the automatic termination at 150 million pieces,
8 and the unconditional cancellation provision all provide the Postal Service with very
9 broad protection against the various kinds of risks inherent in contract pricing. Given
10 these factors, the Bookspan agreement is an ideal mechanism for testing the
11 applicability of negotiated pricing in Standard Mail; it provides for gains in contribution
12 that will benefit all USPS customers, and has been structured in a way that minimizes
13 risk. Moreover, the changes requested have a planned termination date, further limiting
14 the already minimal risk that failure to achieve expected results would have on other
15 postal customers.

16 **IV. THE IMPORTANCE OF THE INTEGRITY OF THE AGREEMENT**

17 In crafting NSAs, the Postal Service tries in advance to identify competitors of the
18 NSA partner and functionally equivalent customers. The Commission has an important
19 role in ensuring that NSAs conform to the Act, including that NSA partners' competitors,
20 who may or may not qualify for functionally equivalent agreements, are not unfairly or
21 inequitably disadvantaged. The Bookspan agreement now before the Commission

this NSA were challenged for the absence of cost savings, after the Capital One NSA was initially challenged for the combination.

1 presents an opportunity to create a more hospitable environment for potential NSA
2 partners and a more fruitful one to meet the objectives of increased net contribution for
3 the Postal Service and customized postal services and prices. I would respectfully
4 urge the Commission to strive to maintain the integrity of the agreement, consistent with
5 the policies of the Act.

6 The imposition of the cap in the Capital One case has had a retarding effect on
7 NSA progress. Most fundamentally, it limits the universe of potential NSA customers to
8 those who present substantial cost savings opportunities. My direct experience tells me
9 that this is a relatively small number of customers, and my participation in many
10 negotiations has led me to conclude that NSAs are generally not the ideal way to
11 implement cost savings initiatives. In addition, the real possibility that an agreement
12 might be altered adds time to the negotiation process, tends to harden negotiating
13 positions, and appears to increase transaction costs. Experience has taught that an
14 unintended consequence of the cost savings cap is to make NSAs impractical for some
15 companies that consider themselves to be competitors of the NSA partner, because
16 they do not present a large enough cost savings opportunity to justify the perceived
17 transaction costs. The Commission now has an opportunity to alter that experience by
18 recommending the changes needed to implement the Bookspan NSA, as negotiated.

19 **SUMMARY AND CONCLUSION**

20 In a comparatively brief time, a number of important breakthroughs have been
21 made in the area of negotiated pricing. The Postal Service recognizes that these
22 breakthroughs would not be possible without the cooperative spirit and willingness to
23 experiment that has been demonstrated by the Commission, and by numerous

1 participants over the last several years. For this effort to continue, and for NSAs to
2 develop into a more integral component of the Postal Service's price structure, will
3 require that those same qualities be maintained over a sustained period of time. The
4 Bookspan NSA offers an opportunity to build gradually on the success of the first NSAs
5 by expanding in a measured, prudent way into a new product area and a new industry.
6 Beyond the business impacts described in witness Yorgey's testimony, this is an
7 opportunity to enlarge the scope of NSAs, and to make negotiated pricing a viable
8 possibility for a much greater number of postal customers. The Commission should
9 recommend the requested rate and classification changes so that the Bookspan NSA
10 can be implemented and ensure that this opportunity is not lost.