

1 **SUPPLEMENTAL TESTIMONY OF ALI AYUB (USPS-T-1)**

2 **I. INTRODUCTION**

3 The purpose of my supplemental testimony is to identify the course over which
4 historical volumes are established, the processes in which the new agreement structure
5 was crafted, and the impact on the USPS analysis on volume projections.

6 Prospective Negotiated Service Agreement (NSA) customers are required to
7 identify mailing permits, meters, entry points and/or mail service providers (MSPs) that
8 they have used over the past three years. This information is used to construct a
9 customer's historical mail profile. Based on prior experience, many customers do not
10 track or do not aggregate mail pieces, individual meters, or permits across diverse
11 business lines as a direct measurement matrix across their entire organization.

12 Mail volumes for a customer are reconciled by comparing a customer's own
13 mailing records of their volumes and permits, with internal USPS documentation of the
14 customer's total volume. These combined efforts are intended to identify all volume
15 that belongs to the prospective NSA customer.

16 Identifying all the permits for WMB (Providian at the time of the analysis) was
17 complicated due to its MSP's use of commingled mail volumes and use of permit
18 names not easily identifiable as Providian. Furthermore, difficulties in identifying the
19 actual date of mailing contributed to the problem. The NSA requirement of unique
20 permit identification prior to implementation eliminates these problems once an
21 agreement is active.

22 In identifying the historical profile for WMB, neither entity identified a specific
23 permit associated with a unique business line in building the historical profile. However,

1 WMB indicated inclusion of projections from the business line for which historical mail
2 volumes for CY 2005 were excluded from the originally reported historical volume base.

3 As noted in WMB Witness Rapaport's Testimony, WMB has not revised its
4 Before-Rates and After-Rates projections. The reasons provided by WMB on why its
5 forecasts do not change are consistent with WMB's approach of using estimated
6 budgets to forecast mail use. However, the changes in WMB's historical volume
7 information caused the USPS range of forecasted volumes to increase. However,
8 because of the increased volumes, the previously agreed-upon thresholds no longer
9 exceeded the 2005 historical volume.

10 The revised historical volumes in USPS FY format¹ are:

Time Period	Original Filing	Revised Filing
FY 2002 (Jan 01 – Sept 01)	Not Filed but included in WMB Historical Volume	384,454,936
FY 2003	393,000,000	453,750,871
FY 2004	352,000,000	320,272,614
FY 2005	394,000,000	474,163,147
FY 2006 (Oct 05 – April 06)	No Data	261,558,402

11 As a result of the change in historical volume, the USPS and WMB restructured
12 the NSA with higher thresholds, as well as higher incentives on new blocks. On June 6,
13 the parties agreed to the following revised discount structure:

14

¹ Monthly data are available in the file WMB_Mail_Volume_REVISED that is included as part of my testimony.

	<u>Year 1 Volume Block</u>	<u>Incremental Incentives</u>
1		
2		
3	490,000,001 – 505,000,000	3.5¢
4	505,000,001 – 520,000,000	4.0¢
5	520,000,001 – 560,000,000	4.5¢
6	560,000,001 – above	5.0¢

7 The key elements of the change include the following:

- 8
- 9 • the initial threshold for the first discount tier has increased from 450 million to 490
 - 10 million FCM pieces;
 - 11 • the discounts in the first three tiers are higher than proposed; and
 - 12 • except for the first tier, the differences between the upper and lower bounds in the
 - 13 volume blocks have been shrunk, so that the higher discounts become available at
 - 14 lower volumes.

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16 The increase in the initial threshold lends further support to the prediction that

17 the incentives will be applied to incremental volume that either is converted from

18 Standard Mail or is new First-Class Mail. As I describe later, the increase in historical

19 volumes does not, on its own, imply that 90 percent of WMB marketing mail volume

20 would shift to First-Class Mail absent appropriate incentives.

21 Under the amended agreement, the size of the incentives blocks was decreased

22 and the incentive amounts were increased to provide incentive for WMB to convert to

23 First-Class Mail as their primary acquisition medium. By committing to an increased

24 threshold, with no change to the Before-Rates forecast, WMB is committed to

1 increasing volume by 40 million pieces at non-discounted rates before it can earn its
2 first incentive. The accelerated incentives at higher levels ensure that WMB receives
3 the same motivation to convert its volumes to First-Class Mail while ensuring that the
4 value of the overall agreement to the USPS remains very close to original projections.

