Postal Regulatory Commission
Submitted 1/14/2011 3:57:33 PM
Filing ID: 71587
Accepted 1/14/2011

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

DISCOVER NSA	Docket No. MC2011-19
DISCOVER NSA	Docket No. R2011-3

NOTICE OF THE UNITED STATES POSTAL SERVICE OF FILING OF CONTRACT AND SUPPORTING DATA AND REQUEST TO ADD DISCOVER FINANCIAL SERVICES NEGOTIATED SERVICE AGREEMENT TO THE MARKET-DOMINANT PRODUCT LIST

(JANUARY 14, 2011)

In accordance with 39 U.S.C. § 3622 and § 3642, and 39 C.F.R. § 3010 and § 3020, *et seq.*, the United States Postal Service hereby provides notice that the Governors have authorized the Postal Service to enter into a negotiated service agreement (NSA) with Discover Financial Services (DFS). The agreement will become effective March 1, 2011, and the Postal Service requests that it be added to the market-dominant product list within the Mail Classification Schedule.[1] This is a market-dominant special classification within the meaning of 39 U.S.C. § 3622(c)(10).[2]

The Postal Service represents that it will inform customers of the new classification and associated price effects.[3] In addition to this Notice, the Postal Service will issue a Press Release announcing the NSA and will post notification on USPS.com. Notice of the NSA will also be published in the *Federal Register*. Thus, widespread notice is being given more than 45 days prior to the planned implementation date.

The Postal Service identifies Mr. Greg Dawson as the official who will be available to provide responses to queries from the Commission.[4] Mr. Dawson's contact information is as follows:

---

[1] 39 C.F.R. § 3010.42(a)(2), § 3020.31(a), (c).
[2] *Id.* § 3020.31(d).
[3] *Id.* § 3010.42(a)(3).
[4] *Id.* § 3010.42(a)(4).

Mr. Greg Dawson
Manager, Pricing Strategy
475 L'Enfant Plaza S.W.
Room 4316
Washington, D.C. 20260-5015

The remainder of this request describes the agreement, identifies each operative component, and provides details regarding the expected improvements in the net financial position of the Postal Service accruing from it.[5] Attachment A is a copy of the Governors' resolution establishing the prices and classification and a certification of the Governors' vote.[6] Attachment B is a copy of the contract between the Postal Service and DFS.[7] Attachment C contains the changes to the Mail Classification Schedule requested in association with this NSA.[8] Attachment D contains the data collection plan.[9] Attachment E is a statement of supporting justification for this request.[10] Attachment F contains the calculations underlying the financial analysis of the agreement.[11]

As described below, and in the attached Statement of Supporting Justification (Attachment E), the Postal Service believes that the DFS NSA conforms to the policies embodied in the Postal Accountability and Enhancement Act (PAEA), and meets the statutory standards supporting the desirability of this special classification. 39 U.S.C. § 3622((c)(10). In particular, it has the potential to enhance significantly the Postal Service's financial position, and it will not cause unreasonable harm to the marketplace.

I. Description of the Agreement

The objective of this multi-class market dominant agreement is to maintain the total contribution the Postal Service receives from DFS First Class and Standard postage, and to provide an incentive for net contribution growth beyond that. Accordingly, this NSA is intended to promote new growth in Standard Mail that will help offset the expected decline in DFS' First-Class Mail volume. The agreement would also provide an incentive for DFS to slow the erosion of First-Class Mail. It would promote these

[5] *Id.* § 3010.42(b)-(f).
[6] *Id.* § 3020.31(b).
[7] *Id.* § 3010.42(a)(1), (2).
[8] *Id.* § 3020.31(f).
[9] *Id.* § 3010.43.
[10] *Id.* § 3020.32.
[11] *Id.* § 3010.42(c).

objectives by moderating the effects of future price increases in both First-Class Mail and Standard Mail. In this regard, the NSA would provide a rebate for a portion of the postage paid for First-Class and Standard Mail as a result of future price increases. DFS would qualify for such rebates when DFS postage revenues meet or exceed an established dollar threshold, which as explained below, takes into account DFS' actual First Class volume declines over time. Full-service Intelligent Mail barcode (IMb) would be required for all qualifying mail volume under this program.

The basic agreement consists of five components: a revenue threshold, a revenue threshold adjustment, a postage commitment, rebates on First-Class Mail, and rebates on Standard Mail.

