

UNITED STATES OF AMERICA
Before the
POSTAL RATE COMMISSION
Washington, DC 20268-0001

Experimental Rate and Service Changes
To Implement Negotiated Service Agreement
With Capital One Services, Inc.

Docket No. MC2002-2

INITIAL BRIEF OF THE GREETING CARD ASSOCIATION

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I. INTRODUCTION

A. The special significance of Docket No. MC2002-2

This case presents the first Negotiated Service Agreement ("NSA") ever to come before the Postal Rate Commission (hereinafter, "Commission"). The NSA mechanism has aroused interest and controversy in the postal community for a number of years. Consequently, the Commission's decision cannot help but constitute a precedent of major significance. The Greeting Card Association hopes in this Brief to show why the Commission must provide clear guidance to the United States Postal Service (hereinafter, "Postal Service" or "Service") and the mailing industry regarding:

1. What will be expected of the proponents of any future NSA proposals brought before it, and
2. What substantive prerequisites are to be met by an NSA.

Because the proposed NSA that is the subject of this docket fails to meet such prerequisites and – independently – because it is not adequately supported by record information, it should be rejected.

B. The Greeting Card Association

The Greeting Card Association is the association of greeting card publishers – ranging from well-known large corporations to "Mom and Pop" small businesses. They

employ over 250,000 people. Americans spend more than \$7.5 billion a year on greeting cards; most of those purchased travel through the mail, predominantly as First-Class letters. Greeting cards account for most of the household-to-household letter mail the Postal Service carries.

Because Americans' ability to communicate their thoughts and wishes to one another through greeting cards depends on affordable, reliable, universal postal services, GCA is also an advocate for the citizen mail user. The single-piece First-Class mail senders and recipients whose interests GCA here represents are likely to be substantially affected by the outcome of this proceeding because the rates for the mail they send and hope to continue to receive will reflect revenues lost by the Postal Service from underpricing of NSA-governed services or from misestimation of the costs and revenues received and foregone for those services.¹ Also, rates and service for single-piece First-Class mail will be affected by the misapplication of postal management resources – better employed pursuing broader opportunities – and by the reactions of other mailers confronted by an apparent need to accept less favored mail rates and service and/or to incur the costs and delays of framing individual mailing arrangements. Rates for First-Class mail will be called upon to cover the NSA-related

¹ The subject NSA proposal has separate provisions for the free provision of electronic address correction service ("EACS") and for discounts related to volumes of First-class mail sent. The volume-related discounts are not based upon cost reductions. Tr. 2/350-51. Unless they induce offsetting volume growth, the volume-related discounts will reduce the contribution to cover institutional costs of the discounted mail.

transaction costs incurred by the Postal Service when those costs are assigned to general overheads and not to specific NSAs.²

II. THE PROPOSED CAPITAL ONE NEGOTIATED SERVICE AGREEMENT

The Negotiated Service Agreement for which the Commission's approval is sought in this proceeding³ would pertain to all First Class mail sent by Capital One Services, Inc. (hereinafter referred to as "COS") and such mail sent by any of its "strategic partners" acting in conjunction with COS and such mail as is sent as a part of COS's strategic alliances with other entities.⁴ During the NSA's term of three years, so long as COS does not opt to withdraw from the agreement, and so long as the volume of mail covered by the agreement exceeds, on an annual basis, 750 million pieces⁵ and certain mail list hygiene practices for COS mail are met, this mail will receive service at rates below that offered to any other mailer.⁶

² Tr. 2/357-58

³ The NSA, in unexecuted form, is filed as Appendix G of the Postal Service's *Request for a Recommended Decision* (hereinafter, "*Request*") in this docket.

⁴ NSA at Sec. I(G). Strategic partners and alliances would encompass all current and future COS joint enterprises (Tr. 2/153-57, 160-64). This ability to bring in new affiliates and strategic partners gives COS an opportunity to engage in arbitrage of postal discounts – eroding postal revenues. Tr. 8/1647-48. The COS cancellation provision is found at NSA Sec. IV(2).

⁵ NSA at Sections II(C) and III(C).

⁶ NSA at Article II. The NSA, at Article I, Section A. recites that "Capital One has mailed, for at least each of the last three Postal Service fiscal years, a minimum of one billion pieces of First-Class mail."

The mail covered by the NSA would be, if undeliverable, destroyed by the Postal Service who would provide electronic address corrections to the mailer, in lieu of physical return of the mail.⁷ If specified annual mail volume thresholds are met, this mail would be subject to declining block rates.⁸ The volume threshold for the receipt of discounts is set below the volume sent by COS in the year prior to when the NSA was negotiated⁹ but still may not be met according to some projections found in the COS rebuttal.¹⁰ As the threshold annual mail volumes for receipt of free electronic notification is far below that for volume discounts, the free notification may be received when volume discounts are not.¹¹

⁷ Tr. 2/125 - 26.

⁸ NSA at Article III.

⁹ Tr. 3/469 - 470.

¹⁰ Tr. 9/1847 - 49, and Rebuttal Testimony of Stuart Elliot, COS-RT-2 at pages 5-7 (Tr.9/1843-1845). COS currently anticipates sending 1.21 billion pieces in the first year of the NSA. Tr. 9/1809.

