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

EXTENSION OF CAPITAL ONE NSA

Docket No. MC2006-6

DIRECT TESTIMONY OF
JESSICA LOWRANCE
ON BEHALF OF THE
UNITED STATES POSTAL SERVICE

TABLE OF CONTENTS

AUTOBIOGRAPHICAL SKETCH

My name is Jessica Lowrance. I joined the Postal Service in 2003 and am currently an Economist in the Pricing Strategy group. I was the witness in the HSBC North America Holding, Inc (HSBC) NSA filing, Docket No. MC2005-2. I also provided financial analysis support for the Bank One Corporation (now J.P. Morgan Chase) Negotiated Service Agreement (NSA) filing, Docket No. MC2004-3, and the Discover Financial Services NSA filing, Docket No. MC 2004-4.

I am one of the project lead for the Postal Service's team in negotiating and preparing NSAs and am responsible for the financial analysis presented in the Postal Service filing. This is my second appearance before the Commission.

I earned a Bachelor of Arts degree in Marketing and in Economics from Lynchburg College, and a Master of Business Administration (MBA) from Strayer University with honors.

I. PURPOSE AND SCOPE OF TESTIMONY

The purpose of my testimony is to describe and analyze the extension of the Capital One NSA. My testimony discusses the value the Postal Service has already recognized from the NSA, and presents projections for the remainder of the life of the NSA, both as currently structured, and under the proposed extension.

My testimony relies on the testimony of USPS witnesses Bizzotto (USPS-T-1), Plunkett (USPS-T-2 and USPS-RT-1), Crum (USPS-T-3), Wilson (USPS-T-4), and Eakin (USPS-RT-2), and Capital One witnesses Jean (COS-T-1), Elliott (COS-T-2 and COS-RT-2), and Shippee (COS-RT-1), all in Docket No. MC2002-2.

Attachment A to my testimony presents the volume, revenue, and cost projections underlying my analysis of the value of the extension.

II. Current Capital One NSA

A. Description of the Capital One NSA

The Capital One Negotiated Service Agreement (NSA) was the first NSA implemented by the Postal Service, and came into effect in September 2003. The NSA provides incentives for increased First-Class Mail volume and substitution of electronic notices for physical returns of UAA pieces. In addition, the Postal Rate Commission (PRC, Commission) imposed a cap on the total amount of incentives Capital One could earn over the life of the agreement.

B. Value of the Capital One NSA

The Postal Service has filed two data collection plans with the PRC regarding the Capital One NSA.[1] The Postal Service estimates that, based on the original filing, the total value from the first two years of the agreement is $33.1 million, including the contribution generated by 150 million new First-Class Mail marketing pieces (see Attachment A, page 1).

In addition, the Postal Service estimates that the provision of 40 million forwarding notices combined with the ACS notices, plus increased address hygiene requirements, have lowered Capital One's First-Class Mail marketing return rate from 9 percent to a little over 6 percent. This improvement represents a 33 percent decrease in expected UAA mail volume, and improves the profitability of future marketing mail pieces.

[1] See Data Collection Report for Sept. 1, 2003 to Sept. 30, 2004, Docket No. MC2002-2 (Jan. 31, 2005); Data Collection Report for October 2005 to September 2005, Docket No. MC 2002-2 (Feb. 7, 2006).

III. EXTENSION OF THE CURRENT CAPITAL ONE NSA

The existing Capital One NSA is set to expire on September 1, 2006. Capital One and the Postal Service are currently discussing an alternative NSA structure to replace the current agreement, but desire to keep the current agreement in effect while the new deal is worked out.

A. Rationale for Extension

Neither party believes the current NSA structure will continue to produce the same benefits it has in the past. Recent USPS rate filings and changes in market conditions within the financial services industry have contributed to lowering the value of the agreement to both parties. Moreover, the volume growth experienced in the first two years of the agreement is not expected to continue.

At the same time, neither party believes it would be in their best interest to allow the current agreement to lapse while preparing a new deal structure for litigation. Capital One and the Postal Service continue to derive value from the switch to electronic ACS as the preferred medium for handling UAA First-Class Mail. An extension of the current agreement for a period of one year should suffice in providing adequate opportunity for both parties to reach a new agreement and litigate the proposal before the Commission.

B. Competitive Impact of Extension

I expect there to be no impact from this extension on the competitors of either the Postal Service or Capital One. Over the life of the current agreement, no party has come forward to claim that they have been harmed by the existence or action of the agreement. In fact, three competitors of Capital One (Discover Financial Services, HSBC Holdings, and JP Morgan Chase) have each become parties to an NSA of their own, and a fourth (Washington Mutual) is in the process of obtaining approval for an NSA.

