

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

**RATE AND SERVICE CHANGES TO IMPLEMENT
BASELINE NEGOTIATED SERVICE AGREEMENT
WITH WASHINGTON MUTUAL BANK**

Docket No. MC2006-3

**DIRECT TESTIMONY
OF
ALI AYUB
ON BEHALF OF THE
UNITED STATES POSTAL SERVICE**

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My name is Ali Ayub. I joined the Postal Service in 2001 and am currently an Economist in the Pricing Strategy group. Previously I was the Postal Service's witness in the Discover Financial Services Negotiated Service Agreement (NSA), Docket No. MC2004-4. My responsibilities included providing financial analysis support and leading and managing the development of our negotiations. I was also involved in the development of the Capital One Negotiated Service Agreement (NSA) filing, Docket No. MC2002-2; the Bank One NSA, Docket No. MC2004-3; and the HSBC NSA, Docket No. MC2005-1. I was responsible for implementation of the Governors' Decision in each of these dockets. I also developed performance metrics and reporting tools for measuring NSA success.

My duties regarding the Washington Mutual Bank NSA included development of the Postal Service's negotiating positions and building the business case for this agreement. I serve as the key point of contact on all Financial Services NSAs for the Pricing Strategy group. I am also responsible for developing our business intelligence on how credit card issuers utilize the mail and how the economic and legal environment in which credit card issuers operate may impact mail volumes.

I earned a Bachelor's Degree in Finance and Information Systems and a Master of Business Administration (MBA) from the George Washington University with honors. While pursuing my MBA, I was also a Chairman's Fellow at the Export-Import Bank (EXIM) of the United States. I am currently a candidate for the Level III portion of the Chartered Financial Analyst (CFA) Examination.

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 Washington Mutual Bank. In this testimony, I refer to Washington Mutual Bank by
5 the abbreviation "WMB".

6 My testimony provides a detailed explanation of how the WMB NSA is structured;
7 analyzes the financial impact of the NSA over the three-year duration of the agreement;
8 and discusses fairness and equity concepts in relation to other users of the mail and the
9 competitors of the parties to the NSA.

10 My testimony relies on the concurrently filed testimony of WMB witness Rapaport
11 (WMB-T-1). On behalf of the Postal Service, I have reviewed Mr. Rapaport's testimony,
12 and affirm that such testimony may be relied upon in presentation of the Postal
13 Service's direct case.

14 Appendix A to my testimony presents the model that calculates the financial
15 impacts of the NSA. The Postal Service has filed this NSA as a baseline case and,
16 although this model mirrors the calculations provided in Attachments (1), (2), and (B) of
17 Witness Crum's testimony (USPS-T-3) in Docket No. MC2002-2, it does not rely on cost
18 data from the Capital One case. Appendix B explains the structure of the financial
19 calculations. Appendix C contains the worksheets and raw data that support the Postal
20 Service's analysis of WMB's Before Rate volume forecasts. Appendix D presents the
21 proposed Data Collection Plan, which is similar to previous data collection plans.

1

2 **II. IMPORTANCE OF NSAs**

3 **A. Background of NSAs**

4 In its Opinion and Recommended Decision in Docket No. MC2002-2, the
5 Commission found that, when the concepts underlying negotiated pricing and declining
6 block rates are applied fairly, benefits can accrue, not only to the customer and to the
7 Postal Service, but also to all other postal customers.¹

8 The Postal Service has implemented four NSAs since the approval of the Docket
9 No. MC2002-2 filing, all of which were based on the basic structure developed in that
10 proceeding. The NSAs that have been implemented and for which Data Collection
11 Reports have been issued (Capital One and Discover Financial Services) have yielded
12 approximately \$34 million in additional contribution since inception.² Furthermore, a
13 new baseline agreement with Bookspan is currently pending review by the Postal Rate
14 Commission.

15 The Postal Service believes that NSAs are an effective tool in generating
16 additional mail volumes, as evidenced by the increased mail volume contributions
17 resulting from existing NSAs. In our view, NSAs serve primarily as a means to generate
18 additional volume and enhance overall contribution to institutional costs. A secondary
19 objective served by NSAs has been the customer's adoption of cost savings
20 mechanisms, although in our assessment, additional worksharing on the mailer's part is
21 not a necessary element of a successful NSA. Used appropriately, negotiated pricing
22 can facilitate incentives for additional mail volume that benefits the Postal Service, its

¹ PRC Op. MC2002-2 at 37.

² Data Collection Reports MC2002-2 for FY 2004, FY 2005 and MC2004-4 CY 2005.

1 business partner, and all users of the Postal Service, through the resulting additional
2 contribution to institutional costs.

3 The Postal Service faces a challenging future. While workshared First-Class Mail
4 has increased since 1999, overall First-Class Mail volumes have generally declined
5 since 2001. In addition, Standard Mail volume now exceeds First-Class Mail volumes,
6 yet the former yields lower unit contribution. NSAs represent one tool that can help to
7 increase the proportion of relatively high contribution First-Class Mail volume, and
8 thereby enhance contribution to institutional cost.

9 **B. Current NSA Environment**

10 The Postal Service has worked with numerous customers over the past three
11 years in attempting to develop NSAs that satisfy the business needs of our customers,
12 while also providing increased contribution to the Postal Service. As reported in the
13 Data Collection Reports for Docket No. MC2002-2, the Postal Service has been in
14 discussions with over fifty companies since FY 2004.³

15 The Postal Service, has faced considerable challenges in persuading some
16 companies to enter into NSAs. In particular, while some customers are prepared to
17 increase their postage expenditures and expand their total mail volume, some are
18 unable to devise means to produce significant cost savings for the Postal Service.
19 These customers have been reluctant to enter into NSAs, despite the potential benefits
20 of increased savings for the mailer, or increased contribution for the Postal Service.
21 Mailers are wary of expending time and resources on NSAs because of the perception
22 that a “cap” may prevent them from reaping the full benefits of NSAs, and because the

³ Docket No. MC2002-2 Data Collection Requirement 10 2004,2005.

1 financial incentives of the deal would be tied to a demonstrated cost savings to the
2 Postal Service. These perceptions, in our view, impede our ability to reap the full
3 potential that NSAs could offer.

4 This case presents the Commission with an opportunity to provide the mailing
5 community with assurances that NSAs need not be subject to the rigid caps or require
6 demonstrated cost savings in order to be recommended to the Governors. For this
7 reason, the WMB NSA presented for the Commission's evaluation does not contain a
8 cap on the total amount of incentives.

9 In its Concurring Opinion in Docket No. MC2004-3 the Commission stated that it
10 would be receptive to an NSA without a cost savings cap. More specifically, the
11 Commission declared that, "the addition of a stop-loss cap in this case should not be
12 construed as establishing a precedent that all NSAs, or even all functionally equivalent
13 to the Capital One agreement must include a stop-loss cap" (Concurring Opinion Docket
14 No. MC2004-3 page 3). The Postal Service Governors have asked the Commission to
15 identify with precision the requirements for a non-capped agreement by asking for
16 reconsideration of the cap that was imposed in the Docket No. MC2004-3 filing.

17 If recommended by the Commission, this case would enable the mailing
18 community to overcome the reluctance that some mailers have towards committing time
19 and effort to negotiations and Commission litigation for NSA proposals that would not
20 operate well under a cap limitation. The unique characteristics of this NSA give the
21 Commission an opportunity to break new ground in this docket by issuing a
22 recommendation for a baseline NSA without a cap. Through this baseline agreement,
23 mailers could enjoy the full benefit of NSAs, in that functionally equivalent mailers would

1 be more likely to enter into arrangements with us to tender contribution-generating
2 volume.

3 Numerous prospective NSA candidates have walked away from the process
4 during negotiations citing the caps imposed in past NSAs as the primary reason for not
5 expending the upfront resources to develop an agreement. In this case, WMB has
6 made it clear that if approved with a cap, it would be financially impractical to accept the
7 terms of this NSA. In addition, by providing a non-capped option that offers protections
8 through risk mitigating tools, the Commission can increase the universe of NSA partners
9 to include entities that fall outside the small universe of very large mailers that can
10 commit the time and resources to submit cases for Commission review within a regime
11 in which cap limitations remain essential elements of such deals.

12 **III. TERMS AND CONDITIONS OF THE WMB NSA**

13 **A. Overview of the Structure of the NSA**

14
15 Limited to the card services division of WMB (formerly Provident), this NSA
16 includes all mailings associated with WMB's credit card operations. The NSA requires
17 that WMB mail at least ninety percent of its forecasted marketing volume or at least 500
18 million solicitation pieces in First-Class Mail. The agreement does not cap the
19 incentives offered to WMB.

20 The other elements of the agreement are based on the same substantive
21 functional elements as were litigated in the Capital One NSA and in subsequent
22 functionally equivalent filings. First, as in the Capital One agreement, the Postal
23 Service's agreement with WMB calls for the implementation of incentives in the form of
24 declining block rates, according to the schedule outlined below.

	<u>Year 1 Volume Block</u>	<u>Incremental Incentives</u>
1		
2	450,000,001 – 465,000,000	2.0¢
3	465,000,001 – 500,000,000	3.5¢
4	500,000,001 – 650,000,000	4.0¢
5	650,000,001 – above	5.0¢

6 Second, as with the Capital One NSA, the WMB agreement contains an address
7 correction element, which creates further cost savings for the Postal Service. In
8 particular, WMB has agreed that the Postal Service can convert the physical return of its
9 undeliverable-as-addressed (UAA) marketing mailpieces into electronic address
10 correction information through the computerized ACS system, more fully described in
11 the testimony of witness Wilson in Docket No. MC2002-2, USPS-T-4 at 2-7.

12 As explained above, although this proposal does not tie the discounts to a cost
13 savings calculation, the Postal Service will nevertheless provide an estimate of these
14 savings in this testimony. The estimated savings did not serve as an underlying
15 rationale to enter into an NSA with WMB. Further, the Postal Service has not relied on
16 any estimated cost savings in calculating the financial basis for this agreement.

