

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

EXPERIMENTAL CHANGES TO)
IMPLEMENT CAPITAL ONE NSA)

Docket No. MC2002-2

INITIAL BRIEF

OF

VALPAK DIRECT MARKETING SYSTEMS, INC., AND
VALPAK DEALERS' ASSOCIATION, INC.

William J. Olson
John S. Miles
WILLIAM J. OLSON, P.C.
8180 Greensboro Drive, Suite 1070
McLean, Virginia 22102-3860
(703) 356-5070

Counsel for
Valpak Direct Marketing Systems, Inc., and
Valpak Dealers' Association, Inc.

April 3, 2003

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
STATEMENT OF THE CASE	1
SUMMARY OF ARGUMENT	5
ARGUMENT	6
I. NSAs CANNOT SUBSTITUTE FOR FIXING SYSTEMWIDE PRICING PROBLEMS	13
II. NSAs MUST DEMONSTRATE THAT THEY DO NOT RESULT IN NET FINANCIAL LOSS TO THE POSTAL SERVICE	19
III. NSAs MUST BE EVALUATED USING MAILER-SPECIFIC COSTS	19
IV. NSAs MUST NOT RESULT IN UNDUE OR UNREASONABLE PREFERENCES TO CERTAIN MAILERS OR DISCRIMINATION AGAINST SIMILARLY-SITUATED MAILERS	27
V. NSAs MUST NOT PROVIDE DISCOUNTS BASED SOLELY ON HIGH VOLUME	34
VI. NSAs MUST NOT PROVIDE UNFAIR REWARDS FOR HIGH-COST MAILERS DISCONTINUING HIGH-COST BEHAVIOR	36
VII. NSAs MUST ATTEMPT TO ANTICIPATE AND AVOID UNINTENDED CONSEQUENCES	38
CONCLUSION	40

TABLE OF AUTHORITIES

	Page
Statutes	
39 U.S.C. § 403	8, <i>passim</i>
39 U.S.C. § 3622	1, 7, 36
39 U.S.C. § 3623	1, <i>passim</i>
 Code of Federal Regulations	
39 CFR 3001.20	1, 2
 Domestic Mail Manual	
DMM Section R900.1.0	13, 14

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

EXPERIMENTAL CHANGES TO)
IMPLEMENT CAPITAL ONE NSA)

Docket No. MC2002-2

INITIAL BRIEF

OF

VALPAK DIRECT MARKETING SYSTEMS, INC., AND
VALPAK DEALERS' ASSOCIATION, INC.

STATEMENT OF THE CASE

The Postal Service's Request

On September 19, 2002, the United States Postal Service filed a request, pursuant to sections 3622 and 3623 of the Postal Reorganization Act (39 U.S.C.) ("the Act"), for a recommended decision by the Postal Rate Commission on a proposed three-year experimental classification change, and related discounts and fee waivers, for qualifying First-Class mailings entered by Capital One Services, Inc. ("Capital One" or "Cap One").

This case is the first Negotiated Service Agreement ("NSA") proposal ever submitted to the Postal Rate Commission. The Postal Service proposes rate and classification changes necessary to implement the terms of a contract between the Postal Service and Capital One.

The Postal Service's case-in-chief consists of the testimony of the following four witnesses:

Witness Anita J. Bizzotto	USPS-T-1
Witness Michael K. Plunkett	USPS-T-2
Witness Charles L. Crum	USPS-T-3
Witness James D. Wilson	USPS-T-4

Capital One sponsored the direct testimony of witness Donald Jean (COS-T-1) and witness Stuart Elliott (COS-T-2) in support of the Postal Service's proposal.

Commencement of Commission Proceedings

On September 24, 2002, the Commission issued a Notice and Order on filing of the Postal Service's request (Order No. 1346).

In accordance with Order No. 1346 and Rule 20 of the Commission's Rules of Practice and Procedure (39 CFR 3001.20), Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc. each filed a notice of intervention on October 17, 2002. These two intervenors have proceeded jointly in this proceeding, and are referred to collectively as "Valpak."

Discovery of the Postal Service's Case-in-Chief

Counsel for Valpak conducted written cross-examination of the following two Postal Service witnesses with respect to their identified direct testimony:

Witness Anita J. Bizzotto	USPS-T-1 (Tr. 3/441-48)
---------------------------	-------------------------

Witness Michael K. Plunkett USPS-T-2 (Tr. 4/749-61)

Counsel for Valpak conducted oral cross-examination of witness Bizzotto, which appears at Tr. 3/485-501.

Direct Testimony of Intervenors

Three intervenors filed direct testimony:

National Newspaper Association Witness Jeff M. David (NNA-T-1)

Newspaper Association of America Witness Christopher D. Kent (NAA-T-1)

Office of Consumer Advocate Witness James F. Callow (OCA-T-1)

Witness J. Edward Smith (OCA-T-2)

Additionally, the Presiding Officer sponsored the direct testimony of one witness — John C. Panzar (JCP-T-1). Valpak's written cross examination of witness Panzar (VP/JCP-T1-1-10) appears at Tr. 8/1626-45. Valpak's oral cross-examination of witness Panzar appears at Tr. 8/1671-1697.

Rebuttal Testimony

The Postal Service sponsored the rebuttal testimony of witness Plunkett (USPS-RT-1) and witness B. Kelly Eakin (USPS-RT-2).

Capital One sponsored the rebuttal testimony of witness Robert Shippee (COS-RT-1) and witness Stuart Elliott (COS-RT-2).

The Association for Postal Commerce, Direct Marketing Association, and Parcel Shippers Association sponsored the rebuttal testimony of witness Robert Posch

(PostCom, et al., -RT-1, Tr. 10/1971-79). Counsel for Valpak orally cross-examined witness Posch on his rebuttal testimony (Tr. 10/2002-48).

Settlement Negotiations

On March 13, 2003, the Postal Service, Capital One, and the Office of the Consumer Advocate (“OCA”) requested a two-week extension of the briefing schedule in order to undertake settlement negotiations. Counsel for Valpak were never contacted with respect to any such settlement negotiations. On Monday, March 31, 2003, three days before this brief was due, counsel for Valpak received an e-mail sent by Postal Service counsel to counsel for all intervenors which advised that a Stipulation and Agreement, entered into by the Postal Service, Cap One, and OCA, and associated documents had been filed with the Commission, and which sought the position of intervenors on the filing relative to a proposed partial settlement. On April 1, 2003, counsel for Valpak advised Postal Service counsel that it would be opposing the partial settlement. Since that time, efforts have been made to revise this Initial Brief to address the fact that the Postal Service has agreed to modify slightly its original proposal. (Valpak reserves the right to comment further on that Stipulation and Agreement in its Reply Brief.)

SUMMARY OF ARGUMENT

This docket presents the Commission with its first opportunity to evaluate a Negotiated Service Agreement. Although this agreement will apply to only one mailer, the Commission must evaluate it as a mail classification case to be decided under the criteria of 39 U.S.C. section 3623(c), as well as a rate case to be decided under the criteria of 39 U.S.C. section 3622(b).

