

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

RATE AND SERVICE CHANGES TO IMPLEMENT)
BASELINE NEGOTIATED SERVICE AGREEMENT) Docket No. MC2007-1
WITH BANK OF AMERICA CORPORATION)

INITIAL BRIEF

OF

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

William J. Olson
John S. Miles
Jeremiah L. Morgan
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.

August 2, 2007

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES.	ii
STATEMENT OF THE CASE.	1
ARGUMENT.	8
1. The Postal Service Has Failed to Provide Mailer-Specific Costs, and the Proxy Chosen for those Costs Is Fatally Flawed.	8
2. The Postal Service Has Failed to Provide Any Justification for Not Using Niche Classification.	13
3. The Postal Service Proposal Could Reward One Mailer for Activities that Will Be Required of or Undertaken Voluntarily by Many Mailers.. . . .	16
4. The BAC NSA Is Not an Experiment and Could Open the Floodgates to Significant Revenue Loss.. . . .	18
CONCLUSION.. . . .	22

TABLE OF AUTHORITIES

	Page
Code of Federal Regulations	
39 CFR § 3001.193.	8, 9, 10
39 CFR § 3001.195.	13, 21
39 CFR § 3001.196.	19
 Postal Regulatory Commission Opinions and Recommended Decisions	
Docket No. MC2003-5, <i>Op. & Rec. Dec.</i> , Dissenting Opinion of Commissioner Goldway. .	14

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

RATE AND SERVICE CHANGES TO IMPLEMENT)
BASELINE NEGOTIATED SERVICE AGREEMENT)
WITH BANK OF AMERICA CORPORATION)

Docket No. MC2007-1

INITIAL BRIEF

OF

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

STATEMENT OF THE CASE

Postal Service Request

On February 7, 2007, the United States Postal Service filed a request, pursuant to Chapter 36 of the Postal Reorganization Act (“the Act”), 39 U.S.C. section 3601, *et seq.*, for a recommended decision by the Postal Regulatory Commission to implement a proposed three-year Negotiated Service Agreement (“NSA”) with Bank of America Corporation (“BAC”) that provides BAC with performance-based discounts.¹

The Postal Service’s case-in-chief consists of the testimony of one Postal Service witness:

¹ Request of the United States Postal Service for a Recommended Decision on Classifications, Rates and Fees to Implement a Baseline Negotiated Service Agreement with Bank of America Corporation, February 7, 2007 (“USPS Request”).

USPS witness Ali Ayub

USPS-T-1

Co-proponent BAC filed the testimony of one witness:

BAC witness Richard D. Jones

BAC-T-1

In its request, the Postal Service stated that it would rely on the testimony of the Postal Service witness as well as the Bank of America witness, and included a Compliance Statement² to that effect.

This case is, in effect, the fourth baseline NSA, if one counts the initial NSA with Capital One Services, Inc. (“Capital One”),³ which antedated the baseline terminology, and the NSA with Washington Mutual Bank, which was withdrawn.⁴ It is the third baseline NSA to be filed under the Commission’s rules applicable to proposed NSAs, which were established in Docket No. RM2003-5 (Order No. 1391, February 11, 2004).

² See USPS Request, p. 3 and Appendix E-4.

³ NSAs are currently in effect with Capital One (Docket No. MC2002-2, extended in Docket No. MC2006-6), Bookspan (Docket No. MC2005-3), and three other companies whose NSAs were considered to be “functionally equivalent” to the Capital One NSA: Bank One Corporation (Docket No. MC2004-3), Discover Financial Services, Inc. (Docket No. MC2004-4), and HSBC North American Holdings, Inc. (Docket No. MC2005-2).

⁴ See Docket No. MC2006-3, USPS Notice of Withdrawal of Request for a Recommended Decision on Negotiated Service Agreement with Washington Mutual Bank (December 8, 2006).

Commission Proceedings

On February 9, 2007, the Commission issued a Notice and Order (Order No. 3) on the filing of the Postal Service's request and scheduled a prehearing conference for March 14, 2007.

In accordance with Order No. 3 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 March 2, 2007. These two intervenors, referred to collectively as "Valpak," have proceeded jointly in this docket.

On March 2, 2007, the Postal Service filed a motion for the establishment of settlement procedures.