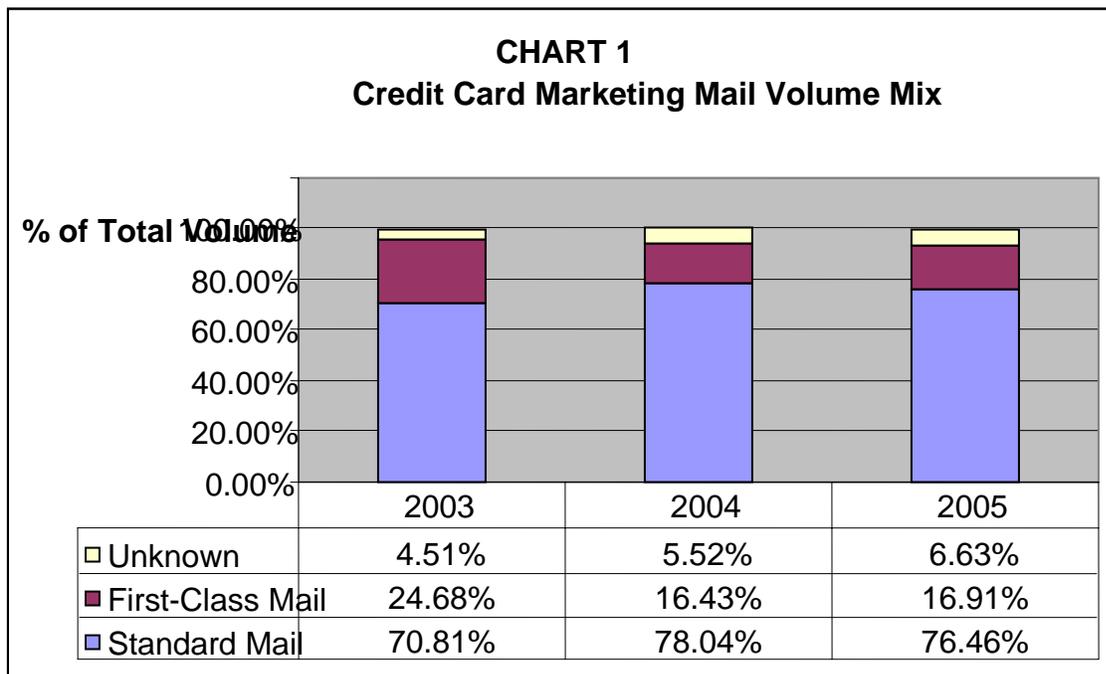
17 **B. First-Class Mail Solicitation Volume Guarantee**

18 Previous NSAs have offered various mailing incentives in the hopes that a mailer
19 would increase its First-Class Mail volumes. The WMB NSA is the first NSA that
20 guarantees First-Class Mail volume growth, by specifically including a Solicitation Mail
21 Volume Guarantee. The Solicitation Mail Volume Guarantee mitigates risk by ensuring
22 that the mailer will predominately use First-Class Mail for customer acquisition
23 purposes. This volume guarantee differentiates this NSA from past submissions,

1 substantially lowers risk, and affords the Commission an opportunity to approve a
2 baseline NSA without the stop-loss caps deemed necessary in previous NSAs.⁴

3 Article II, Paragraph J of the NSA commits WMB to mailing the lesser of 500
4 million First-Class Mail solicitation pieces or 90 percent of the total marketing mail
5 volume. Failure to meet this commitment will result in a financial penalty of \$250,000.
6 WMB's First-Class Mail solicitation volume in CY 05 was 272 million pieces and its total
7 marketing volume was 404 million pieces. WMB's First-Class Mail solicitation volume
8 forecast for Year 1 of the agreement is 330 million pieces.

9 A limited number of customers use First-Class Mail as their primary acquisition
10 medium. As Chart 1 illustrates, within the credit card industry specifically, the mix is
11 skewed towards the use of Standard Mail as an acquisition medium.⁵



12

⁴ PRC Op. MC 2002-2 at 86-91; PRC Op. MC 2004-3 at 67-70.

⁵ The data in this chart is based on Comperemedia, Mail Monitor® and USPS internal data sources.

1 Per NSA discussions, WMB commits to mail at least 90 percent or more of its
2 marketing volume in First-Class Mail.

3 **C. Annual Threshold Adjustment**

4 The annual threshold adjustment, as identified in Article II, Paragraph F of the
5 NSA provides another example of risk mitigation. The threshold adjustment as defined
6 is similar in structure to those presented in Docket Nos. MC2004-3 and MC2004-4.

7 As noted, among other objectives, this NSA is intended to create incentives for WMB to
8 increase First-Class Mail marketing volumes over the duration of the agreement.

9 However, statement volume growth could have the unintended consequence of
10 diminishing the incentives for new marketing mail volume. The annual threshold
11 adjustment protects against this contingency, and against greater discount exposure
12 (leakage), by adjusting the thresholds following the first year of the agreement, using a
13 formula based on the percentage change in the number of credit card accounts held by
14 WMB. For example, if the number of accounts were currently at an annual volume level
15 of 10 million pieces, and were to increase to 12 million pieces, then the volume
16 threshold would be adjusted upward by 20 percent.

17 The logical correlation between accounts and statement volume will allow the
18 Postal Service to use the threshold adjustment to mitigate the risk that exogenous
19 factors will result in threshold levels that do not provide the appropriate incentive for
20 marketing mail. As noted in the Declaration of Michael K. Plunkett in Docket No.
21 MC2004-3 (pages 13 to 16), growth in marketing mail volume correlates highly with
22 growth in the number of accounts. Based on data from previous and current NSA

1 discussions the correlation coefficient between account growth and marketing mail
2 volumes is 0.78. This would indicate a marked degree of correlation.

3 The exogenous factors that drive the growth in accounts, such as reduction in the
4 cost of credit (e.g., decline in interest rates) or increase in quantity demanded (e.g., rise
5 in household income) also drive up mail volume. Therefore, by adjusting the threshold
6 upward based on the growth in the number of accounts, we are in effect controlling for
7 the impact of exogenous factors that would result in an increase in the Before Rates
8 volumes. Hence, even if an exogenous factor would cause an increase in mail volume
9 that we did not anticipate, the agreement provides a mechanism to correct the volume
10 threshold. This self-correction occurs in the second and third year of the agreement.

11 **D. Adjustments for Merger, Acquisition or Purchase of a Portfolio**

12 As noted in the Bank One Negotiated Service Agreement, “[t]he Commission
13 considers merger and acquisition clauses a necessary component of this style of
14 Negotiated Service Agreement to protect the Postal Service.”⁶ Section II.G. of the
15 agreement (the mergers and acquisitions clause of this NSA) provides the sophisticated
16 protections to prevent against volume growth resulting from mergers. This language,
17 which is preferred by the Commission, provides adequate safeguards.

18 **E. Termination and Penalty Clauses**

19 The WMB agreement includes termination and penalty clauses that ensure that
20 the NSA is employed in a manner that is consistent with the intentions of the parties.
21 The penalties ensure that tangible financial penalties are associated with any
22 breakdowns in the implementation of the agreement.

⁶ PRC Op. MC 2004-3 at 71.

1 The penalty clause of \$250,000 associated with the solicitation commitment
2 ensures that WMB will utilize First-Class Mail as its primary marketing medium for the
3 majority of the forecasted solicitation mail volumes.

4 In addition, the Postal Service has an unencumbered option of terminating the
5 agreement with 30 days notification. This provision attempts to satisfy previously
6 expressed concerns that the Postal Service would be obligated to remain a party to an
7 NSA agreement that harmed the financial standing of the Postal Service. This liberal
8 termination right for the Postal Service alleviates such concerns.

9 **F. Address Correction Service**

10 The WMB NSA also requires the adoption of Change Service Request (CSR)
11 Option 2 for all WMB solicitation pieces. Similar to the requirements in previous NSAs,
12 this provision benefits the Postal Service by replacing the physical return of First-Class
13 Mail solicitation pieces with electronic notice.

14 In addition, the agreement requires WMB to convert to OneCode ACS within a
15 commercially reasonable period of time once available. OneCode ACS incorporates the
16 participant code and auxiliary requests into the new barcode system that will be
17 introduced by the Postal Service. Incorporating the data into the barcode will free up
18 envelope space for WMB mail and will automate some ACS transactions. As in
19 previous cases, WMB cannot use the ACS notices to comply with its Move-Update
20 requirements, and must use the ACS notices to update its mailing databases.

21 The Postal Service did not include the savings from WMB's conversion to ACS
22 as a functional element because WMB has made it clear during discussions that the

1 imposition of a cap based on cost savings would prevent WMB from implementing the
2 agreement.

3 **G. Other Terms and Conditions of the WMB NSA**

4 The WMB NSA incorporates a variety of other terms and conditions beneficial to
5 the Postal Service. Such requirements include:

- 6 • WMB waiving the seal against postal inspection of mail;
- 7 • WMB preparing mail under applicable standards;
- 8 • WMB enhancing its address management practices;
- 9 • WMB making necessary records and data available to the Postal Service
10 to facilitate and monitor compliance with the agreement; and
- 11 • the parties limiting the subject matter of the agreement to WMB's credit
12 card products and credit card services.

13 **IV. EVALUATION OF VOLUME FORECAST**

14 **A. Background**

15 In my role with Pricing Strategy, I have helped develop and implement a set of
16 qualitative and quantitative tools used to evaluate mail volume forecasts provided by
17 mailers such as WMB when seeking an NSA.

18 Over time, the Postal Service has learned a considerable amount about the
19 factors that influence demand for mail in the credit card industry. It has developed
20 expertise in this area through its own independent research, its experience with other
21 NSAs such as the Capital One and Bank One agreements, and a multitude of
22 discussions with other banks and financial firms. Even before we began to negotiate
23 the WMB NSA, we had compiled, developed, and analyzed the factors likely to affect

1 Standard Mail and First-Class Mail volumes; and had developed extensive knowledge of
2 how credit card companies work and how they communicate with, acquire, and retain
3 customers through use of the mail and other channels. After the commencement of
4 negotiations with WMB, the Postal Service performed extensive additional research on
5 the company using data from Postal Service systems and from publicly available
6 sources.

7 In order to gauge the reliability of a company's Before Rates forecasts, the Postal
8 Service has based evaluations on a combination of:

- 9 • Analysis of volume trends,
- 10 • Analysis based on economic variables,
- 11 • Analysis based on growth in accounts,
- 12 • Research and discussions with analysts, and
- 13 • Analysis of the company's responses during negotiations.

14 Each of these processes produces a range of forecasts that we attempt to incorporate
15 into our analysis. However, each individual technique cannot be evaluated
16 independently. The results must be evaluated in terms of qualitative analysis.

17 As the Postal Service gains experience in negotiating more and more NSAs, we
18 are able to further refine and supplement our methodologies for evaluating forecasts
19 with greater precision and accuracy. In addition, we continually incorporate new data
20 and data sources to improve our forecasts. While no model offers the promise of
21 perfection, when paired with the guaranteed volumes and risk mitigating factors
22 discussed above, the possible advantages of this NSA outweigh the unlikely potential of
23 an incorrect analysis.

1 The Postal Service believes that customers stand in the best position to provide
2 a specific and accurate point-estimate of future mail volumes required for this mail
3 classification process. To confirm these estimates provided by customers, the analysis
4 described within my testimony provides ranges in which WMB's forecast should fall
5 paired with a sensitivity analysis measuring where the Before Rate forecast lies in
6 relation to these ranges. The process of evaluating WMB's forecast is an iterative
7 process that continues through the course of our NSA negotiations.

8 Before engaging in any formal discussions, we require potential NSA partners to
9 provide forecasts for the entire period of the proposed NSA. Many of the initial
10 forecasts provided by customers to satisfy this requirement are based on volume
11 trends. Once a customer has entered negotiations and has built an internal business
12 case for pursuing an NSA, however, the customer will develop a more detailed forecast
13 that incorporates data from its various individual business lines.

