

UNITED STATES OF AMERICA
Before The
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

Rules Applicable to Baseline
And Functionally Equivalent
Negotiated Service Agreements

Docket No. RM2003-5

OFFICE OF THE CONSUMER ADVOCATE
REPLY COMMENTS
(October 14, 2003)

The Office of Consumer Advocate (OCA) hereby submits comments in reply to comments filed on September 29 concerning the proposed rules of practice governing Negotiated Service Agreements (NSAs). For the most part, OCA finds the comments of other parties quite helpful. Especially helpful have been the comments of First Data Corporation, National Newspaper Association (NNA), Valpak, and the Postal Service. Indeed, with only a few exceptions, the OCA believes that the Postal Service's comments provide a good framework for dealing with NSA filings. The OCA's primary concerns relate to the need for (1) a connection between the filing of waiver requests and the imposition of a 150-day deadline, (2) a test period equal to the duration of the NSA, and (3) a requirement that NSAs unambiguously benefit the Postal Service.

The OCA suggests that the imposition of a deadline for a recommended decision be conditioned on the absence of any motions for waiver of filing requirements. It is the filing of all essential information at the beginning of a case, after all, that allows for

expedition. The OCA also continues to stress that NSAs are useless for the Postal Service and its stakeholders unless the agreements produce a substantial and certain benefit to the Postal Service. Finally, the need for both the Postal Service and the Commission to estimate the overall financial consequences of an NSA should be obvious. This need implies an analysis covering the full duration of the contract.

Necessity for Win-Win Agreements

It is absolutely essential that an NSA provide significant benefit to the Postal Service.¹ The Postal Service appears to accept this condition. The Service also seems to recognize that the benefits to the Postal Service must be evaluated over the life of an NSA, to the extent feasible.² However, the Postal Service has not discussed the financial risks associated with NSAs other than to stress that some information is difficult to procure.

The OCA discussed the problem of uncertainty in its initial comments.³ OCA witness Callow also testified on ways to reduce risk in the Capital One proceeding.⁴ Witness Callow was able to put bounds on the possible financial benefits to the Postal Service in a way that insured that such benefits would always be material and positive.⁵ In its initial comments the OCA urged the Commission to establish a basic policy of recommending only NSAs that “unambiguously” benefit the Postal Service.⁶ One of the

¹ Order No. 1383, August 27, 2003, Attachment at 2, § 3002.190(b).

² Initial Comments of the USPS, September 30, 2003, at 7-12.

³ OCA Comments, September 29, 2003, at 4.

⁴ Docket No. MC2002-2, Tr. 7/1379-80.

⁵ Id. at 1375-77.

⁶ OCA Comments, App. at 1, § 3001.190(b).

reasons given for adding the “unambiguous” requirement was to ensure that the Postal Service would explicitly hedge risk.⁷ Particularly in the case of quantity discounts, uncertainty is paramount. As the Postal Service pointed out in the Capital One case, “Once discounts intended to influence mailer behavior are established, it is not possible to ‘observe’ what mailer behavior would have been without such discounts.”⁸ Consequently, it is never possible to know with certainty whether quantity discounts will produce or have produced increased contribution.⁹ The OCA continues to urge the Commission to include a risk-hedging requirement in its NSA rules.

Data Requirements

The Commission’s proposed rules for NSAs contain both stringent filing requirements and liberal provisions for waiving the requirements. In its initial comments, the OCA suggested that, for NSAs, the data-filing requirements should not be waivable or otherwise avoidable. In a sense, the Postal Service has made a similar suggestion.

The filing requirements contained in proposed § 3001.193(a)—as well as the list of situations justifying lack of compliance with the filing requirements—trace their origin to Rule 54(a). That rule governs rate case filings. More importantly, it governs *general* rate case filings. In the context of a general rate case, *i.e.*, when the Postal Service needs new revenue on a large scale, liberal waiver of filing requirements makes some sense.

⁷ OCA Comments at 8-9.

⁸ Docket No. MC2002-2, Tr. 4/767.

⁹ This type of risk is especially hard to deal with when a mailer contends that it plans to reduce volume unless a discount is forthcoming.

Particularly in the early 1970s, when Rule 54(a) was drafted, the Postal Service's need for immediate new revenue was great. In those days, the Postal Service could file for a rate increase and implement temporary rates 90 days later. The duration for litigation of the request had no limit (*i.e.*, ten months). Given that participants in the first two general rate cases had far more time to conduct discovery and prepare direct cases than they do now, the liberal waiver provisions of Rule 54(a) made sense.