Valpak participated in the March 14, 2007 prehearing conference and the settlement conference immediately following. Valpak was not present at the close of the closed hearing to participate in the settlement conference conducted by the Postal Service on June 14, 2007, but spoke with counsel for the Postal Service shortly thereafter. The Postal Service submitted a report on the first settlement conference to the Commission on March 19, 2007, and a report on the second settlement conference on June 20, 2007.

The Commission issued Presiding Officer's Ruling No. MC2007-1/1 on March 20, 2007, which established the procedural schedule for the case. On May 1, 2007, the American Postal Workers Union, AFL-CIO ("APWU") filed a motion to reschedule the May 8, 2007

hearing on the proponents' case-in-chief. The Commission granted that motion, rescheduling the hearing for June 14, 2007.⁵

Discovery of the Proponents' Case-in-Chief

By April 6, 2007, the deadline for written discovery,⁶ Valpak had conducted written cross-examination of the following witness with respect to his direct testimony, and also conducted follow-up written cross-examination within the time allowed:

USPS witness Ali Ayub

VP/USPS-T1-1-33

Valpak timely designated all responses to its interrogatories received from witness Ayub for inclusion in the record on May 3, 2007 and June 11, 2007.⁷

On June 14, 2007, counsel for Valpak conducted oral cross-examination of Postal Service witness Ayub (Tr. 2/333-380).

⁵ Presiding Officer's Ruling No. MC2007-1/5, May 3, 2007.

⁶ See Presiding Officer's Ruling No. MC2007-1/1, March 20, 2007, Attachment.

⁷ Valpak filed an interrogatory to witness Ayub, part of which was redirected to BAC, VP/USPS-T1-32(b). BAC filed an institutional response to that interrogatory, with part of its response under seal. After Valpak objected to including the unresponsive response in the record, the Commission struck the sealed portion of the response from the record, leaving only the unsealed response. See Presiding Officer's Ruling No. MC2007-1/12, June 27, 2007.

Notice of Inquiry No. 1

On April 3, 2007, the Commission issued Notice of Inquiry (“NOI”) No. 1, inviting interested persons to comment on the problems raised by the failure to base discounts on mailer-specific data:

to comment on the methods of establishing baselines in longer term (three years in this instance) **pay-for-performance agreements** where **actual mailer information is unavailable**. Specific comments are encouraged which discuss the need to incorporate **adjustment mechanisms**, and the benefits or detriments of incorporating the approach outlined in the example above compared with an approach that **solely utilizes system-wide averages**. [NOI No. 1, pp. 2-3 (emphasis added).]

BAC, the Office of the Consumer Advocate, the Postal Service, and Valpak filed comments on April 17, 2007. Valpak’s comments suggested criteria for evaluating the appropriateness of using system-wide averages as a baseline for a pay-for-performance NSA, discussed usage of mailer-specific information when available, and argued that it is premature to consider an NSA when system-wide averages are the only data available. Valpak then discussed possible mechanisms for adjusting the baseline in future years of an NSA that begins without customer-specific information.

APWU, BAC, the Postal Service, and Valpak filed reply comments on April 24, 2007. Valpak’s reply comments addressed the comments of the co-proponents, the Postal Service and BAC.

Commission Standards Governing Baseline NSAs

Commission rules which govern baseline NSAs, which were effective March 19, 2004 (after Commission issuance of its *Opinion and Recommended Decision* in the Capital One NSA case, Docket No. MC2002-2), govern Commission consideration of this Postal Service Request. These rules provide that:

- (a) ... The Postal Service request shall include:
 - (1) A **written justification** for requesting a Negotiated Service Agreement classification as opposed to a **more generally applicable form of classification**; and
 - (2) A description of the operational bases of the Negotiated Service Agreement, including **activities to be performed** and facilities to be used **by both the Postal Service and the mailer under the agreement**. [39 CFR § 3001.195 (emphasis added).]

