

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

RATE AND SERVICE CHANGES TO IMPLEMENT
FUNCTIONALLY EQUIVALENT NEGOTIATED
SERVICE AGREEMENT WITH DISCOVER
FINANCIAL SERVICES, INC.

Docket No. MC2004-4

RESPONSES OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB
TO INTERROGATORIES OF THE OFFICE OF THE CONSUMER ADVOCATE
(OCA/USPS-T1-35-40)
(August 16, 2004)

The United States Postal Service hereby provides its responses to the following interrogatories: Office of the Consumer Advocate Interrogatories to United States Postal Service Witness Ali Ayub (OCA/USPS-T1-35-40), filed on August 5, 2004.

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

Respectfully submitted,
UNITED STATES POSTAL SERVICE

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August 16, 2004

RESPONSE OF THE UNITED STATES POSTAL SERVICE WITNESS AYUB
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OCA/USPS-T1-35. Please refer to your response to OCA/USPS-T1-12, which states that the

Postal Service's understanding of the 'stop-loss' provision is that the 'stop-loss' is equal to 95% of the ACS cost savings over the term of the agreement. The ACS cost savings are presented in Appendix A, page 11, line (2), of my testimony is \$8,006,949.

Also, please refer to Table 8-2 from PRC Op. MC2002-2, reproduced as an attachment to this interrogatory.

- a. Please confirm that Table 8-2 presents the Commission's methodology for calculating the "ACS Related Savings" used in estimating the stop-loss for the Capital One NSA. If you do not confirm, please explain.
- b. Please confirm that the Commission did not use in its development of Table 8-2 the Return Cost Savings figure (\$13,094,000) calculated by witness Crum (USPS-T-3) in Attachment B, page 2 of his testimony in Docket No. MC2002-2. If you do not confirm, please explain.
- c. Please confirm that, in preparing your response to OCA/USPS-T1-12 as it relates to the Discover NSA, you did not use the Commission's methodology as presented in Table 8-2 to calculate "the 'stop-loss' [that] is equal to 95% of the ACS cost savings over the term of the agreement." If you do not confirm, please explain and calculate the stop-loss that is equal to 95% of the ACS cost savings over the term of the agreement using the same methodology and format as presented by the Commission in Table 8-2. Provide citations to all sources.

Table 8.2

ACS Related Savings

(1)	FC Physical Return Unit Cost	\$ 0.5347
(2)	"Electronic Return" Unit Cost	\$ 0.3321
(3) = (1)-(2)	Difference	\$0.2026
(4)	Solicitation Percentage of Revised Capital One TYBR First-Class Volume	55.3%
(5)	Capital One TYBR First-Class Volume (thousand)	1,559,248
(6) = (4)*(5)	Capital One TYBR First-Class Solicitation Volume (thousand)	862,612
(7)	Capital One First-Class Solicitation Return Rate	9.6%
(8) = (6)*(7)	Capital One TYBR First-Class Solicitation Return Volume (thousand)	82,811
(9)	ACS Success Rate	85%
(10) = (8)*(9)	Volume of Capital One Physical Returns converting to ACS (thousand)	70,389
(11) = (3)*(10)	Total Test Year Savings (thousand)	\$14,259

Sources: (1) & (2) - USPS-LR-1
(4) - COS-LR-4, Exhibit 3
(7) & (9) - USPS-T-3, Attachment A, page 2

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RESPONSE:

(a) Witness Crum calculated the test year savings of \$13,094,000 based on Capital One's Before Rates total volume forecast of 1,408,000,000 at USPS-T-3, Attachment B, page 2. The Commission based its calculation on the estimated savings in Table 8.2, on an estimated volume of 1,559,248,000 million. This, however, was not Capital One's TYBR First-Volume forecast as identified. The number 1,559,248,000 is the point at which the Commission believed the ACS Cost Savings equaled Total Discounts paid (See 8028 and 8029). In addition, the Commission assumed that "Solicitation Percentage of Revised Capital One TYBR First-Class" would be a constant, in calculating the cost savings at a variety of TYBR volume levels. However, the Postal Service believes that such an assumption is not valid. It is not probable that the percentage of solicitation mail versus total mail volume can remain constant at higher volume levels. The current ratio of Discover's marketing mail volume to total First-Class mail volume is 33.6%. Applying this ratio to higher TYBR volume level provides the statement volumes presented below.