In issuing its recommended decision, the Commission will not just be deciding the instant case, but also will be establishing important principles that will apply to future NSAs. Indeed, the precedential nature of this docket may be more important than the NSA itself. Valpak has developed a series of principles drawn from the Act, to provide a useful framework for the evaluation of this and other NSAs:

- I. NSAs cannot substitute for fixing systemwide pricing problems
- II. NSAs must demonstrate that they do not result in net financial loss to the postal service
- III. NSAs must be evaluated using mailer-specific costs
- IV. NSAs must not result in undue or unreasonable preferences to certain mailers or discrimination against similarly-situated mailers
- V. NSAs must not provide discounts based solely on high volume
- VI. NSAs must not provide unfair rewards for high-cost mailers discontinuing high-cost behavior
- VII. NSAs must attempt to anticipate and avoid unintended consequences

Because this proposed NSA violates most of these principles, Valpak urges that the Commission deny the proposed NSA, and encourage the Postal Service to turn its attention to develop a lawful and appropriate cure for the substantial problems with First-Class bulk Non-forwardable UAA Mail that have come to light during the litigation of this docket.

ARGUMENT

Valpak is of the view that NSAs, properly designed and implemented, have the potential to give the Postal Service a new mechanism to change mailing practices in ways that would reduce costs, increase volume and increase contribution to overhead, and would be of mutual benefit to mailers and the Postal Service. For example, NSAs can provide incentives for individual mailers to perform additional work, not required by Postal Service regulations, which results in reduced Postal Service costs.

Twofold Importance of this Docket

The importance of this docket is twofold. First, the Commission must respond to the Postal Service's proposal, and by recommendation either approve or disapprove, or perhaps modify, the specific NSA requested. Obviously, the Commission's recommended decision could have a significant effect on Capital One, the Postal Service, and other mailers. But as important as a ruling is on the specific NSA proposed in this docket, there are other important considerations as well.

Second, the Commission must be exceedingly mindful that its opinion and recommended decision will establish the initial standards and principles on which future NSAs will be proposed by the Postal Service, viewed by mailers, and evaluated by the Commission.¹ If the Commission were to allow an NSA which is poorly conceived or

¹ The Postal Service has stated that “[w]hile the Commission has in the past recommended narrow classification changes applicable only to a few mailers, a proposal based on an agreement with a single mailer (NSA) has never been considered

(continued...)

badly designed, it would establish the precedent that poorly-conceived or badly-designed NSAs are acceptable. Likewise, it would send the wrong message if an NSA is adopted which could adversely affect Postal Service finances. It may even give the erroneous impression that it has improperly delegated to the Postal Service its authority to set mail classification and set rates under the Postal Reorganization Act (also the “Act”). In rendering a decision in this docket, the Commission serves the role that it was assigned under the Act by scrutinizing the Postal Service’s proposal according to statutory criteria. And, in this first-of-its-kind docket, the Commission also serves the role of setting policy for the future.

Statutory Criteria for Mail Classification Cases

Although the proposed NSA seeks a limited, three-year “experimental classification” change applying to only one mailer, the Commission must judge this NSA by the standards for Commission evaluation of any mail classification case, as set out in the Postal Reorganization Act.² The Act states that:

[t]he Commission shall make a recommended decision on establishing or changing the schedule in accordance with the **policies of this title** and the **following factors**:

(1) the establishment and maintenance of a **fair and equitable** classification system for all mail;

¹(...continued)
and approved.” USPS Request for a Recommended Decision, p. 3.

² Since the Postal Service has proposed rate changes, the rate making criteria of 39 U.S.C. § 3622 also must be met, but are not expressly discussed herein.

(2) the relative value to the people of the kinds of mail matter entered into the postal system and the desirability and justification for special classifications and services of mail;

(3) the importance of providing classifications with extremely high degrees of reliability and speed of delivery;

(4) the importance of providing classifications which do not require an extremely high degree of reliability and speed of delivery;

(5) the **desirability** of special classifications from the point of view of both the **user** and of the **Postal Service**; and

(6) such other factors as the Commission may deem appropriate. [39 U.S.C. § 3623(c) (emphasis added).]

In this docket, the (c)(1) “fair and equitable” and the (c)(5) “desirability” criteria are particularly significant. One of the “policies of the Act” referred to in 39 U.S.C. section 3623 of particular importance here is the Act’s discrimination/preference prohibition contained in 39 U.S.C. section 403. This provision states:

[i]n providing services and in establishing classifications, rates, and fees under this title, the Postal Service shall not, except as specifically authorized in this title, make any **undue or unreasonable discrimination** among users of the mails, nor shall it grant any **undue or unreasonable preferences** to any such user. [39 U.S.C. § 403(c) (emphasis added).]

Valpak urges the Commission to use its opinion and recommended decision to establish that, for NSAs to be approved, 39 U.S.C. section 3623(c) and the policy of the Act set out in 39 U.S.C. section 403(c), require, at a bare minimum, that all NSAs adhere to the seven principles discussed below, which grow out of the application of the

statutory criteria discussed above. This list of principles is not exhaustive, as the specific facts of each of the next several NSAs undoubtedly will raise different issues not raised in this docket.

Proposed Principles for Evaluation of NSAs

Principle No. I — NSAs Cannot Substitute for Fixing Systemwide Pricing

Problems. An NSA likely will constitute a mail classification/rate change, but it is not a mail classification/rate change of general applicability, and cannot be used to substitute for a necessary general mail classification/rate change. An NSA is based on a contract with a particular mailer, and applies to that mailer only. A systemwide problem in pricing can be corrected only by a systemwide change in pricing — and not by an NSA. Indeed, offering NSAs to the largest mailer(s) affected by systemwide problems could have the adverse effect of delaying necessary systemwide corrections, and of being both impermissibly discriminatory and preferential.

Principle No. II — NSAs Must Demonstrate that They Do Not Result in Net

Financial Loss to the Postal Service. An NSA must not decrease the benefitted mailer's contribution to Postal Service institutional costs.³ Ideally, an NSA should increase the mailer's contribution to the Postal Service's institutional costs; however,

³ The costs of a particular NSA as discussed herein do not include the Postal Service's cost of negotiating, proposing, litigating, implementing, and monitoring the NSA, although these costs are real, substantial, and directly associated with the NSA.

break-even is a minimum requirement. If an NSA were to result in the Postal Service incurring a net loss, all other mailers, including Valpak, would be adversely affected.

Principle No. III — NSAs Must Be Evaluated Using Mailer-Specific Costs.

To help ensure that Principle No. II is not violated, Postal Service testimony in support of an NSA must make an assiduous effort to develop and present Postal Service costs which are specific to the individual mailer, and not use systemwide average costs. Any mailer who qualifies for an NSA can be expected to be somewhat removed from the “average.” Systemwide average costs should be used only as a last resort, where the record contains compelling evidence explaining both (i) why development of mailer-specific costs is not feasible, and (ii) why systemwide average costs are a suitable proxy for mailer-specific costs for the NSA in question.

