

POSTCOM, ET AL. RT-1

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

**Experimental Rate and Service Changes To
IMPLEMENT NEGOTIATED SERVICE AGREEMENT WITH
Capital One Services, Inc.**

Docket No. MC2002-2

TESTIMONY OF ROBERT POSCH
ON BEHALF OF POSTCOM, et al.

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My names is Robert Posch. I am testifying in this matter in my capacity as a member of the Board of Directors of the Association for Postal Commerce (“PostCom”). I do so on behalf of PostCom, The Direct Marketing Association, and the Parcel Shippers Association (“PostCom et al”). I am Senior Vice President, Legal, Postal and Governmental Affairs for Bookspan, have more than 20 years of experience in direct marketing and postal matters, and have previously testified before this Commission.

The purpose of my testimony is to explain why PostCom, et al. believe that Negotiated Service Agreements – bilateral agreements between the Postal Service and an individual mailer – should be affirmatively encouraged. In so doing, I hope to answer the suggestions, made in this proceeding, that it is better to convert company-specific agreements into more broadly available rate categories. We urge the Commission to reject this concept. I will show that, from a business perspective, Negotiated Service Agreements and niche classifications are not the same thing. Each serves a legitimate, different purpose in the postal environment.

I further will explain – again, from a business perspective – the type of information the Commission can reasonably expect to be provided by companies that enter into Negotiated Service Agreements and why we believe that the Commission should accept subclass average costs, subject to known adjustments, and should not insist upon precision in modeling and forecasting in the NSA setting. The views I set forth below are based on extensive discussions that have occurred during meetings of the various organizations that are sponsoring this testimony, as well as at public forums such as last summer’s Postal Summit and in discussions my company has had with the Postal Service on this topic. It is not our purpose to address the specifics – the types and depth of discounts, the volume triggers and other details – of the agreement between Capital One and the Postal Service which is under consideration here. Those matters are specific to the two parties and are beyond the scope of this testimony

A. Why NSAs Are Important From A Business Perspective.

The mailing industries have long recognized that the use of average costs to develop rates and discounts is not going to suit the needs and interests of all the mailers who might otherwise be able to qualify their mail for a particular rate category. Average price signals do not meet the needs of mailers whose particular business model or cost structure does not closely replicate the average. Average price signals will be false for those mailers. That is, in part, why the existing worksharing initiatives and optional services are not fully utilized by mailers. From an industry perspective, this poses something of a dilemma: on the one hand, mailers recognize that the more worksharing they engage in, and the more efficient optional services they use, the better off the postal system as a whole will be; on the other, mailers cannot rationally respond to rate

incentive if the cost to the mailer -- including capital and other costs -- is greater than the savings in postage costs they will realize, given their particular business operational and cost structures.

NSAs are a vehicle for resolving this dilemma. Niche classifications are another. While it seems to be the view of some participants in this proceeding that there is no real distinction between the niche classification and a NSA, we in the industry do not see it that way. The essential difference between the niche classification and an NSA is that in the former case, it can be reasonably and confidently expected that the incentive to be proposed will be responsive to the needs of a group of mailers. The co-palletization proposal that the Commission recently favorably recommended is an example of this. In that case, there was a known group of mailers whose mail has closely similar cost and operational conditions; the size of the group was limited, but the arrangement was plainly of interest to more than one mailer. By contrast, an NSA involves contract rates that are worked out between a particular mailer and the Postal Service so that the obligations imposed on the mailer and the incentives that are offered in exchange are tailored to meet the particular needs and operational requirements of that company, and it is not known whether there may be other mailers with closely comparable needs and comparable mail characteristics.

From a business perspective, the distinction is important for the following reasons. If an arrangement that was worked out and tailored to meet the needs of a particular mailer is opened up to a broader group of mailers with dissimilar mail or mailing practices, the business dynamics of the original arrangement will be altered. That is, by prematurely opening up an NSA, the cost savings the Postal Service expects

to realize will be reduced and/or the corresponding incentives it is able to offer will be diminished. The result may be that the value of the arrangement is so altered and the price signal so changed, to reflect the characteristics of a larger group of potential users, that the incentive no longer serves the interests of the original NSA party or of the Postal Service. And, there can be no assurance that the incentive serves the interest of any other potential user. This kind of unpackaging of the terms of an NSA and attempting to convert the NSA into one or more general rate schedules makes no sense since it serves no mailer or Postal Service interest.

