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

EXPERIMENTAL RATE AND SERVICE CHANGES TO IMPLEMENT NEGOTIATED SERVICE AGREEMENT WITH CAPITAL ONE SERVICES, INC.

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REPLY BRIEF
OF
CAPITAL ONE SERVICES, INC.

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I. NAA And GCA Contentions That NSAs Are Unlawful Are Not Supported by The PRA, By Case Law, Nor By Commission Precedent.

NAA's argument that the Commission has no lawful authority to recommend an NSA, that is, an agreement with a single customer, is premised upon the Commission's primacy in determining postal rates that comply with the Act. NAA Brief at 5. Neither the Postal Service nor Capital One challenges the Commission's primary role in recommending classifications and rates; nor is there any question that NSAs by themselves in any way usurp that role. On the contrary, Capital One and the Postal Service are before the Commission asking it to apply the statutory criteria and recommend the classification and rates necessary to implement the NSA.

The fact that Capital One and the Postal Service collaborated in a negotiation to arrive at the classification and the rates that it is requesting the Commission recommend does not in any way distinguish that from the usual ratemaking or classification process where it is the Postal Service, or an individual party, who proposes to the Commission a particular class or rate that it would recommend. Contrary to NAA arguments, there is no possible construction of Section 3622 nor section 3623 that would preclude the Commission from recommending classes and rates for a singular mailer or a limited group of mailers, as opposed to all mailers. The only case the NAA cites to support its reading of the Act as precluding single mailer classifications in rates is *United Parcel*

Service, Inc. v. *United States Postal Service*, 604 F. 2d. 1370, 1375-76 (3d. Cir 1979) cert. denied, 446 US 957 (1980). [1]

Nor has the NAA attempted to distinguish a single customer NSA from a legally valid niche classification. The NAA arguments against a single classification for a single mailer would be equally applicable to such a classification applicable to ten mailers. The fact that a niche classification may, in the words of NAA, "be used to address unusual needs of a particular grouping of mailers," as distinguished from the needs of one mailer, is a meaningless distinction so far as the power of the Commission under 3623(c)(5). Likewise, the Commission's powers remain unfettered whether it is a niche classification or a single mailer NSA: the Commission has full power either to approve, reject or recommend changes in the proposals. It is then up to the Postal Service (and the party to the NSA, if it is an NSA) to determine whether they wish to accept the Commission's recommendation.

Just as in the case of full classifications, niche classifications or omnibus rate proceedings, the Commission, while it has the power to make changes in the proposal in its recommendations, does not have the power to coerce the Postal Service or other parties to accept its recommendations. The Postal Service always remains free simply to disregard the Commission's recommendations for mail classification changes, as it has done at times over the life of the Commission. Just as has been the case where the Commission has changed classification proposals submitted by the Postal Service, the

[1] As elaborated in our Initial Brief, that case provides absolutely no support for the proposition for which it is cited. On the contrary, the United Parcel case makes it clear that the Postal Rate Commission has the authority to recommend the adoption of an experimental rate for a small group of mailers, so long as the Postal Service does not on its own attempt to create such a deal without seeking the approval and recommendation of the Commission. The Capital One NSA in this proceeding observes all of the requisites of that case.

consequence of a non acceptance of the Commission's recommendation in this case would have the same result. The Postal Service would not get its classification change.

GCA enunciates a principle that NSAs are appropriate only for unique situations where a niche classification is infeasible. GCA Brief at 8. We do not necessarily disagree. In fact, the record is replete with testimony about the uniqueness of Capital One's usage of First-Class solicitation mail and the cost savings opportunity that unique usage creates for the Postal Service. The Postal Service testified that they were not aware of any comparable First-Class solicitation mailer where the same cost savings were possible. To the extent it materializes that there are, then the procedures proposed, and the classification itself, provide the opportunity for that mailer, or those mailers, to seek the same treatment. The testimony also discloses that most of Capital One's competitors are in active discussions with the Postal Service about their own unique opportunities for deals and are merely awaiting the outcome of this case to proceed. Tr. 9/1889-1890.