Principle No. IV — NSAs Must Not Result in Undue or Unreasonable Preferences to Certain Mailers or Discrimination Against Similarly-Situated Mailers. An NSA must not violate 39 U.S.C. section 403(c), which provides that the Postal Service may not “grant any undue or unreasonable preferences” to any mailer. If other mailers exist who are situated similarly to the mailer in the proposed NSA, the Postal Service should not propose an NSA, but rather a niche classification that automatically would be available to all such mailers immediately upon implementation. Moreover, the NSA should not use separable, unrelated factors as a way to establish artificial “uniqueness” and thus preclude other mailers from qualifying for a generally-similar NSA.

Principle No. V — NSAs Must Not Provide Discounts Based Solely on High Volume. Unless clearly justified by mailer-specific cost savings, NSAs must not be structured as, or operate as, discounts based simply on high volume.

Principle No. VI — NSAs Must Not Provide Unfair Rewards for High-Cost Mailers Discontinuing High-Cost Behavior. The cost of handling each postal product can be viewed as being an average of innumerable mailer-specific costs. Due to differences in mailer profiles, within each postal product are mailers who cause the Postal Service to incur higher costs and others who cause the Postal Service to incur lower costs. The “low cost” mailers implicitly support the “high cost” mailers. An NSA must not operate to reward unfairly those “high cost” mailers who are willing simply to forsake some of their “high cost” ways.

Principle No. VII — NSAs Must Attempt to Anticipate and Avoid Unintended Consequences. In negotiating and litigating an NSA, the Postal Service doubtless will be focused on the mailer in question. However, the exclusivity of an NSA requires the Commission to make certain that the effect on, and reactions by, other mailers are considered, with particular concern to avoiding unintended consequences.

Valpak Position

For the reasons discussed below, Valpak believes that this initial NSA with Capital One violates most of the fundamental principles discussed above, and should be rejected by the Commission.⁴

⁴ There is a way for a Commission decision in the instant case to avoid the establishment of binding policy regarding the foundation and requirements for future NSAs. This could occur if the Commission should decide that this first NSA test case should be judged by a lower standard than all future NSAs. Possibly, the Commission could make a deliberate decision to “lower the bar” in certain respects for the NSA in this docket, recognizing that the Postal Service prepared this docket in the absence of Commission guidance as to what was required for NSAs by the Postal Reorganization Act. The Commission might want to overlook certain shortcomings in this NSA, while putting the Postal Service and mailers on notice that under no circumstances will it in the future recommend NSAs which do not adhere to articulated policies. While Valpak does not endorse such an approach, should this approach be selected, Valpak would urge that the Commission make clear to all, using unequivocal language, that the “bar lowering” is a one-time-only occurrence — a non-repeatable event, with deviations from articulated principles tolerated solely because this case will function as the one and only, groundbreaking test case for NSAs. If this approach is taken, the NSA in this docket must terminate when the next omnibus rate case is implemented, to help ensure that the Postal Service proposes a systemwide fix in that docket. Presiding Officer’s witness Panzar anticipated such a Postal Service fix of the problem in the next available docket:

Well, I think the improper — the **unfortunate** pricing structure has to do with the bundling nature of the first-class tariffs... **At the next rate hearing or classification hearing** ... it might be time to address the **distorted** pricing structures that is built into return policies... I would think if you **designed** the rate structure and return policy **from scratch** you could do better. [Tr. 8/1785 (emphasis added).]

I. NSAs CANNOT SUBSTITUTE FOR FIXING SYSTEMWIDE PRICING PROBLEMS

Historically, non-forwardable Undeliverable-as-Addressed (UAA) First-Class Mail (hereafter referred to as “Non-forwardable UAA Mail”) has been returned (physically) to senders free of charge. This service is provided to both single piece and bulk First-Class Mail. Each year the Postal Service must deal with billions of pieces of Non-forwardable UAA Mail. Although Cap One may be the largest contributor to this burden, the issue is obviously far larger than Cap One. The cost of physically returning Non-forwardable UAA Mail, which may exceed \$1 billion annually, has been included in the rates for First-Class Mail. Each mailer therefore pays a share of those costs. Rate-averaging enables a costly service to be provided at no additional charge for pieces which require the service.

More recently, the Postal Service has developed an electronic notice option, Address Correction Service (“ACS”), to inform senders electronically about mailpieces that cannot be delivered as addressed. DMM Section R900.1.0. Use of the electronic alternative is not intended for, or available to, single piece letters; it is restricted to those mailers who send First-Class **bulk** mail.

The Postal Service’s cost of providing the electronic alternative (and destroying the undeliverable mail) is considerably lower than the cost of physically returning mail. Therefore, mailer use of the electronic alternative with destruction of the mailpiece **wherever feasible**, generally should result in a **net gain in efficiency** for the Postal Service.

The Postal Service charges First-Class bulk mailers who elect to use the electronic Address Correction Service a fee of 20 cents per piece, regardless of how few electronic returns are received during a billing period. DMM Section R900.1.0. If the Postal Service can bill those First-Class bulk mailers which use the service for even a small number of electronic notices, an important but unanswered question is why it also could not similarly bill First-Class bulk mailers for **physical returns** of their Non-forwardable UAA Mail, especially those mailers with a large volume of such mail.

Whatever the reason, the Postal Service is currently in the position of providing its costliest service for Non-forwardable UAA Mail at no charge (*i.e.*, free), while charging cost plus a markup for the more efficient, lower-cost alternative. This situation with respect to Non-forwardable UAA Mail has been described by Presiding Officer's witness Panzar as:

the **unfortunate** pricing structure [having] to do with the bundling nature of the first-class tariffs ... the **distorted** pricing structure that is built into return policies.... [Tr. 8/1785 (emphasis added).]

The First-Class bulk mailer in the country which sends the largest volume of Non-forwardable UAA Mail, by far, is Cap One, the beneficiary of the NSA proposed herein. Plunkett, USPS-T-2, p. 3, ll. 2-3. (Tr. 4/675.) The record in this docket also reveals that Cap One has an extremely high **percentage** of its First-Class Mail which uses this service — 9.6 percent, compared to an average of approximately 1.23 percent for First-Class commercial mail. (Crum Direct Testimony, USPS-T-3, Attachment A,

p. 2; Tr. 2/42.)⁵ Cap One thus causes the Postal Service to incur a disproportionately large expense to return its Non-forwardable UAA Mail.

Further, to the extent that senders benefit from return of their Non-forwardable UAA Mail, Cap One is in the position of receiving a disproportionately large benefit from the Postal Service's policy of providing free return of Non-forwardable UAA Mail.

The Postal Service now proposes an NSA with Cap One under which Cap One would receive the Postal Service's lower-cost electronic Address Correction Service for free, **and, in addition**, be given the benefit of a declining block discount on its First-Class Mail in excess of specified volumes. Plunkett, USPS-T-2, p. 2, l. 9 through p. 6, l. 14. As proposed, virtually all such discounts received by Cap One would be funded with the net savings from substituting the lower-cost electronic Address Correction Service for the higher-cost physical return alternative for Non-forwardable UAA Mail.