TYBR Volume	Marketing Volume	Statement Volume	Growth in Statement Volume
496,100,000	166,792,241	329,307,759	11.63%
541,200,000	181,955,172	359,244,828	21.78%
586,300,000	197,118,103	389,181,897	31.93%
631,400,000	212,281,034	419,118,966	42.07%
676,500,000	227,443,966	449,056,034	52.22%
766,700,000	257,769,828	508,930,172	72.52%

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There is no evidence to suggest that Discover's solicitation mail to total mail ratio can remain constant, or that Discover can grow its statement and operation mail volume at such high levels. In addition, the annual adjustment mechanism addresses any factors that may affect increases in statement volume. Inflating the statement volume in the TYBR leads to a scenario where you underestimate the cost savings, which would push the point where ACS Cost Savings equals Total Discounts paid further out along the demand line that the Commission used to calculate the 1,559,248,000 in Figure 8.2 of the PRC Opinion in Docket No. MC2002-2. For this reason, applying the Commission's methodology applied in Capital One to Discover, or in any other case, limits a smaller-marketing mailer's ability to use the price incentives to grow its First-Class marketing mail volumes.

The cap on discounts proposed by DFS provides an alternative solution that does not discriminate against smaller First-Class marketing mailers in using the price incentives to grow their marketing mail volumes. While both DFS and the Postal Service agree that a cap limits the potential volume response to the price incentives, DFS appears to believe that the cap of \$14 million for the term of the agreement or (\$4.6 million per year) provides them ample opportunity for growth.

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To reach the \$4.6 million per year discount cap DFS would have to mail an additional 89 million pieces above the Before Rates volume forecast.

Threshold		Volume	Discount
405,000,000	435,000,000	30,000,000	\$0.025
435,000,000	465,000,000	30,000,000	\$0.030
465,000,000	490,000,000	25,000,000	\$0.035
490,000,000	515,000,000	25,000,000	\$0.040
515,000,000		25,370,378	\$0.045
	Total	135,370,378	

Applying the fixed ratio of 33.6% to the additional 89 million pieces implies that, of those additional pieces, 60 million pieces would be statement mailings. In the volume history provided in Appendix A of my testimony, that is greater than any 1-year change in DFS volume, and represents a 20% increase in statement volume in a 1-year period. This scenario is highly unlikely, and exposes the limitations of applying a fixed ratio established for a specific company (Capital One) to both future mailings and other unique companies.

(b) Please see my response to (a) above.

(c) I calculated the “stop-loss” for Discover as 95% of estimated cost savings based on the projected Before Rates volume. It is not possible, in my opinion, to use the Commission’s Capital One methodology to calculate a cost savings on future volume for Discover because the application of a fixed ratio of solicitation mail volume to total mail volume is not applicable to Discover. Please see my response to (a) above.

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OCA/USPS-T1-36. Please refer to your response to OCA/USPS-T1-28(a), where you failed to confirm that “the calculated stop-loss estimate for Discover is consistent with the Commission’s calculation of the stop-loss estimate with respect to Capital One.” Also, please refer to Table 8-2 from PRC Op. MC2002-2, reproduced as an attachment to this interrogatory.

- a. For Year 1 of the Discover NSA, please calculate the “ACS Related Savings” for the stop-loss using the same methodology and format as presented by the Commission in Table 8-2. For each line in Table 8-2, please provide the corresponding figures for Discover, and show all calculations used to derive each line. Provide citations to all sources.
- b. For Year 2 of the Discover NSA, please calculate the “ACS Related Savings” for the stop-loss using the same methodology and format as presented by the Commission in Table 8-2. For each line in Table 8-2, please provide the corresponding figures for Discover, and show all calculations used to derive each line. Provide citations to all sources.
- c. For Year 3 of the Discover NSA, please calculate the “ACS Related Savings” for the stop-loss using the same methodology and format as presented by the Commission in Table 8-2. For each line in Table 8-2, please provide the corresponding figures for Discover, and show all calculations used to derive each line. Provide citations to all sources.

