

**UNITED STATES OF AMERICA
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001**

**Rules Applicable to Baseline
And Functionally Equivalent
Negotiated Service Agreements**

Docket No. RM2003-5

COMMENTS OF CAPITAL ONE SERVICES, INC

Introduction

Pursuant to Commission Order No. 1383 Capital One Services, Inc (“Capital One”) offers the following comments.

Capital One is pleased that the Commission has acted so promptly to promulgate rules governing the future approval of Negotiated Service Agreements (NSAs). Capital One would particularly like to compliment the PRC on the significant step it took when it approved the Capital One NSA and made the legal and policy determination that it has the power to and should recommend NSAs. The proposed rules will resolve uncertainties and questions about the appropriate procedures to be followed and the evidentiary standards to be met. However, Capital One must express disappointment that the Commission has chosen to impose procedural and evidentiary burdens on the consideration of new baseline NSAs that are more time consuming and extreme than those employed in the consideration of the Capital One NSA, a docket with 29 parties that consumed 239 days from its commencement to its conclusion, required the testimony of 15 witnesses, filled over 2,200 pages of testimony and required three sets of hearings and cross examination.

We are concerned that the proposed rules unrealistically expect the Postal Service and mailers to be able to project mailer-specific costs, volumes and revenues over a lengthy period of time using methodologies that have the appearance of objectivity. It is simply unrealistic to tell mailers they are expected to have this kind of information about themselves when they do not normally or regularly collect it, nor project it, nor use it in their business. It seems to us equally unrealistic to expect the Postal Service to become an expert about what it costs to handle the mail of each particular mailer in the United States, or, at least, each particular mailer that wants to do an agreement. We think the formalistic requirements that have been established in these proposed rules, particularly sections (e) and (f), go well beyond any need to protect the integrity of the net contribution to the bottom line of the Postal Service.

The Commission refused to consider the Capital One agreement under the rules for experimental changes. Capital One understood the Commission's desire, because of the precedential nature of the proceeding, to go slow and to ensure that every party had the fullest opportunity to be heard. The procedures used and the evidentiary requirements caused Capital One to incur considerable expense, not just for lawyers and experts, but also in the consumption of large amounts of the time of valuable personnel of Capital One, diverting their attention away from their regular duties. Capital One, however, believed that once the initial proceeding was concluded, the Commission would take the lessons of that proceeding and design a streamlined but fair procedure for the consideration of NSAs.

Capital One is concerned that the complexity and burden imposed by the proposed rules will have a chilling effect on other postal customers who are considering NSAs in the wake of the Capital One Agreement. Had such rules been in effect during the consideration of the Capital One Agreement, the time consumed in considering the agreement, and the costs to both the Postal Service and to Capital One, would have been even greater than the significant costs that were actually incurred. Not only will the data and information required by the proposed Rules discourage very large mailers such as

Capital One, we believe the transaction costs imposed by these proposed rules would be particularly discouraging to small and medium sized mailers who would be discouraged even to explore NSA possibilities.

Proposed Section 3001.193 - Contents Of Formal Requests

Capital One's principal concerns with the proposed Rules focus on the required contents of requests for NSAs, specifically: 1 the required financial analysis, Rule 193(e)(4), (5), (6), (7) and (8); and 2, the impact analysis of the proposal on competitors, Rule 193(f).

Subsections (e)(4), (5), (7) and (8) all require the provision of mailer-specific costs, volumes, revenues, and elasticity factors, plus explanations of the bases and methodology used to derive such, and for each year of the agreement, before and after rates. As we will explain, such mailer-specific costs are generally not known, nor are there reliable mailer-specific elasticities, and certainly none that could be projected for a three year period. We recognize that section (e) does provide that : "If mailer-specific costs or elasticity factors are not available, the basis of the costs or elasticity factors that are proposed shall be provided, including a discussion of the suitability of the proposed costs or elasticity factors as a proxy for mailer-specific costs or elasticity factors." And Rule 193 (a)(2) does provide that parties can request a waiver for such mailer-specific information as required in section (e), based upon the unavailability of such data and its continued unavailability without undue burden, and, under Rule 193(a)(3), can request a waiver of data and information required by section (e) by explaining the reasons why the character of the request and its circumstances justify a waiver.

We believe that, in the great majority of the cases, the Postal Service and the parties are going to request waivers, claiming that the information is unavailable, that it cannot be produced without undue burden, and that it is inappropriate in the circumstances. Either exceptions to the Rule will have to become the Rule, or mailers will not pursue NSAs. The information and data requirements that are ultimately proposed by the Commission should include a presumption in favor of the Postal Service with regard to the need to produce unavailable data, as is the approach of existing Commission Rule 67(b) relating

to experimental classifications. This obviates the necessity to obtain waivers for such unavailable data.