C. Expected Value of Extension

The value to the Postal Service from extending the current agreement will primarily occur from the use of electronic ACS notices to replace manual notices. The estimated savings from marketing pieces converted to electronic ACS notices is $5.9 million for FY2006, and $5.1 million for FY2007 (see Attachment A, page 1).

Data available at the time of this filing leads me to believe Capital One will not earn incentives in the third year of the agreement. Based on historical trends, Capital One mails about 58 percent of its mail in the first and second fiscal quarters. In the first half of the third year of the agreement, Capital One has only sent mail equal to 48 percent of the threshold. Therefore, if present trends continue, Capital One will miss the threshold by about 20 percent. I expect these trends to moderate somewhat in FY 2008, but I anticipate that Capital One will still miss the threshold (see Attachment A, page 2).

USPS Value Calculation

		[A]	[B]	[C]	[D]	[E]
				Projected	**with Extension**	
		Year 1	**Year 2**	**Year 3**	**Year 3**	**Year 4**
		2004	**2005**	**2006**	**2006**	**2007**
	First-Class Letter Volume					
[1]	Total Volume	1,396,268	1,305,460	934,181	1,008,086	854,182
[2]	ACS Returns	46,073	42,041	30,084	32,464	27,508
[3]	ACS notices provided	22,375	19,868	14,218	15,342	13,000
[4]	Threshold	1,327,083	1,225,000	1,122,917	1,225,000	1,122,917
[5]	Volume Above Threshold	69,185	80,460	0	0	0
[6]	Leakage Volume	0	13,133	0	0	0
[7]	*Incremental Pieces*	*85,435*	*67,327*	*0*	*0*	*0*
	New Marketing Mail Contribution					
[8]	Capital One Revenue per Piece	$ 0.292	$ 0.294	$ 0.304	$ 0.304	$ 0.315
[9]	Capital One Cost per Piece	$ 0.121	$ 0.151	$ 0.099	$ 0.099	$ 0.101
[10]	Capital One Contribution per Piece	$ 0.171	$ 0.143	$ 0.205	$ 0.205	$ 0.213
[11]	Capital One Contribution	$14,596	$ 9,613	$ 0	$ 0	$ 0
[12]	Discount on Incremental Volume	$ 2,174	$ 2,566	$ 0	$ 0	$ 0
[13]	Total Discount Leakage	$ 0	$ 394	$ 0	$ 0	$ 0
[14]	New Mail Contribution	$12,423	$ 6,653	$ 0	$ 0	$ 0
	Return Cost Savings					
[15]	Manual Return Cost	$ 0.535	$ 0.484	$ 0.316	$ 0.316	$ 0.323
[16]	Electronic Return Cost	$ 0.332	$ 0.310	$ 0.120	$ 0.120	$ 0.123
[17]	Return Cost Savings	$ 0.203	$ 0.174	$ 0.196	$ 0.196	$ 0.200
[18]	ACS Savings	$ 9,353	$ 7,315	$ 5,888	$ 6,353	$ 5,503
	Forwarding Costs					
[19]	Cost of Providing ACS notices	$ 0.061	$ 0.063	$ 0.031	$ 0.031	$ 0.032
[20]	Total Forwarding Costs	$ 1,356	$ 1,252	$ 443	$ 479	$ 415
[21]	**Total USPS Value**	**$20,420**	**$12,716**	**$ 5,444**	**$ 5,875**	**$ 5,088**

Notes:

[1]-[3] [A]-[B] Data Collection Reports
[C]-[E] Appendix A, Page 2
[4] MC2002-2
[5] If [1]>[4], then [1] − [4]
[6]-[7] Data Collection Reports
[8] [A]-[B] Data Collection Reports
[C]-[D] [B] × (.25 + .75 × 1.054)
[E] Weighted average of [B] and LR-L-130, TYAR Revenue/Piece
[9] [A]-[B] Data Collection Reports
[C]-[D] [E]/1.0222
[E] Capital One cost per piece, TYBR 2008 from Docket R2006-1, deflated to FY 2007 AR
[10] [8] − [9]

[11] [7] × [10]
[12]-[13] [A]-[B] Data Collection Reports
[14] [11] − [12] − [13]
[15]-[16] [A]-[B] Data Collection Reports
[C]-[D] [E]/1.0222
[E] Docket R2006-1, LR-L-62, deflated to FY 2007 AR
[17] [15] − [16]
[18] [2] × [17]
[19] [A]-[B] Data Collection Reports
[C]-[D] [E]/1.0222
[E] Docket R2006-1, LR-L-62, deflated to FY 2007 AR
[20] [3] × [19]
[21] [14] + [18] + [20]