

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

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

Docket No. MC2006-3

**RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS AYUB TO
INTERROGATORIES OF VALPAK DIRECT MARKETING
SYSTEMS, INC., AND VALPAK DEALERS' ASSOCIATION, INC.
(VP/USPS-T1-9-19)**

June 21, 2006

The United States Postal Service hereby provides the responses of witness Ayub to the following interrogatories of ValPak Direct Marketing Systems, Inc., and ValPak Dealers' Association, Inc.: VP/USPS-T1-9-19, filed on May 11, 2006. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Anthony Alverno
Chief Counsel, Customer Programs

Frank R. Heselton
Attorney

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1135
(202) 268-5204; Fax -6187
June 21, 2006

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

VP/USPS-T1-9.

- a. Please confirm that your USPS-T-1, Appendix A, page 1, assumes that the average return rate for all First-Class Mail is 1.23 percent. If you do not confirm, please provide the correct figure.
- b. Please define "return rate" as you use that term in your Appendix A. In particular, explain whether the return rate refers to all undeliverable as addressed ("UAA") mail, or only that portion of UAA mail that is returned (electronically or physically) because it cannot be forwarded.
- c. If the average "return rate" for First-Class Mail is 1.23 percent, what is the percentage of First-Class Mail that also is UAA, but is forwarded to addressees instead of being returned?
- d. Please confirm that, for WMB's solicitation mail, the return rate assumed in your Appendix A, pages 5 and 6, is 4.5 percent. If you do not confirm, please provide the correct figure.
- e. Please provide the source of the 4.5 percent return rate for WMB mail shown in your Appendix A, pages 5 and 6, and explain whether the percentage is based on actual returns of First-Class solicitation mail or Standard solicitation mail sent by WBM (including its predecessor, Providian). If the return rate is based on experience with Standard solicitation mailings, please explain its derivation, since Standard mail normally is not returned.
- f. If the return rate for WMB mail shown in your Appendix A, pages 5 and 6, refers only to that portion of WMB's UAA mail that must be returned because it cannot be forwarded, what is the estimated percentage of WMB's solicitation mail that is UAA — *i.e.*, mail that is UAA and is forwarded, as well as returned (electronically or physically) when it cannot be forwarded?

RESPONSE:

- a. The average return rate for all First-Class Mail is 1.23 percent.

However, in the updated Appendix A, which includes data from Docket No. R2006-1, the return rate used is 1.70 percent, which corresponds to the UAA rate for automation and presort First-Class Mail.
- b. It refers to the all volume that is returned to sender because it is UAA.
- c. Please see Witness Sam Cutting's testimony in Docket No. R2006-1, specifically, LR-L-62 and LR-L-61.

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

- d. The 4.5 percent rate is used only for First-Class Mail marketing purposes. The 1.0 percent rate is used for First-Class Mail operational pieces.
- e. It is based on historical data provided by WMB on their First-Class mail marketing volume.
- f. We do not have an estimate of WMB's UAA volume that is forwarded.

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

VP/USPS-T1-10.

- a. With respect to FY 2005, what is the Postal Service's estimate of (i) the total volume of First-Class UAA mail, and (ii) the total cost of handling such UAA mail?
- b. For all First-Class Mail in FY2005, what is the ratio of the volume of UAA mail forwarded to the volume returned?
- c. In FY 2005, what was the unit cost to:
 - (i) forward a piece of UAA mail?
 - (ii) physically return a piece of UAA mail?
 - (iii) supply the sender with an electronic address correction for a piece of UAA mail?

RESPONSE:

(a-c) Please see Witness Sam Cutting's testimony in R2006-1, specifically, LR-L-62 and LR-L-61.

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

VP/USPS-T1-11.

- a. Please confirm that one goal of the Postal Service's Strategic Transformation Plan 2006-2010 (September 2005) is to reduce the volume of UAA mail, and confirm that goal is stated in the Transformation Plan at p. 59. If you cannot confirm, please explain.
- b. Are you aware that Postmaster General Potter reiterated the importance of the Transformation Plan goal to reduce the volume of UAA mail in his keynote address to the National Postal Forum in Orlando, Florida, April 3, 2006?
- c. Please state whether you agree with the PMG Potter's assessment of the importance of the Transformation Plan goal to reduce the volume of UAA mail.
- d. When negotiating NSAs that encourage the conversion of Standard Mail to First-Class Mail, what consideration, if any, do you give to the goal of reducing the volume of UAA mail when the mailing lists used for such solicitation mail are known to contain percentages of UAA mail that far exceed the average in First-Class?