Based upon the “ACS Related Savings” developed in parts (a) – (c) of this interrogatory, please provide the total “ACS Related Savings” during the three years of the Discover NSA, and the amount equal to “95% of the ACS cost savings over the term of the agreement.” Please show all calculations and provide citations to all sources.

Table 8.2

ACS Related Savings

(1)	FC Physical Return Unit Cost	\$ 0.5347
(2)	"Electronic Return" Unit Cost	\$ 0.3321
(3) = (1)-(2)	Difference	\$0.2026
(4)	Solicitation Percentage of Revised Capital One TYBR First-Class Volume	55.3%
(5)	Capital One TYBR First-Class Volume (thousand)	1,559,248
(6) = (4)*(5)	Capital One TYBR First-Class Solicitation Volume (thousand)	862,612
(7)	Capital One First-Class Solicitation Return Rate	9.6%
(8) = (6)*(7)	Capital One TYBR First-Class Solicitation Return Volume (thousand)	82,811
(9)	ACS Success Rate	85%
(10) = (8)*(9)	Volume of Capital One Physical Returns converting to ACS (thousand)	70,389
(11) = (3)*(10)	Total Test Year Savings (thousand)	\$14,259

Sources: (1) & (2) - USPS-LR-1
(4) - COS-LR-4, Exhibit 3
(7) & (9) - USPS-T-3, Attachment A, page 2

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RESPONSE:

(a)

**DFS Table 8.2
ACS Related Savings**

(1)	Manual Letter Returns Unit Cost	\$0.55
(2)	Electronic Letter Returns Unit Cost	\$0.34
(3)=(1)-(2)	Difference	\$0.21
(4)	Solicitation Percentage of DFS TYBR First-Class Volume	34.59%
(5)	DFS TYBR First-Class Volume (thousands)	497,360
(6)=(4)*(5)	DFS TYBR First-Class Solicitation Volume (thousand)	172,037
(7)	DFS First-Class Solicitation Return Rate	9.3%
(8)=(6)*(7)	DFS TYBR First-Class Solicitation Return Volume (thousand)	15,999
(9)	ACS Success Rate	85%
(10)=(8)*(9)	Volume of DFS Manual Returns converting to ACS (thousands)	13,600
(11)=(3)*(10)	Total Test Year Savings	\$2,856

Sources (1), (2), (7), (9) MC2004-4, USPS-T-1, Appendix A, page 1
(4) MC2004-4, USPS-T-1, Appendix A, page 2 Cell G8/G9
(5) MC 2004-4, USPS-T-1, Appendix A, page 2

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(b)

DFS Table 8.2
ACS Related Savings

(1)	Manual Letter Returns Unit Cost	\$0.57
(2)	Electronic Letter Returns Unit Cost	\$0.36
(3)=(1)-(2)	Difference	\$0.21
(4)	Solicitation Percentage of DFS TYBR First-Class Volume	34.98%
(5)	DFS TYBR First-Class Volume (thousands)	501,928
(6)=(4)*(5)	DFS TYBR First-Class Solicitation Volume (thousand)	175,574
(7)	DFS First-Class Solicitation Return Rate	9.3%
(8)=(6)*(7)	DFS TYBR First-Class Solicitation Return Volume (thousand)	16,328
(9)	ACS Success Rate	85%
(10)=(8)*(9)	Volume of DFS Manual Returns converting to ACS (thousands)	13,879
(11)=(3)*(10)	Total Test Year Savings	\$2,915

Sources (1), (2), (7), (9) MC2004-4, USPS-T-1, Appendix A, page 1
(4) MC2004-4, USPS-T-1, Appendix A, page 2 Cell H8/H9
(5) MC 2004-4, USPS-T-1, Appendix A, page 2

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(c)