Additionally, requests for NSAs are required to include certain financial information, as follows:

(e) *Financial analysis*. Every formal request shall **include** an analysis, as described in § 3001.193(e)(1), of the **effects of the Negotiated Service Agreement on Postal Service volumes, costs and revenues** in a one-year period intended to be representative of the first year of the proposed agreement. If the agreement is proposed to extend beyond one year, the request shall also include an analysis of the effects of the agreement on Postal Service volumes, costs and revenues in each subsequent year of the proposed agreement, as described in § 3001.193(e)(2). For each year, the analysis shall **provide such detail that the analysis of each component of a Negotiated Service Agreement can be independently reviewed**, and shall be prepared in **sufficient detail to allow independent replication**, including citation to all referenced material.

- (1) The financial analysis for the one-year period intended to be representative of the first year of the proposed agreement shall:
 - (i) Set forth the estimated **mailer-specific** costs, volumes, and revenues of the Postal Service for that year, assuming the then effective postal rates and fees absent the implementation of the Negotiated Service Agreement;

(ii) Set forth the estimated **mailer-specific** costs, volumes, and revenues of the Postal Service for that year which result from implementation of the Negotiated Service Agreement;

(iii) Include an analysis of the **effects** of the Negotiated Service Agreement **on contribution to the Postal Service** for that year (including consideration of the effect on contribution from mailers who are not parties to the agreement);

(iv) Utilize **mailer-specific** costs for that year, and provide the basis used to determine such costs, including a discussion of material variances between **mailer-specific** costs and system-wide average costs; and

(v) Utilize **mailer-specific** volumes and elasticity factors for that year, and provide the bases used to determine such volumes and elasticity factors.

If mailer-specific costs or elasticity factors are not available, the bases 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. [39 CFR § 3001.193(e) (emphasis added).⁸]

⁸ Commission rules also require that the Postal Service's financial analysis for subsequent years include certain specific information, as follows:

(2) The financial analysis for each subsequent year covered by the agreement (if the proposed duration of the agreement is greater than one year) shall:

(i) Identify each factor known or expected to operate in that subsequent year which might have a material effect on the estimated costs, volumes, or revenues of the Postal Service, relative to those set forth in the financial analysis provided for the first year of the agreement in response to § 3001.193(e)(1). Such relevant factors might include (but are not limited to) cost level changes, anticipated changes in operations, changes arising from specific terms of the proposed agreement, or potential changes in the level or composition of mail volumes;

(ii) Discuss the likely impact in that subsequent year of each factor identified in § 3001.193(e)(2)(i), and quantify that impact to the maximum extent practical; and

(iii) Estimate the cumulative effect in that subsequent year of all factors identified in § 3001.193(e)(2)(i) on the estimated costs, volumes, and revenues of the Postal Service, relative to those presented for the first year of the agreement in response to § 3001.193(e)(1). [39 CFR § 3001.193(e)(2).]

ARGUMENT

Valpak does not, in principle, oppose NSAs. *See, e.g.*, Valpak's initial comments and reply comments (filed September 29, 2003 and October 14, 2003, respectively) in Docket No. RM2003-5. Valpak signed the Stipulation and Agreement in Docket No. MC2004-3, the Bank One Corporation NSA (October 5, 2004). However, Valpak believes that NSAs must be reviewed carefully by the Commission for compliance with the Commission's own rules and previously-articulated standards. The NSA proposal under consideration in this docket fails to meet the Commission's standards.

1. The Postal Service Has Failed to Provide Mailer-Specific Costs, and the Proxy Chosen for those Costs Is Fatally Flawed.

The cost of processing automation compatible letter mail is inversely related to the percentage of letters that can be successfully read by automation equipment — *i.e.*, the higher the percentage that can be read, the lower the cost, and vice versa — because letters that cannot be read by automation equipment have a higher processing cost. A direct linkage thus exists between mailer-specific read/accept rates and mailer-specific costs. If the read/accept for Mailer X were exactly equal to the national average, it would be reasonable to infer that the cost to process letters of Mailer X is equal to the national average. By the same token, if the read/accept rate for Mailer X's letters were higher than the national average, it would be reasonable to infer that the cost to process letters of Mailer X is less than the national average.