While GCA appears to concede that an NSA is appropriate and lawful for a unique situation, nevertheless, the rhetoric of its brief makes it plain that it does not believe that such unique situations can exist, nor that "single-mailer" NSAs can be lawful. They simply pronounce: "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 mailer succeeded in negotiating NSAs of their own." GCA Brief at 10. But that is not the situation here: the evidence of record is that, so far as anybody knows, there are no other mailers that have the *same* characteristics as Capital One's First-Class solicitation mail with its consequent high return rate. This suggests that the GCA actually believes that all NSAs exclude mailers that have the *same* characteristics; whereas, the actual precondition of an NSA is that there is no readily known group of other mailers who meet those conditions exactly. While pretending to admit an NSA can be lawful (perhaps because the PRC has so found), the logic of GCA's arguments contradict that pretense. There is no other way to read their brief than that NSAs are contrary to the Postal Reorganization Act.

II. Val-Pak's So-Called Seven Core Principles For Judging NSAs Consist Of Two Obvious Commands From the PRA And Five Flawed Arguments.

Val-Pak says that it has devised a framework of principles to judge NSAs, seven in number. Val-Pak Brief at 5. The two Val-Pak principles that make sense are commanded by the Postal Reorganization Act: The NSA should not produce a net financial loss; the NSA shall not give "undue or unreasonable preferences" to certain mailers or discriminate against similarly situated mailers. The other so-called five "core principles" are not principles at all, but rather argument. We take issue directly with each of them:

1. An NSA simply cannot fix one part of a system-wide problem. (In other words, Val-Pak says that it is better to curse the darkness than to light one candle).

2. An NSA must be evaluated using the mailer's own specific costs (even though that may mean that, as a practical matter, no NSA could ever be approved).

3. An NSA cannot provide a discount that is based solely on volume (even though the extra volume generated by the discount would increase the contribution to overhead).

4. An NSA should not reward a mailer who agrees that the Postal Service can discontinue providing a particular service (even though the reward to that mailer is less than the cost the Postal Service will avoid from elimination of the service).

5. The NSA must anticipate and avoid consequences that are not intended (even though, presumably, such consequences are only unintended because they are unforeseeable).

Val-Pak's agreement that properly designed and implemented NSAs are acceptable is disingenuous because no NSA could be negotiated under the "principles" advocated by Val-Pak. The example of an acceptable NSA that it gives - - an NSA that provides incentives for individual mailers to perform additional work not required by regulation that results in avoided postal costs - - is not an NSA; it is either a rate category or a niche. The example also fails one of Val-Pak's principles: it fails to solve the problem that other mailers who could perform such additional work, thereby reducing Postal Service costs, will not do so because they are not covered under the agreement.

III. The NSA Will Increase Capital One's Contribution to Institutional Costs.

Our initial brief established that the agreement will significantly increase the contribution that Capital One makes to institutional costs. In fact, as was shown, the increase in contribution will likely be significantly higher than the $11.4 million presented by Dr. Elliott in his rebuttal testimony. Capital One Brief at 10-23. Rather than repeating the discussion from our initial brief, this section simply addresses and rebuts particular arguments made by NAA, GCA, and Val-Pak in initial briefs.

Before replying to specific arguments put forth by these intervenors, however, it is worth noting that none of them calculated that the NSA will reduce the contribution that Capital One makes to institutional costs or even showed the extent to which their criticisms impacted total contribution. This silence is evidence that no credible arguments can be made that the NSA will reduce contribution.

A. *Contrary to NAA's and GCA's Contention, The Savings From Electronic Returns Provides a Significant Margin For Error.*

In its brief, NAA states, "the Postal Service's estimated net benefit leaves relatively little margin for error." NAA Brief at 18.[2] Not only is this contention mistaken, it is also contrary to the testimony of its own witness. In response to a question posed at the hearing, NAA witness Kent calculated that the agreement would be approximately contribution neutral even if the cost savings from the agreement were 64 percent less than estimated by the Postal Service. Tr. 10/1967F. In other words, even if the cost savings were 7 cents per electronic return, 13 cents below the Postal Service's cost savings estimate of 20 cents, the agreement would still be approximately contribution neutral. As we discussed in our initial brief, Capital One Brief at 19, one benefit of combining declining block rates with electronic returns is that the savings from electronic returns provides a enormous margin for error, not (as suggested by NAA) a "little margin."[3]

Furthermore, NAA witness Kent's calculation of the 64 percent figure was based upon Capital One's initial Test Year Before-Rates volume forecast of approximately 1.4

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[2] GCA's brief makes a similar erroneous contention by describing the net benefit forecast as "relatively thin." GCA Brief at 23.