¹¹ The threshold for receipt of free EACS is 750 million pieces per year, NSA at Sec. II(C); the threshold for volume discounts is a minimum of 1.225 million pieces per year, NSA at Sec. III(E).

III. ARGUMENT

A. The Commission Must Provide Guidance on What Will Constitute an Acceptable – and a Credibly Supported – NSA

Virtually from the beginning of mail classification under the Postal Reorganization Act, the Commission has recognized, and fulfilled, its central role in shaping the Domestic Mail Classification Schedule.¹² The form which a new service – or a new combination or disaggregation of existing services – should take is a question for the Commission to resolve, using the criteria of 39 U.S.C. §§ 3622 and 3623; and the answer, to be fully useful, may involve an analysis of the faults and merits of particular types of classification on a scale much broader than that of the individual proposal.¹³ Such independent review is, if anything, even more important where the proposal

¹² This history is reviewed in *Mail Classification Schedule, 1995 – Classification Reform I*, Docket No. MC95-1, ¶¶ 2050 et seq. The proper classification vehicle – subclass or rate category – for the Postal Service’s proposed changes to First Class was a major issue in that case. See PRC Op. MC95-1, ¶¶ 5030 et seq., explaining the reasons for rejection of the Service’s proposed subclasses.

¹³ In the *Classification Reform I* opinion, the Commission stated that

. . . classification reforms of fundamental magnitude should be crafted to last for longer than a test year. While the ratemaking criteria of § 3622 can be applied for the shorter term, secure in the knowledge that circumstances will generate another request by the Postal Service in a few years, § 3623’s standards require a longer term view, at least in major proceedings.

PRC Op. MC95-1, ¶ 2084. The present situation is analogous: the direction marked here out for the use of NSAs will have effects well into the future.

involves, for the first time, a type of classification which would not be available, by its own terms, to any suitably-situated mailer.¹⁴

NSAs, such as the one here presented, present risks and potential opportunities to the Service, to other NSA parties, and to others who mail and receive First-Class mail. These other mailers and mail recipients will be left holding the bag if an NSA fails to produce net revenue benefits, discourages other remunerative mail volumes, or serves to preclude opportunities for the Postal Service. These opportunities can relate to charges agreed to in an NSA that are less than the Service would have received as the result of a carefully-conducted negotiation; they can also relate to (lost or postponed) opportunities to develop promising niche classifications.¹⁵ Indeed, the potential benefits of such niche classifications underline the importance of setting clear guidelines in this case.

More specifically, the Commission has the authority and responsibility to set guidelines for the Service and the postal community regarding

¹⁴ The Postal Service appears to recognize that the Commission's review of any NSA is mandatory. Tr. 2/345-46.

¹⁵ Well-designed niche classifications can more reliably produce needed net revenues from a range of mailers – and their results are not tied to the decisions and circumstances of an individual mailer. Moreover, they are much less likely to create competitive disadvantages, concerns about Postal Service favoritism toward a particular mailer, and concerns about the need for individual mailers to incur substantial transaction costs if they are not to be disadvantaged. However, in contrast to other situations, here the Postal Service did not consider employing a niche classification – in lieu of the proposed NSA – to avoid large volumes of returned mail. Tr. 3/502.

1. When it is appropriate to use an NSA rather than some more inclusive type of classification;
2. What characteristics an NSA should have to be likely to receive the Commission's approval; and
3. What information should be presented to demonstrate that any proposed NSA is well-conceived and will be implemented in a manner that produces for the Service, the Commission, other NSA parties, and similarly-situated mailers the information feedback needed both to assess the NSA's efficacy and to lead to possibly broader or more effective use of the approaches the NSA embodies.

This authority is recognized in the Commission's February, 2002, report to Congress, *Authority of the United States Postal Service to Introduce New Products and Services and to enter into Rate and Service Agreements with Individual Customers or Groups of Customers*, ("Report"), where the Commission suggested when NSAs and niche classifications would be, respectively, appropriate for the Service. There, the Commission stated that an NSA or a niche classification, to be legally permissible, must be reviewed in a public proceeding and the agreed-upon rate and service changes should work to the mutual benefit of mail users and the postal system as a whole. *Report at*

1. The Commission stated that niche classification proposals "are essentially Negotiated Service Agreements[,] without any associated legal uncertainties or additional administrative barriers."

In the pages that follow, we will show both what standards the Commission should set out in this precedent-setting case, and why the proposed Capital One NSA does not pass muster.

B. NSAs Are Appropriate Only for Unique Situations, Where a Niche Classification Open to All Is Infeasible

On the broad question of when the NSA mechanism should be considered, GCA's position can be stated simply:

NSAs should not be used when a classification open to additional mailers could provide benefits to the Postal Service, and to more than one mailer. In those circumstances, the Service can anticipate receiving larger and broader-based benefits, and both the Service and the mailers would save transaction costs.

