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

RATE AND SERVICE CHANGES TO IMPLEMENT FUNCTIONALLY EQUIVALENT NEGOTIATED SERVICE AGREEMENT WITH BANK ONE CORPORATION	Docket No. MC2004-3

UNITED STATES POSTAL SERVICE NOTICE OF THIRD ERRATA TO DIRECT TESTIMONY OF MICHAEL K. PLUNKETT (THIRD ERRATA)
(September 14, 2004)

The United States Postal Service provides notice that it is filing a third errata to witness Plunkett's testimony. Three revised pages are attached for inclusion in the text of witness Plunkett's testimony and two revised pages in Appendix B. The changes were prompted by the revisions to Appendix A made on August 6, 2004 and on September 1, 2004. The revised pages are dated September 13, 2004, because these changes were already incorporated into the copies of witness Plunkett's testimony provided to the Commission on September 13, 2004.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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Standard Mail, and percent of marketing mail converted from Standard Mail to First-Class Mail.

As Bank One witness Rappaport explains, the price incentives in the NSA are expected to produce a First-Class Mail volume response of 19 million pieces for the first year of the agreement and 99 million additional pieces in Year 2 and Year 3. BOC-T-1 at 8. The new contribution must account for any substitution leakage that would result from the loss of contribution from Standard Mail pieces converted to First-Class Mail marketing pieces. To be conservative, witness Rappaport has estimated that 100 percent of incremental volume would be converted from Standard Mail. (BOC-T-1 at 8). The Postal Service believes that the incremental volumes will exceed the forecast. *Id*. (See Part C., Conservatism of Assumptions, below).

The final value determinant is the expected discount exposure. The discount exposure lowers the value of the NSA and is the result of price incentives applied to any volume that would have occurred without a price incentive. As described by Postal Service witness Eakin, in the baseline case, setting a threshold below forecast volume is economically efficient because it reduces the mailer's marginal price of First-Class Mail relative to other forms of solicitation, and reduces the gap between marginal price and marginal cost of the mailer's First-Class Mail. Docket No. MC2002-2; USPS-RT-2 at 4-5.

I estimate the value to the Postal Service of the Bank One agreement, when considering all three value drivers over the three years of the NSA, as follows:

ACS Cost savings:	$7.8 million
Increased contribution (less incremental discounts):	$6.8 million

Discount exposure: $(2.9) million

The agreement therefore would result in net benefit to the Postal Service of $11.7 million over the life of the NSA. A detailed analysis of the financial impact is provided in Appendix A.

B. Financial Model

I believe that the analysis provided in the valuation model of the Bank One NSA complies with the guidelines established by the Commission in Rule 193(e). The model follows Postal Service witness Crum's methodology in Docket No. MC2002-2, except in instances where a change allows it to conform more closely to the requirements of Rule 193(e). The features of the model are described below; the model is in Appendix A and any changes are discussed in Appendix B.

The Postal Service and Bank One have provided more data than in Docket No. MC2002-2, in order to comply with Rule 193(e)(2), and to present a more representative estimate of the cost and volume effects of the NSA in Years 2 and 3 of the agreement (see Appendix A). In witness Rappaport's testimony, Bank One has provided its best estimate of mail volume forecasts in Years 2 and 3 of the agreement. BOC-T-1 at 5-8.

In addition, as described in Appendix B, the Postal Service applies a 4 percent annual inflationary cost adjustment factor to estimate unit costs in each year of the Bank One agreement and to account for cost increases since litigation of the Capital One NSA agreement. This cost adjustment factor will provide a better estimate of the value

Bank One, because its potential cost savings are not nearly as large as the potential cost savings for Capital One, which is a larger originator of First-Class Mail marketing solicitations than Bank One. Fears that the customer would have significantly increased mail volumes should be mitigated in the current environment of declining First-Class Mail volumes and potentially adverse business conditions.