DFS Table 8.2
ACS Related Savings

(1)	Manual Letter Returns Unit Cost	\$0.60
(2)	Electronic Letter Returns Unit Cost	\$0.37
(3)=(1)-(2)	Difference	\$0.23
(4)	Solicitation Percentage of DFS TYBR First-Class Volume	35.37%
(5)	DFS TYBR First-Class Volume (thousands)	506,540
(6)=(4)*(5)	DFS TYBR First-Class Solicitation Volume (thousand)	179,163
(7)	DFS First-Class Solicitation Return Rate	9.3%
(8)=(6)*(7)	DFS TYBR First-Class Solicitation Return Volume (thousand)	16,662
(9)	ACS Success Rate	85%
(10)=(8)*(9)	Volume of DFS Manual Returns converting to ACS (thousands)	14,163
(11)=(3)*(10)	Total Test Year Savings	\$3,257

Sources (1), (2), (7), (9) MC2004-4, USPS-T-1, Appendix A, page 1
(4) MC2004-4, USPS-T-1, Appendix A, page 2 Cell I8/I9
(5) MC 2004-4, USPS-T-1, Appendix A, page 2

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(d)

DFS		
ACS Related Savings		
(1)	OCA/USPS-T1-36a	\$2,856
(2)	OCA/USPS-T1-36b	\$2,915
(3)	OCA/USPS-T1-36c	\$3,257
(4)=(1)+(2)+(3)		\$9,028
(5)	95% of the ACS cost savings over the term of the agreement	\$8,577

Sources (1), (2), (3) Total Test Year Savings
(5) = 95% * (4)

These calculations are based upon the Commission's methodology of keeping the ratios constant throughout the life of the agreement. The methodology presented fails to recognize the contribution increase from any new volume response based on the discounts earned by DFS. Lines 1, 2, and 3 in part (d) are based upon TYBR analysis, where ACS cost savings equals the total discounts earned. These TYBR are not in anyway a representation of DFS' forecasted volume. There is no evidence to suggest DFS will reach these volume levels in the current environment.

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OCA/USPS-T1-37. Please refer to your response to OCA/USPS-T1-27, which states “The higher the proportion of marketing mail the higher the cost savings would be which would in turn increase the cap.” Also, please refer to the attachment to this interrogatory.

- a. Please refer to Table 1, Year 1 – ACS Related Savings in the attachment. Please confirm that Discover’s Year 1 ACS unit cost saving is \$0.01644240 $[(\$0.55 - 0.34) * 0.093 * 0.85 * 1.00]$, where $(\$0.55 - 0.34)$ represents the difference between manual return unit costs and electronic return unit costs, 0.093 represents Discover’s physical return rate, 0.85 represents the ACS success rate, and 1.00 represents Discover’s solicitation mail as a percent of extra BR volume. If you do not confirm, please explain and show all calculations.
- b. Please refer to Table 2, Year 1 – Discount Leakage in the attachment. Please confirm that Discover’s BR Equilibrium First-Class Volume is 518,233,050. If you do not confirm, please explain and show all calculations.
- c. Please refer to Table 1, Year 2 – ACS Related Savings in the attachment. Please confirm that Discover’s Year 2 ACS unit cost saving is \$0.01710010 $[(\$0.57 - 0.36) * 0.093 * 0.85 * 1.00]$, where $(\$0.57 - 0.36)$ represents the difference between manual return unit costs and electronic return unit costs, 0.093 represents Discover’s physical return rate, 0.85 represents the ACS success rate, and 1.00 represents Discover’s solicitation mail as a percent of extra BR volume. If you do not confirm, please explain and show all calculations.
- d. Please refer to Table 2, Year 2 – Discount Leakage in the attachment. Please confirm that Discover’s BR Equilibrium First-Class Volume is 526,559,959. If you do not confirm, please explain and show all calculations.
- e. Please refer to Table 1, Year 3 – ACS Related Savings in the attachment. Please confirm that Discover’s Year 3 ACS unit cost saving is \$0.01778410 $[(\$0.60 - 0.37) * 0.093 * 0.85 * 1.00]$, where $(\$0.60 - 0.37)$ represents the difference between manual return unit costs and electronic return unit costs, 0.093 represents Discover’s physical return rate, 0.85 represents the ACS success rate, and 1.00 represents Discover’s solicitation mail as a percent of extra BR volume. If you do not confirm, please explain and show all calculations.
- f. Please refer to Table 2, Year 3 - Discount Leakage in the attachment. Please confirm that Discover's BR Equilibrium First-Class Volume is 535,772,530. If you not confirm, please explain and show all your calculations.