Mailer-Specific Costs

In explaining its requirement of mailer-specific costs, the Commission's Rulemaking Notice specifically points out that the Capital One NSA was predicated on Postal Service average costs "as opposed to mailer-specific costs, and on less than complete knowledge of Capital One's likely future mailing strategies." (Page 5). To avoid confusion, we should explain that what the Commission really means are not costs that Capital One incurs, but rather the costs that USPS incurs in performing services for Capital One in the delivery of its mail. Capital One does not know what it costs the Postal Service to perform a specific handling function on Capital One's mail, versus the average cost of performing that function for all mail of that type. (What it costs a mailer to perform certain in-house functions is largely irrelevant to the issues in such proceedings, except to understand why a mailer may or may not undertake a particular function that the Postal Service would otherwise perform.) While it is true that some agreements may be predicated on the unique circumstance of a particular customer and, therefore, the cost avoidance to be enjoyed by the Postal Service would depend upon the Service's costs in performing that function for that particular mailer, unless the cost to be avoided or to be incurred by the Postal Service is known to deviate from average costs, it seems an impermissible burden to require the Postal Service, let alone the customer, to conduct a special study for each such discrete costs.

The Rulemaking statement that mailer-specific information will more accurately represent before and after affects of a deal on the Postal Service is confounded by its impracticality. As previously mentioned, the Postal Service does not know what it actually costs to deliver any particular mailer's mail. The Postal Service has an intricate and elaborate cost collection and attribution system which provides the average costs of delivery of a particular type of mail. While it is a truism that "using system average information is less likely to give a true representation of the financial affects" of handling Capital One's mail, we do not believe there is a practical alternative. The cost and

burden of determining mailer-specific costs, as distinct from the system average costs, both total cost, and costs disaggregated by function for a particular customer, would doom any further negotiated agreements.

The PRC Notice states that, in the Capital One Agreement, part of the justification was Capital One's higher than average return rate, and that information was vital in analyzing the benefit of the agreement to the Postal Service. That, of course, is true. However, the assumed value of the avoidance of the return was based on average return costs because the Postal Service had no knowledge of what it uniquely cost to return a Capital One First Class Mail piece. We believe that, where such mailer-specific costs are known, because they have been the subject of a special study, or because that customer's mailing patterns are so unique, those costs should be used if a specific part of the agreement is dependent upon knowledge of that specific cost for that mailer, rather than the average cost.

Mailer-Specific Volume Forecasts

The Rulemaking implicitly criticizes the failure of Capital One to have had complete knowledge of its likely future mailing strategies in that Docket. (Page 5). Capital One's mailing strategies, like those of any other sophisticated mailer, are constantly subject to changing market conditions; that does not mean that, at any given time, a company does not know what its mailing strategy is. However, to deduce from a given mailing strategy that there is a certainty that a particular volume of mail will be mailed, particularly over the 3 year period of the duration of an NSA, contradicts the known experience of mailers. It was difficult for Capital One, through the utilization of expert consultants, to estimate the volumes it would mail during the first year of the three year agreement; and, in addition to that challenge, the forecast changed during the course of the proceeding. The requirement of the proposed rules that such volume forecasts be made, not just for the Test Year, but for the entire three years of the agreement, is taking wishful thinking to the extreme. Any forecast that a mailer were to make about its own mail for the next three years would be speculative, built on nothing more than a series of assumptions, all of which could be contradicted immediately by the next market change. Volume predictions for individual mailers extrapolated on historical trends are unreliable, far less

reliable than the use of the average elasticities developed by the Postal Service and used with considerable confidence by the Commission in many proceedings.

Some of the Commission's concerns about volume projections, and they are legitimate concerns, can of course be mitigated if the agreement is premised upon guarantees of volumes. If the agreement provides that, in order to earn a benefit, the customer must achieve certain volume guarantees, then the accuracy of the customer's forecast assumes far less importance.

Proposed Section 3001.193 (e)(6) and (f)(1) and (2) – Affects On Competitors Of The Parties To The NSA

We object to subsection (e)(6) and section (f): both require that the Postal Service assess the impact of the agreement on contribution to the Postal Service from mailers who are not parties to the agreement, and supply any special studies that determine that impact and, if no studies were performed, explain the alternate basis for its estimates of the impact. These requirements derive from concerns raised by Professor Panzar in the Capital One docket. Professor Panzar posed the hypothetical question whether, even though contributions received from a party to the agreement would increase, the system-wide contribution might decrease due to competitive affects in the marketplace. The burden of meeting these requirements would be onerous. Professor Panzar himself pointed out that determining the impact on competitors of the mailer proponents would require a study that “would take ... years, not weeks and months”.