The **threshold** is based on the amount of DFS' total postage paid for First-Class Mail Automation Presort letters, Standard Mail Automation Presort letters, and Standard Mail Carrier Route letters. The baseline for the revenue threshold is DFS' total postage for these categories over the period from February 2010 through January 2011. For the first year of the agreement, the threshold is calculated as an amount 10 percent above the baseline; for the second year, 15 percent above the baseline; and, for the final year, 20 percent above the baseline. If DFS meets or exceeds the threshold in a contract year (adjusted as described below), it will earn rebates on its qualifying First-Class Mail and Standard Mail postage. This threshold is intended to ensure that DFS' postage paid will continue to increase.

The revenue **threshold adjustment** is intended to ensure that total contribution from DFS' overall business will continue to grow, after rebates, even if its use of First-Class Mail continues to decline. It adjusts the threshold upward by 65 cents for every dollar decline in DFS' First-Class Mail postage. Under this adjustment, to qualify for rebates DFS must send an extra $1.65 worth of Standard Mail to offset each dollar decline in postage from First-Class Mail. This mechanism is intended to control the difference in contribution margin between First-Class Mail and Standard Mail, and to maintain or increase overall contribution from DFS mail.

As part of the agreement, DFS has agreed to a **postage commitment**, equal to the adjusted threshold. If the amount of DFS' total postage from eligible mail in the first year of the contract is less than the adjusted threshold, DFS will pay the Postal Service 10 percent of the difference between the two. Penalties for the second and third years of the contract will be negotiated between the Postal Service and Discover based on economic and market conditions.

If DFS meets or exceeds the adjusted postage thresholds in any given year of the contract, it will earn **rebates** on its qualifying First-Class Mail and Standard Mail postage. The rebate for First-Class Mail will be equal to 75 percent of the increase in postage as a result of a subsequent cumulative price increase (relative to First-Class Mail prices in existence at the initiation of the agreement) for all qualifying pieces. For Standard Mail, the rebate will be equal to 37.5 percent of the increase in postage as a result of a subsequent cumulative price increase (relative to Standard Mail prices in existence at the initiation of the agreement) for all qualifying pieces. For purposes of applying this provision, the amount of the price increase will be calculated using a Laspeyres index of the relevant price categories for each class, with DFS' volumes by price category for the current year as the weights.

Beyond these five basic components, the agreement also contains the following additional elements: (1) a merger and acquisition clause, which adjusts the baseline postage (and thus the threshold) to account for increased mailing activity (or decreased, in the case of a sale or closure); (2) a termination clause that allows either party to end the agreement within the first nine months of any contract year without penalty; and (3) a clause that states that DFS can participate in incentive programs upon agreement with the Postal Service on the terms of that participation. The goal of this clause is to prevent DFS from double-dipping on incentives, while still maintaining the possibility of providing further inducement.

The Postal Service regards each of the five main elements described above (threshold, threshold adjustment, postage commitment, and First-Class Mail and Standard Mail rebates) to be an essential component of this agreement, although the exact values for these parameters in the DFS NSA were determined based on the Postal Service's evaluation of DFS' volume and revenue trends, current and future economic conditions, and negotiation between the parties. Evaluation of these parameters supports the conclusion that the NSA will lead to significant additional contribution from DFS. This design imperative — to generate additional contribution— and the basic structure of the agreement with DFS, as described above, will guide the

Postal Service in the negotiation of similar agreements, and may, in other NSAs, yield parameters that are substantially different from those in this agreement.

In assessing the desirability of this agreement, the Postal Service believes that the defining characteristics of DFS are its size, its large but declining billing and statement volumes, and its significant volume of advertising mail.[12] In offering a similar agreement to other customers, the Postal Service will look for all of these characteristics. Steady, increasing, or no First-Class Mail use would undermine or nullify the desirability for this type of agreement, since it is intended to maintain or increase the value of a customer whose use of highly-profitable First-Class Mail is declining. Heavy use of both First-Class Mail and Standard Mail is necessary, because it is by managing the total value of DFS' business that the agreement allows the Postal Service to offset the decline in DFS' First-Class Mail volume over time. A customer seeking a similar agreement would need to demonstrate that it also had the resources and infrastructure to effect such a switch.

II. Financial Analysis

The Postal Service estimates that this agreement will generate an additional $2 million to $15 million in contribution. The calculations that lead to this estimate are provided in the attached Excel workbook "Discover NSA.xls" (Attachment F).