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**DISCOVER NSA
Stop Loss Estimate Model**

**TABLE 1
Year 1 - ACS Related Savings**

[1]	Manual Letter Returns Unit Cost	\$0.55
[2]	Electronic Letter Returns Unit Cost	\$0.34
[3]	Discover Return Rate - Solicitation Mail	9.3%
[4]	Address Change Service (ACS) Success Rate	85%
[5]	Discover BR Customer Mail Volume	295,000,000
[6]	Discover BR Solicitation Mail Volume	156,000,000
[7]	Solicitation Mail % of Extra BR Volume	100.00%
[8]	Discover ACS Unit Cost Savings	\$0.01644240
[9]	Discover BR Equilibrium First-Class Volume	518,233,050
[10]	Discover BR Solicitation Letter Volume	223,233,050
[11]	Total ACS Test Year Savings	\$3,670,487

**TABLE 2
Year 1 - Discount Leakage**

<u>Volume Block</u>		<u>Incremental</u>	<u>Discount</u>	<u>Discount</u>	
[a]	[1]	<u>Volume</u>	[3]	<u>Leakage</u>	
		[2] = [1b] - [1a]		[4] = [2] * [3]	
	[a]	[b]			
405,000,000	to	435,000,000	30,000,000	\$0.025	\$750,000
435,000,001	to	465,000,000	29,999,999	\$0.030	\$900,000
465,000,001	to	490,000,000	24,999,999	\$0.035	\$875,000
490,000,001	to	515,000,000	24,999,999	\$0.040	\$1,000,000
515,000,001	to	518,233,050	3,233,049	\$0.045	\$145,487
Total					\$3,670,487
Difference - ACS Savings and Discount Leakage					(\$0)

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**DISCOVER NSA
Stop Loss Estimate Model**

**TABLE 1
Year 2 - ACS Related Savings**

[1]	Manual Letter Returns Unit Cost	\$0.57
[2]	Electronic Letter Returns Unit Cost	\$0.36
[3]	Discover Return Rate - Solicitation Mail	9.3%
[4]	Address Change Service (ACS) Success Rate	85%
[5]	Discover BR Customer Mail Volume	290,000,000
[6]	Discover BR Solicitation Mail Volume	156,000,000
[7]	Solicitation Mail % of Extra BR Volume	100.00%
[8]	Discover ACS Unit Cost Savings	\$0.01710010
[9]	Discover BR Equilibrium First-Class Volume	526,559,959
[10]	Discover BR Solicitation Letter Volume	236,559,959
[11]	Total ACS Second Year Savings	\$4,045,198

**TABLE 2
Year 2 - Discount Leakage**

<u>Volume Block</u>		<u>Incremental Volume</u>	<u>Discount</u>	<u>Discount Leakage</u>
[1]	[2]	[2] = [1b] - [1a]	[3]	[4] = [2] * [3]
[a]	[b]			
405,000,000 to	435,000,000	30,000,000	\$0.025	\$750,000
435,000,001 to	465,000,000	29,999,999	\$0.030	\$900,000
465,000,001 to	490,000,000	24,999,999	\$0.035	\$875,000
490,000,001 to	515,000,000	24,999,999	\$0.040	\$1,000,000
515,000,001 to	526,559,959	11,559,958	\$0.045	\$520,198

Total **\$4,045,198**

Difference - ACS Savings and Discount Leakage **(\$0)**

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**DISCOVER NSA
Stop Loss Estimate Model**

**TABLE 1
Year 3 - ACS Related Savings**

[1]	Manual Letter Returns Unit Cost	\$0.60
[2]	Electronic Letter Returns Unit Cost	\$0.37
[3]	Discover Return Rate - Solicitation Mail	9.3%
[4]	Address Change Service (ACS) Success Rate	85%
[5]	Discover BR Customer Mail Volume	285,000,000
[6]	Discover BR Solicitation Mail Volume	156,000,000
[7]	Solicitation Mail % of Extra BR Volume	100.00%
[8]	Discover ACS Unit Cost Savings	\$0.01778410
[9]	Discover BR Equilibrium First-Class Volume	535,772,530
[10]	Discover BR Solicitation Letter Volume	250,772,530
[11]	Total ACS Third Year Savings	\$4,459,764