In his rebuttal testimony, witness Plunkett admits that:

[t]his case has brought to light important issues relating to the pricing of address correction services, and the associated operational impacts. These issues warrant careful consideration in light of the total rate and fee structure, but they are not amenable to comprehensive resolution in this case. [Plunkett, USPS-RT-1, p. 6, ll. 19-22, Tr. 9/1868.]

⁵ This NSA deals exclusively with the problem of Non-forwardable UAA Mail, and therefore the record does not reveal with respect to whether Cap One also causes the Postal Service to incur a disproportionately large expense to forward, for free, pieces of mail which are deliverable.

This statement indicates that the Postal Service was less than fully aware of the pricing problems for electronic Address Correction Service when it initiated this docket. It also admits that these pricing problems simply cannot be solved in a “comprehensive” manner via the NSA being considered in this docket. What witness Plunkett does not do is explain why the Postal Service continues to press this NSA rather than work to cure the new systemwide information that has been brought to light.

Once the flaw in pricing of electronic Address Correction Service for First-Class Mail was realized, the Postal Service should have withdrawn this case and redeployed its resources to litigating a mail classification case before the Commission which would provide a “comprehensive” solution to the problem, not mask it. It would have been better for the Postal Service to have requested the Commission to modify the Domestic Mail Classification Schedule in order to provide a systemwide solution to the problem inherent in First-Class Mail. Indeed, it is difficult to believe that the Postal Service would have initiated this docket had it been aware of its distorted pricing structure within First-Class Mail.

Achieving a “comprehensive” solution to the Postal Service’s pricing problem would not be unusually difficult. One approach would be to calculate the cost of both physical and electronic return of information relating to undeliverable First-Class bulk mail, and to remove these costs from the cost base of First-Class bulk mail. Then rates for all bulk First-Class mailers could be reduced, and offsetting cost-based charges could be imposed on bulk mailers for both physical and electronic returns. This would result in a significantly higher price for physical return than for electronic return,

thereby providing all bulk mailers with appropriate incentives. Such an unbundling of the pricing of Non-forwardable UAA Mail would result in fees that are rationally related to the respective cost of each method. Mailers who cause the Postal Service to incur certain discrete costs would pay their fair share of those costs. Annual minimum fees could be imposed to deal with the problem of covering the costs for this new service where there was little actual utilization.

Under the above scenario, appropriately designed fees would motivate mailers to select the alternative which, from their perspective, would be the most efficient.

Presiding Officer's witness Panzar has testified that:

Well, I think the improper — the **unfortunate** pricing structure has to do with the bundling nature of the first-class tariffs.... At the next rate hearing or classification hearing ... it might be time to address the **distorted** pricing structures that is built into return policies... **I would think if you designed the rate structure and return policy from scratch you could do better.** [Tr. 8/1785 (emphasis added).]

In this way, a problem in Postal Service pricing which applies to all First-Class bulk mail would be solved for all users of First-Class bulk mail, as well as for the entire Postal Service. As witness Plunkett admits, the Cap One NSA brought to light, but does not cure, a systemwide problem. Indeed, there is no way that the NSA process can substitute for a real fix in the Postal Service's mail classification schedule that would give proper pricing signals to all First-Class bulk mailers. This would be true even if there were not one, but a dozen, or even a hundred, NSAs presented. Even if new streamlined NSA procedures were to be established, the Postal Service

clearly would be hard-pressed to design, negotiate, implement, manage, and monitor numerous NSAs such as the Capital One NSA in this docket. Indeed, in view of the limited resources available at the Postal Service to work on such matters it is highly unlikely that there will be more than a handful of beneficiaries of such a mini-fix for the foreseeable future. (*See* Tr. 9/1888, 1945.)

The Postal Service should be invited to shift directions to deploy its resources away from an NSA that benefits Cap One exclusively to a systemwide fix that would treat fairly all First-Class bulk mailers who then would pay for the services they require, and no more.

The only justification for allowing the Cap One NSA mini-fix would appear to be an attempt to reward this one mailer for having invested time and effort to litigate this initial NSA docket. However, Cap One is not the only party that has invested time and effort in litigating this docket, as the Commission, the Postal Service, and all intervenors have seen this initial case function as a test case to develop principles which will be applied to a wide variety of postal products and affect many postal customers.

This docket has had the fortunate result of bringing to light and focusing attention on a \$1 billion-plus problem — a problem that heretofore has not received the attention it deserves. Valpak believes that the time and effort invested in this case can, if properly directed to a systemwide fix, significantly increase productivity and reduce costs.

The Capital One NSA obviously tries to do too much, violating the principle that an NSA should not be used as a substitute fix for systemwide pricing problems.

**II. NSAs MUST DEMONSTRATE THAT THEY DO NOT
RESULT IN NET FINANCIAL LOSS TO THE POSTAL SERVICE**

and

III. NSAs MUST BE EVALUATED USING MAILER-SPECIFIC COSTS

This section discusses two closely-related principles — both intended to ensure that other mailers are not harmed by the NSA under consideration.

A. Effect of NSA on Postal Service Finances

The Cap One NSA includes two components that have no discernable economic relationship to each other and which could be analyzed separately,⁶ but which nevertheless have been linked in the proposed contract: (1) declining block discounts, and (2) cost savings on Non-forwardable UAA Mail from using the electronic Address Correction Service. Each is discussed in turn.

1. Declining block discounts. In this docket, the Commission must first determine whether declining block discounts are in conformance with the Postal Reorganization Act. Then it must determine the conditions under which declining block discounts, as a policy matter, are desirable.

Valpak does not believe that declining block discounts are prohibited by the Postal Reorganization Act. Properly employed, they could be a useful device for encouraging and rewarding increased mail volume and increased contribution to Postal Service overhead.

⁶ See Panzar, Tr. 8/1673, ll. 2-9.

The specific terms and conditions for declining block discounts in the Cap One NSA, however, are problematic. The trigger points for the declining block discounts are set below the projected volume mailed by Cap One. Thus, if Cap One mails as expected, the Postal Service revenues will be reduced below what they otherwise would have been.⁷ Needless to say, Valpak and all other large volume mailers would like to be offered declining block discounts that start below projected volumes.

No claim is made that the declining block discounts in this instance will increase the contribution to the Postal Service's institutional costs. Quite the contrary. In fact, the NSA is designed to reduce the contribution below what it otherwise would be by rebating to Cap One some of the savings from the efficiency gains discussed below. Thus, the declining block discounts here are not designed to increase "profits" as they have been in other industries.

The stated rationale for the proposed threshold is that any reduction in revenues from the declining block discounts is said to be more than offset by Postal Service efficiency gains and cost savings that arise from substituting electronic information

⁷ Theoretically, it is conceivable that the declining block discounts could increase the net contribution received by the Postal Service. This would occur if Cap One had a substantial increase in its volume of First-Class Mail that reasonably could be said to have been caused by the discounts. However, no testimony or evidence in the record demonstrates that this will be the case.