Direct detriments from using the NSA mechanism where a niche classification would serve. When an NSA is used for other than a truly unique situation, an opportunity is wasted to create niche classifications of broader and, relatedly, more reliable mutual benefit. Absent a niche classification, even if the Postal Service intends – or explicitly agrees – to entertain proposals from other, similarly-situated mailers, both time and resources must be expended in creating corresponding NSAs for them. For both sides, this constitutes an avoidable direct cost.

Excessive cost is not the only problem. In any classification decision, the Commission is required to consider “the establishment and maintenance of a fair and equitable classification system for all mail” [39 U.S.C. § 3623(c)(1)] and to help the Postal Service perform its duty of avoiding “any undue or unreasonable discrimination among users of the mails, [and] . . . any undue or unreasonable preferences to any such user” [39 U.S.C. § 403(c)].¹⁶ Where a niche classification, open to all mailers in a position to make use of it¹⁷, is feasible, the risk of unfairness or undue discrimination in a single-mailer NSA argues powerfully against the use of that approach.

The kind of unfairness inherent in a single-mailer arrangement is illustrated by one of the main criticisms the Commission leveled against the Service’s Docket MC95-1 proposal to split First Class into Automation and Retail subclasses:

. . . the Service’s proposed division of First-Class Mail into a somewhat exclusive Automation subclass and a residual Retail subclass is difficult to reconcile on the level of pure classification analysis. “Automation” and “Retail” are not naturally disjunctive classifications or mutually exclusive categories of mail. The empirical demonstration of this observation is the existence of Courtesy Envelope Mail and other examples of single-piece letter mail, which the record of this and prior proceedings have shown to be fully compatible with automated processing. The proposed inclusion of such mail in the residual Retail subclass belies any logical division of First-Class Mail into groupings based on the mail’s susceptibility to automated processing. *It also raises grave concerns about the fairness and equity of*

¹⁶ Section 403(c) is one of the “policies of this title” which are to govern classification decisions under § 3623(c). The relevance of these provisions to NSAs and niche classifications was recognized in the Commission’s *Report* at page 11.

¹⁷ Even if, initially, it was developed by negotiation between the Service and a smaller group of mailers.

the proposed subclasses by denying entry into the Automation subclass to less than bulk quantities of mail that could, in fact, be equally compatible with automated processing.

PRC Op. MC95-1, ¶ 5031 (italics ours).

The situation potentially presented by a single-mailer NSA is even more egregious. In *Classification Reform I*, the proposal at least involved a classification open to all mail with certain characteristics – although the characteristics were, as the Commission found, illogically and unfairly specified. With an exclusive NSA, even mail that had, or could readily be given, the *same* characteristics as the mail covered by the NSA would be excluded – unless and until the excluded mailers succeeded in negotiating NSAs of their own.

What response can be expected from mailers not enjoying NSA partner status?

The reasons given above for avoiding NSAs where a more inclusive classification could be created concerned direct costs and the (perhaps not unrelated) issue of fairness to other Postal Service customers. A full exploration of the problem also requires attention to how those mailers who do not – or do not yet – have access to an NSA may react to a competitor's obtaining one.

Much of the bulk-entered, business-oriented mail that is likely to be the subject of NSAs is an input to some economic activity in a competitive market.¹⁸ It is likely that

¹⁸ Dr. Panzer testified that block rate discounts are not efficient as a means of changing behavior. Tr. 8/1669-70.

“non-NSA” participants in the relevant market will react to a perceived cost advantage bestowed on one of their competitors by seeking offsetting economies elsewhere.¹⁹ As conceded by Postal Service Witness Eakin (Tr. 10/2109 - 2116), competitors may react to the NSA by reducing their communications or shifting them to non-postal media. An example of such action would be a non-NSA bank pursuing cost savings by accelerating its conversion to e-media of solicitations or other letter mail – resulting in loss to the Service of *all* the net revenue from the departing volumes. Also, when an NSA is employed to give one competitor a service at a cost less than that afforded others, perverse incentives are created. These include the incentive the favored mailer’s competitors receive to restrict volumes, or forego a service altogether, until they see if they can negotiate the same rate provided for in the NSA. Another possible perverse incentive would be to demand rewards for remedying particularly bad mail situations²⁰ – even when a self-initiated remedy would work to the mailer’s net benefit.²¹

Thus, where an NSA benefits but one of a group of competitors, the mutual benefits available if the activity the NSA seeks to encourage were to be encouraged on

¹⁹ Tr. 8/1666-67.

²⁰ See the testimony of Newspaper Association of America witness Kent (Tr. 6/1190 - 95).

²¹ COS has an uncommonly high undeliverable mail rate of 9.6 per cent for its solicitation mail. Tr. 2/122, 165. While it would save money and improve marketing by reducing that rate, in the NSA the Service is proposing to provide COS with Electronic Address Correction Service free of charge while charging others for that service. Tr. 2/343-44, 454. The opportunity cost of waiving the EACS fees for COS is not known but appears to be substantial. Tr. 3/476-78.

the part of other mailers are foregone. Given the Service's public service mission and its legal monopoly over all forms of letter mail, it obviously should not attempt to pick and choose among competitors – a course it is, necessarily, following when it uses an NSA when a niche classification could be used, e.g., to encourage the use of electronic notification in lieu of the physical return of First-Class mail.