The conditions that the Commission cited to support a cap on the discounts in the baseline case do not apply here. The major concern expressed over the course of the Capital One case was that mail volume would have grown in the absence of a discount so that the discounts would exceed the cost savings. By comparison, Bank One's volume history is stable, and even if its marketing mail volume were to match its historic high, the Postal Service would receive a positive benefit from the NSA. Specifically, Bank One's highest annual marketing letter First-Class Mail volume was 79 million pieces in 2001, prior to the most recent rate increase. If Bank One, without price incentives, could reach this same level for all three years of the agreement, it would receive $8.0 million in discounts on their before-rates volumes over the term of the agreement (as opposed to the $2.9 million estimate presented above in Section IV.A.). This discount earned by Bank One would correlate to exposure for the Postal Service. But, despite the increase in exposure, the NSA would be contribution-positive because of ACS savings. Under the situation described above, the Postal Service would have underestimated the savings from ACS and, in absolute terms, the savings at 79 million marketing pieces would have been $10.5 million (as opposed to the $7.8 million presented above in Section IV.A.). This means that the NSA would still generate $2.4 million in additional contribution for the Postal Service.

counting of the 36,080,000 (Y1BR – Beginning Threshold: 571,080,000 – 535,000,000) mail pieces occurs in the discount and exposure calculations, because the 36,080,000 pieces are in the exposure calculation. The Y1AR volume of 590,135,000 is made up of the Y1BR volume plus the 19,055,000 additional marketing pieces. To account for this double counting, the Postal Service subtracts the discount from the exposure, to get the "real" discount calculation of $597,325 (Appendix A, page 11).

UAA Calculations

In lieu of receiving physical returns, Bank One will accept electronic diversion of address changes or corrections, as Capital One does. This results in cost savings to the Postal Service by replacing costly physical returns with the less costly transmission of electronic information. The estimated Capital One physical and electronic return unit costs described in USPS-LR-1/MC2002-2 will be used in the Bank One model. The total return costs savings vary from the Capital One model because of the different marketing mail volumes and return rate forecasts (9 percent for Bank One's marketing mail letters) and the inclusion of the contingency on the base cost.

To calculate the cost savings, multiply the expected volume of Bank One's UAA mail times the unit costs savings for each piece processed through the ACS times the percentage of Bank One's UAA mail that will be processed. The calculation relies upon the evidence in Docket No. MC2002-2 for (1) the estimated percentage of Bank One's UAA mail that will be processed through the ACS system (85 percent) and (2) the unit savings for each UAA piece processed through the ACS system. The contingency is not applied until page 11.

Standard Mail Revenue Calculations and Standard Mail Cost Calculations

The Standard Mail Regular and Enhanced Carrier Route (ECR) Revenues are based on the Standard Mail Regular and ECR billing determinants of Bank One. The revenue per piece for both Regular and ECR is a weighted average of the revenue per piece and the percent of Bank One volume. The Standard Regular and ECR unit costs are based on Docket No. R2001-1 for TY 2003 unit costs (Docket No. R2001-1, USPS LR-J-58). These data are based on the USPS version of the cost models, due to the fact that a PRC-version is not available for some of the data. Specifically, the total unit costs of Standard letters and Standard ECR letters are needed for this analysis. These data are found in the USPS Weight Study (Docket No. R2001-1 USPS LR-J-58), and there is no PRC version of this document. The format for 2004 unit costs follows the First-Class Mail Unit Cost estimates on pages 4 and 5 of Appendix A. This provides the customer-specific revenue and cost data on Bank One’s Standard Mail. The standard mail cost is adjusted by the contingency, as was the First-Class Mail cost.

Contribution Inputs

The Contribution Inputs calculate the contribution per piece of Bank One’s operational mail and marketing mail letters. This per piece calculation provides the Postal Service with before and after rates revenue, cost, and contribution for First-Class Mail and Standard Mail on a customer-specific basis. It also allows for forecasting future contribution per piece in the out-years of the agreement by allowing the inflationary growth to be multiplied by the cost of each subclass. Unit revenue remains constant over the three-year agreement.

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.

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