Based on DFS' volume and revenue trends and expectations for current and future economic conditions, the Postal Service projects that the total amount of First-Class Mail postage paid by DFS will decline five percent per year over the course of the agreement, and that DFS' Standard Mail postage will increase between seven and 11 percent per year. In order to qualify for a rebate (and avoid paying a penalty), DFS will have to increase the Standard Mail postage it pays another five to 15 percent. As stated above, even though this agreement offers a rebate on First-Class Mail as well, the Postal Service believes it will encourage DFS to grow Standard Mail, and the model is constructed to reflect that belief. Given CPI and cost inflation expectations, and corresponding expected price increases, this growth results in an increase in contribution of $14 to 26 million. DFS earns rebates of $12 million.

[12] In practical terms, given current relationships between revenue and cost, almost complete reliance on letter-shaped mail is also a requirement.

III. Risk

The main risk to this agreement lies in Postal Service projections for DFS' growth in the absence of the agreement. In almost any case, because it is letter-shaped and automated, DFS' mail will still cover its attributable cost and make a healthy contribution to institutional cost, but, to the extent that the Postal Service might have underestimated baseline performance, the estimated value of the NSA could be different.

If DFS does not meet the threshold, the expected value of the agreement would still be positive, because of the penalty DFS must pay, but would likely be substantially less than estimated.

IV. Conclusion

As explained above and in the supporting justification, the Postal Service believes that this agreement will improve the net financial position of the Postal Service and that it is appropriate to add it to the market-dominant products list. The Commission should therefore approve this request as set forth in its rules.

Respectfully submitted,

UNITED STATES POSTAL SERVICE
By its attorneys:

Daniel J. Foucheaux, Jr.
Chief Counsel, Pricing and Product Support

Brandy Osimokun

475 L'Enfant Plaza, S.W.
Washington, D.C. 20260-1137
(202) 268-2982, Fax -6187
Brandy.A.Osimokun@usps.gov
January 14, 2011

ATTACHMENT A TO REQUEST

GOVERNORS' RESOLUTION

RESOLUTION OF THE GOVERNORS

OF THE

UNITED STATES POSTAL SERVICE

Resolution No. 11-2

Price and Classification Changes

for Market Dominant Categories of Mail

RESOLVED:

Pursuant to section 404(b) and Chapter 36 of title 39, United States Code, the Governors establish price and classification changes for market dominant products. These changes establish a negotiated service agreement with Discover Financial Services (DFS), which provides DFS with a discount in the form of a rebate for First-Class Mail and Standard Mail.

These changes shall become effective on March 1, 2011, or the first day of the month following Commission approval, whichever is sooner, and will be in effect for three years after the effective date.

Postal management is directed to provide the required public notice and to file with the Postal Regulatory Commission notice of the changes in prices and classifications, in accordance with Part 3010 of Title 39, Code of Federal Regulations.

The foregoing Resolution was adopted by the Governors on January 11, 2011.

Julie S. Moore

Julie S. Moore
Secretary, Board of Governors

ATTACHMENT B TO REQUEST

NEGOTIATED SERVICE AGREEMENT

NEGOTIATED SERVICE AGREEMENT BETWEEN THE UNITED STATES POSTAL SERVICE AND DISCOVER FINANCIAL SERVICES

This Agreement ("Agreement") is made as of December __, 2010 (the "Agreement Effective Date") by and between Discover Financial Services, a Delaware Corporation, with its principal place of business located at 2500 Lake Cook Road, Riverwoods, IL, 60015, and its subsidiaries and affiliates ("DFS"), and the United States Postal Service ("Postal Service"), an independent establishment of the Executive Branch of the United States Government established by the Postal Reorganization Act, Public Law 91-375, as amended, with its principal office at 475 L'Enfant Plaza, SW, Washington, DC 20260. The Postal Service and DFS are referred to herein collectively as the "Parties" and each entity as a "Party."

WHEREAS, it is the intention of the Parties to enter into Negotiated Service Agreement ("NSA") that will benefit the Postal Service, DFS, and the postal system as a whole, and that will comply with the requirements of the Postal Reorganization Act and the Postal Accountability and Enhancement Act, Public Law 109-435,

NOW, THEREFORE, the Parties agree as follows:

I. Key Conditions for NSA Treatment.

The Postal Service finds that the following key conditions, taken together, support this Negotiated Service Agreement:

A. In the last three government fiscal years, DFS mailed an average of approximately $222 million annual postage in First-Class Mail and Standard Mail letters and flats to consumers, which include prospective and existing customers of DFS. For the purposes of this Agreement, DFS First-Class Mail and Standard Mail eligible for discounts ("DFS Eligible Mail") shall include all First-Class Mail Automation Presort letters ("DFS Eligible First Class Mail") and Standard Mail Automation and Enhanced Carrier Route letters which are eligible for the full-service Intelligent Mail Barcode ("IMb") discount ("DFS Eligible Standard Mail") sent by DFS and by entities in which DFS holds controlling shares, and by their vendors on their behalf.