**TABLE 2
Year 3 - Discount Leakage**

<u>Volume Block</u>	[1]	<u>Incremental Volume</u>	<u>Discount</u>	<u>Discount Leakage</u>
		[2] = [1b] - [1a]	[3]	[4] = [2] * [3]
[a]	[b]			
405,000,000 to	435,000,000	30,000,000	\$0.025	\$750,000
435,000,001 to	465,000,000	29,999,999	\$0.030	\$900,000
465,000,001 to	490,000,000	24,999,999	\$0.035	\$875,000
490,000,001 to	515,000,000	24,999,999	\$0.040	\$1,000,000
515,000,001 to	535,772,530	20,772,529	\$0.045	\$934,764
Total				\$4,459,764
Difference - ACS Savings and Discount Leakage				\$0

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TABLE 1 (Years 1-3)

Notes & Sources

- [1] USPS-T-1 (Ayub), Appendix A, page 1
- [2] USPS-T-1 (Ayub), Appendix A, page 1
- [3] USPS-T-1 (Ayub), Appendix A, page 1
- [4] USPS-T-1 (Ayub), Appendix A, page 1
- [5] USPS-T-1 (Ayub), Appendix A, page 2
- [6] USPS-T-1 (Ayub), Appendix A, page 2
- [7] Assumes all extra BR volume is solicitation mail.
- [8] = ([1] - [2]) * [3] * [4] * [7]
- [9] = Table 2 [1b]
- [10] = [9] - [5]
- [11] = [8] * [10]

TABLE 2 (Years 1-3)

Notes and Sources: Request, Attachment B

- [1] Request, Attachment B
- [3]

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DISCOVER NSA

TABLE 3
Calculation of Total Stop Loss Estimate

	<u>Volume</u> [1]	<u>Discount</u> <u>Leakage</u> [2]	<u>Return</u> <u>Cost</u> <u>Savings</u> [3]
Year 1	518,233,050	\$3,670,487	\$3,670,487
Year 2	526,559,959	\$4,045,198	\$4,045,198
Year 3	535,772,530	\$4,459,764	\$4,459,764
			<u>\$12,175,449</u>
Passthrough Percent			95%
TOTAL STOP LOSS ESTIMATE			\$11,566,676

Notes and Sources

[1] & [2] TABLE 2, for the year indicated

[3] TABLE 1, for the year indicated

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RESPONSE:

- (a) Confirmed that the ACS unit cost savings for total marketing mail volume per piece is \$0.01644240.
- (b) The projected Discover's Before Rate total First-Class mail volume of 518,233,050 is the point at which the ACS cost savings equals the discounts earned by Discover. This assumes that DFS's Before Rates forecast has been understated by 16% or 67 million pieces. In addition, it assumes that any volume above the Before Rates forecast of 451,000,000, presented in Appendix A page 2 of my testimony, is marketing mail. The "equilibrium" presented ignores any increase in contribution from increased marketing mail volume in response to the price incentives. This conflicts with the testimony of witness Giffney, who describes the effect of the price incentive on Discover future mailing decision making process. In effect, this volume of 518,233,050 represents "equilibrium" between a higher Before Rate forecast and ACS costs and discounts, but does not represent in any manner Discover's equilibrium Before Rate First-Class mail volumes forecast.
- (c) Confirmed. Please see my response to (a).
- (d) Not confirmed. Please see my response to (b).
- (e) Confirmed. Please see my response to (a).
- (f) Not confirmed. Please see my response to (b).

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OCA/USPS-T1-38. The following interrogatory concerns Discover Financial Services' "free rider" volumes.