Use of an NSA where a niche classification would serve needlessly creates process inefficiencies. The transaction costs caused by the development and negotiation of the Capital One NSA are unknown – because the Service has throughout treated them as institutional and not sought to associate them either with the transaction itself or the subclass to which it pertains – but may be presumed to be substantial in relation to the size of the benefits expected from the agreement. Since the Service has presented (at best) mixed messages as to whether many or few similar NSAs or requests for NSAs can be expected, we cannot estimate the additional transaction costs that will be incurred in the negotiation of individual NSAs.²²

Unlike the case of a classification open to all appropriately-situated mailers, the NSA approach will require separate negotiations and (one hopes) risk analyses to achieve an equivalent broadening of benefits and protection against risks of idiosyncratic behavior. The Commission should put all concerned on notice that a necessary

²² Tr. 2/44; 3/450, 459-63, 510 - 517; 9/1891 - 94.

element in the presentation of an NSA proposal will be a reasonable showing that the expected benefits could not be achieved by such a niche classification.²³

It is not just in the preliminaries that misuse of the NSA mechanism can cause inefficiency. Niche classifications may actually take less time to be reviewed and put in effect. The Appendix to the Commission's *Report* describes three experiences with niche classifications – each of which took no more than six months and in two case about three months to proceed through this Commission. Since the report was issued, the co-palletization case²⁴ progressed from filing, through settlement, to approval by the Governors in about fifteen weeks.

Niche classifications, finally, need not attempt to rely on projections based upon actions of one firm and upon that firm's undisclosed or undeveloped internal projections. The usefulness of data that might be obtained if an NSA is implemented may be expected to be far less than that which might be obtained from a multiplicity of mailers using a niche classification. Hence the NSA is likely to prove a less efficient means of

²³ We recognize that there may be a “gray area” in which the Service finds that more than one mailer could use a proposed arrangement, but is also (justifiably) confident that (i) it has identified all such mailers, and (ii) they are few enough to be practicably included in a single analytical and negotiating process. If such a situation arose, the objections to presenting the resulting agreement as an NSA would be lessened. The present case, however, is clearly not such a situation: the work-reducing initiatives involved could be widely adopted and, in any event, the Service clearly has not conducted the inquiry needed to establish whether only a manageably small number of mailers could use the proposed arrangement.

²⁴ *Experimental Periodicals Co-Palletization Dropship Discounts, 2002*, Docket No. MC2002-3.

acquiring and evaluating operational and cost experience than a niche classification would be.²⁵

C. An NSA Should Not Combine Independently Usable, Unrelated Elements

An NSA should not conjoin independent schemes to benefit a mailer²⁶ when, as here, the schemes could be pursued separately (i) so as to afford greater fairness to mailers who could use at least one of the schemes if it were made a niche classification and (ii) so as to afford the measurable results needed to objectively evaluate the value and future potential of the scheme.

The independence of the elements of a contemplated or proposed NSA should be assessed without regard to the fact that the parties in fact wish to combine them in a single agreement. Put differently: that the Service and Mailer A have agreed, for reasons respectively satisfactory to themselves, to combine, e.g., a worksharing scheme and a promotional discount in a single contract does not affect the potential ability of other Mailers B, C, D . . . to benefit, and concurrently provide benefits to the

²⁵ The informational limitations of a single-mailer arrangement are also a *substantive* limit on its acceptability – particularly in this case.

²⁶ E.g., a declining block rate scheme of volume discounts and separate provision of free electronic address correction service in lieu of the physical return of mail.

Service, from using one of these elements.²⁷ Consequently, that the Service and Mailer A have agreed on the combination is not a substantive reason for approving it.

The mere fact that an agreement combines the two elements must, we recognize, be distinguished from the quite different circumstance of one party's being *unwilling* to use either element if not combined with the other in a single agreement. If, for example, COS were shown to be unwilling or unlikely to convert from physical return to EACS²⁸ absent the provision for declining block rates on additional volume, it might be arguable that the combination is necessary to obtain any of the hoped-for additional benefits from COS's mailings. Such a showing might well not suffice to justify the combination of inherently independent elements²⁹, but it would at least be relevant to that issue.

On this record, however, no such evidentiary showing³⁰ has been made. COS, of course, entered into the proposed NSA prior to the Service's offering comparable (CSR Option 2) service to others; therefore COS's failure to use the fee-for-service

²⁷ Prior to its entry into the NSA, the Service did not offer EACS in lieu of physical return. Subsequently, the Service has offered EACS at a unit price of 20.3 cents. Tr. 2/343-344. Since the offering of this service occurred so recently, it is too early to judge its market penetration at the currently offered price.

²⁸ Even assuming that EACS fees were waived, as they are in the present NSA.

²⁹ The greater the number of mailers who could use one element of the combination but are excluded from doing so by the elements' being combined, the less likely it is that such justification could be established.

³⁰ In particular, with testimony from COS.