B. DFS mail relates to its own direct banking and payment services business, including, but not limited to, sales and other promotions run in conjunction with DFS's strategic partners or as part of strategic alliances with other entities.

C. DFS agrees to document the volume of DFS Eligible Mail and the volume of other types of mailpieces DFS enters under its own, its partners' or vendors' PostalOne!™ permit accounts (including pre-cancelled stamps, imprints, and postage evidencing indicia), primarily First-Class Mail™ and Standard Mail.

D. DFS shall be eligible to participate in other incentive programs offered by the Postal Service during the term of this Agreement as mutually agreed by the Parties. It is the mutual intent of both parties that the DFS postage to be used to calculate thresholds in this Agreement shall be the net of any rebates or other incentives, and that such rebates or incentives shall be realized and applied for accounting purposes under this Agreement to the period in which they were earned.

II. Eligible Mail Rebates and Calculations.

A. *Eligible Mail Rebates.* In consideration of the rebates available to DFS under this Agreement, DFS shall enter into the mails an amount of DFS Eligible Mail sufficient to meet at a minimum the adjusted revenue threshold for DFS Eligible Mail specified below during the term of this Agreement.

B. *Revenue Threshold.*

1. Baseline Revenue. The baseline revenue is the total postage from DFS Eligible Mail less any sales rebates earned for the twelve month period preceding February 1, 2011.

2. Year 1 Revenue Threshold. The revenue threshold for Year 1 is the Baseline Revenue plus ten percent ("Baseline Revenue + 10%").

3. Year 2 Revenue Threshold. The revenue threshold for Year 2 of the Agreement is the Baseline Revenue plus fifteen percent ("Baseline Revenue + 15%").

4. Year 3 Revenue Threshold. The revenue threshold for Year 3 of the Agreement is the Baseline Revenue plus twenty percent ("Baseline Revenue + 20%").

5. Revenue Threshold Adjustment. For every one dollar ($1) that DFS' total DFS Eligible First-Class Mail postage for the current contract year falls below the total DFS Eligible First-Class Mail postage for the preceding year, the revenue threshold for the current contract year for total DFS Eligible Mail shall be adjusted upward by sixty-five cents ($0.65). Any rebates received on the preceding year's First-Class Mail postage shall be excluded from the calculation of that year's total DFS Eligible First-Class Mail postage.

C. *Rebates.* DFS shall be eligible for a discount in the form of a rebate each year if its revenue from DFS Eligible Mail meets or exceeds the adjusted revenue threshold described above. Each year DFS shall be entitled to a rebate of seventy-five percent (75%) of the percent increase in DFS' average postage price per piece in the current contract year for DFS Eligible First-Class Mail multiplied by the volume of DFS Eligible First-Class Mail in the current contract year, and thirty-seven and one half percent (37.5%) of the amount of the percent increase in DFS' average postage price per piece in the current contract year for DFS Eligible Standard Mail multiplied by the volume of DFS' Eligible Standard Mail in the current contract year.

D. *Average Price Increase.* The average price increase for DFS Eligible First-Class Mail and DFS Eligible Standard Mail will be calculated as the change in a Laspeyres index of the relevant price categories for each class, using DFS' volumes in the preceding contract year as weights.

E. *Penalty.* If DFS does not meet the revenue threshold set forth in Article II.B in contract year one (1), DFS shall pay the Postal Service ten percent (10%) of the difference between DFS' revenue threshold and actual total postage paid for DFS Eligible Mail for contract year one (1). No later than seven months into contract year one (1), the parties shall agree upon a penalty for DFS if DFS fails to reach the revenue threshold set forth in Article II.B for contract year two (2). No later than seven months into contract year two (2), the parties shall agree upon a penalty for DFS if DFS fails to reach the revenue threshold set forth in Article II.B for contract year three (3).