5 **II. Volume Analysis**

6 Although the change in historical volumes did not cause WMB to recalculate its
7 forecasts, we determined that the possible range of before-rates forecasts could be
8 impacted. I have summarized the changes to the models I previously identified in my
9 testimony as forming the basis of the USPS evaluation of the WMB before-rate
10 forecast.

11 I evaluated recent mailing patterns to identify any obvious trends. As witness
12 Rapaport notes, WMB increased mailing in FY05 as a result of a merger as a result of a
13 one-off event. Comparing January 2006 to April 2006 First-Class Mail volume to the
14 same period in the previous year shows that the growth is about five percent.² Using
15 the January 2006 to April 2006 growth rate as a proxy, one can develop a crude
16 forecast range. Based on the use of that proxy, one would expect that based on FY 05
17 volume of 474 million pieces, the volume estimate for FY 06 would be almost 497
18 million pieces.

19 Failure to revise the thresholds could result in leakage in addition to that
20 estimated in my original testimony. However, WMB's 210 percent growth in Standard
21 Mail³ to 71 million pieces during that same time period amplifies the observation that

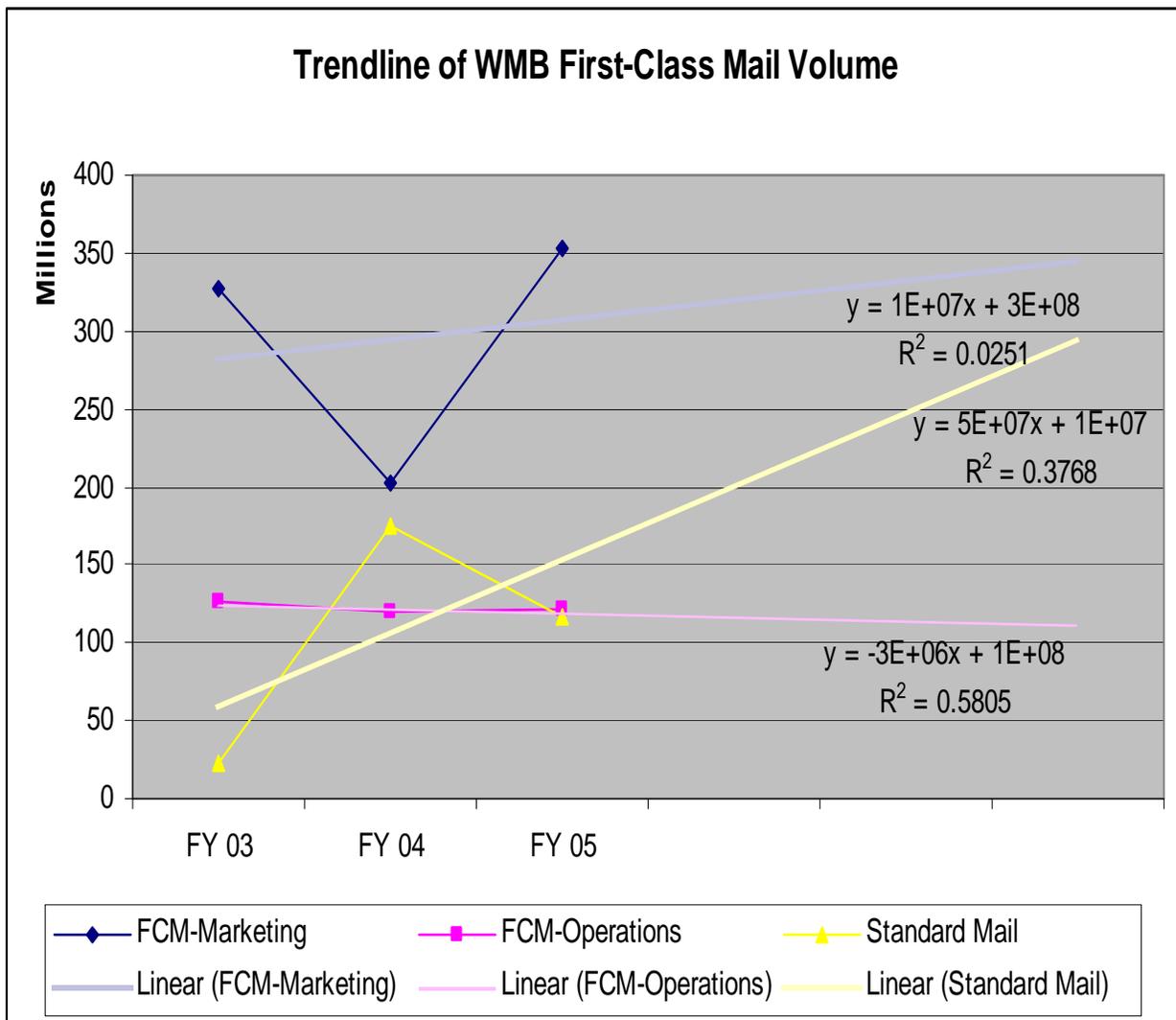
² For January to April { FY 06 Volume (91) – FY 05 Volume (86) } / FY 05 Volume (86)

