Postal Rate Commission
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BEFORE THE
UNITED STATES 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**

BRIEF OF PITNEY BOWES IN SUPPORT OF THE PROPOSED NEGOTIATED SERVICE AGREEMENT BETWEEN THE UNITED STATES POSTAL SERVICE AND CAPITAL ONE, INC.

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I. INTRODUCTION AND STATEMENT OF INTEREST

Pitney Bowes Inc., is a leader in integrated mail, messaging, and document management solutions, and a major manufacturer and distributor of dedicated postal meters and computer-based metering technology. Pitney Bowes has a long-standing and demonstrated interest in a viable and competitive Postal Service and in postage rates and mail classifications related to all classes of mail, particularly to First-Class Mail. Pitney Bowes intervened as a full participant in this proceeding on October 17, 2002.

The U.S. mail is critical to commerce, serving as a vital channel for business. According to a recent analysis conducted by the Mailing Industry Task Force, a group comprised of 65 mailing industry senior executives and the Deputy Postmaster General, the mailing industry generates about $900 billion in business revenues annually and employs more than 9 million people. This represents more than 8% of our country's Gross Domestic Product.

The way in which the U.S. Postal Service ("USPS" or "Postal Service") conducts its function has a dramatic impact on American business. More than 90% of the mail stream today is business related – business to business, business to consumer, consumer to business. Much of this is what the Postal Service refers to as "commercial mail," or "bulk mail," that originates with known mailers.

In recognition of the critical role of the U.S. Mail in commerce, Pitney Bowes has long maintained that the Postal Service should work to maximize and revitalize the value of First-Class Mail. The key to the revitalization of mail as an essential communications tool is the constant improvement of the customer value. Consistent with this position, Pitney Bowes supports reform initiatives that will provide the USPS greater pricing flexibility as a means of enhancing the relative value of First-Class Mail for its customers. Flexible pricing models will allow for greater management discretion to enter into arrangements favorable to both the Postal Service and its customers. Further, flexible pricing models will enable the USPS to more effectively use its capacity, thus, lowering total average prices and, therefore, stimulating increased mail volume.

Today the USPS and the mailing industry are threatened by a convergence of problematic trends, including increasing costs, increasing prices, and increasing competition in the form of electronic diversion of "traditional" transactional mail. Pitney Bowes believes that the best way for the Postal Service to confront these challenges is to focus on "growing the mail" – taking actions that enhance the value of mail, reduce costs, increase productivity, and price the product attractively. These measures will drive increases in mail volume and USPS revenues. To achieve these ends, Pitney Bowes supports flexible pricing models, which include negotiated service agreements ("NSAs") of the type at issue in this proceeding. Furthermore, because ratepayers would ultimately bear the costs of lengthy ratemaking and approval processes, Pitney Bowes supports NSAs as a means to establish flexible pricing mechanisms promptly and efficiently.

II. SUMMARY OF ARGUMENT

Negotiated service agreements can serve as an important vehicle to achieve pricing flexibility and increased customization of services. The benefits of NSAs in principle were widely acknowledged in this proceeding and were endorsed specifically by the Commission's designated witness, Professor Panzar. The pending NSA moves the Commission beyond the realm of the theoretical and confirms that NSAs can achieve pricing flexibility without undue burden to the parties to the agreement.

Pitney Bowes respectfully requests that the Commission decline the invitation presented by some parties to recommend unwarranted and unduly burdensome cost and volume projection requirements and other costly requirements that would unnecessarily discourage the use of NSAs. Such requirements could impose transaction costs that outweigh the benefits sought from the NSA and, thus, could inadvertently prejudice small and mid-size mailers for whom such requirements might be disproportionately more burdensome.

Pitney Bowes supports the Stipulation and Agreement entered into between the Postal Service, Capital One and the Office of the Consumer Advocate ("OCA") to settle this proceeding, and believes the Commission should make a recommendation based on its terms. The Stipulation and Agreement appear consistent with the principles that Pitney Bowes believes are central to this proceeding – it offers a model of pricing flexibility, and it does so under terms and conditions that the parties have accepted as not unduly burdensome.

III. ARGUMENT

A. The negotiated service agreement between the Postal Service and Capital One provides an opportunity for the Commission to endorse the pricing flexibility and private workshare arrangements possible through NSAs.

Many customers within the mailing industry have unique relationships with the Postal Service based on their business models and mailing requirements. In light of these unique relationships, pricing flexibility and workshare arrangements can achieve economies and efficiencies for the customer, the Postal Service, the mailing industry, and the public at large.

The Postal Service, the Commission, and the mailing industry have discussed negotiated service agreements since the 1970s. The pending NSA between USPS and Capital One represents a customized agreement that addresses Capital One's unique business needs while resulting in an anticipated positive net contribution both in terms of increased revenues and reduced costs. Accordingly, Pitney Bowes supports the NSA as an innovative approach in pricing flexibility that will result in an anticipated increase in Capital One's overall contribution to the USPS. This NSA is particularly attractive because it is designed to enhance the relative value of First-Class Mail.

The proper use of NSAs can also present a useful vehicle for advancing the Postal Service's policy of encouraging efficient worksharing arrangements. Often the private sector can reduce the Postal Service's costs of preparing, processing, and delivering mail through its own efforts, thus improving the efficiency of the mail delivery system and improving overall system performance. Examples include presorting, prebarcoding, and dropshipping mail. Properly understood, worksharing discounts reflect costs avoided by the Postal Service as the result of the efforts of its customers. Pitney Bowes believes that the Postal Service should encourage these efficiency-enhancing measures wherever appropriate.