The record amply reflects the fact that Professor Panzar's concern was so remote as to be an impractical consideration to burden the consideration of NSAs. The same indirect effect could be posited in any general rate proceeding where discounts are offered to some competitors who are able to do something but not to other competitors, because they are unable to perform a certain function. Will they mail less because they are less able to compete because they do not get a discount? That happens in every general rate proceeding and the Commission has never suggested that consideration had to be given to such remote affects. Moreover, a fair reading of Professor Panzar's testimony, including

responses to questions, is that there was a great likelihood, even if there were a competitive affect on Capital One's competitors, that the affect on the Postal Service would be to increase and not decrease contribution.

We also object to section f (2) to the extent that it requires the Postal Service to estimate the impact on competitors of the Postal Service. As the Commission has held, the statutory requirement is that the Commission's obligation is to ensure that proposals promote rather than harm competition, not to assess whether they promote or harm a particular competitor of the Postal Service.

Use of Experimental Rules

While the Commission did, in its Capital One decision, discuss why the Experimental Rules would not be appropriate for consideration of NSAs, it is obvious that those Rules could be easily adapted to the exigencies of NSA cases. There is no reason so suppose that future NSAs will be any more complex or have more impact than the typical experimental case, for example, the most recently approved Experimental Parcel Return Services case. In fact, that case involved financial consequences to the Postal Service that were double those involved in the Capital One case, on an annual basis, and it is predictable that most future NSAs will have less financial impact than that of the Capital One NSA. Properly adapted, the experimental rules could provide ample opportunity for protection of due process rights, the handling of unavailable data, data collection, limitation of issues, and particularly the issuance of a decision not more than 150 days from the determination that the proceeding be treated as experimental or from the date of the filing, whichever occurs later.

Where data is unavailable, those situations should be handled as they are under Rule 67c. Under that rule, if the Service believes that data that otherwise is required to support an NSA is unavailable, the Postal Service need only explain that unavailability as required by rule 64a(2). That is subject to a showing by an interested party that it would be "clearly unreasonable" for the Postal Service to ask that the NSA be approved without first securing such information.

Proposed Section 3001.196 - Requests To Recommend A Negotiated Service Agreement That Is Functionally Equivalent To A Previously Recommended Negotiated Service Agreement

Capital One supports proposed Section 3001-196 regarding the accelerated process for functionally equivalent NSAs. This proposed rule promises to permit postal customers who wish to take similar advantage of already approved deals a quicker and more efficient method for doing so. The rules provide for accelerated review and a recommended decision to be issued not more than 60 days after a determination the agreement is functionally equivalent if no hearing is held, or 120 days after such a determination is made and a hearing is scheduled. The procedures specified, and the evidentiary burdens proposed, guarantee due process to affected parties and ensure that such agreements will comport with the dictates of the Act.

Conclusion

We hope the Commission will reconsider these proposed Rules based on our comments. The proposed evidentiary burdens are extreme considering the character of the likely agreements; the complexity and the costs will have a chilling effect on most business mailers; and the information required is far more precise than a business would normally use to evaluate the merits of a particular deal. Most mailers simply do not forecast mail volumes in the manner these rules contemplate because (1) mail is often a small input to the overall product, and (2) the difficulty of such calculations outweighs the benefits. While mailers may forecast their marketing expenses in some manner, those expenses are not forecasted for a significant future period, including three years, because the number of variables would make such forecasts too unreliable.

While it is understandable, given the burdens and complexities spelled out in these rules, that there is no timeframe given for the approval of a baseline agreement, the fact that there is no firm deadline for those decisions will itself be a deterrent to businesses seeking such agreements.

NSAs offer considerable opportunities both to the Postal Service and to mailers to advance the mail order business and to help sustain the Postal Service in a difficult time. The Commission's decision in the Capital One case recognized NSAs as a way to add flexibility to ratemaking. The Commission struck just the right note when it stated that NSAs invest the Postal Service "with the ability to take advantage of special situations to improve its profitability by developing innovative rate designs to meet the need of diverse, individual customers."

The Commission's decision was forward looking and statesmanlike in that it overcame the difficulties the parties grappled with during the proceeding and found on balance that the agreement was in the interests of the Postal Service and all mailers. The Commission has shown in the past that it is able to provide a fair hearing to those who have genuine issues of fact, total up the evidence, and arrive at a fair answer as to whether something is going to save money for the Postal Service or not. It is in that spirit that we ask the Commission to continue in that vein and not ensnare new postal flexibility with the bureaucratic stranglehold these proposed rules imply.

Respectfully submitted,

Timothy J. May
Patton Boggs, LLP
2550 M Street, NW
Washington, DC, 20037
Tel: (202) 457 6050
Fax: (202) 457 6315
Email: tmay@pattonboggs.com
Counsel for Capital One Services, Inc

September 29, 2003