RESPONSE:

- a. Confirmed.
- b. Confirmed.
- c. I agree with this principle, and also believe it is important for the Postal Service to grow revenue and manage its cost structure efficiently.
- d. The NSA encourages the conversion of mail that results in a higher overall net contribution to the Postal Service. We balanced against the risk of higher UAA costs, however, by including provisions in the NSA to reduce the amount of UAA mail. Furthermore, NSAs of this type have been helpful in lowering the UAA rate of our ACS customers, which benefits both Standard Mail and First-Class Mail. It is never the intent of any customer to send mail that is incorrectly addressed and which will create little or no value for the customer. Moreover, the additional address hygiene requirements of the NSA aid in lowering the UAA rate.

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

VP/USPS-T1-12.

Please explain how giving discounts to encourage conversion of Standard solicitation mail with a relatively high percentage of UAA mail (*i.e.*, “dirty” mail) to First-Class Mail furthers the Transformation Plan’s goal of reducing the volume of UAA mail in the First-Class mailstream.

RESPONSE:

The Postal Service does not consider UAA Standard Mail solicitation to be “dirty” mail.

As discussed in my response to VP/USPS-T1-11, WMB will be taking steps to decrease the risk of UAA mail by utilizing electronic ACS and updating their address lists.

Moreover, the NSA increases the overall contribution to the Postal Service by encouraging the conversion of Standard Mail to more profitable First-Class Mail, which benefits all customers of the Postal Service.

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

VP/USPS-T1-13.

- a. Would you agree that the benefits to the Postal Service from the proposed NSA with WMB are attributable almost entirely to the volume of Standard Mail that converts to First-Class Mail in response to the declining block discounts? If you do not agree, please explain fully.
- b. Would you agree that the volume of Standard solicitation mail that WMB converts to First-Class in response to the declining block discounts are a reflection of WMB's cross-elasticity of demand between Standard and First-Class? If you do not agree, please explain fully.

RESPONSE:

- a. The benefits, as quantified in the filing, are largely attributed to the conversion of Standard Mail solicitations to First-Class Mail. However, the additional benefits are that the NSA:
 - i. lowers the UAA rate on current First-Class Mail solicitations, thereby increasing the amount of net contribution from this mail;
 - ii. encourages new First-Class Mail volume that is not converted from Standard Mail;
 - iii. increases visibility of First-Class Mail as an acquisition medium; and
 - iv. increases contribution of existing First-Class Mail pieces by converting current UAA mail to electronic returns.
- b. The volume of Standard Mail solicitation that WMB converts to First-Class Mail in response to the declining block discounts could be used as a proxy for the cross-price elasticity of demand between First-Class Mail marketing and Standard Mail. However, this would assume that all Standard Mail pieces and current First-Class Mail pieces are exactly

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

the same in terms of the expected value of the prospective customer
and other profitability variables.

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

VP/USPS-T1-14.

Please refer to your testimony at page 20, lines 8-9, where you state that “the quality of a credit card company’s mailing list highly correlates with the class of mail chosen for marketing.”

- a. Please define, or describe more completely, what you mean by the expression “quality of a ... mailing list,” as you use that expression in this part of your testimony. In particular, please distinguish between “quality” as it might relate to (i) the percentage of positive responses expected to be received from the mailing, (ii) the number of pieces in the mailing that are expected to be UAA, and (iii) any other aspects of quality you care to include in your response.
- b. When a credit card company — *e.g.*, one such as WMB — uses a list for a solicitation, how does it determine *a priori* the “quality” of the list? Does it test a segment of the list?
- c. Does your above-cited statement mean that a credit card company somehow determines the quality of a list and then knowingly assigns “low-quality” lists to be entered as Standard Mail, while assigning “high-quality” lists to be entered as First-Class Mail? Regardless of whether your answer is affirmative or negative, please elaborate on what you intend by the above-cited statement regarding the correlation between quality of a mailing list and the class of mail chosen for marketing.

RESPONSE:

- a. The quality of mailing lists, as I describe in my testimony, is meant to include the value of a prospective customer and also an estimate of response rates, which impacts the value calculation. The factors that influence the calculation of the value of a prospective customer can include demographic and economic factors, such as income and credit scores. The estimate of response rate also varies based on certain factors, such as the source of the list and the demographics of the prospective customers.
- b. It is my understanding that card issuers consider a variety of factors when attempting to calculate the value of a list. The factors are similar to those identified in my response to Part (a) of this interrogatory.

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

- c. Not necessarily; as indicated above, the “quality” of a list is closely tied to the value of a prospective customer, and response rates. The decision between choosing either First-Class Mail or Standard Mail comes down to a cost-benefit analysis of the response rate and cost differential between the two classes of mail. If the response rate of a targeted list is the same between First-Class Mail and Standard Mail, in all probability the marketer will use Standard Mail as the preferred acquisition medium. But if First-Class Mail has a higher response rate, then the expected value is compared to the increased cost of First-Class Mail, and the marketer must decide if the higher investment in First-Class Mail is justified by the higher expected value.