Although mailer-specific costs generally are required by the Commission's rules (*see* 39 CFR § 3001.193(e)(1)), they have not been provided by the Postal Service in this docket because no mailer-specific data are available for BAC's read/accept rate. If such mailer-

specific data were available, the Postal Service has admitted that it would prefer to utilize those mailer-specific read/accept rates. Response of witness Ayub to VP/USPS-T1-27(b), Tr. 2/294-95. In other words, the baseline proposed here represents a temporary “second-best,” or fallback, position. In the current docket, the data used for the proposed baseline read/accept rate are only system-wide national data (*i.e.*, not even regional or otherwise somehow narrowed down so as to better reflect BAC’s read/accept rate). Improvements in read/accept rates will be measured from a purported national average of 96.8 percent for First-Class Mail, and 96.9 percent for Standard Mail. Response of Postal Service witness Ayub to OCA/USPS-T1-6-7, Tr. 2/81-82. Moreover, there are many reasons to believe the proxy chosen has virtually no applicability to BAC’s actual read/accept rate and associated costs. The Postal Service has failed to demonstrate “the suitability of the proposed costs ... as a proxy for mailer-specific costs....” 39 CFR § 3001.193(e)(1).

In both initial comments (April 17, 2007) and reply comments (April 24, 2007) to Notice of Inquiry No. 1, Valpak and other intervenors have extensively addressed problems with the proposed baseline. Not only did the Postal Service fail to demonstrate the “suitability” of the proposed proxy, the record demonstrates that the **proxy is unsuitable** for several reasons, resulting in great unfairness to other mailers.

a. The baseline is based on a July 19-23, 1999 estimate of system-wide read/accept rates. Response of witness Ayub to OCA/USPS-T1-43, Tr. 2/215. *See also* Tr. 2/365, ll. 5-7. Those eight-year old baseline data already are far from current, and, with each year under the proposed NSA, they will get older still. As such, they also are more accurately described as historic than current — based on eight-year old data.

b. The system-wide read/accept rates (*i.e.*, the baseline) proposed for this docket were used in Docket No. R2006-1 as the basis for determining 100 percent passthroughs for barcode workshare discounts already being provided to large mailers like BAC. Response of United States Postal Service to Notice of Inquiry No. 1, p. 4 [unnumbered] (April 17, 2007). Additional discounts for mail that already has a higher-than-average read/accept rate will result in aggregate workshare discounts exceeding 100 percent of avoided costs with no record explanation or justification.⁹

c. In recent years, MERLIN has raised the bar on barcode quality. Response of witness Ayub to VP/USPS-T1-9(f), Tr. 2/261. The Postal Service has deployed MERLIN widely, and results indicate that a high MERLIN read/accept rate correlates with a high automation read rate. Response of witness Ayub to VP/USPS-T1-26(c), Tr. 2/292. Any major mailer with access to MERLIN (including BAC) can thus obtain a good prediction of whether the read/accept rate of their mail will exceed the eight-year-old system-wide average. The co-proponents introduced no BAC MERLIN data into the record in this docket.

⁹ 39 CFR § 3001.193(e)(1)(iii) states that: “The financial analysis for the one-year period intended to be representative of the first year of the proposed agreement shall ... (iii) Include an analysis of the effects of the Negotiated Service Agreement on contribution to the Postal Service for that year (**including consideration of the effect on contribution from mailers who are not parties to the agreement**).” (Emphasis added.)

For 50 percent of all automation letter mail, the read/accept rate exceeds the national average, while it is less than the national average for the other 50 percent. The effect of using the national average read/accept rate as the baseline for the half of all automation letters that exceed the national average and are not party to the agreement would be to reduce the contribution to the Postal Service by a significant amount, with no corresponding reduction in costs. Since NSAs are selective, it is reasonable to presume that the 50 percent that could benefit from using the nationwide average would opt for such an NSA, while the other 50 percent would not.

d. The Postal Service continues to work with mailers to educate them on mail quality issues and improve mail quality. Response of witness Ayub to VP/USPS-T1-17(h)(ii), Tr. 2/275-76. Unless it is demonstrated that these efforts by the Postal Service have been totally for naught, mail quality, including read/accept rates, should have improved over the last eight years. This issue was ignored by the co-proponents' case-in-chief.

e. Since the read/accept rates were estimated in 1999, the Postal Service has spent approximately \$150 million to improve barcode read/accept rates. Response of witness Ayub to VP/USPS-T1-26(b), Tr. 2/292. It cannot be assumed that these costly improvements had no effect on read/accept rates. Discounts, or payments, under the proposed NSA to BAC for read/accept rates higher than the baseline (as well as any discounts or payments to other mailers arising from subsequent functionally-equivalent NSAs) are tantamount to paying BAC (and any other similarly-situated mailers) for improvements that have been sponsored, implemented and paid for by the Postal Service.