14 As in all negotiations, WMB and the Postal Service had asymmetrical
15 information. To improve the Postal Service's bargaining position, we apply our
16 analytical tools for generating additional information about our potential NSAs partners
17 and use them to test and assess their negotiating positions. We also use these tools
18 during our discussions with potential NSA partners to assess the risks and benefits of
19 various negotiating positions. Throughout this process, we identify potential risks to the
20 profitability of the deal and seek various contractual obligations from the NSA partner to
21 mitigate such risks, as described in Section III of this testimony.

22 Once the parties have negotiated an agreement, the NSA undergoes a rigorous
23 internal review process at the Postal Service, including review by a cross functional

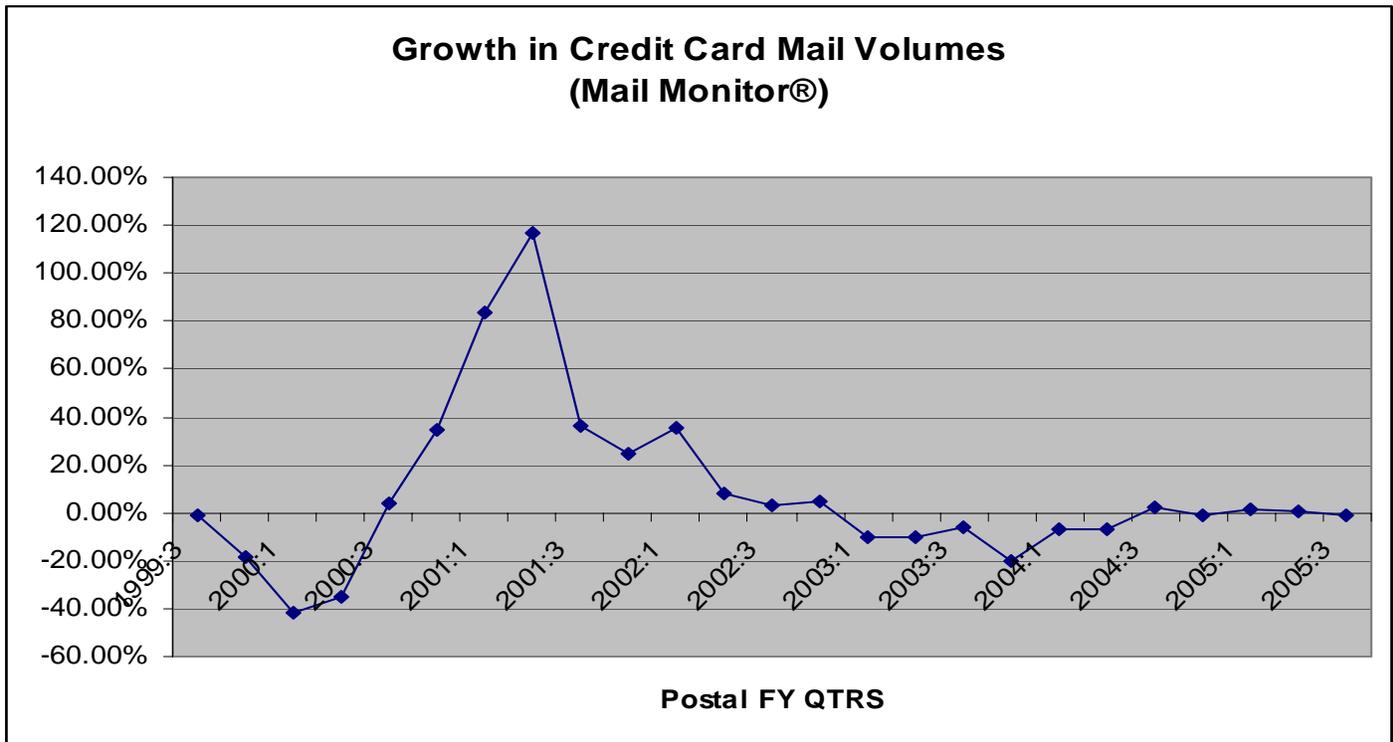
1 group of managers and executives. It must then be approved by the Board of
 2 Governors.

3 **B. Analysis of Credit Card Mail Volumes**

4 The Postal Service utilizes a variety of internal and external data sources in
 5 developing our understanding of the credit card industry.

6 Total credit card solicitation volume estimates vary across data sources;
 7 however, the consistent trend from all sources indicates that credit card solicitation mail
 8 volume growth rates are stable and that the total volume of solicitations should not vary.

9 The Postal Service does not expect growth due to various market conditions
 10 such as: consolidation within the industry, rising interest rates, a weaker economy,
 11 lower response rates and market saturation.



12
 13 Graph 1 above illustrates that growth in total credit card mail volume within this
 14 sector has slowed and stabilized at lower rates than the past. The Postal Service

1 believes this trend will continue in the immediate future. The recent wave of mergers in
2 the industry suggests that credit card issuers such as WMB have reached a more
3 mature point in the life-cycle of their products. As a result of such maturity, the Postal
4 Service expects new growth in this segment to develop through other means than new
5 customer acquisition.

6 In addition, the top 10 card issuers, which include WMB, account for more than
7 95 percent of the total credit card solicitation volume. Individual card issuers may
8 experience significant growth in mail volume in contrast to our observation of the total
9 card solicitation market. More likely candidates for such growth would have different
10 economic and market variables than the overall market.

11 It is our opinion WMB will most probably have an increase in overall mail volume
12 that will not mirror the industry trend due to changes in their market and economic
13 conditions. However, the Postal Service believes that any such increases, if realized,
14 would result in the majority of growth occurring in Standard Mail rather than First-Class
15 Mail.

16 As described in Chart 1 in Section III of my testimony, Standard Mail accounts for
17 the current majority of credit card solicitation volume. According to the most recent
18 data, the mix of Standard Mail to First-Class Mail between January 2005 and February
19 2005 shows Standard Mail is an estimated 83 percent of total solicitations. Clearly, the
20 industry utilizes Standard Mail as the preferred medium to acquire new customers.

21 Furthermore, based on comparisons of internal data sources from previous and
22 current NSA discussions as well as internal and external sources, the Postal Service
23 has not identified a single credit card mailer (outside of WMB) that sends more than 50

1 percent of its acquisition volume as First-Class Mail. Current matrices demonstrate a
2 migration away from First-Class Mail to acquire new customers in favor of Standard
3 Mail.

4 WMB's historical mail profile mirrors this trend toward Standard Mail, which
5 makes its commitment to marketing through First-Class Mail a significant change within
6 the industry. WMB's migration to First-Class Mail is, in our view, clearly attributed to the
7 incentives possible under this NSA.

8 In addition, factors such as the recent postage rate hikes, increases in ancillary
9 postage related costs, and rising interest rates amplify the total per customer acquisition
10 cost. Mailers' efforts to lower such per customer costs will serve to increase the
11 representative entities within this category of mailers that transition more mail to
12 Standard Mail from First-Class Mail. Considering these trends, a commitment to either
13 500 million First-Class solicitation pieces or 90 percent of total marketing volume in
14 First-Class Mail would prove highly unlikely without the incentives of this NSA.

15 **C. USPS Analysis of WMB Before Rates Forecasts**

16 As a first step in analyzing the potential mailing activities of a company like WMB,
17 the Postal Service gathers simple trend analysis to evaluate specific volume forecasts.
18 This analysis forecasts mail demand solely as a function of time. We do not include in
19 our trend analysis any modifications for economic, demographic, legislative, policy,
20 technological, seasonal, or other market specific variables.

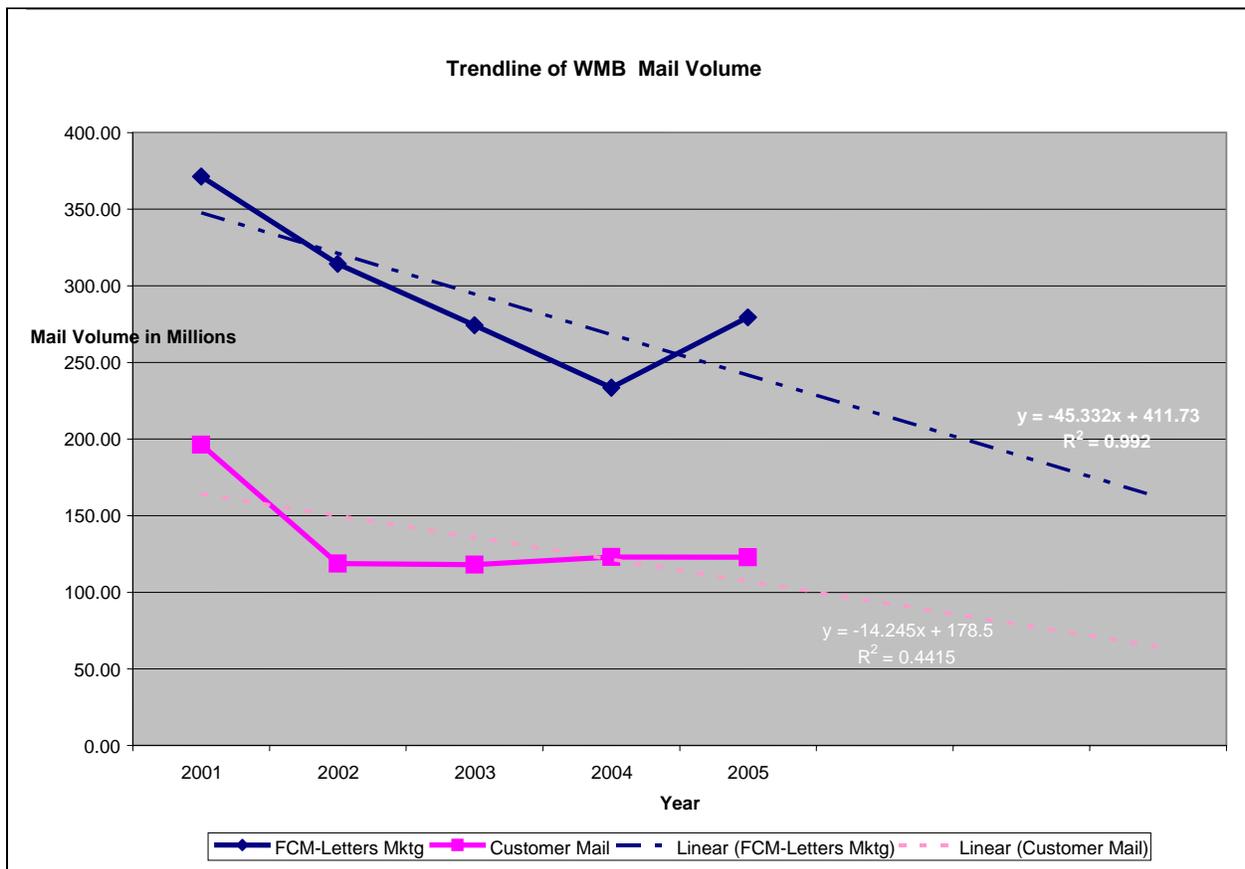
21 Based on historical volumes, we extrapolate the bank's mailing history in a linear
22 fashion into the future creating a basic snapshot of a company's historical profile. This
23 serves as the Postal Service's starting point for discussions with potential NSA

1 candidates. In past filings, these data provided a cross-check of the forecasts
 2 requested by the Postal Service from each company.