[3]The significant margin for error also renders the exclusion of transaction, performance monitoring, and disposal costs unimportant (GCA Brief at 20, 22) since there is no credible evidence on the record that these costs could even make a dent in the cost savings.

billion First-Class Mail pieces. Capital One's revised volume forecast (which was based upon more recent data) indicates that its before-rates volume will be close to the threshold of 1.225 billion pieces (Tr. 9/1843-1844)[4] and the declining-block rate portion of the agreement will break even on its own.[5] Therefore, the Capital One NSA will increase contribution as long as the NSA does not increase Postal Service costs. Not even opponents of the agreement have argued that the NSA will increase Postal Service costs.

B. *Using Reasonable Proxies to Determine That the Postal Service Will Benefit From This Agreement Is Appropriate.*

In out initial brief, we explained why the use of non-mailer-specific proxies is reasonable and replied to specific criticisms raised by NAA witness Kent regarding the Postal Service's unit cost estimates. Capital One Brief at 11-15.[6] Therefore, we simply

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[4]Despite its concerns about Capital One's Test Year mail volume forecast, even GCA concurs that the lower-than-originally-estimated volume forecast is likely, stating that it "now appears likely [that] COS will mail substantially less than originally thought." GCA Brief at 24.

[5]Contrary to NAA's contention (NAA Brief at 10), it is quite likely that (based upon the revised volume forecast) the declining block rate portion of the agreement will generate a positive contribution since these rates will encourage volume growth (and therefore contribution growth) with minimal (if any) revenue leakage to existing volume. This also shows that GCA is mistaken in its contention that "the proposed discounts could serve to reduce, not enhance Postal Service net revenues." GCA Brief at 19.

[6]We would, however, like to extend our rebuttal on one point. NAA witness Kent contends that the Postal Service understated the cost of the eACS component of electronic returns by using an average of the cost of the ACS COA notification operation and of the ACS nixie processing operation. NAA Initial Brief at 24. We rebutted this point on pages 11 and 12 of our initial brief and, in fact, noted that the Postal Service actually overstated this cost. Here, we simply make two additional points. First, the most appropriate way to develop a proxy for the eACS cost of processing Capital One's returns is to determine which operation is most similar to the eACS process that the Postal Service will use to process Capital One's electronic returns, not to try to determine which operation title seems most applicable. In this particular situation, the most similar operation is the ACS COA notification process because it is a mechanized operation that is similar to the operation that USPS witnesses Wilson and Plunkett anticipate for Capital One's electronic returns. USPS-T-4 at 5; Tr. 9/1959-1960. In fact, as testified by USPS witness Plunkett, the mechanized operation anticipated for Capital One's electronic returns is expected to be somewhat less costly than that for forwarded mail since fewer keystrokes are required. Tr. 9/1872. Second, in attempting to rebut witness Plunkett on this issue, NAA contends (NAA Brief at 24) that it seems unrealistic that 42 percent of UAA mail is processed on non-mechanized terminals (apparently since many UAA pieces are compatible with mechanization). We disagree. It is not surprising that a small portion of UAA mail that can be processed on mechanized terminals will be processed in a non-mechanized manner (just as not every one of Capital One's returns will be processed electronically under the agreement), which would tend to increase the

note here that the use of non-mailer-specific proxies is even more appropriate when there is a significant margin for error (as discussed above).

For example, a concern raised by Val-Pak about the Postal Service's cost estimate for physical returns is that "Richmond's automated sorters [may] segregate all of Cap One's Non-forwardable UAA Mail into a dedicated bin (or bins) on a single pass, which would avoid an incoming secondary sortation and therefore be less costly than the average handling procedure." Val-Pak Brief at 24. This concern is unimportant because even if it were the case, it would not cause the agreement to reduce contribution. This is because avoiding an automated sort saves a penny or less, Docket No. R2001-1, USPS-LR-J-60 at 29, much less than the margin for error discussed above.