f. The most recently-deployed letter-sorting machines can read the Intelligent Mail Barcode ("IMB") and the IBIP (2D) barcode. Response of witness Ayub to VP/USPS-T1-26(d), Tr. 2/292-93. Tests of letters with the IMB that BAC will use show read/accept rates of 97.1 to 99.0 percent, which is somewhat higher than the proposed baseline. Response of witness Ayub to OCA/USPS-T1-36(a), Tr. 2/205. To the extent that read/accept rates are higher on more recently deployed automation equipment, which all mailers helped pay for, incentive payments should not go only to those who are selected to receive a pay-for-performance NSA such as the one here.

g. The Postal Service does not have data showing the trend in read/accept rates since 2000. Response of witness Ayub to VP/USPS-T1-8(d), Tr. 2/258-59. Having system-wide read/accept rates for only one year — *i.e.*, the lack of comparable read/accept rate data for any other year that either preceded or followed 1999 — means that the extent of any trend in the read/accept rate for automation letters, which almost certainly has risen, has not been presented on the record in this docket.

h. The Postal Service has testified that it has no plans to update its data on the system-wide read/accept rates for letter mail, *i.e.*, the baseline, during the pendency of this docket. Response of witness Ayub to VP/USPS-T1-26(e), Tr. 2/293. Even if the eight-year old baseline somehow were to be deemed suitable in 2007 for this baseline NSA, it cannot serve indefinitely as the baseline for subsequent functionally equivalent NSAs. Any data which are as critical to ratemaking as the read/accept data here should be updated on a regular basis. The Postal Service's decision not to update data even when clearly possible is not compatible with good ratemaking.

i. In August 2006, the Postal Service announced that the IMB would become a requirement for automation mail in calendar year 2009. Response of witness Ayub to VP/USPS-T1-17(d), Tr. 2/272-74. However, the IMB is ready for mailer adoption at this writing, and early adoption by major bulk letter mailers is encouraged (without any compensation by the Postal Service, except for BAC). Consequently, all bulk letter mailers, including BAC, will be required to make whatever investment is necessary to implement the IMB. *See* response of witness Ayub to VP/USPS-T1-27(b), Tr. 2/294-95. Although the IMB alone may not enable determination of mailer-specific read/accept rates, in the very near future

mailer-specific read/accept rates should be available for a large number of major mailers as they adopt the other prerequisites (*e.g.*, Seamless Acceptance).

For all the foregoing reasons, the read/accept rate based on 1999 average national data has been demonstrated on the record in this docket to be a completely unsuitable proxy for BAC's read/accept rate and BAC's costs, thereby virtually guaranteeing that this NSA will overcompensate BAC for cost savings from this NSA, if any, to the prejudice of other mailers.

2. The Postal Service Has Failed to Provide Any Justification for Not Using Niche Classification.

The Commission's rules for baseline NSAs require the proposal to include an explanation of why the NSA is preferable to a niche classification. Specifically, Rule 195(a)(1) requires the Postal Service provide a "written justification for requesting a Negotiated Service Agreement classification as opposed to a more generally applicable form of classification."

In the last baseline NSA which was not withdrawn, Docket No. MC2005-3 (Bookspan), the Postal Service asserted that such a required justification existed in either the Postal Service's Request or in witness testimony, addressing the issue very briefly in its Request but without providing supporting evidence. Docket No. MC2005-3, Request of the United States Postal Service for a Recommended Decision on Classifications and Rates to Implement a Baseline Negotiated Service Agreement with Bookspan, p. 4. Although Commission Rule 195 (established in 2004, after Docket No. RM2003-5) may have been relatively new when the Bookspan case was filed, the Postal Service still has not complied with this requirement or presented any justification or evidence that this NSA is superior to a niche classification in 2007. Although the Commission essentially chose to waive its own rules once in Docket No.