F. *Acquisition or Merger.* The parties agree that Baseline Revenue will be adjusted upward to the extent that DFS merges with or acquires any entity which mailed either First-Class Mail or Standard Mail or both. The adjustment shall be an amount equal to the total First-Class Mail presort letter and Standard Mail presort letter and Carrier Route letter postage paid by the acquired or merged entity in the twelve months preceding the current contract year.

DFS shall notify the Postal Service of any merger or acquisition with an entity that mails First-Class Mail or Standard Mail or both. The notification must include

1. the name of the acquired entity
2. the First-Class Mail and Standard Mail postage paid by the acquired entity for the 12 months preceding the merger or acquisition
3. the postage paid for First-Class Mail presort letters and Standard Mail presort letters and Carrier Route letters during that period
4. a list of the meters and PostalOne!™ permit accounts and their locations through which the First-Class Mail and Standard Mail was processed.
5. a list of the CAPS accounts, if any, used by the acquired entity.

All adjustments to the Baseline Revenue due to mergers or acquisitions shall be made on a pro-forma quarterly basis beginning in the contract quarter immediately following the date of acquisition or merger.

G. *Sale or Closure.* The parties agree that the Baseline Revenue will be adjusted downward to the extent that DFS sells or closes a division or entity that mailed First Class Mail or Standard Mail or both. The adjustment shall be an amount equal to the total DFS Eligible Mail revenue lost from that particular entity or division in the year preceding the sale or closure.

DFS shall notify the Postal Service of any sale or closure of any of its divisions or entities that mails First-Class Mail or Standard Mail or both. The notification must include

1. the name of each sold or closed division or entity
2. the DFS Eligible postage of each sold or closed division or entity for the 12 months preceding the sale or closure
3. the meters and PostalOne!™ permit accounts and their locations through which the First-Class Mail and Standard Mail was processed
4. an indication of whether those accounts and meters will continue to be used for DFS First Class Mail and Standard Mail.

All adjustments of the Baseline Revenue due to sales or closures shall be made on a pro-forma quarterly basis beginning in the contract quarter immediately following the date of sale or closure.

H. *First Class Mail/Standard Mail Accounting.* DFS will provide the Postal Service with the a list of the PostalOne!™ permit accounts and their locations that will determine DFS' eligibility for discounts. Permit accounts will be used in determining eligibility for discounts only upon the Postal Service's written acknowledgement of their transmission from DFS. The data in these permit accounts will be used to determine whether the revenue threshold for a contract year has been reached, and the Postal Service shall keep such data in a form auditable by DFS.

I. *Rebate Payments.* If DFS qualifies for rebates, the Postal Service shall provide such rebates to DFS within forty-five (45) days after the end of each contract year. Rebates shall be made in the form of credits to DFS' CAPS account as mutually agreed upon. Late payments shall incur a penalty of 1.5% per month.

III. Compliance and Other Issues.

A. *Compliance.* DFS will make necessary records and data, including, but not limited to IMb-related documentation, available to the Postal Service to facilitate and monitor compliance with this Agreement.

B. *Appeals.* DFS may appeal a Postal Service decision regarding the following: First Class Mail and Standard Mail counted toward the adjusted revenue threshold and the amount of discounts paid set forth in Article II.A, Article II.B, Article II.C, Article II.D, and Article IIE. Any such appeal must be made in writing to the Pricing and Classification Service Center in New York, within 30 days of receiving notice of the Postal Service decision. The decision of the Manager, PCSC, will be final. Any decision that is not appealed to the Manager, PCSC, within the 30 day time period becomes the final Postal Service decision.

This appeal process relates only to the issues identified above that arise as a result of the implementation of this agreement.

C. *Effective Date.* The Agreement is effective on the latest date of signing by both Parties. References to "years" of the Agreement refer to periods ending on the anniversary date of the implementation date referred to in Article III.D below.

D. *Regulatory Review and Implementation Date.* This contract is subject to approval by the Governors of the Postal Service as well as by the Postal Regulatory Commission ("the Commission"). In accordance with Title 39 and the Commission's Rules of Practice and Procedure, and upon approval of the Postal Service Governors, the Postal Service will make the required filings with the Commission. Provided that all required regulatory review is completed, the implementation date of this contract shall be February 1, 2011. Should regulatory review not be completed by February 1, 2011, the implementation date of this contract shall be on the first day of the following month.

