

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

EXPERIMENTAL CHANGES TO IMPLEMENT
CAPITAL ONE NSA

Docket No. MC2002-2

REQUEST OF THE UNITED STATES POSTAL SERVICE
FOR A RECOMMENDED DECISION ON CLASSIFICATION, RATES
AND FEES FOR CAPITAL ONE SERVICES, INC.
NEGOTIATED SERVICE AGREEMENT

Pursuant to chapter 36 of title 39, United States Code, the United States Postal Service has determined that it would be in the public interest, and in accordance with the policies and applicable criteria of that title, to create an experimental classification implementing in pertinent part the attached Negotiated Service Agreement (NSA) with Capital One Services, Inc. Accordingly, the Postal Service requests that the Postal Rate Commission submit to the Governors of the Postal Service a recommended decision recommending the experimental change, as herein requested.

The Capital One NSA, appended here as Attachment G,¹ is a negotiated contract founded on a distinct operational and service relationship between the Postal Service and Capital One. As described in the testimony and materials supporting the Postal Service's Request, the NSA outlines reciprocal requirements, conditions, and conduct that would alter the rates of specified services available to Capital One, if the Commission recommends and the Governors approve the changes to the Domestic

¹ "Negotiated Service Agreement Between Capital One and United States Postal Service," (hereinafter "Agreement").

Mail Classification Schedule proposed by the Postal Service in the instant Request. Under the Agreement, if the DMCS is amended, the Postal Service would provide to Capital One, at certain levels of volume, electronic address corrections ² without fee for solicitations sent by First-Class Mail that are undeliverable as addressed and cannot be forwarded under existing regulations. In return, Capital One would agree to forgo its current practice of receiving free return of such undeliverable mail, under the existing service features of First-Class Mail. Additionally, if the foregoing conditions are met, Capital One would be eligible for per-piece discounts for certain of its First-Class Mail solicitation volume. Beyond an overall annual volume threshold, these discounts would vary under a "declining block" rate structure, if specified levels of volume are provided by Capital One. The Agreement also requires specific actions by Capital One to maintain and improve the address quality for mail sent by First-Class Mail.

Under the Postal Service's proposals, the Postal Service, Capital One, and other mail users are expected to benefit. In particular, the changes proposed are expected to lead to a net reduction in the Postal Service's costs related to the handling of forwarded and returned mail. In addition, the changes are expected to enable Capital One to reduce its postage costs. If the volume conditions are met, the revenue effects are expected ultimately to result in a reduction in proportional contribution to institutional costs from other mailers.

Adoption of the experimental rate and classification changes associated with the NSA will also allow the Postal Service and the Commission to test the effectiveness of the NSA approach, as a means of providing pricing flexibility under the existing statutory

² DMCS 911.

ratemaking scheme. The concept of rates and classifications based on particular operational and service relationships with distinctly-situated individual mailers has long been discussed and advocated within the postal community. Agreements similar to NSAs have been successfully employed to set prices in other regulated industries, by foreign posts, and by the Postal Service with its international customers. In light of the ongoing interest in legislative reform of postal ratemaking, exploring and testing the NSA concept within the existing statutory framework, and under proven Commission procedures, is eminently sensible.

The Postal Service believes that it would be appropriate for the Commission to review and recommend the operative rate and classification elements of the NSA as an experimental classification, under procedures specified in the Commission's Rules of Practice and Procedure (39 C.F.R. §§ 3001.67). The Capital One NSA and the Postal Service's proposals conform to the purposes underlying the experimental classification approach and the Commission's rules. First, several elements of the Postal Service's proposals are novel. While 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 and approved. The instant proposal also involves, in effect, an exchange of service features promoting more efficient address correction within the existing DMCS. This innovation would induce mailer behavior that would save substantial costs associated with return and forwarding of undeliverable mail. In addition, the proposals incorporate overall volume thresholds, and a declining-block approach to volume-based discounts designed to

stimulate volume, an approach that has never been employed in domestic postal rates and classifications in the forms proposed here.

Second, the relative impact, duration, and scope of the proposed changes conform to the logic of the experimental approach. The overall cost, volume, and revenue effects of the proposals would be relatively minor. As proposed, the changes would apply only to one, discretely-positioned mailer.³ The duration of the experiment would be limited to three years by the terms of the NSA. The experimental changes would apply only to the rates, fees, and classifications for Address Correction Service and First-Class Mail. No other mail classes or special services would be changed.