3 The trend-line of WMB's First-Class Mail marketing and statement volume
 4 indicated a downward trajectory. The R^2 of 0.992 for WMB's First-Class Mail marketing
 5 volumes would also suggest that this decrease may continue.

6 Based on the trend analysis of WMB's First-Class Mail volume, the data
 7 appeared to support the observation that WMB's First-Class Mail marketing volume is
 8 shrinking. The

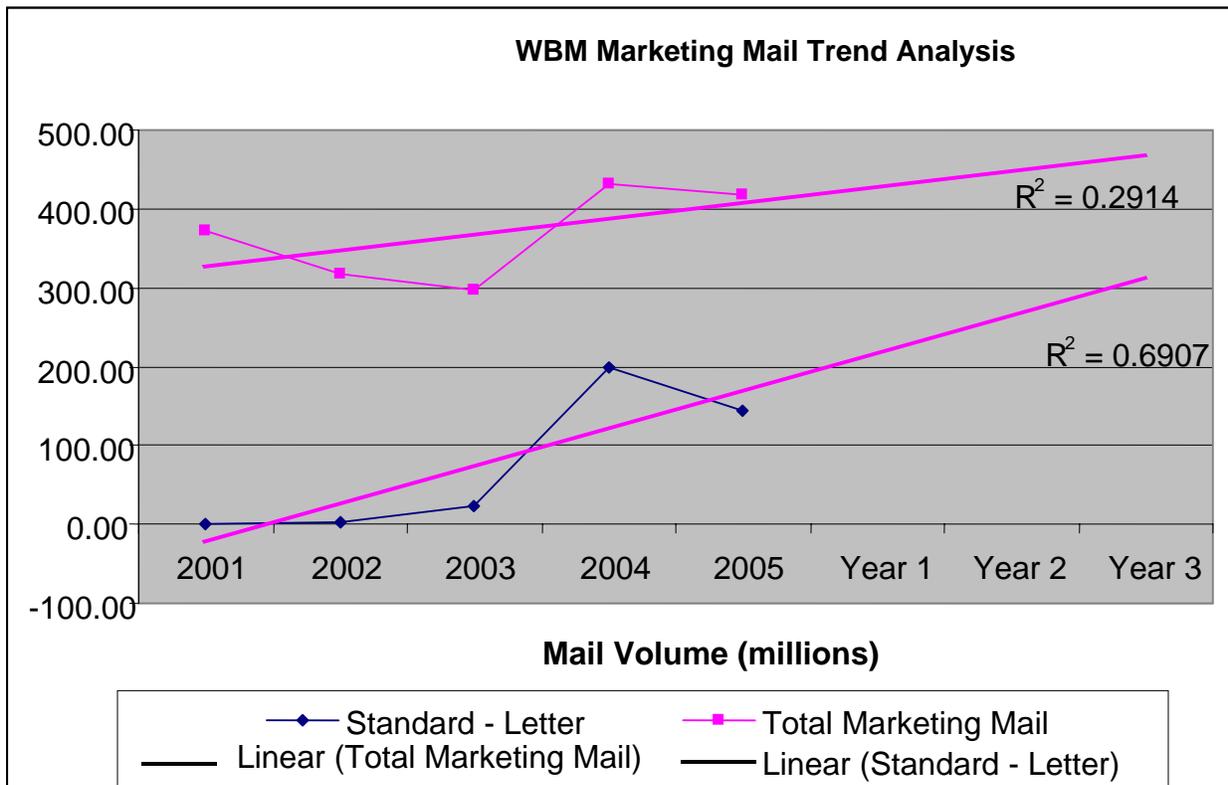
9



10

11 Postal Service also analyzed WMB Standard Mail marketing volume and total marketing
 12 volume to develop a basic framework of WMB's total marketing trends.

1 Based on a linear regression, the trend analysis of Standard Mail volumes
 2 indicates that Standard Mail volumes will continue to grow. The linear trend for Standard
 3 Mail had an R^2 of 0.69. Furthermore, the trend reveals that total marketing mail
 4 volumes for WMB should grow at a slight rate.



5
 6 The Postal Service's due diligence confirms the trend toward little or no growth in
 7 total marketing mail volume in the credit card industry. We recognize that a simplified
 8 trend analysis ignores exogenous factors such as pricing changes, interest rates,
 9 bankruptcy rates, competitors' strategies, unemployment rates and a host of other
 10 variables; however, this trend analysis merely provides a starting framework for
 11 understanding the mailing profile of WMB and a useful cross-check of the company's
 12 short-term forecasts.

1 With this trend analysis, the Postal Service commenced discussions to identify
 2 the factors responsible for the shift from First-Class Mail to Standard Mail, which
 3 identified postage rates, declining response rates, and customer acquisition strategies as
 4 the key drivers for the shift.

5 The merger of Providian and WMB provided another important factor as a result
 6 of WMB card services group's acquisition of 19.5 million customers. Assertions from
 7 similarly situated industry players, and the knowledge gained from past NSAs has
 8 revealed that the quality of a credit card company's mailing list highly correlates with the
 9 class of mail chosen for marketing.

10 The Postal Service also analyzed public comments issued by WMB, such as its
 11 Fourth-Quarter Card Services and 2005 Year-End reports. Such information reveals that
 12 Card Services will intensify its focus on cross-selling products to other WMB customers.
 13 In light of this cross-selling initiative, WMB will be using established addresses it knows
 14 are valid. As a result, the use of First-Class Mail under this schema would prove less
 15 attractive to WMB because the benefits of using First Class Mail, such as the forwarding
 16 and return of mailpieces, would prove less valuable. This also is consistent with the
 17 migration from First-Class Mail to Standard Mail that we have seen in the past two years,
 18 and strengthens our projections of WMB's natural move toward Standard Mail in lieu of
 19 First-Class Mail utilization absent the incentives provided under the NSA.

20 The Postal Service identified correlations of marketing mail volumes with
 21 company specific variables and
 22 market or industry variables. Based
 23 on previous NSA discussions and

Correlation Table 1	FCM-Letters Mktg
Customer Mail	0.8898
Total Marketing Mail	-0.4362
Total Solicitation and Advertising Spend	0.8941
Net Income	-0.9812
Reported Delinquency Rate	0.6433
Managed Delinquency Rate	0.5461
Total Number of Customers	0.9158

1 analysis the variables identified in Table 1 and Table 2 impact mail volumes.

2 The general results of the company specific variables shown in Correlation Table
3 1 were consistent with results observed in previous NSA cases within the same industry
4 with some anomalies.

5 Previously, net income and delinquency rates correlated more positively with
6 both total marketing volume and First-Class Mail marketing volumes. Furthermore, for
7 the market and industry variables, we found differences between information garnered
8 from previous discussions and this analysis. For example, CPI and charge-off rates
9 correlated more positively than identified in this analysis.

10 Despite these few differences, the Postal Service's analysis remains accurate

Correlation Table 2	FCM-Letters Mktg	Standard – Letter
<i>Employment Cost Index 1</i>	0.0756	-0.134
<i>Charge-Off Rates 2</i>	-0.122	-0.442
<i>Bankruptcy Filings 3</i>	0.009	0.327
<i>Average Hourly Earnings of Production Workers</i>	-0.356	0.507
<i>Bank Prime Interest rates 2</i>	0.526	-0.302
<i>Consumer Price Index</i>	-0.288	0.540
<i>Unemployment rates</i>	-0.4641	0.056
<i>Federal Funds rate</i>	0.529	-0.297
<i>Consumer Credit Outstanding 6</i>	-0.357	0.426
<i>Retail and food services sales, Total</i>	-0.340	0.311

11 and the anomalies can be understood when one includes the non-quantifiable events in
12 the regulatory environment, and applies them to WMB's marketing strategy.

13 Historically, WMB (or more precisely, the former Providian) focused on the
14 standard market segment, which they identified as, "higher risk and generally
15 underserved customers who might not ordinarily qualify for credit cards, including

1 customers with past credit card problems or limited credit history.”⁷ Based on previous
2 discussions and examinations of credit card volumes, a significant portion of total First-
3 Class Mail marketing volumes targeted this segment of the population.

4 Regulatory and legislative changes in 2001 and 2002 required Providian to
5 reevaluate its marketing strategies.⁸ Based on these legislative restrictions, as noted in
6 Providian’s 2003 10-K, the company “suspended new account marketing to customers in
7 our highest risk standard market segment, and we are currently refocusing our business
8 on the middle and prime market segments.” The legislative requirements, along with the
9 merger with WMB are consistent with the company’s claim regarding the improbability of
10 any large-scale migration back to First-Class Mail as a marketing channel.

11 As in the past, the Postal Service has determined that the active number of
12 customer accounts strongly affects both operational and marketing mail volumes.
13 Forecasting mail volumes through such tangible criteria diminishes the need to use a
14 variety of macro and micro economic variables, and provides insulation against factors
15 that cannot be modeled, such as regulatory environments.

16 The correlation between account growth and total marketing mail volume
17 remains a valid reflection of this mailing segment despite unforeseeable factors that
18 could affect the mail mix. According to industry reports, direct mail accounts for the
19 majority of customer acquisition for credit-card issuers (upwards of 90 percent), thereby
20 confirming the Postal Service’s assertion that demand for total marketing mail mirrors
21 account growth strategies.

⁷ Providian Annual Report 2003 page 26 and Annual Report page 31.

⁸ Providian Annual Report 2004 at 27.

1 Analyst reports surveyed in our company research indicate that the expected
 2 number of net new customers that WMB is forecasted to acquire has a high estimate of
 3 1.3 million per year. Additionally WMB is expected to market additional card features to
 4 their existing customer base. These changes we expect to result in a combined estimate
 5 of 2 million customers. Furthermore, the average response rates for a credit card
 6 solicitation fall between 0.3 percent and 0.4 percent, according to our data sources.

7 Accordingly, the Postal Service projects that

8 WMB would have to mail between 500
 9 million total marketing pieces and 666 million
 10 total marketing pieces in order to acquire its
 11 targeted number of customers and
 12 transactions.

# of New Customers	0.30%	0.40%
1,000,000	333,333,333	250,000,000
1,250,000	416,666,667	312,500,000
1,500,000	500,000,000	375,000,000
1,850,000	616,666,667	462,500,000
2,000,000	666,666,667	500,000,000
2,250,000	750,000,000	562,500,000
2,500,000	833,333,333	625,000,000
2,750,000	916,666,667	687,500,000
3,000,000	1,000,000,000	750,000,000

13 Chart 3 (Number of New Customers)

14 shows the amount of total marketing pieces needed to acquire new customers based on
 15 the previously stated response rates. For this purpose, we have assumed that a
 16 transaction to an existing card holder still qualifies as a new customer. The calculation is
 17 simply the Number of New Customers divided by Response Rates.

18 The estimates of mail volume at a 0.4 percent response rate would tend to
 19 indicate lower total mail volumes than projected by WMB. Thus, it is more likely that
 20 WMB's total response rate is lower than 0.4 percent. This inverse relationship implies
 21 that as response rates rise, WMB needs less mail to acquire those customers. Given the
 22 ranges identified, the Postal Service believes that the forecasts provided by WMB
 23 accurately reflect the environment within which it is operating.