E. *Expiration.* This Agreement shall expire three (3) years from the implementation date, unless (i) terminated or cancelled by one of the Parties pursuant to Article III.F, (ii) renewed by mutual agreement in writing, and subsequent approval by the Governors of the Postal Service and the Commission, (iii) superseded by a subsequent contract between the Parties, (iv) ordered by the Commission or a court, or (v) otherwise required to comply with subsequently enacted legislation. It is further agreed that should the expiration date of this Agreement fall prior to the end of a Postal Service fiscal quarter, then for the period of time between the end of the preceding Postal Service fiscal quarter and the expiration date, the applicable adjusted revenue threshold will be pro-rated as mutually agreed by the Parties.

F. *Termination.* Prior to the last ninety days of each contract year, each party reserves the right to terminate this Agreement for convenience, without penalty, with ninety days written notice to the other party.

IV. Public Communications.

The form, substance, and timing of any press release or other public disclosure of matters related to this Agreement shall be mutually agreed to by DFS and the Postal Service in writing which consent shall not be unreasonably withheld, except to the extent of disclosure which DFS or the Postal Service is required by law to make, in which instance the non-disclosing Party shall be advised and the Parties shall use their reasonable efforts to cause a mutually agreeable disclosure to be issued.

V. Amendments.

This Agreement shall not be amended except expressly, in writing, by authorized representatives of the Parties.

VI. Notices.

Service of all notices under this Agreement shall be in writing and sent by either U.S. Certified Mail, return receipt requested, postage paid, addressed to the Party to be served notice at the following addresses. All such notices and communications shall be effective upon receipt.

United States Postal Service:

Paul E. Vogel
President and Chief Marketing/Sales Officer
United States Postal Service
475 L'Enfant Plaza SW, Room 10229
Washington DC 20260-5127

Managing Counsel,
Pricing and Product Development Law
United States Postal Service
475 L'Enfant Plaza SW
Washington DC 20260-1135

Discover Financial Services:

General Counsel
Discover Financial Services
2500 Lake Cook Road,
Riverwoods, IL, 60015

Robert J. Brinkmann, Esq.
Law Offices of Robert J.
Brinkmann LLC
1730 M Street NW Suite 200
Washington, DC 20036-4530

Vice President
Marketing Operations
Discover Financial Services
2500 Lake Cook Road
Riverwoods, IL 60015

IN WITNESS WHEREOF, the Parties hereto have caused this Agreement to be duly executed as of the day and year first written above.

UNITED STATES POSTAL SERVICE

By: ____________________

Printed Name: Paul Vogel

Title: President and Chief Marketing/Sales Officer

Date: 12/16/10

DISCOVER FINANCIAL SERVICES

By: ____________________

Printed Name: Harit Talwar

Title: EVP, President - U.S. Cards

Date: 12/15/10

ATTACHMENT C TO REQUEST

MAIL CLASSIFICATION CHANGES

1600 NEGOTIATED SERVICE AGREEMENTS

[insert the underlined text below]

****

<u>1635 DISCOVER FINANCIAL SERVICES, INC. NEGOTIATED SERVICE AGREEMENT</u>

Eligible Mail: Eligible First-Class Mail and Standard Mail under this section are defined as all First-Class Mail Automation Presort letters and Standard Mail Automation and Enhanced Carrier Route letters which are eligible for the full-service Intelligent Mail Barcode discount sent by Discover Financial Services, Inc. and by entities in which Discover Financial Services, Inc. holds controlling shares, and by their vendors on their behalf. Eligible mail under this section sent by Discover Financial Services, Inc. will be for the purpose of direct banking and payment services business, including, but not limited to, sales and other promotions run in conjunction with Discover Financial Services' strategic partners or as part of strategic alliances with other entities.

Eligible Mail Rebates and Calculations: The following adjusted revenue threshold for otherwise eligible First-Class Mail Automation Presort letters and Standard Mail Automation and Enhanced Carrier Route letters must be met before any rebates under this section are payable:

a. *Baseline Revenue.* The baseline revenue is the total postage from Discover Financial Services, Inc.'s eligible mail less any sales rebates from February 2010 through January 2011.

b. *Year 1 Revenue Threshold.* Baseline Revenue + 10%.

c. *Year 2 Revenue Threshold.* Baseline Revenue + 15%.

d. *Year 3 Revenue Threshold.* Baseline Revenue + 20%.

e. *Adjusted Revenue Threshold.* For every one dollar that Discover Financial Services, Inc.'s total eligible First-Class Mail postage for the current contract year falls below the total eligible First-Class Mail postage for the preceding year, the revenue threshold for the current contract year for all of Discover Financial

Services Inc.'s, total eligible mail will be adjusted upward by sixty-five cents. Any rebates received on the preceding year's First-Class Mail postage shall be excluded from the calculation of that year's total eligible First-Class Mail postage.