Even the Presiding Officer's witness Panzar had reservations about "**the threshold** [for declining block discounts] **being less than the initial quantity**. It doesn't mean there aren't good reasons for that, but as I think I said earlier, **the burden of proof should be on those who depart from that readily verifiable historical benchmark**." Tr. 8/1772 (emphasis added).

return for physical return of Cap One's Non-forwardable UAA Mail. If the Commission decides by recommendation to approve this first NSA, despite the lack of any logical linkage between its components, Valpak recommends that the Commission expressly disavow tolerating such a linkage in this docket as setting any precedent for future NSAs.

Bulk discounts could stimulate additional volume and increase the contribution to institutional costs if they were implemented fairly and made available to all similarly situated mailers, as witness Panzar has testified. However, to the extent that declining block discounts are simply or primarily a means of giving the mailer a rebate in recognition of cost savings generated elsewhere, a better (and simpler) approach would be to give a direct rebate, based on the volume of electronic returns that are substituted for physical return, as witness Panzar states.⁸

2. Cost savings on Non-forwardable UAA Mail. The amount of cost savings at issue is the difference between (i) the cost of physically returning Cap One's Non-forwardable UAA Mail, and (ii) the somewhat lower cost of providing Cap One with electronic Address Correction Service concerning such mail.

The record in this case reflects cost savings that have been developed using the systemwide average cost for physical return of Non-forwardable UAA Mail. On that basis, the Postal Service's cost savings from returning information electronically appear

⁸ Response to VP/JCP-T1-4 (Tr. 8/1631-32).

to be rather substantial.⁹ Thus, there is reason to believe that electronic return of UAA information, where feasible, in general would produce a measurable gain in efficiency. One major issue, though, is how accurately the cost savings have been estimated for the Cap One NSA.

B. Failure to Present Mailer-Specific Costs

A major flaw of the proposal in this docket is the Postal Service's failure even to attempt to develop any cost data that are specific to the physical handling of Cap One's Non-forwardable UAA Mail.¹⁰ By the Postal Service's own admission, the cost of handling returned pieces can depend upon a number of factors.

The type of handling [Cap One's return pieces] receive and where they receive it is determined by the Richmond P&DC.

⁹ Moreover, having the information in electronic form probably results in a substantial savings to Cap One, which no longer will have to deal with millions of pieces of return mail. (This aspect of Cap One's use of electronic information was not discussed in the record.)

¹⁰ Presiding Officer's witness Panzar has his own reservations on this score. He states that the use of "cost savings not on average, but that come from the experience of the NSA recipients is a useful thing to have in terms of evaluating the success of the experiment ... the numbers for individual mailers aren't typically collected so it's not surprising that they are average numbers now. However, as a means of evaluating the experiment more precisely, [cost data] closely tied to Capital One would be desirable, because, remember, one of the reasons driving this thing is the particular characteristics of Capital One's mailstream ... and so the success and impact of the experiment has ultimately got to be judged on the basis of Capital One's specific numbers." Tr. 8/1782, ll. 5-24. *See also* witness Panzar's response to VP/JCP-T1-5 and 6 (Tr. 8/1633-35).

The type of handling that Capital One[s'] return mail receives could depend on several factors, including their automatability and the extent of intermingling with other non-Capital One returns destinating in the Richmond area. This May, when several headquarters personnel visited the area, the Processing and Distribution Center often transported Capital One returns to an annex facility where postal employees would manually riffle the mail to remove pieces that should not be returned to Capital One. **Now, apparently, all handling, whether automated or manual, occurs at the Richmond P&DC.** [Response to NAA/USPS-10, Tr. 5/904, emphasis added]

This part of the interrogatory response thus indicates that the way Non-forwardable UAA Mail is handled, and presumably the cost as well, is subject to considerable variation. Moreover, it also indicates that the procedures and cost for handling Cap One's Non-forwardable UAA Mail have changed, perhaps significantly, since the case was prepared. The remainder of the interrogatory response indicates that the Postal Service has made absolutely no effort to study or take account of these variations.

It should be remembered that **the actual handling practices were not relied upon to develop cost or savings estimates in this case**, so that any changes in operations in this regard have no effect on the cost or savings estimates underlying this case. [*Id.*, emphasis added.]

Rarely has the Postal Service attempted to make the total absence of information about Postal Service costs and operating procedures sound so good. Neither cost models nor any kind of empirical data or information specific to the cost of handling Cap One were offered in evidence. Although the Postal Service's cost witness (witness Crum) admits to having gone to the Richmond, Virginia Area Distribution Center (the plant to which all Cap One's Non-forwardable UAA Mail is returned), he did not even

bother to go into the plant itself. Rather, he went only to an annex to which Cap One's mail was then being taken after being separated from other (non-Cap One) incoming mail. Consequently, he cannot testify as to whether Richmond's automated sorters segregate all of Cap One's Non-forwardable UAA Mail into a dedicated bin (or bins) on a single pass, which would avoid an incoming secondary sortation and therefore be less costly than the average handling procedure. The record does not even indicate whether Cap One has an unique 5-digit ZIP code. Nor does the record contain any evidence concerning how the handling and cost of Cap One's Non-forwardable UAA Mail after separation compares with the systemwide average cost, which undoubtedly often involves the cost of movement to downstream facilities beyond area distribution centers ("ADCs"). As a result, when computing estimated savings, the record does not enable the Postal Service or the Commission to compute estimated savings based on the cost of handling Cap One's Non-forwardable UAA Mail. Nor does the record contain any evidence sufficient to allow the Commission to use the systemwide average cost as a reasonable proxy for the specific cost of handling Cap One's Non-forwardable UAA Mail.

In view of the way the Postal Service developed the record, only the systemwide average cost is available to the Commission. Yet nothing about Cap One's Non-forwardable UAA Mail appears to be anywhere close to the systemwide average characteristics of Non-forwardable UAA Mail, including the volume handled.¹¹ The

¹¹ Each day of the week, Cap One receives, on average, a small truckload
(continued...)

absolute volume of Cap One's Non-forwardable UAA Mail is alleged to far exceed that of any other mailer, which would suggest scale economies in processing physical returns. Also, an extraordinarily large percentage of Cap One's Non-forwardable UAA Mail is returned, relative to the average First-Class mailer. In fact, the percentage of mail returned to Cap One (9.6 percent) is so far removed from the average percentage (1.23 percent) as to support the claim that Cap One is unique, which is alleged to be the *raison d'être* for submitting this NSA proposal rather than a niche classification.¹² The total absence of any effort to develop the cost of returning Cap One's Non-forwardable UAA Mail, coupled with the absence of any credible effort to establish that the systemwide average cost of returning Non-forwardable UAA Mail is a suitable proxy, makes the Postal Service's estimate of cost savings highly suspect. Under these circumstances, the Commission cannot have any confidence whatsoever in the estimated unit savings presented by the Postal Service, and if it cannot have any confidence in the estimated unit savings, it cannot have confidence in the estimates of aggregated savings. When all is said and done, the Commission is being asked to base a central aspect of their docket on a cost figure that is almost certainly wrong.