CSR Option 2 does not tell us whether and to what extent it would join 819 other mailers (Tr. 3/571) in using it, absent the NSA. With regard to the severability of the two elements, COS seeks to proceed with the NSA though it does not project receiving the volume discounts – at least for now.³¹ Postal Service witness Plunkett testified on cross-examination that the schemes did not constitute a quid pro quo³² nor has any showing been attempted to explain how any mutual benefits of the volume discounts would be lessened if the benefits were separately offered. And the NSA does not condition receipt of the free EACS upon receipt of volume discounts; rather, it sets the volume threshold for the free EACS far below that for volume discounts.³³

The COS NSA, if it confers costs savings on the Service, will do so only if and to the extent that EACS provides net savings over the costs of physical return of undeliverable First-Class mail. Correspondingly, there is no reason to believe that COS would not use EACS without the provision for a volume discount as EACS confers an obvious independent saving for COS. As noted earlier, COS proposes to proceed with the NSA despite not being in a position presently to receive the volume discounts.³⁴ EACS,

³¹ Tr. 9/1809, 1847-1849.

³² Tr. 9/1879.

³³ See fn. 11, *supra*.

³⁴ COS does not, as a normal practice, forecast its mailing volumes. Tr. 2/115. It presented such a forecast in its direct case, using elasticities which were not specific to COS but rather were Postal Service system-wide First-Class Mail estimates. Tr. 2/247-248. These forecast volumes were revised sharply downward on rebuttal (Tr. 9/1847-1849), falling below the NSA's volume discount threshold. Tr. 9/1809. This sharp decline, it should be noted, illustrates the difficulties of forecasting the actions of

even at its normal charge, is far cheaper than costs of repeat postage to UAA addresses coupled with the unit production costs of undelivered letters and the costs of correcting mailing lists using returned mail which then must be disposed of.³⁵ The volume discount and the free EACS schemes could work independently, and – other than being in one agreement – have no evident functional relationship.³⁶

Inappropriately combining separately-usable elements presents serious risks of unfairness. If some mailers could use one but not both of the elements³⁷ which are

a single firm – yet, as explained by Dr. Panzar. A reliable estimate of volumes is a prerequisite to the sound structuring of a volume discount (Direct Testimony, JCP-T1 at page 12; Tr. 8/1649-51, 1665-1666, 1681).

In the event that COS were to add mail volumes from “strategic partners,” this now unknown mail volume would be eligible even though it is not known whether this “new” mail volume is fostered by the volume discounts. We do not know who COS’s future strategic partners will be. Obviously, neither COS nor the Service is in a position to predict the volume performance of these unknown firms. If the volume were not in fact to be new, the arrangement would be a mere collection of rent by COS at the Postal Service’s expense – and could have anticompetitive effects. Tr. 8/1647-1648, 1658.

³⁵ COS witness Jean described their process for returned letters at Tr. 2/120-123.

³⁶ The Postal Service expects that the use of *fee-paying* EACS will grow (Tr. 3/544). Some 819 mailers are stated to be participating at present (Tr. 3/571).

³⁷ To use the present NSA as an example: a mailer which calculated that EACS in lieu of physical return would save it money, but which expected its volume to remain more or less constant, could use the work-reduction but not the promotional feature of the NSA. Its access to the former would be unproblematic if it had been tendered to COS independently; the hypothetical mailer would then be, pro tanto, “similarly situated” (i.e., able to secure benefits and yield back corresponding benefits by adopting EACS), and so in a position (transaction costs permitting) to demand a similar agreement. (Its access would, of course, be even more unproblematic if the scheme formed a normal classification.)

arbitrarily combined in an NSA – and benefit themselves and the Service by doing so – excluding them from enjoyment of the usable element by coupling it with the other violates the fairness and non-discrimination provisions of the Act. That the discrimination would be “unreasonable” is suggested, most obviously, by the fact that it would cause the Service itself to forego economic benefits.³⁸

Combining inherently independent elements in a single NSA blurs the data generated from operations under the agreement. If, as in this case, two independent schemes are proposed to be joined, then if volume discounts are actually used along with EACS, the utility of the data the proposed NSA might provide is impaired. This is because one cannot readily separate the effects of the two schemes, to study how one or the other might be best extended.³⁹

D. The COS NSA Cannot Be Approved on the Record in this Proceeding

Introduction. In the preceding sections of this Brief we have attempted to set out general principles which would help insure that NSAs in general will be utilized appropriately and, correspondingly, will reliably produce benefits both for the mailer(s) concerned and for the Service. In the process, we have pointed to some of the ways in

³⁸ Which, ex hypothesi, would be available to it from mailers who would use EACS Option 2, but who did not expect or intend to gain from declining-block rates for additional volumes.

³⁹ In our case, the informational value of any data would be further clouded by the loose restrictions the NSA puts on what may be counted as eligible mail volumes. See Tr. 2/153-156, 160-164.

which the proposed COS NSA fails to conform to those principles. In what follows, we focus on the proposal in more detail, and in particular on the numerous ways in which the record either fails to justify it or affirmatively shows that it should be rejected.

The proposed discounts could serve to reduce and not enhance Postal Service net revenues. It has been insisted from the outset that a main reason for entering into the COS NSA is to enhance the Postal Service's net revenue.⁴⁰ The record does not show that it would, and contains much evidence pointing to the probability of a net revenue detriment, rather than a benefit.