While the Postal Service did make adjustments for known differences between the process for returning First-Class Mail in general and Capital One, Tr. 2/328, the significant margin for error allows the Postal Rate Commission to determine that the agreement will increase the contribution that Capital One makes to institutional costs without knowing every difference in process.

C. *NAA's and GCA's Interpretations of Dr. Panzar's and Dr. Eakin's Economic Testimony Are Mistaken.*

NAA's brief presents a several-page discussion of Dr. Panzar's testimony, which ends by stating, "Professor Panzar's testimony suggests that the only situation in which NSAs with postal business customers theoretically might benefit the public interest

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proportion of UAA mail processed in a non-mechanized manner somewhat. The Postal Service accounts for this fact in its financial calculations by using the $0.145 cost for the eACS component of electronic returns, thereby implicitly assuming that 42 percent of Capital One's electronic returns will be processed on non-mechanized terminals. We expect the actual percentage of Capital One's electronic returns that will be processed in a non-mechanized manner to be much lower. Therefore, the Postal Service's use of the $0.145 cost is quite conservative.

would be where the Postal Service enters into NSAs with every firm that competes in the same market." NAA Brief at 33. This is a complete mischaracterization of Dr. Panzar's position on NSAs.[7] Dr. Panzar, in fact, stated that he supports NSAs in general and, while not evaluating the financial calculations underlying the proposed NSA, thought its logic made sense, stating:

> I, in general, support NSAs … I am quite pleased to see the issue of NSAs in general being considered by the Commission and evaluated…. Without commenting on the numbers, the logic of [this NSA] seems to generate an improvement by avoiding sending returned material that Capital One doesn't want. Tr. 8/1771-1772, 1786.

GCA noted in its brief that Dr. Eakin (at Tr. 10/2109-2116) conceded that "competitors may react to the NSA by reducing their communications or shifting them to non-postal media." GCA Brief at 11.[8] While Dr. Eakin did state that he "can't right now say no [to the contention that competitors might reduce their communications], that it's not possible, but I do believe it would be a very unusual case," Tr. 10/2114, this is not much of a concession. In fact, two other times during this line of examination, he noted that this scenario was quite improbable, calling it "an unlikely case" (Tr. 10/2111) and "a very unusual case" (Tr. 10/2113).

[7] Furthermore, while Dr. Panzar did state that one cannot presume that NSAs for inputs are beneficial, Dr. Panzar argues that there should also be no automatic presumption that they are harmful. Rather, he noted that whether such an NSA is beneficial or not is an empirical question and can be examined through the type of analysis that is typically performed in rate proceedings. Tr. 8/1589. He further advocated use of the type of bounding analysis put forth by Mr. May to analyze the impact of interdependence of demands. Such analysis shows that (even in a worst case scenario) interdependence will not cause this NSA to reduce contribution. Tr. 8/1705-1709, 1774, 1785.

[8] In the same section of its brief, GCA cites Dr. Panzar's cross examination (Tr. 8/1666-1667) in arguing that "[i]t is likely that 'non-NSA' participants in the relevant market will react to a perceived cost advantage bestowed on one of its competitors by seeking offsetting economies elsewhere." GCA Brief at 10-11. This is not an accurate summary of the cited portion of Dr. Panzar's cross examination. Rather, on the referenced pages, Dr. Panzar argued that it is possible that competitors of the NSA firm may lose market share and therefore mail less. This potential issue, which (even in a worst-case scenario) will not cause the agreement to reduce contribution, is addressed in detail in Section III.E. of our initial brief. Capital One Brief at 20-22.

Dr. Eakin also noted that the more likely response of Capital One's competitors to Capital One increasing its solicitation mailings[9] would be to "undertake a solicitation effort of their own." Tr. 10/2115. This is because "[i]f it were [more profitable for competitors to reduce communications], they would have done it already regardless of the Capital One NSA." Tr. 10/2116. Dr. Panzar agrees with Dr. Eakin on this point and further noted that competitors undertaking solicitation efforts in response to Capital One's increase in solicitation mailings would increase the NSA's contribution, not reduce it:

> You could imagine the situation where as a result of the rivalry between the NSA firm and its competitors more postal services were consumed by both parties. So obviously that modifies my conclusions because in those cases then one doesn't need to worry about the profitability of the -- profitability loss from the impact on competitors. It would actually reenforce the main contribution effect. Tr. 8/1788-1789.