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

VP/USPS-T1-15.

Please refer to your testimony beginning at page 21, line 13, and extending to page 22, line 10. In particular, please refer to your statements that (i) historically, Provident focused on “higher risk and generally underserved customers who might not ordinarily qualify for credit cards, including customers with past credit card problems or limited credit history,” (ii) the company has stated that it is “currently refocusing our business on the middle and prime market segments,” and (iii) the statement that First-Class Mail was used to solicit accounts from customers who were known to be high-risk and to have had past credit card problems, while solicitation of potential customers in “the middle and prime market segments” makes improbable “any large-scale migration back to First-Class Mail as a marketing channel.”

- a. Please state your understanding of why First-Class Mail would be the marketing medium of choice for potential customers who are known to be high risk, either by virtue of past credit card problems, or for any other reason.
- b. Please state your understanding of why Standard Mail would be the marketing medium of choice for potential customers who are considered to fall in the middle of prime market segments. In particular, what are the primary factors that make Standard Mail the marketing medium of choice for this more upscale market segment, and why is an NSA with declining block discounts a necessary and desirable way to overcome the factors that make Standard Mail the preferred medium?

RESPONSE:

- a. It is our understanding from previous NSA discussions and research that the targeted lists for potential customers who are assumed to be high risk generally have higher response rates to First-Class Mail. The factors that influence the higher response rates vary across issuers. The variables could include: pricing of the card, fee structure, credit limits, address sources, and other demographics.
- b. The middle-markets for issuers like WMB primarily are customers who have established relationships with the issuer or one of their competitors. It is our understanding that for this segment of the market, the cost-benefit analysis for WMB is that Standard Mail is a preferred

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

medium even though First-Class Mail may have a higher response rate.

This is because the cost of First-Class Mail acquisition is significantly higher than Standard Mail. The NSA is an effective and desirable tool in making First-Class Mail the preferred acquisition medium because we can identify the price-point at which customers will use First-Class Mail over Standard Mail.

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

VP/USPS-T1-16.

Please refer to your testimony at page 12, lines 11-12, and page 20, lines 11-12. At page 20, you note that "Card Services will intensify its focus on cross-selling products to other WMB customers," and at page 12 you state that another term and condition beneficial to the Postal Service is that the subject matter of the agreement is limited to WMB's credit card products and credit card services.

- a. Please list all other services of which you are aware that WMB offers to its customers, (e.g., mortgages, home-equity lines of credit, insurance of any kind (life, title, credit, etc.), checking accounts, savings accounts and CDs, mutual funds, stock brokerage services, etc.) that might be "cross-sold" by Card Services to other WMB customers.
- b. For purposes of this proposed NSA, are all of the other services listed in your response to preceding part a considered to be "card products," or "credit card services?" If not, please indicate which items would be considered to fall under either of these two terms, and which would be excluded from falling under either of these two terms.
- c. To what extent does the above-cited limitation mentioned on page 12 (ll. 11-12) of your testimony restrict Card Services from cross-selling WMB products that are not "card products" or "credit card services?" Please give examples of WMB products that could not be cross-sold by solicitation mail entered under this proposed NSA agreement.

RESPONSE:

- a. The NSA agreement only covers mail that is associated with the credit card services. It is my understanding that the card service group does not cross-sell mortgages, home equity, life insurance, and other financial products. They are involved only with credit card offerings, such as balance transfers, new cards, or rewards.
- b. Please see the answer to Part (a).
- c. The cited limitation limits the NSA to credit card mailings, which does not include life insurance and other types of financial products.

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

VP/USPS-T1-17.

Please refer to your testimony at page 23, lines 5-6, where you state that “the average response rates for a credit card solicitation fall between 0.3 and 0.4 percent, according to our data sources.”

- a. Do your data sources for response rates for credit card solicitations distinguish between the response rates for solicitations sent via First-Class Mail and those sent via Standard Mail?
- b. Please indicate the level of detail about response rates that is available to the Postal Service for its evaluation of volume forecasts by NSA applicants. For example, do your data sources provide you with (i) the range of response rates experienced by various credit card mailers, and/or (ii) one or more measures of dispersion around the average response rate?

RESPONSE:

- a. Our data sources do not distinguish between First-Class Mail and Standard Mail.
- b. The data cannot be broken down by provider or by specific campaign mailings. There are no measures of dispersion around the average response rates.

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

VP/USPS-T1-18.

Please refer to footnote 11 on page 27 of your testimony, where you (i) discuss the possibility of a rate increase during the term of this agreement, (ii) indicate that such an increase has not been accounted for in the revenue calculations, and (iii) state that ignoring any future revenues from future rate increases may undercount revenues in the out-years, thereby giving greater credence to the conservatism of any assumption.