³ For January to April { FY 06 Volume (71) – FY 05 Volume (23) } / FY 05 Volume (23)

*all numbers in millions

1 there is a shift towards Standard Mail in the credit-card industry as a whole. Given the
 2 growth rates in Standard Mail, I believe that 5 percent growth in First-Class Mail for the
 3 remainder of the year may be overly optimistic. However, by adjusting the threshold to
 4 490 million pieces, we mitigate the risk associated with this growth.

5 In my original testimony at pages 18 and 19, I describe a trend analysis used to
 6 evaluate the historical profile of WMB. I have recreated the trend lines below:



7

8 Based on the original data, the trend line indicated that First-Class Mail
 9 marketing volumes were expected to decrease. The R^2 for the First-Class Mail

1 marketing volume in fact was particularly high at 0.992,⁴ suggesting that First-Class
2 Mail volumes would decrease significantly over the next three years.

3 However, the initial before-rate forecast of 330 million First-Class Mail marketing
4 pieces provided by WMB was not consistent with the output of the original trend
5 analysis. As noted in my testimony, the trend line is a simple “cross-check of the
6 company short-term forecast,”⁵ and is not intended to be a comprehensive analysis of a
7 company’s before rates forecast.

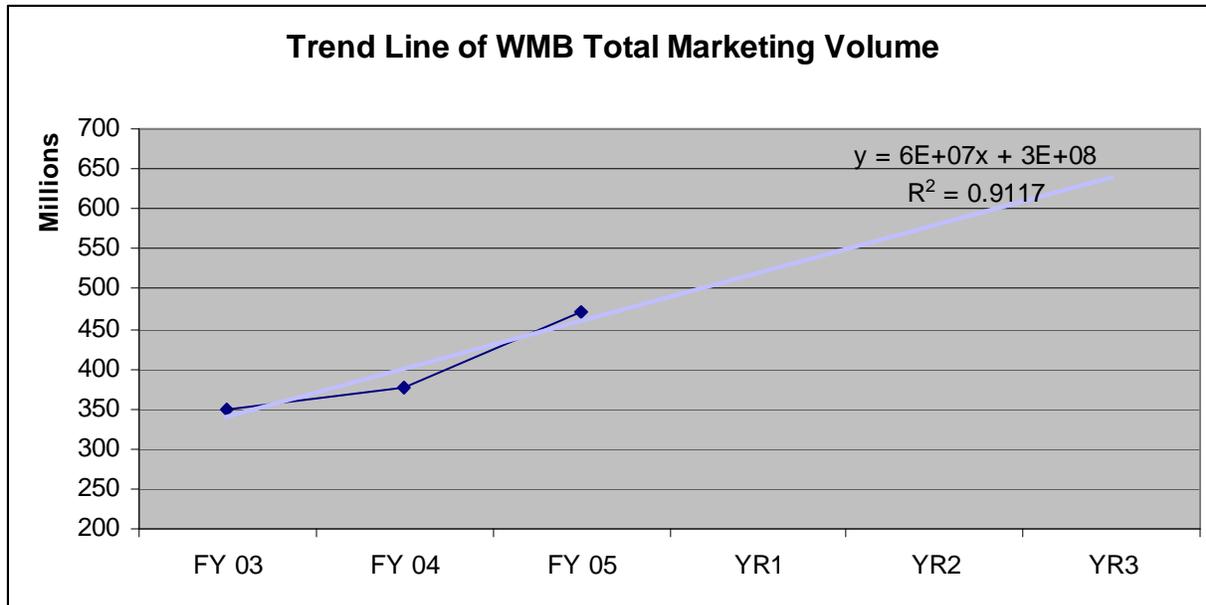
8 Usually, the trend line is effective in identifying cases in which customers provide
9 before-rates estimates that are lower than expected. However, in this instance, the
10 WMB initial forecast was significantly higher than the results predicted by the trend line.
11 The trend line now points towards First-Class Mail marketing volumes that are more
12 stable or may experience minor growth, whereas previously it had predicted significant
13 decrease in First-Class Mail marketing volumes. This result is more consistent with the
14 330 million piece forecast provided by WMB.