Finally, the prospects for producing data and information demonstrating the effects of the proposed changes warrant adopting an experimental approach. Available historical cost, volume, revenue and demand data are typically developed from the behavior of all mailers across a range of rate and fee cells. While helpful, these data do not directly support permanent changes based on the Capital One NSA, which seeks to encourage efficiencies in the creation and handling of just one customer's mail. While Capital One's own historical volume and cost data provide a sufficient foundation for the Capital One NSA as an experiment,⁴ the effects of the proposed changes will arise from changing mailer behavior in a fluid business environment, so as to induce new volume that avoids Postal Service return and forwarding costs, improves address quality, and increases overall contribution from Capital One. During the three-year term of the

³ The Postal Service acknowledges that application of the proposed changes to similarly-situated customers might be considered as a condition of a permanent classification change.

⁴ A preliminary cost and revenue analysis has been prepared based on Capital One's historical mailing practices.

proposed experiment and afterwards, more complete data would be generated and analyzed to determine how the Capital One NSA affects postal costs and revenues.

The Commission's specialized procedures for considering experimental classifications are comprehensive enough to explore and resolve whatever factual and legal issues might be raised regarding the Postal Service's proposals. To the extent that questions exist regarding the administration of rates and classifications based on NSAs, or regarding the relationship between the NSA and the existing rate schedules and the DMCS, actual experience through the course of the experiment will provide a sound basis on which to evaluate the NSA concept. In light of the relatively small financial impact expected from the proposed changes, the overall risk to rates and revenues in general would be relatively small.

Although the Commission's rules are broad and flexible enough to review the changes proposed pursuant to the Capital One NSA, in some respects procedures to consider NSAs could be refined.⁵ For example, existing rules and past practice contemplate sole Postal Service sponsorship of testimony supporting Postal Service proposals in the first instance.⁶ In the typical case, mailer support for such proposals is interjected at a second stage of testimony, after discovery and cross-examination of the Postal Service's evidence. Intervenor opposing the Request are also heard at this

⁵ The Postal Service anticipates that in the future it may be worthwhile for the Commission to consider creating specialized procedures, and perhaps a classification framework, for consideration of proposals based on NSAs. Such procedures might involve more expeditious review than currently contemplated under the experimental rules, standardization of evidence and of analytical approach in evaluating proposals, and mechanisms that will effectively protect sensitive proprietary information, while maintaining the integrity of the review process. For the instant proceeding, the Postal Service believes that existing rules will be adequate, as applied and augmented in accordance with the motions filed today.

second stage. Proposals based on NSAs, however, arise out of a contractual relationship between the Postal Service and a customer or other entity. Such proposals will be mutually advantageous to the Postal Service and the NSA partner, and will be based on information provided by both parties. In the truest sense, these proposals are jointly sponsored, and Commission and intervenor review and assessment will inevitably be based on the combined presentations of the NSA parties. In this circumstance, it is both logical and more efficient to consider the testimony of both the Postal Service and the NSA partner as constituting primary support for the proposals.

In this instance, both the Postal Service and Capital One are submitting their respective cases-in-chief with the instant Request. The Postal Service is also filing a motion requesting joint sponsorship of the proposals, and requesting leave to rely on testimony submitted by Capital One, outside the typical schedule for presentation of evidence by intervenors.⁷ The combined evidence submitted by the Postal Service and Capital One should therefore be considered as providing support for the proposals embodied in the Postal Service's Request, in accordance with Rules 53 and 63. Furthermore, the proposals arise out of a contractual relationship with the Postal Service in which Capital One has independent interests. Capital One, moreover, developed its testimony based on exclusive knowledge of its own operations and

⁶ See .39 C.F.R. §§ 3001.53, 63.

⁷ Capital One is simultaneously filing a motion seeking intervention, consistent with this approach. It is the intention of both the Postal Service and Capital One that Capital One also join the motion for joint sponsorship, as well as the other motions filed today in connection with the Postal Service's Request. Capital One's status as co-movant in advocating joint sponsorship of the Postal Service's proposals, and supporting the other motions, should be considered conditioned on the grant of its motion for intervention in accordance with its petition for waiver. In this regard, the Postal Service supports Capital One's petition for waiver and its request for status as an intervenor.

policies. It is therefore logical and appropriate for Capital One to represent itself on issues of procedure and discovery pertaining to the witnesses it presents. In almost all foreseeable circumstances, the Postal Service and Capital One will take consistent and supporting positions on issues involving procedure and advocacy of the proposed changes. Since much of the information submitted by Capital One will be considered by it to be proprietary and commercially sensitive, however, it makes the most sense for Capital One to be allowed to represent itself independently on matters involving the disclosure and disposition of such information.⁸

To implement the Capital One NSA, the Postal Service requests the Commission to recommend new DMCS section 610. Among other provisions, DMCS 610 prescribes the criteria for determining eligibility of Capital One mail for the proposed rate changes, describes the conditions under which Address Correction Service fees would not be charged, describes the manner and conditions under which discounts would be applicable to Capital One volume, and specifies a duration of three years for the experimental classification. The Postal Service believes that these provisions would further the general policies of efficient postal operations and reasonable rates and fees enunciated in the Postal Reorganization Act. See 39 U.S.C. §§ 101(a), 403(a), and 403(b). The requested changes would also conform to the criteria of 39 U.S.C. §§ 3622(b) and 3623(c).