MC2005-3 with respect to Bookspan, it is not reasonable for the Postal Service again to ignore these rules in this docket, especially in view of the Dissenting Opinion of Commissioner Goldway. *See generally* Docket No. MC2005-3, *Op. & Rec. Dec.* (“the Commission’s Negotiated Service Agreement rules require rigorous evidentiary presentations for new baseline cases.... I believe that the Postal Service needs to place more emphasis on due diligence, and should share the results of these efforts with the Commission when presenting its Negotiated Service Agreement requests.”).

In the instant case, the Postal Service Request contains a description of the requirement of Commission Rule 195, namely, that the Postal Service provide a:

written justification for requesting a Negotiated Service Agreement classification, as opposed to a more generally applicable form of classification.... [USPS Request, Attachment E-11.]

The Postal Service’s summary response to this Commission requirement is as follows:

These requirements are discussed in the Request, and within the testimony of witnesses Ali Ayub (USPS-T-1) and Richard D. Jones (BAC-T-1). [*Id.*]

The accuracy of this representation has been called into question. On oral cross-examination, witness Ayub was asked:

let me ask you to point in your testimony where you discuss, where present on the record that a niche classification would not work? [Tr. 2/356, ll. 21-23.]

Witness Ayub demonstrated a familiarity with the Commission’s requirement and believed that he had addressed it in his testimony:

I can’t seem to find it right now. I do believe it is in there somewhere. [Tr. 2/357, ll. 11-12.]

However, after looking through his entire testimony at length, he was asked:

But you can confirm that this topic is not addressed in your testimony; correct? [Tr. 2/358, ll. 9-10.]

At which point, he admitted:

That is correct. [*Id.*, l. 11.]

An examination of the testimony of BAC witness Richard D. Jones (BAC-T-1) reveals that this Commission requirement is not addressed in that testimony, either.

The only other reference to this Commission requirement is contained on page 3 of the Postal Service's Request, where the following sentence was identified by witness Ayub (Tr. 2/360, ll. 2-9) as being responsive to the Commission's rules:

Because the mailing profiles of other mailers, including other banks, are likely to differ a generally applicable classification would not be a reasonable substitute for the NSA presented in this request. [USPS Request, p. 3.]

Although it is certainly true that the mailing profile of every mailer "is likely to differ" from the mailing profile of every other mailer, a recitation of this general tautology is not a reasoned analysis applicable to this specific NSA. A difference in profiles among mailers can be found in every existing classification. By any standard, this sentence fails to meet the Commission requirement for a "written justification."

Had the Postal Service explicitly addressed the possibility of a niche classification in this specific docket, some significant problems in this proposed NSA likely would have been highlighted. For example, when the Postal Service proposes a niche classification, requirements for entering mail under the niche classification are carefully defined; *i.e.*, from

the very outset it is known which mail — and, generally, which mailers — will qualify to use the classification. That is not the case with NSAs, especially this one.

3. The Postal Service Proposal Could Reward One Mailer for Activities that Will Be Required of or Undertaken Voluntarily by Many Mailers.

BAC has agreed that it will undertake to the fullest extent a number of activities, now optional, that BAC either is not doing at all or is doing only partially. All activities related to BAC's obligations are now optional, but some already are slated to become mandatory in the near future, and still others may become candidates for new requirements. Response of witness Ayub to VP/USPS-T1-18(c), Tr. 2/278-79. An examination of these various activities calls into question the basic concept of the NSA.

For example, BAC currently does not put a Four-State Barcode on any of its letter mail, but all qualifying letter mail entered under this NSA is required to have a Four-State Barcode. In 2009, the Postal Service plans to require a Four-State Barcode on all automation letter mail (response of witness Ayub to VP/USPS-T1-17(d)), hence, during pendency of this NSA, this activity no longer will be optional, and all mailers of automation letters will have to invest whatever amount is necessary to implement the Four-State Barcode. Once every automation letter mailer routinely is required to print a Four-State Barcode on all of its letter mail, it is unclear why BAC should be compensated for doing so.

BAC has agreed to use Seamless Acceptance, eDropship, and Centralized Automated Payment System ("CAPS"). The Postal Service does not expect to offer any inducements to any bulk mailers to adopt and use Seamless Acceptance (response of witness Ayub to VP/USPS-T1-3(e)(ii), Tr. 2/247), but "it will encourage mailers to adopt [voluntarily] the new

platforms [e.g., Seamless Acceptance].” Response of witness Ayub to VP/USPS-T1-22(c)(i).