1 The amount of capital available for acquiring new customers also constrains
 2 WMB's mail mix profile. Based on WMB's historical marketing budgets and postage
 3 spent, the Postal Service has determined
 4 a ratio 40 percent of

Table 5		Mail Volume Estimate		
Percent of FCM	680,000,000	650,000,000	600,000,000	
80.00%	\$204,000,000	\$195,000,000	\$180,000,000	
70.00%	\$195,840,000	\$187,200,000	\$172,800,000	
60.00%	\$187,680,000	\$179,400,000	\$165,600,000	
50.00%	\$179,520,000	\$171,600,000	\$158,400,000	
40.00%	\$171,360,000	\$163,800,000	\$151,200,000	
30.00%	\$163,200,000	\$156,000,000	\$144,000,000	
20.00%	\$155,040,000	\$148,200,000	\$136,800,000	
10.00%	\$146,880,000	\$140,400,000	\$129,600,000	

5 postage to overall
 6 marketing
 7 expenditures.
 8 According to analyst
 9 reports, discussions
 10 and annual reports reviewed by the Postal Service, WMB's marketing budget could
 11 reach \$400 million. If 40 percent of this budget were allocated to postage, then postage
 12 expenditures would reach \$160 million.

13 Table 5 illustrates the total postage expenditure based on the percentage of
 14 First-Class Mail at the mail volume ranges identified previously. The percent of First-
 15 Class Mail multiplied by the Mail Volume Estimate calculates WMB's postage
 16 expenditures at different percentages of total First-Class Mail volume. For example, at
 17 680 million total acquisition pieces, the Postal Service believes a maximum of 30 percent
 18 could be mailed using First-Class Mail. Otherwise, a higher rate of First-Class Mail
 19 would exceed the ranges of historical postage expenditures.

20 Based on this analysis, one can assume that if WMB mailed the forecasted 644
 21 million pieces, that the upper limit for First-Class Mail would be 40 percent. The point-
 22 estimates provided by WMB fall within this range, which is consistent with the Postal
 23 Service's analysis.

1 **V. FINANCIAL IMPACTS**

2 **A. Value Factors/Elements**

3 The WMB NSA contains two factors affecting its value calculation: new volume
4 contribution and discount exposure (leakage).

5 Volume contribution from new volume generated by the NSA represents the key
6 value driver for the Postal Service. To determine this calculation, the Postal Service
7 utilizes the following inputs: per piece contribution of First-Class Mail, per piece
8 contribution of Standard Mail, and the percent of new First-Class Mail marketing mail
9 converted from Standard to First-Class Mail.

10 As WMB Witness Rapaport explains, the price incentives in this NSA are
11 expected to produce a First-Class Mail volume response of 263 million pieces in Year
12 one, 275 million pieces in Year two, and 285 million pieces in Year three of the
13 agreement. The new contribution associated with this increased First-Class Mail
14 volume is offset by substitution leakage that results from the loss of contribution from
15 Standard Mail pieces converted to incremental First-Class Mail marketing pieces.

16 To be conservative, the Postal Service has estimated that 100 percent of
17 incremental volume would be converted from Standard Mail. During discussions, WMB
18 indicated that it expects new incremental growth in First-Class Mail. Furthermore, the
19 Postal Service has assumed that the rates that WMB will pay on its mail volume will
20 remain constant over the three-years of the agreement.

21 The expected discount exposure represents the final value driver. The discount
22 exposure could lower the value of the NSA if price incentives get applied to any volume
23 that would have occurred without a price incentive. As described by witness Eakin,

1 setting a threshold below forecast volume is economically efficient because it reduces
2 the mailer's marginal price of First-Class Mail relative to other forms of solicitation, and
3 reduces the gap between marginal price and marginal cost of the mailer's First-Class
4 Mail.⁹

5 The Postal Service does not believe that discount exposure will occur in the first
6 year of the agreement. The threshold adjustment in the second and third years of the
7 agreement will limit any risk from discount exposure in those years.

8 The value to the Postal Service of the WMB agreement, when considering value
9 drivers, over the three years of the NSA, is as follows:

10	Increased contribution (less incremental discounts):	\$47.6 million
11	Discount exposure:	(\$2.3) million

12 The agreement therefore would result in a net benefit to the Postal Service of
13 \$45.3 million over the life of the NSA. This valuation assumes that there is no
14 adjustment in the threshold in Year 2 and Year 3 of the agreement. Appendix A
15 provides a detailed analysis of this financial impact.¹⁰

16

17 **B. Financial Model**

18 The analysis provided in the valuation model of the WMB NSA complies with the
19 guidelines established under Rule 193(e). The requirements outlined by the
20 Commission include a total assessment of the financial impact of all factors of the

⁹ MC2002-2, USPS-RT-2 at 4-5, Tr. 10/2069-70.

¹⁰ Contractually WMB can mail up to 10 percent of its marketing volume Standard Mail. For simplicity purposes the model assumes no net change in the total number of marketing pieces.

1 agreement. The cost numbers utilized in calculating the value are based on the costs
2 provided in Docket No. R2005-1.

3 The spreadsheets chart a simple calculation of the effects of converting Standard
4 Mail solicitation volumes to First-Class Mail. The only other outputs of the model
5 include any exposure (leakage) and the total incremental discounts. Appendix B more
6 fully describes this model.

7 Use of the contingency factor represents one of the key differences in
8 assumptions in variables in Appendix A from those in previous NSAs. The use of this
9 contingency factor is consistent with the contingency factor used in Docket No. R2005-
10 1.

11 In addition, as described in Appendix B, the Postal Service applies a 4 percent
12 annual inflationary cost adjustment factor to estimate unit costs for each year of the
13 agreement. This cost adjustment factor provides a better estimate of the value of the
14 NSA in the out-years of the agreement as requested by the Commission,¹¹ and mirrors
15 adjustment mechanisms of previous NSAs.

16 **C. Sensitivity Analysis**

17 The concern in developing NSAs has centered on the argument that exogenous
18 factors may cause a substantial increase in a customer's mail volume, thereby
19 eliminating the need for incentives to increase mail volumes. The concern as described
20 by the Commission is that there is a "risk of losses from discounts on mail that would

¹¹ 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.

1 have been sent without the agreement.”¹² While the Commission has expressed
 2 concerns that the Before Rate Mail volumes projected by the customer and vetted by
 3 the Postal Service might be understated by a significant volume, such concerns have
 4 not materialized. Indeed, the Postal Service has attempted to point to exogenous
 5 factors that might affect mail volumes, and has attempted to mitigate these risks through
 6 the terms of this NSA.

7 In developing the sensitivity analysis, the Postal Service believes that most of the
 8 factors that are likely to influence mail volume will impact solicitation volume. Customers
 9 have more leeway in making marketing decisions affecting mail than in identifying
 10 whether to mail a statement. Statement mail is directly correlated to the number of
 11 customers. It is highly unlikely an incentive will encourage a mailer to send statement
 12 volume that exceeds its customer base. For this reason, we deal with variability only
 13 with regard to marketing mail.

14 Table 5 illustrates the impact on WMB if it
 15 were to increase its First-Class Mail marketing
 16 volumes in the absence of an NSA. The table
 17 illustrates that for WMB to increase its First-Class
 18 Mail marketing volumes, it would require double
 19 digit growth rates. As described previously, the
 20 Postal Service does not believe that WMB will be
 21 able to increase its First-Class Mail volumes by the rates in Table 5 without the
 22 incentives offered by this NSA.

Table 5 (millions)		
Marketing Volume	Growth in Marketing Volume	Total Increase in Postage Expenditure
330.0	-	-
380.0	15.15%	\$16.22
430.0	30.30%	\$32.45
480.0	45.45%	\$48.67
530.0	60.61%	\$64.89
580.0	75.76%	\$81.12
630.0	90.91%	\$97.34
680.0	106.06%	\$113.56

¹² PRC Op. MC2004-3 at 4.

1
2 Higher than expected leakage would accompany an underestimation of the
3 Before Rates, which would lower the potential
4 value of the agreement if one assumes no
5 increase in the after-rates volume.

6 Table 6 illustrates that the NSA would
7 have little value to the Postal Service if WMB's
8 First-Class Mail marketing Before Rates volume
9 reaches 480 million pieces or 45 percent higher
10 than current volumes.

Table 6 (millions)		
Marketing Volume	Total First-Class Mail Volume	USPS Value
330.0	450.0	16.1
380.0	500.0	11.0
430.0	550.0	5.8
480.0	600.0	0.6
530.0	650.0	(4.6)
580.0	700.0	(9.7)
630.0	750.0	(14.9)
680.0	800.0	(20.0)

11 However, no evidence suggests that an exogenous factor might impact WMB's First-
12 Class Mail marketing volume that might increase their First-Class Mail mix to that level.

13 There is some level of variability that exists in all processes and forecasts. The
14 WMB forecast should also be expected to have some variability around the point
15 estimate provided. An important part of the Postal Service analysis is to identify the
16 sources of variability, whether technical or financial, and to manage and reduce the
17 variability. Certainly, the analysis, the tools used, and the risk mitigation provisions in
18 the agreement insulate the Postal Service from excessive variation that could cause an
19 adverse material impact on the Postal Service's valuation of the agreement.

20 **VI. RETURN VOLUME**

21 **A. Basis for Not Including Cost Savings**

22 The Postal Service recognizes that by not including the savings from ACS,
23 the overall value of the agreement is understated. The Commission's imposition of stop-

1 loss caps specifically linked to the ACS savings in previous NSAs has signaled that the
2 Commission recognizes that converting to ACS provides tangible savings. Based on
3 Commission precedent, the Postal Service believes including ACS as a contractual term
4 benefits the Postal Service because of the implied benefits of ACS on First-Class Mail
5 marketing pieces. If required contractually, the application of ACS on both existing
6 First-Class Mail marketing volume and potential volume that converts from Standard
7 Mail would only increase the value of the NSA.

8 The increased costs associated with undeliverable as addressed (UAA) mail from
9 converted Standard Mail are included in the After-Rates First-Class Mail solicitation unit
10 cost estimates. This ensures that we include the costs associated with ACS in our
11 valuations.

12 The Postal Service believes that the financial value and impact of the agreement
13 must be evaluated on the basis of the increase in First-Class Mail volumes. The
14 provision of ACS to First-Class Mail, as evidenced in previous NSAs, illustrates that the
15 ACS component of this agreement will afford immediate savings to the Postal Service.

16 **B. Return Cost Savings**

17 Similar to the Capital One NSA, in lieu of receiving physical returns, WMB will
18 accept electronic information for address changes or corrections. This provides cost
19 savings to the Postal Service by replacing physical returns with the less costly
20 transmission of electronic information. The estimated Capital One physical and
21 electronic return unit costs described in USPS-LR-1/MC2002-2 are updated with
22 associated cost numbers from Docket No.R2005-1.