D. *Val-Pak's Contention That Other Mailers of First-Class Mail May Reduce Their Purchases of Address Correction Services Due to the NSA Is Contrary to Economic Theory.*

In its brief, Val-Pak contends, "some – perhaps many – First-Class mailers may feel that forcing them to pay 20 cents for each electronic return while (i) not charging Cap One for electronic returns, and also (ii) giving Cap One a further rebate via a declining block discount, is treating them unfairly. The feeling of unfairness may cause some – perhaps many – of these other mailers to resist adopting the more efficient and less costly electronic return service. When evaluating the benefits of the NSA, all losses

[9] Note that solicitation mailings, not all Capital One mailings, were the subject of the cross examination of Dr. Eakin at Tr. 10/2109-2116.

from ‘failure to adopt’ **because of resistance created by the Cap One NSA** must be offset against any gains derived directly from the Cap One NSA.” Val-Pak Brief at 39.[10]

Put into economic terms, Val-Pak contends that the Postal Service should account for the possibility that profit-seeking businesses will "fail to adopt" profit-maximizing behavior. The suggestion that companies would fail to adopt a behavior that would improve their profitability is contrary to basic economic theory. Although individuals may sometimes cut off their nose to spite their face, it strains credulity to suggest that a profit-seeking firm will turn down a good deal just because another firm received a slightly better one. In analyzing this NSA, the Commission should presume that firms will behave like rational profit seekers rather than petulant schoolchildren.

E. *The NSA Will Increase Contribution Not Only in the Test Year, But Also Over the Duration of the Agreement.*

NAA contends that it is inappropriate to evaluate the financial impact of an NSA based upon one Test Year. NAA Brief at 21. While, for the reasons we discussed in our initial brief, Capital One Brief at 33-34, we disagree, any reasonable analysis of the financial impact of the NSA over the duration of the agreement would show that the agreement increases contribution. As the Postal Service found in its sensitivity analysis, the agreement will increase contribution over the duration of the agreement even if Test Year Before Rates volume is approximately 1.4 billion pieces and Capital One’s Before Rates volumes grew at a rate of 15 percent per year over the duration of the agreement. Tr. 5/962, 965. Capital One’s Test Year Before Rates volume and outyear growth rate will be lower.

[10] GCA similarly contends that the NSA may cause mailers to not remedy mailing problems “even when a self-initiated remedy would work to the mailer’s net benefit.” GCA Brief at 11.

As estimated by Dr. Elliott, Test Year Before Rates volume will be near the volume threshold. Tr. 9/1843-1844. Furthermore, trends in Capital One's First-Class Mail volumes suggest that growth will be substantially below 15 percent. First, the trend in Capital One's First Class Mail solicitations is downward. Tr. 9/1841, 1854-1855. Furthermore, the growth in Capital One's customer mail volume has recently dropped significantly, suggesting lower future growth rates. Tr. 9/1841.

NAA also is concerned that the implementation of PARS will reduce the outyear savings from the agreement. NAA Brief at 20. This concern is misplaced. First, PARS will only process one-third of pieces in FY 2005 (and only about one-quarter of these pieces will be intercepted before the DDU[11]) and less in FY 2004. Tr. 5/891. Second, as Postal Service witness Plunkett noted upon cross examination, the implementation of PARS is only expected to have a minor impact (which may be positive or negative) on the savings from electronic returns. Tr. 4/778-780.[12]

IV. The Fee Waivers Were Appropriately Excluded From the Evaluation of the Impact of the NSA on Postal Finances.

In its brief, NAA stated, "The fee waivers should be included in the cost of this NSA to the Postal Service" because "the waived fees are lost revenue from the arrangement in the contract." NAA Brief at 25. NAA is mistaken because the fees do

[11] Note that intercepting UAA mail at origin facilities before the DDU (and before the destination sectional center facility) is the source of the savings from PARS. Furthermore, the percentage of Capital One's UAA mail that will be intercepted early will likely be much lower since "[o]ne main feature of Capital One's mail, of course, is that it is presorted and is sent to destination and opened at destination before it is run across any or our automated equipment, which negates the ability of the PARS system to capture the that mail at origin." Tr. 4/779.