¹¹(...continued)

of Non-forwardable UAA Mail. The volume of Cap One's returned mail is about the only pertinent data that are available. That is, annual returns are in the neighborhood of 75 million pieces, or about 250,000 to 300,000 pieces every day. With a volume of this magnitude, there is good reason to suspect that the cost of handling Cap One's returned mail may be far removed from, and substantially lower than, the systemwide average. If so, the alleged savings may be substantially overstated.

¹² Crum Direct Testimony, USPS-T-3, Attachment A, p.2; Tr. 2/42.

The issue of average versus mailer-specific costs will not go away in the future. The situation presented by this NSA proposal should not be thought of as atypical. A mailer whose mailing practices deviate from the norm would appear to be a general characteristic that is likely to be common to other NSAs. Indeed, a mailer whose “profile” (*e.g.*, unit cost, percentage of returns) closely matches the average — no matter how large its volume — would seem an unlikely candidate for an NSA. This means that the Postal Service therefore must be prepared to undertake mailer-specific cost studies to support NSAs.

Clearly, the In-Office Cost System (“IOCS”) offers no basis for developing mailer-specific cost data, as it was never designed for that purpose. And the Commission has not been assisted in the slightest by the Postal Service in the technique of developing mailer-specific cost data, as no such effort was made. If the Postal Service wants to propose additional NSAs in the future, the Commission must require the Postal Service to develop and present reasonable estimates of mailer-specific costs. Cost models tailored to the way a specific firm’s mail is handled would seem almost essential, especially if key facets of any such model have been calibrated and verified in the larger context of an omnibus rate or mail classification case. Other types of mailer-specific empirical data also may be appropriate.

Even if the Commission were to allow this NSA to be approved without mailer-specific cost data because it is the first test NSA docket, it should insist that for any future NSA the Postal Service should develop and present mailer-specific cost data. Any effort by the Postal Service to use average costs, or anything but mailer-specific

costs, should be rejected. The only conceivable circumstance in which an exception could be made is if the Postal Service presents clear and compelling, if not totally unchallenged, proof that (i) the development of mailer-specific cost is not feasible, and (ii) average costs are an appropriate proxy for mailer-specific costs for that particular NSA.

To sum up, the record evidence in this case is totally devoid of any effort to develop mailer-specific costs, despite the extraordinarily large volume of Cap One's Non-forwardable UAA Mail. Because of this, the estimated cost savings must be regarded as completely unreliable and likely substantially overstated.¹³ In light of the rebate given to Cap One via declining block discounts, it is altogether unclear whether the Postal Service would not suffer a reduction in the contribution to its overhead if the NSA were approved.

IV. NSAs MUST NOT RESULT IN UNDUE OR UNREASONABLE PREFERENCES TO CERTAIN MAILERS OR DISCRIMINATION AGAINST SIMILARLY-SITUATED MAILERS

The Postal Reorganization Act requires:

[i]n providing services and in establishing classifications, rates, and fees under this title, the Postal Service shall not, except as specifically authorized in this title, make any **undue or unreasonable discrimination** among users of the mails, nor shall it grant any **undue or unreasonable preferences** to any such user. [39 U.S.C. § 403(c) (emphasis added).]

¹³ If Cap One return costs are indeed below average, this would be magnified by the application of a piggyback factor.

In the 30-plus years since passage of the Postal Reorganization Act, focus has been on the first part of this prohibition — “undue or unreasonable discrimination.” The advent of NSA agreements with individual mailers highlights the Commission’s duty to ensure that Postal Service through an NSA not grant “undue or unreasonable preferences” to certain mailers.

The Postal Service has appeared to avoid the preference/discrimination issue, promising that it would be fair, but refusing to be bound to any particular standard of operation. Early in this docket, an interrogatory was posed to Postal Service witness Plunkett asking whether similarly-situated mailers could avail themselves of the Cap One proposal. The response of the Postal Service was anything but the unqualified “yes” that would have been expected to avoid any claim of discrimination or undue or unreasonable preference.

NAA/USPS-4. Please refer to the preamble of the NSA submitted as Appendix G of the Request, and in particular to the statement that the NSA “will be transferable to other mailers willing to meet the same conditions and terms.” Please refer also to the Request, page 4, line 6, at which the Postal Service States: “As proposed, the changes would apply only to one, discretely-positioned mailer.” **Please clarify whether the NSA is available to other mailers, or if it applies only to one mailer.**

RESPONSE:

Both.... The Capital One NSA indicates that the terms and conditions of the agreement with Capital One **would be available** to other mailers. This statement is not a term or condition of the Capital One NSA, but, rather, **expresses the Postal Service’s willingness** to enter into the same NSA with another mailer capable of

accepting and willing to accept the same terms and conditions.

To the best of the Postal Service's knowledge, **no other mailer is situated exactly like Capital One** with respect to the terms and conditions embodied in the Capital One NSA. Nevertheless, the Postal Service would be willing to enter into an agreement consisting of the **same terms and conditions** with another mailer willing to accept them. The mailer would have to demonstrate to the Postal Service that it is similarly situated, that the Postal Service would derive from the agreement with the new mailer the **same or substantially the same benefits** resulting from the Capital One NSA.

Any agreement with a new mailer duplicating the terms and conditions embodied in the Capital One NSA would be presented to the Commission as a request for a recommended decision for an experimental change in the DACS....

As a result of **inherent differences** among mailers, the Postal Service would expect that any NSA it was considering with other mailers would have terms and conditions different from the Capital One NSA, and would reflect the distinct characteristics of the mailer and its relationship with the Postal Service. The Postal Service is **willing to consider** new NSAs on those different terms, as negotiated between the mailer and the Postal Service....
[Emphasis added.]

Valpak recognizes that the purpose of this docket is to consider the NSA as presented. Although it might not be appropriate for the Commission to recommend any alternatives or amendments to the NSA at this time, it nevertheless is highly appropriate to be aware of such alternatives. An NSA should not be evaluated myopically, in some kind of vacuum, as though it were the only possible solution to a pressing problem.

Two obvious alternatives to the proposed NSA would be:

- (1) a niche classification designed to extend the basic cost-saving offer of the Cap One NSA, so as to encourage more mailers to forego physical return and instead use the electronic Address Correction Service; and
- (2) a complete unbundling of fees for Non-forwardable UAA First-Class bulk mail.

Either alternative would motivate great numbers of mailers to forego costly physical handling of their Non-forwardable UAA mail, thereby resulting in noteworthy savings and enhanced efficiency.

Viewed in isolation, the NSA might be considered a worthwhile experiment, and a temporary way forward. When evaluated against either of these readily available alternatives, however, its minuscule size compared to the vast problem, and preferential nature, makes it a poor “second-best” — or even “third-best” — solution to issues raised in this docket.