Rebate. Discover Financial Services, Inc. will be eligible for a rebate of 75% of the cumulative postage increase resulting from any price change for its eligible First-Class Mail letters, and 37.5% of the postage increase resulting from a price change for Standard Mail letters if Discover Financial Services, Inc. meets or exceeds its revenue threshold in that year. The average price increase for Discover Financial Services, Inc.'s eligible First-Class Mail and Standard Mail will be calculated as the change in a Laspeyres index of the relevant price categories for each class, using Discover Financial Services Inc.'s volumes in the preceding contract year as weights.

Penalties. Discover Financial Services, Inc. will pay the Postal Service 10% of the difference between the adjusted revenue threshold for the year and their actual postage if Discover Financial Services, Inc. fails to meet the adjusted revenue threshold in the first year of the contract. Penalties for the second and third years of the contract will be agreed between the Postal Service and Discover Financial Services, Inc. 90 days before the end of each previous contract year, to allow room for adjustment based on economic and market conditions.

Mergers and Acquisitions. The baseline revenue will be adjusted upward to the extent that Discover Financial Services, Inc. merges with or acquires any entity which mailed either First-Class Mail or Standard Mail or both. The adjustment shall be an amount equal to the total First-Class Mail presort letter and Standard Mail presort letter and Carrier Route letter postage paid by the acquired or merged entity in the twelve months preceding the current contract year.

Sale or Closure. The baseline revenue will be adjusted downward to the extent that Discover Financial Services, Inc. sells or closes a division or entity that mailed First Class Mail or Standard Mail or both. The adjustment shall be an amount equal to the total Discover Financial Services, Inc. eligible mail revenue lost from that particular entity or division in the year preceding the sale or closure.

Termination. Either the Postal Service or Discover Financial Services, Inc. can terminate this agreement with no penalty within the first nine months of any contract year. At the end of the ninth month, both parties are locked into the contract for the rest of that contract year.

Expiration. This agreement expires three years from the implementation date set by the Board of Governors.

ATTACHMENT D TO REQUEST

DATA COLLECTION PLAN

Not later than 90 days after the end of each contract year, the Postal Service shall provide to the Postal Regulatory Commission a report of:

1. DFS' volumes entered by qualifying price category for the just ended contract year
2. DFS' postage paid by qualifying price category for the just ended contract year
3. The adjusted threshold used to establish DFS' eligibility for rebates and payment of fines, and the calculations underlying the threshold's determination.
4. The index used to establish DFS' average price increase, and the calculations underlying the index's determination
5. The rebate paid to or penalty paid by DFS (if any) and the calculations underlying their determination.

ATTACHMENT E

STATEMENT OF SUPPORTING JUSTIFICATION

I, Greg Dawson, Manager, Pricing Strategy, am sponsoring this request that the Commission add the DFS NSA to the list of market-dominant products. This statement supports the Postal Service's request by providing the information required by each applicable subsection of 39 C.F.R. § 3020.32. In addition, this statement provides the information required by 39 C.F.R. § 3010.42(b)-(e). I attest to the accuracy of the information contained herein.

(a) Demonstrate why the change is in accordance with the policies and the applicable criteria of chapter 36 of title 39 of the United States Code.

As demonstrated below, the change complies with the applicable statutory provisions.

(b) Explain why, as to market dominant products, the change is not inconsistent with each requirement of 39 U.S.C. § 3622(d), and that it advances the objectives of 39 U.S.C. § 3622(b), taking into account the factors of 39 U.S.C. § 3622(c).

The objectives of section 3622(b) are as follows:

(b) Objectives.—Such system shall be designed to achieve the following objectives, each of which shall be applied in conjunction with the others:

(1) To maximize incentives to reduce costs and increase efficiency.
(2) To create predictability and stability in rates.
(3) To maintain high quality service standards established under section 3691.
(4) To allow the Postal Service pricing flexibility.
(5) To assure adequate revenues, including retained earnings, to maintain financial stability.
(6) To reduce the administrative burden and increase the transparency of the ratemaking process.
(7) To enhance mail security and deter terrorism.
(8) To establish and maintain a just and reasonable schedule for rates and classifications, however the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.
(9) To allocate the total institutional costs of the Postal Service appropriately between market-dominant and competitive products.