- a. In light of the Postal Service's filing in Docket No. R2006-1, made on May 3, 2006, would you agree that, during the life of this proposed NSA agreement, at least one omnibus rate increase appears likely? Please explain any disagreement.
- b. When you state that "revenues in the out-years have been undercounted," are you referring to (i) the gross revenues from mail expected to be entered at proposed First-Class rates, (ii) the gross revenues from mail that would have been entered at proposed Standard rates, (iii) the net revenues from WMB's Standard mail that is expected to convert to First-Class, or (iv) the net contribution to Postal Service overhead? Please explain.
- c. Please revise and submit relevant pages of your Appendix A showing the effect on revenues and contribution to overhead under the NSA from rates proposed by the Postal Service in Docket No. R2006-1.
- d. Please explain how the failure to consider the effect of higher rates gives "greater credence ... to the conservatism of any assumption."

RESPONSE:

- a. I am not privy to the decision regarding the next omnibus filing, and in any event, such a decision would have to be made by the Board of Governors.
- b. I am referring to the fact that "gross-revenues" at the time of the filing did not include the proposed increased rates in Docket No. R2006-1.
- c. Please see the revised Appendix A.

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

- d. Appendix A assumes that all costs increase on a yearly basis by 4 percent. However, we do not assume any changes in the prices, thereby decreasing the estimated contribution in the out-years.

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

VP/USPS-T1-19.

Please refer to your testimony at page 30, lines 8-15, where you discuss the increased costs of UAA mail from converted Standard Mail, and state that those costs are included in the After-Rates First-Class Mail solicitation unit cost estimates.

- a. Did your computations include the cost for forwarding UAA mail that is forwardable?
- b. How many times does WMB send solicitation mail to the same list of addressees? In your response, please distinguish between (i) in-house lists of existing WMB customers, and (ii) rented lists used strictly for solicitation.
- c. When WMB receives electronic address corrections for a list or lists that it no longer intends to use for its own purposes, why should it make any effort to correct such lists? Please explain how correcting a list that WMB no longer intends to use might be expected to add value for the Postal Service, for WMB, or for anyone else.
- d. For WMB solicitation UAA mail that is forwarded, does the proposed NSA agreement provide that the Postal Service will supply WMB with an electronic address correction for such mail? If so, what is the Postal Service's cost to provide each electronic address correction for forwarded mail?
- e. Please explain why the Postal Service agrees to provide free electronic address correction service ("ACS") for mail that is being heavily discounted by the proposed NSA agreement. That is, why does not the Postal Service make any kind of return, whether it be physical return or electronic return, an option which the mailer with declining block discounts could obtain only by paying an appropriate cost-based fee? That is, if the mailer neither cares nor desires to receive any kind of return or electronic address correction, in lieu of the endorsement for electronic ACS, the mailer would indicate "No address correction required."
- f. (i) To what degree does WMB send its solicitation mail to rented lists which are used only once?
(ii) Why would WMB want physical return or electronic address correction on those occasions when it makes only a single use of rented lists?
(iii) Why would the Postal Service want to expend funds to provide WMB with electronic address correction which would not be used by WMB to improve the quality lists used for mailings?
- g. If WMB currently does not care to purchase electronic return for its solicitations sent as Standard Mail, why would WMB want or need to obtain electronic address correction for its anticipated First-Class Mailings under the NSA?

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

RESPONSE:

- a. We did not include either the cost-savings or costs associated with forwards in our calculations. This is consistent with previous NSA filings.
- b. I do not have this level of information.
- c. There is a high probability that addresses are repeated across a variety of lists, and it is highly unlikely that an address will only be targeted once. Furthermore, the card-service groups may use the corrected addresses for other purposes; for example, they may share the corrected addresses with the parent organization.
- d. Under the OneCode environment, this cost is less than \$0.002 per notice.
- e. The incentives in this proposal are not linked to the savings associated with the electronic address correction service. The incentives are used to encourage conversion of Standard Mail to First-Class Mail. The adoption of electronic ACS is an additional requirement that lowers our costs of handling WMB UAA mail volume.
- f.
 - (i) I do not have this information.
 - (ii) WMB total marketing volume is greater than 500 million pieces, and with only 144 million delivery points in FY05, there is a high probability that WMB mailed multiple times to the same delivery point.
 - (iii) There is no evidence to suggest that the data will not be used in future mailings.

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

- g. WMB has entered into this mutually beneficial arrangement, and WMB agreed to this provision, which should lower USPS costs and provide WMB with updated address information.

CERTIFICATE OF SERVICE

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

Frank R. Heselton

475 L'Enfant Plaza, S.W.
Washington, D.C. 20260-1135
June 21, 2006