See also responses of witness Ayub to VP/USPS-T1-28 and 31, Tr. 2/296-97 and 302-03.

As part of this NSA and the incentives (*i.e.*, discounts) contained therein, BAC has agreed to use CONFIRM service. Other mailers will not be compensated in any way for doing so.

Although the Postal Service policy is not to compensate other mailers for these activities, would any mailer that voluntarily adopts any or all of these functions be entitled to (or disqualified from receiving) a functionally equivalent NSA? The answer is unknown. Would a mailer’s decision to implement these activities bar its access to a functionally equivalent NSA? The Postal Service provides a somewhat ambiguous response, saying only that “such adoption would not automatically disqualify [the mailer] from being a candidate for a functionally equivalent pay-for-performance NSA.” Response of witness Ayub to VP/USPS-T1-29(f), Tr. 2/300. *See also* Tr. 2/373, ll. 1-9 (“That would be acceptable, I believe” “if [a] mailer was already using seamless acceptance, was already using CAPS, et cetera, and came to [the Postal Service] and said, ‘We will continue to use those things, and we want to have an NSA?’”).

If other mailers are encouraged or required to engage in these activities, why should only BAC be rewarded? If voluntary adoption by a mailer of many or all of the measures agreed to by BAC should disqualify the mailer from being eligible for a functionally equivalent NSA, might that not have a chilling effect on voluntary adoption of these new procedures? Conversely, once a mailer already has adopted many or all of the measures agreed to by BAC, that raises a question of why the mailer should be eligible for an NSA that is designed to

incentivize and compensate for activities which the mailer is **not** then doing, as opposed to those which the mailer already is doing. Nor has the Postal Service hesitated to require that all mailers make various substantial investments in order to qualify for existing discounts. In light of these factors, there is a serious issue concerning the basic rationale undergirding this proposed NSA.

4. The BAC NSA Is Not an Experiment and Could Open the Floodgates to Significant Revenue Loss.

The Postal Service has asked that this agreement with BAC be considered as a baseline NSA under the Commission’s rules governing NSAs. In consequence thereof, witness Ayub notes in his testimony (USPS-T-1) that the Postal Service considers itself to have an “affirmative obligation” to offer functionally equivalent NSAs to all similarly-situated mailers. Specifically, in his testimony (USPS-T-1) at page 26, lines 21-23, witness Ayub says:

Finally, the Postal Service recognizes an **affirmative obligation** to make comparable terms available to companies that are deemed functionally equivalent, thus obviating the possibility that any competitor of BAC need be affected by the Agreement. [Emphasis added.]

This pay-for-performance NSA would appear to be potentially applicable to a large number of bulk mailers — so many, in fact, that one could see this NSA as opening the floodgates to a revenue hemorrhage of substantial proportions.

Elsewhere, the Postal Service seems to perceive the potential scope of this NSA to be somehow highly limited. “NSAs like the Bank of America NSA offer opportunities to test new ways to price discriminate effectively for appropriate reasons **on a relatively small scale.**”

Response of witness Ayub to VP/USPS-T1-3(c), Tr. 2/246 (emphasis added). The responses

of witness Ayub to VP/USPS-T1-15(a) and 18(c), Tr. 2/268 and 278-79, also indicate that the Postal Service considers this contract with BAC to be more an experiment than a baseline NSA designed for widespread replication.

BAC, also sensing that this could be a significant problem, discusses the possibility that the proposed arrangement would comport well with rules governing experimental classifications, and suggests that the proposed NSA be considered “as a large scale beta test for the numerous additional functionalities that the Four-State Barcode and Intelligent Mail are likely to permit.” Comments of Bank of America Corporation in Response to Notice of Inquiry No. 1 (April 17, 2007), pp. 17-18. *See also* Tr. 2/368, ll. 14-17 (“...this is a test environment for us. The NSA allows us to test new policies and procedures before we implement.”). But clearly this NSA was not filed as any kind of an experiment, and the record is devoid of evidence with respect to an experimental classification. Discussion of a possible “beta test” is simply irrelevant in this docket. Obviously, though, no factors that might seriously restrict eligibility are indicated here, or elsewhere. The Postal Service and BAC cannot be allowed to have it both ways.