A troubling aspect of this case as presented by the Postal Service was the Service’s indication that it highly values “uniqueness” and that this criterion can be met by a mailer being the largest (or one of the largest) mailers in a subclass. Witness Bizotto stated that “Capital One is unique as one of the Postal Service’s **largest** first class mail customers.” She also said that “[i]f another customer, (1) were willing to commit to all the same terms and conditions included in the Capital One Negotiated Service Agreement ... and (2) could demonstrate that it would generate **equal or greater savings** ... the Postal Service would **consider** seeking an extension of the terms of this NSA to that customer.” Bizotto response to APWU/USPS-T1-8, Tr. 3/415-16

(emphasis added). While on the stand, witness Bizzotto did retreat somewhat from the implication in her testimony that only the largest customer in a subclass would be “unique” and that any other customer would need to be as large as Cap One to be, at least, considered for NSAs. (Tr. 3/495.)

However, an unresolved problem that the Cap One NSA has been structured to give it the characteristic of being “unique,” and thus not replicable by other mailers. The declining block discount provision and the use of electronic Address Correction Service are, admittedly, linked by terms of the contract between Cap One and the Postal Service. However, since no economic rationale has been established for joining the two, the uniqueness is artificial. Every major mailer has some characteristic, or combination of characteristics, that distinguishes its mail sufficiently to make it unique. If the Commission accepts the Postal Service’s savings estimate from using electronic Address Correction Service in lieu of physical return of the mailpieces, then clearly many mailers could benefit from this and simultaneously help the Postal Service save money. Linking this switch to declining block discounts, and then using this linkage to exclude other mailers, serves no useful purpose but to give Cap One an undue preference, thereby facilitating discrimination against mailers who are similarly situated with respect to the return of undeliverable mail.

Niche classification. Capital One clearly is not the only company with Non-forwardable UAA Mail of no personal or intrinsic value that would require the mailpiece to be returned to sender (*e.g.*, advertising, as opposed to newly-issued credit cards). Both the Postal Service and other mailers who could use electronic information

in lieu of physical return would gain by adoption of the less costly, more efficient electronic alternative. Why an NSA is used to motivate only one mailer to do that which many mailers should be motivated to do is thus a major concern. If all mailers who do not need to have their Non-forwardable UAA Mail returned were to adopt the less costly alternative, the result would be “win-win.” Those mailers would be ahead, the Postal Service would be ahead, and all mailers would benefit from the reduction in unnecessary cost. A niche classification, at a minimum, would extend the efficiency gains to a number of other mailers.

Unbundled fees for return service. As noted under Principle No. I, *supra*, Presiding Officer’s witness Panzar has testified that “the unfortunate pricing structure [for return services] has to do with the bundling nature of first-class tariffs ... if you designed the rate structure and return policy from scratch you could do better.” Tr. 8/1785, 1787. Unbundling the fees for return services for First-Class bulk mail, and substituting separate cost-based fees in lieu thereof, would present a comprehensive solution to the unfortunate, distorted pricing structure that now exists.

To sum up, since many, and perhaps most, First-Class mailers have Non-forwardable UAA Mail, this exclusive NSA appears to give one mailer an undue preference, and in this respect it sets a very troubling precedent. When viewed in conjunction with Principle No. VI (discussed below), it also is seen to result in an unreasonable preference.

Proposed Partial Stipulation and Agreement. The Postal Service and Cap One are joined by OCA, and may be joined by certain other intervenors, in proposing a

Stipulation and Agreement which appears to meet, in part, the objections to the NSA that were raised during the litigation of this docket by OCA, but which the Postal Service and OCA now unsuccessfully sought to have stricken from the record.

Apparently to obtain the support of the OCA, the Stipulation and Agreement proposes the addition of a footnote to the Domestic Mail Classification Service which reads as follows:

Comparable NSAs, involving adoption of electronic Address Correction Service in lieu of physical returns for First-Class Mail that qualifies for Standard Mail rates and declining block rates for First-Class Mail, **may be entered into** with other customers, as specified by the Postal Service, and **implemented pursuant to proceedings under Chapter 36** of Title 39, of the United States Code. [Stipulation and Agreement, Attachment A, footnote 4 (emphasis added).]

This footnote would appear to add virtually nothing to the Postal Service's statutory obligation not to give undue preference to a single mailer and to treat similarly-situated mailers in a comparable manner. Even the proposed Postal Service regulations would do little to impose any real duty on the Postal Service to avoid preferring the mailer with the NSA and discriminating against the mailer who wants one.

One of the criteria to which future mailers would be held labeled "Overall positive financial impact on the USPS," states that "[a] minimum payment or transactional penalty is required to ensure a positive contribution." (Proposed regulation 2.1f.) The Cap One NSA requires that Cap One pay the greater of \$1 million or the amount of the electronic Address Correction Service usage, if a minimum

volume threshold of qualifying mail is not met. This does not require a “positive contribution”; it requires a minimum volume threshold. For example, if the Postal Service were later to determine that the use of systemwide average costs substantially overstated the cost savings from Cap One’s forsaking physical return of its mail, there could be no “positive contribution,” yet there would be no additional payment due from Cap One.

In the final analysis, a rejection of an NSA would be appealed not to the Commission, but to the Postal Service’s Vice President, Pricing and Classification. Insofar as this individual likely would be involved in the decision being appealed, this request for consideration is nothing whatsoever like a *bona fide* appeal proceeding, and conveys a right that may sound real, but which is illusory indeed.

The Stipulation and Agreement could be described as much sound and fury, signifying nothing. OCA may have concluded that the proposed compromise would convey significant rights to other similarly-situated mailers; Valpak does not.

V. NSAs MUST NOT PROVIDE DISCOUNTS BASED SOLELY ON HIGH VOLUME

It is essential that the Commission not attempt to justify an NSA providing rewards to a mailer based on the fact that the mailer has particularly (or even uniquely) high volume. *See* 39 U.S.C. § 403(c). Such an approach would be viewed as implementing a non-cost-based quantity or volume discount, and since passage of the

Postal Reorganization Act it has been commonly agreed that such discounts are prohibited.

It is possible, of course, that a mailer with large volume could, in part due to that large volume, be able to prepare or enter its mail in a novel way, not currently required by the Postal Service, that would generate real cost savings for the Postal Service. Large volume may open the door for a mailer to be able to do additional work justifying some cost-based benefit, but it can never be the rationale for the benefit itself. An NSA must be based on Postal Service cost savings demonstrated, specific to the mailer, not just the presence of large volume.

Unless reliable record evidence of cost-savings from Cap One's changes in handling of UAA Non-forwardable Mail can be found by the Commission, it could be viewed as awarding quantity discounts.¹⁴ Basing declining block discounts, and the rate reduction from 20 cents to zero for electronic return service, solely on absolute volume could be an undue or unreasonable preference, in contravention of the statute.

¹⁴ As noted in the discussion under Principle No. III, *supra*, the cost savings here are likely overstated because the specific cost of handling Cap One's Non-forwardable UAA mail is almost surely less than the systemwide average cost.

**VI. NSAs MUST NOT PROVIDE UNFAIR REWARDS
FOR HIGH-COST MAILERS
DISCONTINUING HIGH-COST BEHAVIOR**

When rates are based on systemwide average costs, then by definition some mailers will cause the Postal Service to incur a higher-than-average cost, while others will cause the Postal Service to incur a lower-than-average cost.