- a. Please confirm that in PRC Op. MC2002-2, para. 8016, the Commission described "free riders" as "mail that would have been sent even absent the NSA" If you do not confirm, then explain why not.
- b. Using the definition cited in part a., please confirm that the Discover NSA contains 46 million "free riders," determined as follows;
 - i. The NSA (§III.D.) provides for a threshold for the first year of 405 million, at which point discounts of 2.5 cents will be paid; these discounts continue to be paid up to 435 million pieces.
 - ii. The Before Rates volume forecast is 451 million (Attachment A, page 6 (USPS-T- 1)). Discounts of 3 cents are paid up to the 451 million-piece level (and beyond).
 - iii. The Before Rates volume forecast of 451 million falls within the Commission's description of "volume that would have been sent even absent the NSA."
 - iv. If you do not confirm, then state the number of "free riders" in the Discover NSA. Show all calculations and provide all source documents.
- c. Please confirm that the Commission concluded that, absent a stop-loss provision, "there is a serious risk that discounts given to 'free riders' will exceed savings to the Postal Service and that other mailers will be worse off because of the NSA."

RESPONSE:

- a. Confirmed the term "free riders" was described as "mail that would have been sent even absent the NSA." The reference to "exposure" in my testimony refers to the fact that the threshold has been set below forecasted volume, and accounts for discounts on any mail volume that were not mailed due to the price incentive. Witness Eakin, in Docket No. MC2002-2, USPS-T-4, describes the importance of setting the threshold below the forecasted volume. However, I would like to clarify that the term "free riders" is a misleading concept, as the "free-riders" pieces referred to are, at all

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times, contribution positive. In addition, because the incentive is not applied to all volume, Discover must continue to mail pieces to reach the threshold. Furthermore, the cost of litigating an NSA for a customer carries a significant transaction cost. The cost of litigating an NSA may be absorbed or exceed the discounts earned on the “free riders.”

- b. The Before Rates forecast exceeds the threshold by 46 million pieces, and is calculated as a cost in the NSA in Appendix A, page 6, lines 4 to 8, where the exposure to the Postal Service is identified. The total discount earned on volume that would have been mailed in the absence of a discount is \$1,230,000.
- c. The exposure to the Postal Service from the “free rider” problem in Discover is \$1,230,000 and, assuming no increases in After Rates volumes and ignoring the benefits that cannot be quantified at this time, the value of the NSA to the Postal Service is still \$1.3 million.

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OCA/USPS-T1-39. For Discover Financial Services (DFS), please provide an analysis equivalent to that submitted by witness Crum at Tr. 2/318-22 (Docket No. MC2002-2), in response to POIR 2, question 7.

- a. In your analysis, address specifically the fact that DFS' estimated First-Class Mail (FCM) solicitation volumes are approximately 23% of Capital One's FCM solicitation volumes.
- b. Also, address specifically the fact that in contrast to Capital One, which had an obligation to update its address lists within two days of receipt of electronic ACS notices (Tr. 2/321), DFS is given a longer period of time – 30 days – to update its address lists.
- c. Isn't it generally correct that dividing Capital One's annual volumes of FCM solicitations – 768 million – by the number of delivery points in the United States (witness Crum used a figure of 137,682,00, from the Postal Service's 2001 Annual Report; Tr. 2/320) yielded an implied average number of pieces per delivery point of 5.6? If you do not agree, please explain.
- d. Isn't it generally correct that dividing DFS' estimated annual volumes of FCM solicitations – 174 million – yields an implied average number of pieces per delivery point of 1.27? If you do not agree, please explain.
- e. Doesn't a comparison of the figures set forth in parts c. and d., *i.e.*, 5.6 versus 1.27, suggest that the Postal Service is much less likely to benefit from avoided forwards in the case of DFS than it does in the case of Capital One? If you do not agree, please explain.
- f. Please confirm that an obligation to update address lists within 30 days (DFS) compared to 2 days (Capital One) is likely to result in higher costs for the Postal Service for forwarding and returning DFS' UAA mail as compared to Capital One. If you do not confirm, please explain.

RESPONSE:

As Witness Crum stated in cross examination in Docket No. MC2002-2, Transcript Volume 3, page 363, lines 20-21, the Postal Service provided the information in POIR2-7 from that case in "response and not part of testimony" as a general baseline analysis of what the minimum savings for eliminating future forwards could be calculated as. This is also the reason any benefits from forwarding are not calculated as a savings, or presented as savings, in my

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testimony. Witness Crum identified that the information was not presented in “testimony because I (witness Crum) didn’t believe there was solid support of a number.” (Transcript, Volume 3, page 363, lines 23-25). The Postal Service, in the case of DFS, is similarly unable to provide data other than the “averages” provided by witness Crum. Below, I will address the specific points identified by the OCA.