Of the “host of obligations” that the Postal Service has bundled together in the BAC NSA, how many of these features would be necessary (and in what combination(s) would they have to be contained) in order to make a subsequent, proposed NSA “functionally equivalent” to the BAC NSA as envisioned by 39 CFR § 3001.196(a)? With respect to the elements that would make another NSA functionally equivalent to the one proposed here, the Postal Service represents that this NSA has bundled together a “host of obligations.” Responses of witness Ayub to VP/USPS-T1-28(d) and 29(d), Tr. 2/297 and 299. Interestingly, some activities

associated with this host of obligations are directly associated with improving the read/accept rate, while others bear little or no relationship to the read/accept rate and the discounts provided for in the compensation scheme. *See, e.g.*, Tr. 2/341, ll. 22-24 (“using CAPS” does nothing “to improve the read accept rate of BAC’s mail”); 2/342, ll. 5-7 (using FAST and eDropship do not “affect the read accept rate of a mailer”); 2/347, ll. 18-21 (“the use of the mail.dat files will not increase or alter the read accept rate for BAC’s mail”).

Every activity in this host of obligations, including all those not associated with improving the read/accept rate, is asserted to “add value” for the Postal Service and help justify the discount for any improvement over the 1999 baseline read/accept rate.¹⁰ Valpak discussed problems raised by such bundled pricing in its reply comments to Notice of Inquiry No. 1 (April 24, 2007), at pages 1-2. As noted there, the Postal Service’s comments to Notice of Inquiry No. 1 stress that an interrelationship exists between (1) activities not associated directly with read/accept rates, and (2) contract incentives, because any change to (*i.e.*, increase in) the 1999 baseline assertedly can have a potentially negative effect on those activities unrelated to read/accept rates, despite the fact that the discounts are not explicitly associated with any of those activities.¹¹ In essence, the Postal Service claims that a complex

¹⁰ Other major mailers assert that they, too, make large voluntary investments in optional activities in order to improve mail quality. *See* Docket No. RM2007-1, Initial Comments of Major Mailers Association (June 18, 2007), p. 2. It would seem rather probable that most major mailers also would like to receive additional discounts for voluntarily adopting optional activities.

¹¹ *See also* BAC’s Comments in Response to Notice of Inquiry No. 1 (April 17, 2007) which supported this position; *see* Valpak’s Reply Comments to Notice of Inquiry No. 1 (April 24, 2007) at 2.

interrelationship and linkage exist between (i) the subset of activities not associated directly with the read/accept rate, and (ii) the cumulative discounts BAC expects to derive from the baseline (which is based on the 1999 nationwide average read/accept rate).

The implicit, complex, highly-ambiguous pricing/value relationship custom designed by the Postal Service for this NSA gives rise to a host of questions. In view of the large number of obligations that are involved, a great many variations are possible in subsequent contracts. Different NSAs could include none, or only some, of the obligations not associated directly with the read/accept rate. An essential question is, what does it take for another contract to be functionally equivalent? That is, of the “host of obligations” contained in this contract, how many of those obligations must subsequent contracts include in order for a contract to qualify as functionally equivalent? Would meeting three-quarters of those obligations, or even one-half, be sufficient?¹² Further, of the host of obligations and activities in the BAC contract that are not directly related to improvement of the read/accept rate, how many of these are required in order for another contract to be considered functionally equivalent? Alternatively, if some (or all) of these unrelated activities are omitted, how should this affect any discount for improvement in the read/accept rate? This sort of ambiguity would not arise with a niche classification, which may be one reason why Commission rules are written to prefer niches whenever possible. *See generally* 39 CFR § 3001.195(a)(1).

¹² If the number of elements in subsequent NSAs differ materially from those in this NSA, by how much can (or should) the discount vary in order for the contract to be considered functionally equivalent? Figuratively speaking, over a series of NSAs the Commission may be asked to consider whether all 4-wheel passenger vehicles are functionally equivalent, from a Smart car to a Rolls Royce, including SUVs, Minivans, Hummers, and everything in between.

CONCLUSION

This NSA fails to comply with the Commission's rules and requirements for baseline NSAs, and therefore cannot be approved by the Commission.

Respectfully submitted,

William J. Olson
John S. Miles
Jeremiah L. Morgan
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.

August 2, 2007