1 To calculate the cost savings, the expected volume of WMB's UAA mail is
 2 multiplied by the unit cost savings for each piece processed through the ACS.

3 Table 4 below shows the calculation of the cost savings associated with
 4 conversion of WMB Before Rate First-Class Mail marketing volume to ACS. The unit
 5 cost estimates are based on Docket No. R2005-1 LR-K-59 Attachment 14b. The costs
 6 are inflated by 4 percent per year in Year 2 and Year 3.

7

Table 4: Physical vs. Electronic Cost	Year 1	Year 2	Year 3
Physical Return Cost	\$0.484	\$0.503	\$0.523
Electronic Return Cost	\$0.310	\$0.322	\$0.335
Savings per Piece	\$0.174	\$0.181	\$0.188
Return Rate	4.5%	4.5%	4.5%
BR Marketing Volume (millions)	330	350	370
UAA Marketing Volume Captured by ACS (millions)	12.6	13.4	14.2
Total Savings (millions)	\$2.2	\$2.4	\$2.7

8

9 The cost savings identified above are based only on cost savings associated with
 10 current First-Class Mail marketing volumes. If the belief is that there will be a shift of
 11 WMB's entire Standard Mail portfolio without the need for an incentive this would result
 12 in significantly higher savings under the terms of the agreement, This would account for
 13 savings of approximately \$10 million over the course of the agreement.

14 **C. Incentive for OneCode ACS**

1 The WMB NSA requires conversion to OneCode ACS. OneCode ACS will
2 eliminate the need for a participant code in the address box by incorporating the ACS
3 requirements into the new bar-code system.

4 ACS transactions processed in a OneCode environment will be more efficient to
5 process, and should lead to the differential between electronic and physical returns
6 increasing once implemented.

7 Although the Postal Service does not have current estimates of savings based on
8 the conversion to OneCode ACS, no implementation of the service would occur without
9 foreseeable benefits to the Postal Service.

10 **VII. COMPETITIVE IMPACT ANALYSIS**

11 In the baseline proceeding involving Capitol One, the Commission found little
12 impact on competition, particularly because no competitors within the credit card
13 industry opposed the NSA. Similarly, this NSA should not prove detrimental to
14 competitors. Indeed, some of the WMB's most fervent competitors have entered into
15 NSAs, which can only serve to lower the possibility of detriment to competitors or
16 opposition to this NSA from one of them. Further, in light of this NSA's filing as a
17 baseline, the Postal Service stands ready to offer like terms of this agreement to any
18 similarly situated company.

19 With each NSA approved within this industry, the pool of possible disadvantaged
20 competitors diminishes. In addition, as a baseline that highlights First-Class Mail, it
21 mirrors similar incentives for growth of First-Class Mail in other NSAs.

1 **VIII. CLASSIFICATION AND RATE CRITERIA OF THE ACT**

2 Section 3623 of Title 39, U.S. Code, requires that the Commission evaluate
3 proposed changes in the classification schedule in accordance with the policies of the
4 Title and the 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 WMB NSA:

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

26 The Postal Service believes that the customer-specific rates offered to WMB
27 more than cover the costs associated with WMB's mail, thereby meeting pricing criterion
28 1, which concerns fairness and equity, as well as pricing criterion 3, which addresses
29 the requirement to cover all costs.

30 **IX. SUMMARY AND CONCLUSIONS**

31 This testimony has described and discussed the financial and strategic
32 importance of the WMB NSA to the Postal Service. This NSA offers the Commission an
33 opportunity to recommend a baseline NSA without a stop-loss cap. The volume

¹³ Docket No. MC2002-2, USPS-T-2, page 9, line 36 – page 10, line 15.

1 guarantee, coupled with substantial migration of volume from Standard Mail to First-
2 Class Mail, make this agreement financially advantageous for the Postal Service.
3 Safeguards built into the agreement make the imposition of a cap unnecessary.
4 Moreover, as WMB witness Rapaport states, a cap would make the agreement
5 financially impractical.

6 The financial calculations developed to support the WMB NSA are based on the
7 model submitted in Docket No. MC2002-2, with analytical enhancements as
8 recommended by the Commission in Rule 193(e). The WMB NSA satisfies the
9 classification and rate criteria in the Postal Reorganization Act .

10 For these reasons, the Postal Service seeks a favorable recommendation for the
11 proposed changes to the rates, fees and classifications requested through this baseline
12 filing as they provide benefits to the Postal Service, WMB and the mailing community as
13 a whole.

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DATA AND APPENDICES

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

Washington Mutual NSA Filing Model

Appendix A:

Page 1

	Year 1	Year 2	Year 3
Return Forecast			
(1) Operational Mail (Ops)	1.0%	1.0%	1.0%
(2) Marketing Mail (Mktg)	4.50%	4.50%	4.50%
(3) USPS FCM average return rates	1.23%	1.23%	1.23%
Unit cost assumptions			
(4) Inflation cost adjustment factor	4.0%	4.0%	4.0%
(5) Manual Letter Returns Unit Cost	\$ 0.484	\$ 0.503	\$ 0.523
(6) Electronic Letter Returns Unit Cost	\$ 0.310	\$ 0.322	\$ 0.335
(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	1.00		
(1) Washington Mutual Testimony			
(2) Washington Mutual Testimony			
(3) USPS-LR-1/MC2002-2			
(4) MC2005-2			
(5) YEAR 1 R2005 LR-K-59 Attachment 14b (1 out of 1);(YEAR 2 = Year 1 * (1 + Inflation Factor)); (YEAR 3 = Year 2 * (1 + Inflation Factor			
(6) YEAR 1 R2005 LR-K-59 Attachment 14b (1 out of 1);(YEAR 2 = Year 1 * (1 + Inflation Factor)); (YEAR 3 = Year 2 * (1 + Inflation Factor			
(7) USPS witness Wilson, T4/MC2002-2			
(8) Washington Mutual Testimony			
(9) R2005-1			

Washington Mutual NSA Filing Model

Appendix A:

Page 2

	2003	2004	2005	Year 1	Year 2	Year 3
(1) First-Class Mail Volume calculations						
Before Rates						
Operational mail	118,000,000	119,000,000	122,000,000	120,000,000	125,000,000	130,000,000
Marketing mail letter	275,000,000	233,000,000	272,000,000	330,000,000	350,000,000	370,000,000
Total First-Class Mail	393,000,000	352,000,000	394,000,000	450,000,000	475,000,000	500,000,000
Standard Mail - Letters	17,000,000	181,000,000	132,000,000	314,000,000	330,000,000	345,000,000
After Rates						
Operational mail	118,000,000	119,000,000	122,000,000	120,000,000	125,000,000	130,000,000
Marketing mail letter	275,000,000	233,000,000	272,000,000	593,000,000	625,000,000	655,000,000
Total First-Class Mail	393,000,000	352,000,000	394,000,000	713,000,000	750,000,000	785,000,000
Standard Mail- Letters	17,000,000	181,000,000	132,000,000			

Washington Mutual NSA Filing Model

Appendix A:
Page 3

	(1) Volume	(2) Rates	(3) Revenue
Rate Category			
Single-Piece Letters			
First Ounces, except QBRM	-	0.390	\$ -
Qualified Business Reply Mail	-	0.358	-
Additional Ounces	-	0.240	-
Nonmachinable Pieces	-	0.130	-
Single-Piece revenue			-
Revenue Adjustment Factor (a)			1.000
(4) Total Single-Piece Postage Revenue			-
Nonautomated Presorted Letters			
First Ounce	1,663,861	0.352	585,679
Additional Ounces	-	0.225	-
Nonmachinable Pieces	-	0.058	-
Heavy Piece Deduction	-	(0.041)	-
Nonautomated Presorted Revenue			585,679
Revenue Adjustment Factor (a)			1.000
(5) Total Nonautomated Presorted Letters Revenue			585,679
Automation Presort Letters			
Mixed AADC Letters	10,387,770	0.326	3,386,413
AADC Letters	21,768,164	0.317	6,900,508
3-Digit Letters	69,645,770	0.308	21,450,897
5-Digit Letters	62,242,286	0.293	18,236,990
Additional Ounces	-	0.237	-
Heavy Piece Deduction	-	(0.043)	-
Automation Presort Letter Revenue			49,974,808
Revenue Adjustment Factor (a)			1.000
(6) Total Automation Presort Letters Revenue			49,974,808
Automation Carrier Route Letters			
First Ounce	4,351,645	0.290	1,261,977
Additional Ounces	-	0.225	-
Heavy Piece Deduction	-	(0.043)	-
Automation Carrier Route Revenue			1,261,977
Revenue Adjustment Factor (a)			1.000
(7) Automation Carrier Route Letters Revenue			1,261,977
(8) Total Company Letters Subclass			\$ 51,822,464
Total pieces			170,059,496
(9) Revenue per piece			0.305

- (a) Revenue Adjustment Factor not required because customer specific revenue is presented
- (1) CBCIS 2005 WAMU Volume Data
- (2) R2005-1 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

Washington Mutual NSA Filing Model

Appendix A:
Page 4

	(1) Volume	(2) Rates	(3) Revenue
Rate Category			
Single-Piece Letters			
First Ounces, except QBRM	-	0.390	\$ -
Qualified Business Reply Mail	-	0.358	-
Additional Ounces	-	0.240	-
Nonmachinable Pieces	-	0.130	-
Single-Piece revenue			-
Revenue Adjustment Factor (a)			<u>1.000</u>
(4) Total Single-Piece Postage Revenue			-
Nonautomated Presorted Letters			
First Ounce	61,007	0.352	21,474
Additional Ounces	-	0.225	-
Nonmachinable Pieces	-	0.058	-
Heavy Piece Deduction	-	(0.041)	-
Nonautomated Presorted Revenue			21,474
Revenue Adjustment Factor (a)			<u>1.000</u>
(5) Total Nonautomated Presorted Letters Revenue			21,474
Automation Presort Letters			
Mixed AADC Letters	31,944,126	0.326	10,413,785
AADC Letters	23,498,424	0.317	7,449,000
3-Digit Letters	159,695,294	0.308	49,186,151
5-Digit Letters	55,313,665	0.293	16,206,904
Additional Ounces	-	0.237	-
Heavy Piece Deduction	-	(0.043)	-
Automation Presort Letter Revenue			83,255,840
Revenue Adjustment Factor (a)			<u>1.000</u>
(6) Total Automation Presort Letters Revenue			83,255,840
Automation Carrier Route Letters			
First Ounce	173,399	0.290	50,286
Additional Ounces	-	0.225	-
Heavy Piece Deduction	-	(0.043)	-
Automation Carrier Route Revenue			50,286
Revenue Adjustment Factor (a)			<u>1.000</u>
(7) Automation Carrier Route Letters Revenue			50,286
(8) Total Company Letters Subclass			\$ 83,327,600
Total pieces			270,685,915
(9) Revenue per piece			0.324
(a) Revenue Adjustment Factor not required because customer specific revenue is presented			
(1) CBCIS 2004 WAMU Volume Data			
(2) R2005-1 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			

Washington Mutual NSA Filing Model

Appendix A:

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Year 1

Year 2

Year 3

Agreement Structure

Year 1			Year 2			Year 3		
Threshold		Discount	Threshold		Discount	Threshold		Discount
450,000,000	465,000,000	\$ 0.020	450,000,000	465,000,000	\$ 0.020	450,000,000	465,000,000	\$ 0.020
465,000,000	485,000,000	\$ 0.035	465,000,000	485,000,000	\$ 0.035	465,000,000	485,000,000	\$ 0.035
485,000,000	500,000,000	\$ 0.035	485,000,000	500,000,000	\$ 0.035	485,000,000	500,000,000	\$ 0.035
500,000,000	550,000,000	\$ 0.040	500,000,000	550,000,000	\$ 0.040	500,000,000	550,000,000	\$ 0.040
550,000,000	650,000,000	\$ 0.040	550,000,000	650,000,000	\$ 0.040	550,000,000	650,000,000	\$ 0.040
650,000,000		\$ 0.050	650,000,000		\$ 0.050	650,000,000		\$ 0.045

Threshold Adjustment Mechanism	YEAR 2	YEAR 3	
Initial Threshold	450,000,000	450,000,000	These inputs allow the user to model the effect of different account growth rates on the threshold. The adjustment mechanism is based on Section II Article F of the NSA contract.
Estimated Account Growth	0.00%	0.00%	
Threshold Adjustment	450,000,000	450,000,000	

Discount on volume above threshold

(1) Before Rates Forecast	450,000,000	475,000,000	500,000,000
(2) After Rates Forecast	713,000,000	750,000,000	785,000,000
Discount in first tier	\$ 300,000	\$ 300,000	\$ 300,000
Discount in second tier	\$ 700,000	\$ 700,000	\$ 700,000
Discount in third tier	\$ 525,000	\$ 525,000	\$ 525,000
Discount in fourth tier	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000
Discount in fifth tier	\$ 4,000,000	\$ 4,000,000	\$ 4,000,000
Discount in sixth tier	\$ 3,150,000	\$ 5,000,000	\$ 6,075,000
(3) Discount Earned	\$ 10,675,000	\$ 12,525,000	\$ 13,600,000

Exposure on volume above threshold

(4) Threshold	450,000,000	450,000,000	450,000,000
(5) Before Rates Forecast	450,000,000	475,000,000	500,000,000
(6) Exposed Pieces	-	25,000,000	50,000,000
(7) After Rates Forecast	713,000,000	750,000,000	785,000,000
Exposure in first tier	\$ -	\$ 300,000	\$ 300,000
Exposure in second tier	\$ -	\$ 350,000	\$ 700,000
Exposure in third tier	\$ -	\$ -	\$ 525,000
Exposure in fourth tier	\$ -	\$ -	\$ -
Discount in fifth tier	\$ -	\$ -	\$ -
Discount in sixth tier	\$ -	\$ -	\$ -
(8) Total Exposure	\$ -	\$ 650,000	\$ 1,525,000

- (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

Washington Mutual NSA Filing Model

Appendix A:

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Standard Mail Regular Revenue per piece

Mail Category	(1) Revenue per piece	(2) Volume	(3) Weighted Avg.
Mixed AADC Auto	\$ 0.231	1,219,345	281,669
AADC Auto	\$ 0.223	5,311,073	1,184,369
3-Digit Auto	\$ 0.214	71,519,721	15,305,220
5-Digit Auto	\$ 0.200	189,672,355	37,934,471
Basic Nonauto	\$ 0.282	173,630	48,964
3/5 Digit Nonauto	\$ 0.261	469,903	122,645
Total Volume		268,366,027	54,877,338
Revenue per piece			\$ 0.204 (4)

Standard Mail ECR Revenue per piece

Mail Category	Revenue per piece	Volume	Weighted Avg.
Basic Nonauto Letters	\$ 0.204	10,799	2,203
Basic Auto Letters	\$ 0.173	2,494,212	431,499
Saturation Letters	\$ 0.160	-	-
Total Volume		2,505,011	433,702
Revenue per piece			\$ 0.173 (5)

Average Revenue per piece

\$ 0.204 (6)

- (1) R2005-1 Rates Schedule
- (2) USPS Washington Mutual CBCIS Data FY 2005
- (3) (1) * (2)
- (4) Standard Mail Regular: Total Weighted Avg. / Total Volume
- (5) Standard Mail ECR: Total Weighted Avg. / Total Volume
- (6) (Standard Mail Regular Revenue + Standard Mail ECR Revenue) /
(Standard Mail Regular Total Volume + Standard Mail ECR Total Volume)

Washington Mutual NSA Filing Model

Appendix A:
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Standard Regular Unit Cost

	USPS			Washington Mutual			
	TYBR 2006 Total Unit Cost (Dollars) (1)	FY 2005 Mail Volume (Pieces) (2)	FY 2005 Mail Volume (Percent) (3)	TY 2006 Total Unit Cost (Dollars) (4)	FY 2005 Mail Volume (Pieces) (6)	FY 2005 Mail Volume (Percent) (7)	Company Avg. Letter Cost w/Contingency (Dollars) (8)
LETTERS							
Nonauto Basic	0.235	809,733,939	1.9%	0.235	173,630	0.1%	
Nonauto 3/5-Digit	0.220	697,778,977	1.6%	0.220	469,903	0.2%	
Auto Mixed AADC	0.094	2,217,147,820	5.1%	0.094	1,219,345	0.5%	
Auto AADC	0.085	2,496,325,308	5.7%	0.085	5,311,073	2.0%	
Auto 3-digit	0.081	17,989,964,663	41.4%	0.081	71,519,721	26.7%	
Auto 5-digit	0.070	19,265,167,056	44.3%	0.070	189,672,355	70.7%	
				(5)			
Total/average	0.082	43,476,117,763	100.0%	0.074	268,366,027	100.0%	\$ 0.074

Standard ECR Unit Cost

	TYBR 2006	FY 2005	FY 2005	TY 2006	FY 2005	FY 2005	Company Avg.
	Total Unit Cost (Dollars) (9)	Mail Volume (Pieces) (10)	Mail Volume (Percent) (11)	Total Unit Cost (Dollars) (12)	Mail Volume (Pieces) (14)	Mail Volume (Percent) (15)	Letter Cost w/Contingency (Dollars) (16)
LETTERS							
Nonauto Basic Letters	0.094	2,204,590,228	52.3%	0.094	10,799	0.4%	
Auto Basic Letters	0.046	2,008,138,417	47.7%	0.046	2,494,212	99.6%	
				(13)			
Total/Average	0.071	4,212,728,645	100.0%	0.046	2,505,011	100.0%	\$ 0.046

Washington Mutual Average Cost per piece

\$ 0.073

(17)

- (1) Docket No. R2005-1 (USPS-LR-K-48, USPS-LR-K-67, USPS-LR-K-119)
- (2) Docket No. R2005-1 (USPS-T-7, Attachment A, pg. 7)
- (3) Each row in (2) divided by total in (2)
- (4) (1)
- (5) (4) x (7) WAMU weighted average
- (6) CBCIS, Bookspan FY2004 volume (Appendix A, pg. 3)
- (7) Each row in (6) divided by total in (6)
- (8) Total Unit Cost (5) x Contingency Factor Assumption (Appendix A, pg. 1, (3))
- (9) Docket No. R2005-1 (USPS-LR-K-67, USPS-LR-K-84, USPS-LR-K-119)
- (10) Docket No. R2005-1 (USPS-T-7, Attachment A, pg. 7)
- (11) Each row in (10) divided by total in (10)
- (12) (9)
- (13) (12) x (15) WAMU weighted average
- (14) CBCIS, WAMU FY2005 volume (Appendix A, pg. 3)
- (15) Each row in (14) divided by total in (14)
- (16) Total Unit Cost (13) x Contingency Factor Assumption (Appendix A, pg. 1, (3))
- (17) ((8)x(6) + (16)x(14)) / ((6) + (14))

Washington Mutual NSA Filing Model

Appendix A: page

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

First Class Letter

(1) Avg Revenue First-Class Operational Letters	0.305	0.305	0.305
(2) Avg Revenue First-Class Marketing Letters	0.324	0.324	0.324
(3) First-Class Operational Letter cost per Piece Before Rates	0.079	0.082	0.086
(4) First-Class Operational Letter cost per Piece After Rates	0.079	0.082	0.086
(5) First-Class Operational Letter avg. Contribution Before Rates	0.226	0.222	0.219
(6) First-Class Operational Letter avg. Contribution After Rates	0.226	0.222	0.219
(7) First-Class Marketing Letter cost per Piece Before Rates	0.097	0.100	0.105
(8) First-Class Marketing Letter cost per Piece After Rates	0.090	0.094	0.097
(9) First-Class Marketing Letter avg. Contribution Before Rates	0.228	0.224	0.220
(10) First-Class Marketing Letter avg. Contribution After Rates	0.234	0.231	0.227

Standard Mail

(11) Standard Revenue per Piece	0.204	0.204	0.204
(12) Standard Cost per Piece	0.073	0.076	0.079
(13) Standard Mail Contribution per Piece	0.131	0.128	0.125

- (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)

Washington Mutual NSA Filing Model

Appendix A:

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	Year 1	Year 2	Year 3	Total
Contribution from New Volume				
(1) Statement Mail	\$ -	\$ -	\$ -	-
(2) Marketing Mail Letter - Converted Volume	\$ 27,287,371	\$ 28,350,803	\$ 29,185,990	84,824,164
(3) Marketing Mail Letter - New Volume	\$ -	\$ -	\$ -	-
(4) Total Exposure	\$ -	\$ 650,000	\$ 1,525,000	2,175,000
(5) Total Incremental Discounts	\$ 10,675,000	\$ 11,875,000	\$ 12,075,000	34,625,000
(6) Total USPS Value	\$ 16,612,371	\$ 15,825,803	\$ 15,585,990	\$ 48,024,164

- (1) (Statement Mail After Rates - Statement Mail Before Rates) * FCM Statement Letter avg. Contribution After Rates
 (2) Conversion Rate * (Marketing Mail After Rates - Marketing Mail Before Rates) *
 (FCM Marketing Letter avg. Contribution After Rates - Standard Mail Contribution per Piece) +
 (3) (1 - Conversion Rate) * (Marketing Mail After Rates - Marketing Mail Before Rates) * FCM Marketing Letter avg. Contribution After Rates
 (4) Total Leakage (Disc&Leak)
 (5) Discount Earned - Total Leakage (Disc&Leak)
 (6) (1) + (2) + (3) - (4) - (5) - (6)