The cost picture is unclear. The costs of providing the volume discounts and a fee waiver over a three-year period are largely unknown. To develop a reasonable prediction of the costs that may be expected over the NSA's three-year term, it is obvious that reasonable estimates are needed with respect to the volumes involved, the degree of automation that the Postal Service will achieve in forwarding and returning First-Class letters, and the only partially overlapping costs of forwarding and returning COS's undeliverable First-Class letter mail.

In this proceeding, volumes have not been predicted beyond the first year of the NSA's term.⁴¹ With regard to that year, the prediction, which has come only from COS

⁴⁰ See, e.g., Postal Service *Request*, at 2, 4; USPS-T3, at 1-2, 4, 6; Tr. 2/349.

⁴¹ Nor have costs. Tr. 2/358-359.

– and not from the Postal Service – has changed substantially during the course of this proceeding. According to COS Witness Elliot (Table 3 at page 7 of his Rebuttal, COS-RT-2; Tr. 9/1847-1849), estimates of test year after-rate volumes declined from the 1,423,458,969 pieces in his initial testimony to 1,210,249,622 pieces in his rebuttal. Thus, in a matter of a few months, the volume estimate fell by nearly 15 percent. The Service has undertaken no special study of COS volumes⁴², and the volumetric estimates are clearly inadequate to allow for reasonable cost estimation. Moreover, the mail volume response of COS's competitors is unknown and could be negative so far as the Postal Service is concerned (Tr. 10/2109-2116).

The Postal Service's view of how and to what extent the NSA will provide it with net revenue benefits appears to be premised on a theory that the savings it hopes to receive when it provides EACS in lieu of physical return of First-Class mail will exceed the new costs it incurs plus the net revenue it may forego. The net benefit alleged by the Service does not include the costs incurred to develop the transaction or performance monitoring costs.⁴³ Postal Service Witness Crum, who presented the alleged net benefits,

⁴² Tr. 2/361-362, 367-369.

⁴³ Tr. 2/357-358.

- Does not testify concerning costs and benefits in the NSA's second and third year⁴⁴,
- Uses system average First-Class mail costs⁴⁵ as a basis for calculating savings,
- Presents no special study of costs actually incurred to serve COS, and
- Does not present the cost savings the Service anticipates from the gradual institution of its new PARS system – a system to enhance the automation of the treatment of physically returned and forwarded mail so that, inter alia, that mail could be intercepted before it leaves mail processing instead of the older system in which interception does not occur until the mail reaches the carrier.⁴⁶

⁴⁴ Tr. 2/254, 356.

⁴⁵ Tr. 2/340-341, 361-362, 389. The data the Service used are from 1998 (Tr. 3/605-609). While some system costs for physically returning and for forwarding mail are identical, at least in theory, not all of them are; and so changes and costing errors need not be mutually offsetting when forwarding and returning costs are compared. Overstating mail return costs would cause overestimation of the savings to the Service from the use of EACS. As a general matter, moreover, it seems – to put it mildly – incoherent to argue that a new classification tailored to a single mailer is appropriate, while presenting no evidence concerning the per-piece cost of the only mail that would be subject to that classification. Such a procedure would, we submit, not pass muster in an orthodox classification proceeding. The present case is of course not parallel to the more usual classification situation involving a defined worksharing initiative in which *any* mailer in the affected category may participate (and presumably will, if it is remunerative to do so). Since in a case of that kind *all* mail in the relevant category is theoretically a candidate for the new worksharing sub-category, there is no objection to using the category-wide average cost as a basis for calculating worksharing savings.

⁴⁶ Tr. 2/354; 347-348, 353. Insofar as PARS reduces costs to the Postal Service for forwarding and especially returning mail, the result will be a *lower* saving from COS's use of free EACS than the Service has calculated.

He also makes no provision for disposing of unreturned mail.⁴⁷

Pursuant to the proposed NSA, the EACS service that would be provided conforms to that offered to others under CSR Option 2. This service provides electronic address correction service after which unforwardable undeliverable mail is destroyed, and other corrected mail is forwarded. The costs of providing service include those incurred to forward some mail that is now returned, and to destroy other mail. Witness Crum could not identify those costs.⁴⁸

The record is inadequate with respect to revenues – both those foregone and those anticipated to be gained. While Witness Crum attempted – albeit defectively – to estimate the direct avoided costs of EACS, no Postal Service witness addressed the question of whether the Service was leaving money on the table when it agreed to not place any charge on COS for EACS.⁴⁹ Also, no testimony has been provided that

⁴⁷ In an apparent effort to bolster his shaky net benefit analysis, Witness Crum attempted to supplement his testimony with a claim of savings from reduced repeat forwarding. Unfortunately, Mr. Crum could not make a reliable prediction of the number of repeat forwards, Tr. 2/364-369, came forth with a doubtful assessment of the differential between costs of forwarding and returning mail, and neglected the effects of the implementation of the PARS system on both. Tr. 2/354; 3/605-606; 4/777 (Plunkett).

⁴⁸ Tr. 2/349; 366-369 (forwarding volumes not known); 9/1897 (incomplete separation of data on forwarding and return costs).