15 The trend line for WMB total marketing volume now indicates that total marketing
16 mail volume should increase in the short term. In fact, the R^2 increased from 0.2914 to
17 0.917. This output is consistent with WMB forecasts which predict growth in marketing
18 mail.

19 In evaluating the trend lines for First-Class Mail marketing, Standard Mail
20 marketing, and total marketing mail, the analysis reflects potential growth in total
21 marketing mail volumes with the probability that the majority of that growth will come in
22 Standard Mail.

⁴ MC2006-3 USPS-T-1 page 18 line 5

⁵ MC2006-3 USPS-T-1 page 19 line(s) 11-12



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This outcome is more consistent with the initial estimate of WMB of growth in total volume. But in this analysis, the growth primarily comes in Standard Mail, which is consistent with WMB statements. This outcome also strengthens our belief that without the incentives, WMB will not convert large portions of its marketing volume to First-Class Mail.

There are no significant changes to the demand function as described on pages 21 to 23 of my original testimony. Based on the variables identified in the original filing, the current volumes and variables do not create a statistically valid forecast.

Finally, the forward looking methodology identified on page 23 does not materially change because the future account growth is independent of past account growth. Our estimate of total marketing mail volume remains in the range of 500 to 666 million total marketing pieces from this analysis.

However, the analysis that identifies the expected allocation of budget dollars to First-Class Mail and Standard Mail is influenced by the changes. I have reproduced

1 Table 5 from page 24 and the description in lines 13 to 18 of my original testimony
 2 which will provide the framework on which the allocation model is based. I have also
 3 included Providian's 10-K from March 31, 2005⁶, one of the last publicly available filings
 4 by Providian that includes this information.

5 These data show that Providian's total solicitation budget was \$260 million in
 6 CY04. Based on Providian's historical marketing budgets and postage spent, the Postal
 7 Service has determined a revised ratio of 40 percent⁷ of postage to overall marketing
 8 expenditures.

9 According to analyst reports, discussions, and annual reports reviewed by the

10 Postal Service, 11 WMB's total ⁸ 12 marketing 13 budget could 14 reach \$800 ⁹	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

15 million. If we are to assume that 50 percent of WMB marketing budget is allocated to the
 16 card services unit this would indicate a budget of \$400 million for the card services. If 40
 17 percent of this budget were allocated to postage, then postage expenditures could be as
 18 high \$160 million, which is in the same range as previously stated.

⁶ Attachment A

⁷ The ratio was adjusted because in the original filing, postage on First-Class Mail operations mail volume was included in the calculation of the ratio. This ratio is based only on marketing volumes. Including postage on operations mail volume increases the ratio to 49 percent.

⁸ Since the merger of WMB and Providian we do not have independent estimates of the marketing expenditure for only the Card Services.

⁹ This number reflects the estimate for the entire WMB parent company.