To a large extent, this agreement does not substantially alter the degree to which First-Class Mail or Standard Mail prices already address these objectives, or they are addressed by the design of the system itself (Objectives 1, 2, 3, 6, 7, 8, and 9). The agreement itself is an important example of the increased flexibility allowed the Postal Service under PAEA (Objective 4), and the fact that the agreement will provide an incentive for profitable new mail will enhance the financial position of the Postal Service (Objective 5).

In addition to the objectives specified and discussed above, section 3622(c) enumerates fourteen factors, or considerations, that must be taken into account, which are as follows:

> (c) Factors.—In establishing or revising such system, the Postal Regulatory Commission shall take into account—
> (1) the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery;
> (2) the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;
> (3) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;
> (4) the available alternative means of sending and receiving letters and other mail matter at reasonable costs;
> (5) the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;
> (6) simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;
> (7) the importance of pricing flexibility to encourage increased mail volume and operational efficiency;
> (8) 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;
> (9) the importance of providing classifications with extremely high degrees of reliability and speed of delivery and of providing those that do not require high degrees of reliability and speed of delivery;
> (10) the desirability of special classifications for both postal users and the Postal Service in accordance with the policies of this title, including agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers, that—
> (A) either—

(i) improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or

(ii) enhance the performance of mail preparation, processing, transportation, or other functions; and

(B) do not cause unreasonable harm to the marketplace.

(11) the educational, cultural, scientific, and informational value to the recipient of mail matter;

(12) the need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services;

(13) the value to the Postal Service and postal users of promoting intelligent mail and of secure, sender-identified mail; and

(14) the policies of this title as well as such other factors as the Commission determines appropriate.

As with the Objectives of section 3622(b), the agreement does not substantially alter the degree to which First-Class Mail and Standard Mail prices address many of the Factors of section 3622(c) (Factors 1, 4, 5, 6, 8, 9, 11, 12, and 14). The agreement does encourage increased mail volume (Factor 7) by requiring DFS to maintain or increase the amount of contribution the Postal Service receives from its mail and by providing an opportunity to moderate price increases (Factor 3). In addition, the discounts provided in the agreement will not imperil the ability of First-Class Mail or Standard Mail (or this agreement) to cover its attributable costs (Factor 2). Also, because it requires the use of the Intelligent Mail barcode in order to qualify for rebates, the agreement promotes the use of intelligent mail (Factor 13). Finally, the agreement addresses the desirability of special classifications (Factor 10). As demonstrated in the attached financial model, the agreement will generate significant additional contribution to the Postal Service, thus improving its net financial position. In addition, the Postal Service stands ready to negotiate and implement functionally equivalent deals with similarly-situated mailers, as described in the body of this notice, so that there will be no unreasonable harm to the marketplace from a competitive advantage granted solely to DFS.

(c) Explain why, as to competitive products, the addition, deletion, or transfer will not result in the violation of any of the standards of 39 U.S.C. § 3633.

Not applicable. The Postal Service is proposing that this agreement be added to the market-dominant product list. See (e) below.

(d) Verify that the change does not classify as competitive a product over which the Postal Service exercises sufficient market power that it can, without risk of losing a significant level of business to other firms offering similar products: (1) set the price of such product substantially above costs; (2) raise prices significantly; (3) decrease quality; or (4) decrease output.

Not applicable. The Postal Service is proposing that this agreement be added to the market-dominant product list. See (e) below.

(e) Explain whether or not each product that is the subject of the request is covered by the postal monopoly as reserved to the Postal Service under 18 U.S.C. § 1696 subject to the exceptions set forth in 39 U.S.C. § 601.

The agreement applies to pieces mailed as First-Class Mail letters, Standard Mail letters, and Standard Mail Carrier Route; therefore, all volume under the agreement is subject to the postal monopoly.

(f) Provide a description of the availability and nature of enterprises in the private sector engaged in the delivery of the product.

None.

(g) Provide any information available on the views of those who use the product on the appropriateness of the proposed modification.

Having entered into this agreement with the Postal Service, DFS supports adding this product to the product list so that the contract terms can be effectuated.

(h) Provide a description of the likely impact of the proposed modification on small business concerns.

The Postal Service is unaware of any small businesses that could provide a similar service to DFS.

(i) Include such information and data, and such statements of reasons and bases, as are necessary and appropriate to fully inform the Commission of the nature, scope, significance, and impact of the proposed modification.

Additional information is provided in the body of this request.