⁸ The Postal Service and Capital One will make every effort to establish consistent positions on such issues. Indeed, the Agreement specifies that Capital One agrees not to oppose a position taken by the Postal Service. Agreement ¶ IV(d)(5). Nevertheless, it is difficult to anticipate every conceivable circumstance in which the views of the Postal Service and Capital One might conflict.

The Postal Service does not request that the Commission recommend incorporating the Capital One NSA in its entirety as part of the DMCS. Rather, the proposed DMCS language incorporates those elements of the NSA needed to implement changes in rates, fees, and classifications applicable to Capital One. In general, the NSA in its entirety provides a foundation for these changes, and they should be read in concert with the terms of the NSA.⁹ Among other provisions, the NSA specifies: 1) the key conditions making the NSA possible; 2) obligations undertaken by Capital One to ensure avoidance of cost associated with handling of returned and forwarded mail; 3) volume thresholds pertaining to mail qualifying under the NSA for additional discounts; 4) information concerning other issues, such as monitoring, compliance, regulatory review, implementation, withdrawal, and cancellation; and 5) conditions affecting public communications, amendments, and notices.

Pursuant to the Commission's Rules of Practice and Procedure (particularly, 39 C.F.R. §§ 3001.54 and 3001.64), the Postal Service is filing with this Request prepared direct evidence on which it proposes to rely. This evidence consists of four pieces of testimony, including exhibits. The page following this Request is an index of Attachments. The testimony and exhibits of each witness have been marked for identification as shown in Attachment E. Further data submitted for informational purposes or in response to specific sections of the Rules of Practice are included in the other Attachments.

⁹ The Postal Service acknowledges the need to keep a current version of the NSA on file with the Commission and available for public inspection during the course of the experiment, and to notify the Commission and public of any changes to the Agreement.

In accordance with the discussion, above, and the accompanying motions filed by the Postal Service and Capital One today,¹⁰ other evidence on which the Postal Service intends to rely is being filed today by Capital One. Evidence filed by both the Postal Service and Capital One is referenced in the Compliance Statement, filed as Attachment F to this Request.

The instant filing incorporates by reference materials submitted with the Postal Service's Request in Docket No. R2001-1.¹¹ The Postal Service believes that its submissions comply with the Commission's filing requirements in Rules 54 and 64 of the Rules of Practice and Procedure (39 C.F.R. §§ 3001.54 and 64). If the Commission concludes otherwise, the Postal Service respectfully moves for a waiver of the pertinent filing requirements in Rules 54 and 64. *Id.*

¹⁰ Motion Of United States Postal Service for Joint Sponsorship of Proposals and for Leave to Rely on Capital One's Case-In-Chief and Motion of United States Postal Service for Waiver.

¹¹ In light of the nature and scope of the changes proposed, and the minor relative magnitude of the expected financial effects, the Postal Service proposes to incorporate materials pertaining to classes of mail generally that were submitted in connection with the Docket No. R2001-1 filing. This incorporation is meant to address specific filing requirements in the Commission's rules. The Postal Service does not rely on the materials as embodying findings having any binding effect, and acknowledges the limitations on precedent for Docket No. R2001-1 arising out of the Stipulation and Agreement in that case. See Motion of the United States Postal Service for Waiver (Sept. 19, 2002). Additionally, for purposes of demonstrating the particular effects of the Capital One NSA proposal in the instant docket, the Postal Service has relied on cost estimates based on methodologies and approaches for cost attribution approved by the Commission in its recommendations in Docket No. R2000-1. Deference to the Commission's attributions of mail processing costs in this limited circumstance does not indicate the Postal Service's agreement with Commission methodologies, insofar as they have been subject to contention in the past, and may be disputed in future proceedings.

WHEREFORE, the Postal Service requests that the Commission to submit a recommended decision in accordance with this Request.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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CAPITAL ONE NSA

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Attachment B:	Rate Schedules 610A, 610B, 610C and 610C
Attachment C:	Certified Financial Statement
Attachment D:	Certification
Attachment E:	Index of Testimonies, Exhibit Titles, and Associated Attorneys
Attachment F:	Compliance Statement
Attachment G:	Negotiated Service Agreement Between Capital One and United States Postal Service