1 The possible First-Class Mail and total marketing mail volume estimates mix that
2 would fit this budget based on the highest ranges of from Table 5 are:

- 3 • 30 percent of 680 million pieces, which is 204 million First-Class Mail
4 marketing pieces, for a total First-Class Mail estimate of 320 million
- 5 • 40 percent of 650 million pieces, which is 260 million First-Class Mail
6 marketing pieces, for a total First-Class Mail estimate of 380 million
- 7 • 60 percent of 600 million pieces, which is 360 million First Class Mail
8 marketing pieces, for a total First-Class Mail estimate of 480 million

9 Based on the allocation model, as the number of total marketing pieces
10 increases, it becomes less likely that the increase will come in the form of increased
11 First-Class Mail.

12 The outcome of the analysis described above supports WMB's forecast of 450
13 million First-Class Mail pieces. The range of forecasts we have identified is 430 million
14 pieces to 500 million pieces. The revision of the threshold to 490 million pieces
15 decreases the risk of additional leakage even though WMB's own forecast has not
16 changed.

- 1 500 million pieces is plausible before-rates forecast which could result in
- 2 “leakage” and is an acceptable outcome. As the sensitivity chart below demonstrates,

BR Volume	AR Volume	Leakage Pieces	Leakage on Existing Pieces	Incentives on Incremental Pieces	Increased Contribution from converted Pieces	Net Contribution
450,000,000	713,000,000	0	0	\$10,575,000.00	\$34,453,000	\$23,878,000.00
475,000,000	713,000,000	0	0	\$10,575,000.00	\$31,178,000	\$20,603,000.00
500,000,000	713,000,000	10,000,000	\$350,000	\$10,225,000.00	\$27,903,000	\$17,328,000.00
525,000,000	713,000,000	35,000,000	\$1,350,000	\$9,225,000.00	\$24,628,000	\$14,053,000.00
550,000,000	713,000,000	60,000,000	\$2,475,000	\$8,100,000.00	\$21,353,000	\$10,778,000.00
575,000,000	713,000,000	85,000,000	\$3,725,000	\$6,850,000.00	\$18,078,000	\$7,503,000.00
600,000,000	713,000,000	110,000,000	\$4,975,000	\$5,600,000.00	\$14,803,000	\$4,228,000.00
625,000,000	713,000,000	135,000,000	\$6,225,000	\$4,350,000.00	\$11,528,000	\$953,000.00
650,000,000	713,000,000	160,000,000	\$7,475,000	\$3,100,000.00	\$8,253,000	-\$2,322,000.00
675,000,000	713,000,000	185,000,000	\$8,725,000	\$1,850,000.00	\$4,978,000	-\$5,597,000.00
700,000,000	713,000,000	210,000,000	\$9,975,000	\$600,000.00	\$1,703,000	-\$8,872,000.00
725,000,000	725,000,000	235,000,000	\$11,225,000	-\$650,000.00	\$0	N/A
750,000,000	750,000,000	260,000,000	\$12,475,000	-\$1,900,000.00	\$0	N/A

1 even at before-rates forecasts that are significantly higher than the 450 million piece
 2 forecast provided by WMB, the NSA remains contribution-positive. WMB First-Class
 3 Mail before-rates volume would have to be in the range of 630 million pieces for the
 4 agreement to be contribution-neutral. This would represent an increase of over 33
 5 percent over FY05 First-Class Mail volumes.

6 WMB's before-rate forecast of 450 million remains credible, but the possibility of
 7 additional leakage required adjustment of the threshold. By adjusting the threshold, we
 8 mitigated the risk of exposure that existed in the previous agreement. It is my belief
 9 that it is highly unlikely that WMB First-Class Mail will grow to the levels of 713 million
 10 identified in WMB's after-rates forecast without the benefit of the NSA.

11 **III. USPS VALUE**

12 The value of the agreement is:

Contribution from New Volume	86,789,222
Total Exposure	350,000
Total Incremental Discounts	37,200,000
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Total USPS Value	49,239,222

13 The reasons there are changes in the value of the agreement are:

- 14 • The increased threshold eliminates the risk of exposure in Year
 15 2 of the agreement

1 • The costs estimates that were inflated from R2005-1 and were
2 updated with R2006-1 data were in effect lower than projected

3

4 Furthermore, in the cost adjustment for providing ACS, we use electronic ACS as the
5 basis for our adjustments. The cost of OneCode ACS is significantly lower than the
6 electronic ACS adjustment currently used.

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