WMB MONTHLY MAIL VOLUME

Year	Period	FCM-Letters Mktg	Customer Mail	Total First-Class Mail	Standard - Letter
2001	Jan	55,833,828	13,538,209	69,372,037	115,183
2001	Feb	52,111,573	17,594,834	69,706,407	131,778
2001	Mar	59,556,083	20,055,582	79,611,665	86,963
2001	Apr	49,592,265	20,276,521	69,868,786	85,400
2001	May	44,667,062	13,131,405	57,798,467	95,015
2001	Jun	33,500,296	13,190,388	46,690,684	54,805
2001	Jul	18,611,276	16,139,728	34,751,004	47,294
2001	Aug	22,333,531	24,270,920	46,604,451	40,054
2001	Sep	10,188,379	13,624,297	23,812,676	211,478
2001	Oct	6,597,694	13,201,543	19,799,237	238,870
2001	Nov	11,166,765	14,420,104	25,586,869	149,709
2001	Dec	7,205,983	16,819,986	24,025,969	5,006
2002	Jan	32,592,980	5,941,159	38,534,139	0
2002	Feb	13,818,508	9,967,481	23,785,989	11,781
2002	Mar	16,082,511	10,097,311	26,179,822	0
2002	Apr	30,215,322	14,196,170	44,411,492	460,391
2002	May	36,361,648	7,974,361	44,336,009	1,911
2002	Jun	13,539,852	9,787,828	23,327,680	1,780,780
2002	Jul	15,621,415	9,127,203	24,748,618	198,653
2002	Aug	44,080,715	9,608,230	53,688,945	12,395
2002	Sep	29,680,791	6,349,376	36,030,167	19,277
2002	Oct	31,768,875	12,177,801	43,946,676	372,099
2002	Nov	41,312,907	14,942,106	56,255,013	9,383
2002	Dec	9,232,191	8,527,661	17,759,852	321,051
2003	Jan	52,811,892	8,470,964	61,282,856	9,217
2003	Feb	35,566,227	10,432,787	45,999,014	4,818,607
2003	Mar	42,715,327	11,622,829	54,338,156	1,275,037
2003	Apr	43,523,896	11,729,678	55,253,574	56,208
2003	May	20,240,305	8,274,229	28,514,534	1,668,440
2003	Jun	14,684,274	8,302,754	22,987,028	2,239,078
2003	Jul	13,238,299	9,729,084	22,967,383	3,183,626
2003	Aug	7,755,313	13,661,409	21,416,722	2,955,219
2003	Sep	14,517,468	8,512,596	23,030,064	5,664,226
2003	Oct	2,684,365	8,308,148	10,992,513	2,059
2003	Nov	9,931,748	8,897,457	18,829,205	1,033
2003	Dec	16,670,182	10,058,063	26,728,245	271,688
2004	Jan	30,039,928	9,328,905	39,368,833	1,291,794
2004	Feb	13,465,324	11,080,712	24,546,036	36,267,780
2004	Mar	18,497,997	11,215,364	29,713,361	13,116,471
2004	Apr	17,745,840	10,085,125	27,830,965	20,718,717
2004	May	20,928,793	7,772,819	28,701,612	28,988,909
2004	Jun	8,248,600	11,167,177	19,415,777	22,152,033
2004	Jul	20,959,864	11,713,530	32,673,394	21,261,239
2004	Aug	24,103,743	10,746,311	34,850,054	20,161,516
2004	Sep	16,935,624	9,686,995	26,622,619	11,210,643
2004	Oct	10,630,202	10,463,034	21,093,236	15,032,419
2004	Nov	21,614,221	9,847,672	31,461,893	4,077,245

WMB MONTHLY MAIL VOLUME

Year	Period	FCM-Letters Mktg	Customer Mail	Total First-Class Mail	Standard - Letter
2004	Dec	30,410,139	9,891,358	40,301,497	387
2005	Jan	15,921,850	9,255,283	25,177,133	5,020,084
2005	Feb	20,449,031	8,116,337	28,565,368	5,010,536
2005	Mar	26,826,997	10,324,517	37,151,514	7,584,489
2005	Apr	22,820,079	9,648,216	32,468,295	5,020,810
2005	May	28,932,664	10,996,586	39,929,250	13,240,562
2005	Jun	29,989,551	12,100,709	42,090,260	15,011,019
2005	Jul	22,703,791	10,177,830	32,881,621	15,734,318
2005	Aug	23,213,596	10,222,463	31,436,060	16,047,249
2005	Sep	22,976,459	10,224,483	31,436,060	15,523,628
2005	Oct	21,106,924	9,927,976	31,034,900	15,415,850
2005	Nov	22,461,984	10,904,715	33,366,699	15,202,063
2005	Dec	21,939,200	10,990,381	32,929,581	15,997,628

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Appendix B

EXPLANATION OF FINANCIAL MODEL

The WMB 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 structures as the Capital One NSA updated with the rates and costs presented in Docket No. R2005-1. The historical and forecasted volumes are provided by WMB witness Rapaport (WMB-T-1). These inputs provide the basis for calculating the value of the NSA.

Assumptions

The assumptions contain the return rate for WMB's mail mix as provided by witness Rapaport (WMB-T-1). The inflation cost adjustment factor, which is 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 costs adjustments for letters serve as proxies in the WMB Model (USPS-LR-1/MC2002-2). Costs for Years 1, 2, and 3 of the agreement are based on Docket No. R2005-1 and are inflated in the out years of the agreement.

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. Moreover the ACS success rate is also supported by actual success rates in the implemented NSAs.

1 The WMB model assumes 100 percent of the incremental mail volume growth
2 will come from migrating Standard Mail to First-Class Mail for all marketing letters. The
3 contingency is a multiplicative factor applied uniformly to all forecasted postal costs,
4 including First-Class Mail, Standard Mail, and the physical and electronic costs of ACS.¹

5 **Volume Calculations**

6 The Volume Calculations contain WMB's mailing mix, consisting of operational
7 mail and marketing mail letters. The mailing mix for 2003 – 2005 provides a historical
8 overview of WMB's past mailing profile.

9 To illustrate the volume response to incentives, WMB witness Rapaport (WMB-T-
10 1) has provided the volume forecasts for WMB, both in the absence of an agreement
11 (BR) and in the presence of an agreement (AR).

12 **First-Class Mail Revenue Calculations**

13 The Rate Category of the model shows the First-Class Mail profile of WMB. It is
14 similar to the profile in the Capital One NSA (MC2002-2, USPS-T-3). It provides a
15 representation of the estimated revenue per piece for WMB marketing and operational
16 mail pieces based on the rates approved in Docket No. R2005-1.

17 **Operational Unit Cost and Marketing Unit Cost**

18 The cost estimates for Operational Unit Cost were built on the same assumptions
19 of the First-Class Mail Presort Letters/Flats Unit Cost Estimate of witness Crum

¹ 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 WMB 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 (MC2002-2, USPS-T-3 Atta2.xls) for the Capital One NSA. Estimates for the WMB NSA
2 differ from those of the Capital One NSA in the Test Year (TY) calculations, the WMB
3 volumes, and the total unit cost (columns 17 and 18).

4 The TY 2006 are based on the Docket No. R2005-1 filing. The cost estimates for
5 Years 2 and 3 were derived by multiplying the costs for Total Unit Cost by the
6 inflationary growth rate of 4.0 percent per year. FY 2005 Mail Volume for WMB was
7 used because it was the latest full year historical volume available. The Total Unit Cost
8 Estimates, including Contingency (Attachment A, page 4, sources 17 and 18) are equal,
9 based on the assumption that the before and after rates forecasts of operational mail
10 remain the same.

11 The Marketing Unit Cost is built on the same assumptions as the Operational
12 Unit Cost. The major difference is electronic diversion from ACS and the cost
13 differential between manual and electronic returns for UAA mail. Operational mail does
14 not receive the Change Service Requested (CSR) endorsement because it needs to be
15 physically returned to WMB. Marketing mail receives the endorsement, and information
16 is returned from UAA mail electronically 85 per cent of the time. This explains why the
17 Total Unit Cost, including Contingency, differ in sources 17 and 18 (Pg. 6); the after-
18 rates unit cost is 1.0 cent less than the before-rates unit cost.

19 **Discount and Exposure**

20 The declining block rate structure for the proposed NSA for Year 1 begins at
21 450,000,000 pieces, with a discount of 2 cents per piece. Exposure (to the Postal
22 Service) measures the discounted revenue associated with declining block rates for
23 mail volume that WMB would have mailed in the absence of the proposed NSA. WMB's

1 BR Forecast for Year 1 falls below the first tier of the discount structure. Thus total
2 exposure is zero. However if the BR forecast in any year of the agreement is higher
3 than the starting threshold total exposure is therefore calculated for by subtracting the
4 BR Forecast from the beginning threshold, and the difference is multiplied by the
5 corresponding incentive (2 cents).

6 Based on the Y1AR Forecast, WMB could achieve discounts in the first year of
7 the agreement, that amount to \$10.7 million using the same formula as exposure.
8 Discounts are given on pieces mailed above the threshold. If there is exposure in any
9 Year of the agreement, an adjustment is made to ensure that the discount is not double
10 counted. This is similar to the mechanism applied in previous NSAs. To account for this
11 double counting, the Postal Service subtracts the exposure from the discount, to arrive
12 at the incremental discount calculation. This same formula is applied to Years 2 and 3 of
13 the agreement.

14 **Standard Mail Revenue Calculations and Standard Mail Cost Calculations**

15 The Standard Mail Regular and Enhanced Carrier Route (ECR) Revenues are
16 based on the Standard Mail Regular and ECR Billing Determinants of WMB. The
17 revenue per piece for both Regular and ECR is a weighted average of the revenue per
18 piece and WMB volume. The Standard Regular and ECR unit costs are based on
19 Docket No. R2005-1 for TY 2006 unit costs. This provides the customer-specific
20 revenue and cost data on WMB' Standard Mail.

1 **Contribution Inputs**

2 The Contribution Inputs calculate the contribution per piece of WMB's operational
3 mail and marketing mail letters. This per piece calculation provides the Postal Service
4 with before and after rates revenue, cost, and contribution for First-Class Mail and
5 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 approach
14 is used due to WMB's indications that all of its new First-Class Mail volume will be
15 switched from Standard Mail (100% conversion).

Appendix C

WMB FINANCIAL SERVICES NSA PROPOSED DATA COLLECTION PLAN

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

1. The volume of First-Class Mail solicitations by rate category in eligible WMB permit accounts;
2. The volume of First-Class Mail customer mail by rate category in eligible WMB permit accounts;
3. The amount of discounts paid to WMB 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 WMB;
5. The number of electronic address correction notices provided to WMB 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 WMB for solicitation mailpieces that would otherwise be physically returned, including the

1 number of notices processed by CFS units and separately for PARS (when fully
2 operational).

3

4 7. Monthly estimate of the amount of time spent on compliance activity and a
5 description of the activities performed.

6

7 8. For each First-Class Mail solicitation mailing list run against NCOA, WMB will
8 provide NCOA contractor reports that separately identify the number of address
9 records checked and the number of corrections made.

10

11 9. For each Change of Address record that is used to forward a piece of WMB
12 solicitation mail through ACS under the Agreement, the Postal Service will
13 provide the date the record was created, its move effective date, whether it was
14 for a family or individual move, and each date that the record was used to
15 forward a mail piece. No other information from the record would be provided.

16

17 As part of each data collection plan report, the Postal Service will provide an evaluation
18 of the impact on contribution. It will also provide an assessment of trends of WMB'
19 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 each year
- 2 of the Agreement. The Postal Service shall provide the data in a PC-available format.