⁴⁹ This may be thought of as the (unnecessary) incurrence of an opportunity cost, or, more simply, as a possible material defect in the proposed NSA. It is significant not just because it further undercuts the projection of net benefits but because – as an identifiable rate benefit bestowed on the mailer – the EACS fee waiver will become a bargaining objective for other would-be NSA parties basing their requests

attempts to show the relationship, if any, between the volume discounts afforded through proposed declining block rates and any new volumes that can be expected to be forthcoming in consequence of those discounts. A showing of the relationship between the revenues the Service proposes to forego – through the discounts – and how and whether such lower rates would draw forth new mail volumes such as to offset the foregone revenues is not attempted. All the Commission has been offered is a general assertion that if the two discounts are offered and received, the net of these two unrelated matters will be positive for the Service. And that assertion relies on truly doubtful and incomplete analysis.

The relatively thin net benefit forecast by the Postal Service is a single point projection⁵⁰, dependent on speculative volume projections for mail that will be sent and returned. This one-year-only projection neglects transaction costs⁵¹, mail disposal costs, and the opportunity costs that will be most certainly incurred when COS receives free EACS. Because of its incompleteness, its use is not consistent with prudent business planning or sound regulatory projections. In addition, the basis from which the entire exercise must start – COS's mailed volume – is highly uncertain. The Commission is used to working with statistically credible volume estimates for entire subclasses, derived from the collective (and, therefore, often mutually-offsetting) behavior of

on the alleged similarity of their situations to that of COS.

⁵⁰ Tr. 2/358-359.

⁵¹ Tr. 2/357-358.

hundreds, or millions, of individual mailers. Here the volume projection purports to represent the future usage of a single firm, and is fully subject to that firm's idiosyncratic business plan changes and financial vicissitudes. Whether or not a credible volume projection for a single firm is possible, it remains true that no such resource is available on this record.⁵² And, as noted earlier⁵³, we have no information about the identity or likely volume performance of COS's future "strategic partners" – to say nothing of the question of whether any volume they generate will be "new" and thus capable of benefiting the Service's net revenue position.

The proposal will not lead to information of future or general applicability.

Although the proposed NSA was originally presented as an experiment, the data-gathering function of an experiment appears to be neglected. No systems have been developed within the Service to collect data regarding the performance of an NSA, or for its costing or performance monitoring.⁵⁴ Because information regarding an NSA would pertain to only one firm, and that firm may be expected to be continuously evolving, the best data obtainable are not likely to be informative about other firms or

⁵² OCA witness Smith made a creditable attempt to produce volume projections for COS, but had to recognize that, at least for solicitation mail, the usual volume forecasting methods yielded no useful results. Tr. 7/1302-1306 (OCA-T-1 at 10-17). If – as now appears likely – COS will mail substantially less than originally thought, the question arises why the worksharing aspect of the agreement is combined with to a volume discount which COS may well not receive. If the error were in the other direction, it would become more likely that the entire agreement would be a money-loser for the Service.

⁵³ Fn. 34, *supra*.

⁵⁴ Tr. 3/515-517; 9/1891-1894.

even about the subject firm in the future. Since no system has been instituted regarding applications for NSAs or for the systematic collection of costing and other data, the information the Service is likely to obtain through the existence of NSAs is not likely to be substantial. The limited information produced through ad hoc NSA processes will reflect only such information as an applicant is willing to share with the Postal Service. The combination of necessarily limited Postal Service resources devoted to NSA activity and the asymmetric nature of the possession of now-private information inherently limits the usefulness of the NSA process as a source of information to the Service.⁵⁵

IV. THE PROPOSED SETTLEMENT

Late in this proceeding, the Postal Service and the Office of the Consumer Advocate (OCA) announced a proposed settlement.⁵⁶ Briefly, the settlement proposal calls for the Postal Service to adopt internal rules permitting mailers of First-Class mail who could alternatively use Standard Mail to file written requests with the Service for a “comparable” NSA. While the Service would have broad discretion in negotiating an

⁵⁵ If, as we have urged above, NSAs are limited in their use to those cases where only one or a very few firms would be capable of participating, these information limits might be less troubling; there would at least be no material prospect of other, later-arriving NSA applicants whose potential performance as NSA partners could be only incompletely assessed because of lack of data. Of course, that qualification does not mean that a proper system for monitoring the cost and effectiveness of an NSA is not needed – it clearly is, if only to assess the positive or detrimental effects of the agreement on others using the same subclass.

⁵⁶ Stipulation and Agreement, filed March 31, 2003.

NSA that was “comparable but with terms and conditions specific to the mailer”⁵⁷, the agreed-on DMM provisions contemplate submission of applications only for NSAs that joined a provision for free EACS service with a declining block rate. OCA for its part has agreed not to press for adoption of the classification proposal presented by witness Callow (OCA-T-2) as a substitute for the Postal Service-COS agreement.

GCA has not joined in the settlement, though we think it incorporates improvements over the proposal as originally filed. We believe that it represents an ingenious and thoughtful effort to mitigate at least some of the fairness concerns that are inherent in any single-mailer NSA⁵⁸ without discarding the NSA approach altogether.