However, in the context of an expedited proceeding on an NSA, with its concomitant analysis of information that is not routinely collected and reported, liberal waiver of filing requirements is counter-productive. In a proceeding that depends on *ad hoc* data collection and costing methodologies relating to a unique mailer, it is crucial that *all* information that the Commission considers to be essential be available immediately with the filing of a case. Evaluation of a unique and creative NSA is no less difficult than evaluation of a new costing methodology. Both require the Commission and participants to start from scratch to learn the mechanics and theory underlying the NSA or methodology. As the Postal Service stated in its initial comments, "Obviously . . . , the required *up-front* provision of this type of information represents a significant improvement relative to the situation experienced in the Capital One NSA proceeding."¹⁰

Mailer-Specific Information

Many commenters have discussed the need to reduce pre-filing costs imposed on co-proponents of NSAs. While OCA certainly agrees that such costs should be

¹⁰ Initial Comments of the USPS at 12 (emphasis added).

minimized to the extent consistent with expedition and due process, some commenters have suggested that the Commission's need for company-specific information will deter mailers from seeking *any* mutually beneficial agreements with the Postal Service. The OCA suggests that this concern is somewhat overblown. It is the Postal Service—not co-proponents—that will bear most of the burden of gathering information. In the case of cost-based discounts, it is the *Postal Service's* costs to serve the co-proponent—before and after NSA implementation—that will matter. The costs of mailers should be irrelevant—as many commenters have pointed out. Only in the case of quantity discounts would there be a significant—and absolutely necessary—burden on a co-proponent.

The Postal Service argues that it “cannot hope to trace a particular customer's mail through the postal system”¹¹ First of all, given current “smart-mail” technologies, the Postal Service *could* track mail through the postal system, if necessary. More important, however, is that such universal tracking is unnecessary for purposes of evaluating a proposed NSA. The Postal Service only needs—and the Commission need only require—an estimate of the costs to the Postal Service that would change as a result of implementing an NSA. To the extent that a mailer's costs differ from national averages, what the Postal Service needs—and the Commission should require—is a demonstration that the differences cancel out when comparing before- and after-implementation costs. That is the approach taken by witness Crum in the Capital One case. The real issue then was whether witness Crum had identified *all* material deviations of Capital One's costs from the average and either included an

¹¹ Id. at 13.

estimate of them or shown that they would cancel out (*i.e.*, remain unchanged) whatever their magnitude.

As OCA sees this problem, the real issue is whether an NSA rewards a mailer with discounts for work it *already* performs for its own purposes or for *new* changes in behavior that save the Postal Service more money. Only in the latter situation, and only if a traditional worksharing rate category is infeasible, should the Commission consider recommending a cost-based NSA.

Expedition

Speedier action by the Commission goes hand-in-hand with higher transactions costs. Improving the quality of a filing necessarily involves extra effort and extra cost. But the higher the quality of a filing, the easier for the Commission to evaluate a proposed NSA. The Postal Service has suggested that baseline NSA requests be litigated within 150 days.¹² The OCA sees no problem with establishing a 150-day *goal*. However, OCA urges that the new rules make clear that the 150 days will be extended if the Postal Service or its co-proponent(s) either request(s) a waiver of or fail(s) to comply with NSA filing requirements. The Commission could make the 150-day deadline conditional on meeting all filing requirements by restructuring § 3001.191(j), which so concerns the Postal Service.¹³

¹² Id. at 21-23.

¹³ Id. at 19-21.

Quantity Discounts

Offering discounts solely in return for higher volume will continue to be controversial. At least one commenter has suggested that such discounts are illegal. On the other hand, as Professor Panzar has pointed out, such discounts can—in certain circumstances—be highly beneficial in a purely financial sense. A difficult problem arises in practice, however, when one tries to determine the actual magnitude of financial benefit flowing from a quantity discount.

As the OCA pointed out in the Capital One proceeding, many factors other than price affect a company's demand for postal services. OCA witness Smith testified that these other factors—such as the state of the economy or a mailer's marketing strategy—can change unexpectedly,¹⁴ rendering any simple extrapolation of historical volumes uncertain. In order to evaluate the likely profitability of a pure quantity discount, the Postal Service (and the Commission) need a customer-specific demand function of the type presented by the Postal Service in general rate cases. Whether it is the Postal Service or its co-proponent that prepares a demand analysis is irrelevant. What matters is that the Commission (and the Postal Service) have a rational basis for estimating the financial impact of a proposed quantity discount. The OCA strongly urges the Postal Service to develop this capability, if it has not already done so. (It is hard to imagine the Postal Service's evaluating internally the Capital One NSA without such capability.)

¹⁴ Docket No. MC2002-2, Tr. 7/1240-41, 1279-80.

External Diseconomies

Section 3001.193(f) of the Commission's proposed rules requires the Postal Service to conduct and file what amounts to a social cost-benefit analysis of each proposed NSA. Valpak's comments discuss the importance of this requirement. First Data's comments suggest that 193(f) can be deleted, with the Commission relying on adversely affected parties' litigating the issues of competitive impact and negative financial effects. The OCA opposes complete elimination of 193(f).

First Data's suggestion to rely on adversely affected parties' bringing issues to the Commission would work if all adversely affected parties were similar in size and financial resources to an NSA's co-proponent(s). However, if a large number of small firms were adversely affected, no single firm would find it worthwhile to incur the costs of litigation, even if the aggregate negative effect were large. Since the Postal Service operates in the public interest, the Postal Service should want to conduct the thorough cost-benefit analysis contemplated by proposed § 3001.193(f). Since the Commission must find that

each NSA serves the public interest, it should insist on the Postal Service's filing a social cost-benefit analysis.

Respectfully submitted,

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