Singling out those mailers that take advantage of rate averaging and cause average costs to be higher than they otherwise would be, and then giving such mailers special rewards via an NSA, is problematic. It is conceded that substituting a low-cost method for a high-cost method increases efficiency and reduces cost. However, targeting high-cost mailers for exclusive rewards that either are not available to other mailers or are available to a few other mailers determined by the Postal Service to be “similarly situated,” raises a basic issue of fairness.

It is a curious situation that the mailers who are best situated to participate in NSAs of the Capital One type are those (i) who cause the Postal Service to incur the highest cost, (ii) who benefit the most from rate averaging, and (iii) who agree to forego some of the behavior which causes them to be high-cost mailers, and in the process obtain **a rate lower than that paid by the low-cost mailers.**¹⁵ The fairness criteria (39 U.S.C. § 3622(b)(1) for rate changes and 39 U.S.C. § 3623(c)(1) for mail classification changes) requires the Commission to guard against the rewards of NSAs

¹⁵ If rates were de-averaged so as to reflect costs better and provide mailers with appropriate incentives, these mailers would pay more, not less, for their high cost-causing behavior.

being visited upon high-cost mailers, giving them rate advantages over low-cost mailers who do not have expensive, discretionary behaviors to forego for a price incentive. Moreover, suddenly giving a formerly high-cost mailer a rate that is lower than any rate available to low-cost mailers (who for many years have had to pay a share of the costs caused by the high-cost mailers), could be considered an undue or unreasonable preference, in contravention of the statute.

The fairness issue can be illustrated by stepping aside from the NSA at issue in this docket, and pondering the following two illustrations.

Flats vs. Letters. Flats cost more to process than letters, but in First-Class Mail the rate for pieces that weigh 2 or 3 ounces is identical. Should a mailer of 2-ounce flats be offered some kind of discount or rebate for converting its flats to letter-shaped mail? Would that be fair to other mailers who currently send 2-ounce letter-shaped pieces?

Door vs. Cluster Box Delivery. Delivery to the door of individual residences costs more than delivery to a cluster box. Should residences that receive delivery to the door be offered some kind of rebate or other consideration if they agree to switch to cluster boxes? Would that be fair to those who are already using cluster boxes?

If the Commission would not view either of the above two proposals favorably, it should reject the Cap One NSA, which clearly violates this principle.

VII. NSAs MUST ATTEMPT TO ANTICIPATE AND AVOID UNINTENDED CONSEQUENCES

An NSA is, by definition, restricted to one mailer, and not automatically available to similarly-situated mailers, as is the case with a niche classification. Because of this exclusivity, the Commission must give serious consideration to the possibility of unintended consequences. The pricing strategy with respect to handling of Non-forwardable UAA Mail was noted above. Namely, the highest-cost service (physical return) is available free of charge to mailers, while the lowest-cost service (electronic return) costs mailers 20 cents per return.

For purposes of discussion, we might categorize the incentives implicit in pricing strategies in a threefold manner. **First**, there is the “**inverse**” incentive, which is implicit in the current rate schedule. Decision makers (*i.e.*, mailers) are given price signals that perversely encourage them to do the wrong thing. **Second**, there is the “**neutral**” incentive, which would involve charging the same price for physical and electronic return services. They both could be free, they both could be charged 20 cents each, or whatever, so long as the price for each was the same, and left mailers feeling indifferent with regard to the price for each alternative. **Third**, there is the “**positive**” incentive scheme, in which mailers are given signals that encourage them to make the most efficient choices. Here the (unbundled) prices for return services would either equal the underlying cost or would be in proportion to the underlying cost (*e.g.*, cost plus some markup). Under this third pricing scheme, the higher-cost alternative would have a higher price to mailers, who then would have an incentive to use the

lower-cost alternative unless they had a special need for the higher-cost alternative.

With this framework in mind, let us turn to further analysis of the instant NSA.

Exclusively for Cap One, the Postal Service in the NSA proposes to substitute a “**neutral**” incentive scheme for an “**inverse**” incentive scheme. Viewed in isolation, this is a small step in the right direction. Ostensibly, it does no “harm” to other mailers, and on this basis perhaps it should be approved by recommendation of the Commission, with the Commission strongly urging the Postal Service, at a minimum, to extend such pricing to all other First-Class bulk mailers who otherwise must continue to elect their address options solely in the context of the “**inverse**” incentive scheme. Better yet, of course, would be to file a case that would substitute a “**positive**” pricing scheme for all mailers. That, of course, is beyond the proposal under review here.

But there is another consideration, which overlaps with fairness issues, but comes from the department of unintended consequences. Specifically, some — perhaps many — First-Class mailers may feel that forcing them to pay 20 cents for each electronic return while (i) not charging Cap One for electronic returns, and also (ii) giving Cap One a further rebate via a declining block discount, is treating them unfairly. The feeling of unfairness may cause some — perhaps many — of these other mailers to resist adopting the more efficient and less costly electronic return service. When evaluating the benefits of the NSA, all losses from “failure to adopt” **because of resistance created by the Cap One NSA** must be offset against any gains derived directly from the Cap One NSA. Considering that Cap One’s Non-forwardable UAA Mail is but a very small percentage of all Non-forwardable UAA Mail, the losses from

“failure to adopt” — admittedly an unintended consequence — could easily swamp the Postal Service’s gains from the NSA.

The Postal Service appears to have focused myopically on how the NSA will affect it and Cap One, and to have given little thought to the principle enunciated here. The Commission, however, should evaluate the NSA from a broader perspective.

Since the record contains no evidence or discussion about this consideration, admittedly the Commission may have difficulty giving it much weight. With regard to future NSAs, however, the Commission should recommend that the Postal Service address the possibility of any unintended consequences that might result on account of the exclusivity of NSAs.

CONCLUSION

For the reasons set forth above, Valpak believes that this NSA proposal as well as the proposed Stipulation and Agreement filed by certain parties is fatally flawed and should be rejected. The Postal Service should be encouraged to redirect its resources to find a way to motivate, not just one, but all First-Class mailers to reduce the Postal Service’s costs associated with Non-forwardable UAA mail. Such an approach would be more fair and more equitable to all mailers, and would produce greater systemwide efficiency and cost savings. Failing that, should the Commission be willing to overlook the flaws of this particular proposal, possibly because it is the first NSA to come before it, Valpak urges that the Commission’s recommendation of approval be accompanied by the establishment of clear policies for the evaluation of future NSAs, and a clear

statement that the recommendation of approval of the Cap One NSA is based on a one-time, non-repeatable waiver of certain of these principles.

Respectfully submitted,

William J. Olson
John S. Miles
WILLIAM J. OLSON, P.C.
8180 Greensboro Drive, Suite 1070
McLean, Virginia 22102-3860
(703) 356-5070

Counsel for:
Valpak Direct Marketing Systems, Inc., and
Valpak Dealers' Association, Inc.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served this document upon all participants of record in this proceeding in accordance with Section 12 of the Rules of Practice.

William J. Olson

April 3, 2003