We have tried to show above, however, that the instant situation is not in fact an appropriate one for the NSA mechanism. The proposed settlement does not appear to go far enough toward mitigating the problems caused by the choice of an NSA structure for a worksharing initiative that could and should be promoted more widely through a generally available niche classification. (These difficulties, we believe, are not solely related to unfairness: they also concern the fact that using an NSA rather than a niche classification introduces apparently needless inefficiencies into the diffusion of apparently useful work-reducing or volume-building initiatives.) Nor does the settlement deal with the shortcomings in the evidence offered as supporting the instant NSA proposal,

⁵⁷ Section 3.2, draft *Domestic Mail Manual* (“DMM”) language filed with the Stipulation as Attachment D.

⁵⁸ Except, as noted earlier, one that responds to a truly unique situation.

nor the difficulties created by joining two unrelated – if perhaps separately beneficial – schemes in one contractual package. All of these concerns, we suggest, still require clear guidance from the Commission if the NSA approach is to be productive in the future, and counsel against recommending the instant NSA, even as elaborated in the proposed settlement.

V. CONCLUSIONS

If NSAs are to make a useful contribution to the postal system, the Commission must insist that, to be approved, they be based upon careful inquiry and analysis and that they – or their independent parts – be used only in the perhaps relatively rare circumstances in which a broader opportunity can not be afforded through a niche classification.

NSAs should be preceded by considered inquiry into the costs and benefits involved. In its *Report*, the Commission explains that an NSA, to be approved, must meet the requirements of the Postal Reorganization Act. The Act's requirement of no undue preferences or discrimination, § 403(c), and the criteria of §§ 3622 and 3623 apply. *Report* at page 11. Without a considered inquiry into costs and benefits, it cannot be determined if an NSA is fair to others – including the other mailers who are at risk if the NSA does not benefit the Service or if it is anticompetitive, nor can it be determined if the direct costs and opportunities foregone by the use of the NSA outweigh the benefits. Without such an inquiry the extent and presence of mutual

benefits – which the Report calls for – cannot be determined, and even the information needed for a meaningful public hearing may be lacking.

Systems for costing and monitoring performance must be pre-planned along with the formation of an NSA. The information needed to assess a proposed NSA goes beyond general system cost averages and can be produced only through pre-planned, systematic inquiry. Without systematic inquiry, data will not be available to assess proposals and to create an orderly and fair method for queuing NSA proposals and for determining, at a suitably early stage, whether a niche classification could provide wider benefits.

The present NSA proposal is not the product of careful cost analysis; indeed, the costing presented is a mere cobbling together of general system costs whose relationship to the costs of serving COS are not known. The pricing of the two services addressed in the proposed NSA has not been intelligibly related to Postal Service costs, or to the benefits conferred. One of the two benefits addressed, EACS, is offered to others (as CSR Option 2) for a price, and no showing has been made that its value to COS is different than its value to other mailers. When transaction costs and the prospect of opportunity costs (ignored in the analysis) are superimposed upon doubtful and short-sighted direct costing (with its neglect of the development of the PARS), the prospect of real net benefits shrinks from the small amount the Service projects to the vanishing point. Approving the proposed NSA would signal to the Service that in the world of NSAs – which would soon develop, whether or not the Service was prepared to

deal with it – lower standards of factual underpinning and reasoned analysis can be expected to prevail. We submit that this is not the message the Commission should be sending at this critical juncture in the development of the NSA mechanism.

The Commission should emphasize that NSAs are appropriate only when they alone would serve. The proposed COS NSA should be rejected. NSAs are for unique or near-unique⁵⁹ situations where the risk of relying on single-firm volume or cost-behavior predictions must be accepted in order to seek the beneficial effects of a proposed NSA – and where fairness issues do not arise because there are no “similarly situated” customers. In other situations, there is no good legal or valid business reason to not seek to simultaneously benefit more mailers and the Service.

A situation, of course, does not become unique through the artificial joining of elements that are not functionally related, where one or more of those elements could be offered on an independent basis to additional mailers. In that situation, there is no reason to believe that the Service would receive less benefit from the joint offering of a niche classification for one of the elements and, if needed, an NSA for the other.

⁵⁹ For instance: if only a few firms could provide the subservice or the (credible) volume assurance needed, the Service could negotiate those few contracts and bring them to the PRC in a batch – assuring that in one case all the “similarly situated” customers were attended to. (Even there – as noted earlier – the same end could be achieved even more expeditiously via a niche classification.) While “uniqueness” is claimed here by the Service, the Service provides no definition of that term (Tr. 3/492-494), other than to say that the term requires more than mailer size (Tr. 3/486-487, 493-494).

In our case, we are presented with inadequately considered costing, doubtful (and small) benefits, and a situation in which useful data are unlikely to be obtained. The situation regarding EACS is not unique, and is functionally unrelated to the proposed volume discounts. Considerations of fairness, the absence of clear mutual benefits and the likelihood of no benefits, and lack of a showing of a relationship between the value proposed to be singularly conferred on COS and the rates proposed all militate against the approval of this NSA. It should be rejected.

Respectfully submitted,

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