(a) DFS's estimated FCM solicitation volume is approximately 23% of Capital One’s FCM solicitation volume, which would indicate that the potential pool of ACS savings for DFS is smaller than for Capital One.

(b) Confirmed that DFS's obligation to update its list is within 30 days, as compared to Capital One’s obligation of 2 days. This change reflects the difference in operating structure between DFS and Capital One, and that the two mailers have unique business rules and practices.

(c) Confirmed that dividing the number of FCM solicitations for Capital One by the number of delivery points in the United States, yields an implied average number of pieces per delivery point of 5.6. However, as Witness Crum stated in oral cross examination, Volume 3, lines 24-26, “Certainly we don’t know that Capital One mails to every domestic delivery point. I would seriously doubt they do but we had to try to make some calculations to respond to their (POIR request 2) request.” This implies that the analysis provided in response to POIR 2 was the most conservative estimate of savings from eliminating repeat forwards.

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(d) Confirmed that dividing DFS's annual FCM solicitation volume of 174 million by the total number of delivery points yields an implied average of 1.27. However, as Witness Giffney has indicated, DFS may mail multiple times to a prospective customer. Moreover, not every household fits the characteristics (which are variables which could range from credit scores to income) that would meet DFS customer requirements. For these reasons, it is highly unlikely that DFS mails to every delivery point in the United States. Applying the average methodology employed by Witness Crum in response to the POIR to provide a framework for calculating estimated savings from repeat forwards, while applying the same values for all the variables, does not provide a meaningful analysis for smaller FCM solicitation mailers.

(e) Not confirmed. Please see my response to (d) above.

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OCA/USPS-T1-40. Please compare the NSA requirement (§II.C.) for Capital One, *i.e.*, “In exchange for a waiver/suspension of ACS fees, Capital One agrees to update its databases within 2 business days and use the information in all future marketing campaigns,” with the much weaker, non-specific obligation imposed on DFS (NSA §II.B.2.), “For every mailing whose address source is an outside list, DFS agrees to forward the ACS notices to its third party list processor, or arrange to have the Postal Service forward the ACS notices directly to its list processor. DFS will work with its third party list processor to use this data for all future marketing campaigns.”

- a. Please confirm that witness Giffney testifies (at page 6 of DFS-T-1) that: On a monthly basis, DFS procures over 40 mailing lists that make up the entire acquisition campaign mailing. We mail from these lists and not from an internal prospect database. If you do not confirm, please explain why not.
- b. Please confirm that, given DFS’ practice of using purchased mailing lists, as contrasted with Capital One’s practice of using an internal prospect database, there is less certainty that provision of eACS notices will result in reduced DFS UAA pieces compared to Capital One.
- c. Describe in detail the specific procedures that DFS will employ to reduce future UAA mailings to addresses identified as subject to forwarding or return notices.
- d. Please state which provisions of the Data Collection Plan will require reports on the procedures employed by DFS to utilize the eACS information provided under the NSA to reduce the number of future mailings of UAA pieces to addresses identified by the Postal Service as subject to forwarding or return notices.

RESPONSE:

- (a) Confirmed.
- (b) Not confirmed.
- (c) I am not in a position to describe in detail the specific procedures that DFS will employ to reduce future UAA mailings, other than those specifically identified in section II of the NSA contract (Request, Attachment F) between DFS and the Postal Service. Generally speaking, however, it is my understanding that DFS will analyze and test the ACS data provided, and will incorporate the data as it becomes available and falls within the

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business rules and practices of DFS. The cost savings of eliminating future and forwards and returns are not calculated or presented as savings in my testimony.

(d) I am not aware of any provisions of the Data Collection Plan that will require reports on the specific procedures employed by DFS to utilize the ACS information. It is my understanding that DFS believes the specific business rules they apply to mailing lists is propriety information. However, the Postal Service will have data regarding the number of forwarded and return notices provided to DFS.

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.

Brian M. Reimer

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August 16, 2004