Worksharing, outsourcing, and private sector partnering can provide appropriate incentives to ensure that the marketplace works. Such arrangements promote economic efficiency by encouraging the use of the lowest cost provider. Experience demonstrates that through the cooperative efforts of its customers, the postal system as a whole benefits through more affordable product pricing that can translate into increased volume. For example, the USPS goal of 95% barcoded mail set in 1989 resulted in an increased reliance on mailer preparation to apply barcodes, presort mail and enter it further downstream. As a consequence, some $15 billion of potential USPS costs have been shifted through discounts to private industry mailers and intermediaries.

The Postal Service should continue along this path of shifting costs to private sector providers where it is efficient to do so – notably mailers and intermediaries who work on behalf of mailers to reduce their costs. The overall goal should be to reduce the total combined cost of mail preparation and processing for all parties.

The Postal Service should also have all appropriate pricing tools at its disposal to capture these potential benefits. Both NSAs and niche classifications can, in appropriate circumstances, serve this function. The present proceeding offers the Commission an important opportunity to establish this principle in the context of an NSA that would provide benefits to both the Postal Service and the mailer that is party to the agreement, while reducing overall system costs and thus benefiting the industry and the mailing public as a whole.

Under the terms of the pending NSA, Capital One would receive declining block discounts for mail increasing mail volume above established thresholds and electronic notification of its undeliverable First-Class Mail solicitations instead of the physical return of the undeliverable pieces. Capital One would also agree to undertake a robust mail hygiene program to insure the integrity of its address data. These arrangements would simultaneously reduce the cost and enhance the value of First-Class Mail and should be supported by the Commission.

B. The Commission should not recommend unduly burdensome volume or cost projection requirements in the approval process for negotiated service agreements.

The potential benefits of flexible pricing models will be jeopardized if the Commission recommends unnecessary transaction costs as part of the approval process. Accordingly, the Commission should decline the request of some parties to recommend company-specific volume elasticity projections, require out-year justifications beyond the test year, or recommend other costly requirements on the approval of NSAs that are not justified by a compelling need.

Pitney Bowes is sensitive to the concerns raised by OCA witness Smith with respect to the potential for divergence between company-specific volume elasticity and sub-class volume elasticity projections. To require company-specific volume elasticity projections for every NSA would be unworkable in practice, and would likely lead to undesirable results. As witness Smith acknowledges in his written testimony, while the company-specific projections can be most accurate

> presentation of a demand study may not always . . . be feasible. . . . First, the level of study costs in comparison to NSA benefits may render development of the study uneconomic. . . . Second, a specifically prepared study would probably need to be subject to formal regulatory review. This could require the disclosure of otherwise unverifiable private information specific to company operations.

Tr. 7/1248-10 (Smith). In sum, the Commission needs to take great care that the transaction costs of the NSA not overtake any potential realization of benefits, thus creating an unwarranted disincentive for firms to pursue NSAs. Further, the result of any requirement that inflates the transaction costs of the NSA approval process could have the consequence of excluding many smaller or midsize firms, for which such costs might be disproportionate, from even considering an NSA.

The same issues militate against the requirement that parties provide out-year projections to justify the benefits of a multi-year NSA. Specifically, Newspaper Association of America witness Kent contended that out-year projections should be offered to support a multi-year arrangement. We do not believe that out-year projections should be required in the context of a multi-year NSA where, as a matter of practice, out-year projections beyond the Test Year are not required to justify even across-the-board rate adjustments in omnibus rate cases. This requirement seems to have been suggested by NSA opponents more as a way to discourage the use of NSAs than as a way to achieve a legitimate purpose. On the present record, there is no basis on which to conclude that the Postal Service has not made a good faith assessment of the potential benefits of the NSA based on the information provided.

Accordingly, the Commission should not, in recommending the Capital One NSA, put in place unduly burdensome or expensive procedural requirements on the NSA approval process.

C. The proposed Stipulation and Agreement between the Postal Service, Capital One, and the OCA confirm that an NSA can appropriately provide pricing flexibility without undue burden to the parties.

The Stipulation and Agreement that has been presented to the Commission by the Postal Service, Capital One and OCA establishes a process to provide increased pricing flexibility and facilitate NSAs for both Capital One and other parties. Capital One's agreement to the settlement indicates that it does not consider the data collection and reporting requirements unduly burdensome. The Stipulation and Agreement thus appears consistent with the principles that Pitney Bowes believes should govern this proceeding.

Pitney Bowes is mindful that under the settlement this NSA would serve as a template for future agreements for mailers similarly situated to Capital One. In view of the precedential value of this NSA, Pitney Bowes is principally concerned that the Postal Service and the Commission find an appropriate balance so that other parties may benefit from the work that has already been done in pursuit of "comparable" agreements, yet preserve the flexibility of future agreements to meet the unique needs of other mailers. Pitney Bowes recognizes that the Postal Service must preserve its flexibility under the settlement to propose NSAs with different terms and conditions, and different criteria for other cases where circumstances differ.

Accordingly, Pitney Bowes believes that the Stipulation and Agreement will facilitate increased pricing flexibility and would not impose transactional costs viewed as unduly burdensome by the parties.

IV. CONCLUSION

For the reasons set forth above, Pitney Bowes respectfully requests that the Commission recommend the experimental rate and service changes proposed by the NSA between the Postal Service and Capital One, as modified by the Stipulation and Agreement currently before it, because it will promote pricing flexibility and private workshare agreements. Additionally, the Commission should adopt the approach reflected in the settlement and not recommend unduly burdensome transaction costs on the approval process for negotiating NSAs.

Respectfully submitted,

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