In sum, company-specific arrangements are important to the mailing industry because they provide mail users with the opportunity to configure rate and worksharing arrangements that are consistent with their particular business model, while at the same time yielding benefits to the Postal Service that, in turn, accrue to the system as whole.

There seems to be a concern that if the Commission were to favorably recommend a company-specific arrangement, this would be “unfair” because of the unknown possibility that other mailers -- whose mailing and mailing practices virtually replicate that of the NSA participant -- would be willing and able to undertake the same obligations in exchange for the same rate benefits as those contained in the contractual arrangement with the original mailer. We do not see this as a problem. We believe that the Postal Service will act in good faith to extend the terms and conditions of an NSA, once approved, to other mailers – if there are any – who have closely comparable mail, meet the eligibility thresholds and are able and willing to assume all the obligation embodied in the original arrangement. In fact, timidity in recognizing the value of NSAs can have unintended consequences that are economically inefficient. For example, I am

informed that, at present, there is only one mailer participating in the Commission approved Priority Mail Presort experiment. The fact that there is now only one mailer participant suggests that it might have been better to structure that arrangement as an NSA in the first instance and then develop variations on the NSA with perhaps different obligations and incentives to reflect the differences in the needs and interests of those who initially participated in that experiment but have since dropped out.

B. The Commission Should Not Demand Unrealistic and Impractical Cost Projections Volume and Cost Information From NSA Participants.

Because they are company-specific, the type of information that an NSA participant and the Postal Service will be able to provide to the Commission to justify and explain the arrangement is necessarily going to differ from the type of the information used by the Postal Service in omnibus rate cases. The suggestion has been made in this docket that the Postal Service and an NSA participant should have to model the costs of the NSA mailer and determine the volume elasticities for that particular mailer in order to support or justify the agreement. This is unrealistic for several reasons.

First, most mailers – even very large ones – do not engage in the type of econometric forecasts that the Postal Service performs in connection with its rate cases. While it might be theoretically possible for mailers to supply raw data to the Postal Service and have the Postal Service do the modeling, many mailers do not collect or retain the data that the Postal Service would need to perform modeling and forecasting at the level of specificity expected in omnibus rate cases. Further, even if the data are available or could be collected in a form suitable for modeling with rate case specificity, the transaction costs to the Postal Service and the private sector NSA participant would

be such as to completely wipe out the benefits that both parties arrangement expect to realize.

This does not mean that the Postal Service and NSA participants must or should rely on average subclass costs without regard to the costs or elasticities of the individual mailer. To the extent that the difference between company-specific costs or elasticities and subclass averages are readily ascertainable and demonstrable, they should be taken into account in formulating the terms of the negotiated service arrangement. Of course, the fact that these types of adjustments should be made further counts against opening of the terms of an NSA to a larger group of mailers: the adjustment to average cost may well differ for every mailer in the larger group.

A somewhat different problem arises concerning the appropriate use of the Test Year in proceedings involving NSAs. By their very nature, all NSAs require the participant mailer to agree to change the way it has conducted business with the Postal Service with respect to the matters that are subject to the NSA. The mailer has to take the risk that it will be able to meet its obligations under the NSA and have sufficient time to recover both the upfront and ongoing costs it will incur under the contract. The result is that it is unlikely the Commission will ever see an NSA which terminates at the end of the Test Year. In fact, the 3-year period essentially required by the experimental rules will itself have an inhibiting effect in some large and complex deals.

The fact that an NSA will continue for a period that goes beyond the end of a Test Year should not change the way the Commission uses the Test Years to judge the arrangements. Rates set in an omnibus rate case often last beyond the end of the Test Year.

Since the Commission's rate case determinations are based on Test Year information, we see no reason why that should be different in the context of an NSA.

In the context of NSAs, the question the Commission needs to address is not whether this is the "best deal" the Postal Service or the private sector participant could get. The Commission's responsibility is simply to see to it that the deal does not harm the interests of other stakeholders and, in one fashion or another, adds value to the bottom line. The Commission can and should accept the proposition that the normal negotiation process yields the best deal that the parties could get in all of the circumstances and that process yields a result that benefits both parties. If it were not, one or the other of the parties would have refused the deal and there would be nothing for the Commission to consider.

CERTIFICATE OF SERVICE

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

Respectfully submitted,

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