[12] On a related note, GCA contends that if PARS reduces costs, the savings from electronic returns will automatically be reduced. GCA at 21, Footnote 46. This contention is mistaken. As USPS witness Plunkett notes, PARS will affect both the cost of physical returns and electronic returns. Tr. 4/778-780. Therefore, the implementation of PARS could theoretically increase or decrease the savings from electronic returns.

not represent lost revenue. As suggested by Dr. Panzar, the agreement should be evaluated by comparing the situation that would occur under the agreement with the situation in the absence of the agreement. Tr. 8/1786.

Following Dr. Panzar's advice, one should not include revenue from eACS fees in either side of the equation because Capital One will not pay these fees regardless of whether the agreement is implemented. As noted by Capital One witness Jean, Capital One does not currently participate in the ACS program. Tr. 2/83. Further, Capital One will not pay them in the absence of the agreement. This is because, as discussed by USPS witness Plunkett, paying for eACS simply is not a cost-effective alternative for Capital One and other large First-Class mailers: "if they were subscribing to that service today, they would incur millions of dollars in additional costs. They have been able to identify what is in their minds an appropriate substitute at much lower cost. I think as has also been stated, that appears to be typical." Tr. 9/1873-74.

The fact that, as discussed by USPS witness Plunkett, Capital One's behavior is typical for large First-Class mailers provides further confirmation that it is reasonable that Capital One will not pay for eACS in the absence of the agreement, eliminating NAA's concerns about "asymmetric information." NAA Brief at 25.

V. Capital One's Solicitations Are Low-Cost, High-Contribution Solicitations.

In their briefs, intervenors criticized this NSA as rewarding a mailer for engaging in high-cost behavior. Val-Pak Brief at 36; NAA Brief at 14. This is not a reasonable characterization of this NSA. In fact, Capital One mails its solicitations in a way that produces a much higher-than-average contribution for solicitations.

While it is true that Capital One's return percentage for solicitations is higher than the average for First-Class Mail, this is due to the nature of solicitations, not due to poor address hygiene practices. Capital One Brief at 23-25. For this reason, Capital One's return rate is likely to be equal to or less than that of other solicitations mailed at First-Class Mail rates.

Furthermore, given that address correction service is not a cost-effective alternative for large mailers of First-Class Mail (as discussed by USPS witness Plunkett), the only option (other than this NSA) for reducing Capital One's return rate would be for Capital One to mail these pieces at Standard Mail rates. This would be a terrible outcome for the Postal Service because, as discussed in our initial brief, it would reduce contribution to institutional costs by $36 to $53 million. Capital One Brief at 27. Dr. Panzar agreed that an economist would not advocate such a solution,

> **Q** Let me give you a hypothetical. Assume that the Postal Service would lose $50 million in contribution in institutional costs through [Capital One converting its First-Class Mail solicitations to Standard Mail]. Would an economist advocate that solution?
>
> **A** Probably not. Tr. 8/1700.

Therefore, the NSA is not, as suggested by others, rewarding a high-cost mailer for improving its behavior. Rather, it is a mutually beneficial way to reduce the cost and increase the contribution of already low-cost, high-contribution solicitation mailings.

VI. Migration of Standard Mail to First-Class Mail Would Increase the Financial Benefit of the Agreement to the Postal Service, Not Decrease It.

In its brief, NAA states, "The Postal Service's analysis does not consider any possible losses of contribution if COS were to shift mail from Standard to First-Class Mail in order to reach the discount threshold." NAA Brief at 28. While it is true that Dr. Elliott projected no migration from Standard Mail to First-Class Mail due to the NSA and Capital One witness Jean stated that there will be no significant migration (Tr. 2/66), if such migration were to occur, it would increase the financial benefit of the agreement to the Postal Service, not decrease it. This is because the unit contribution of Capital One's solicitations that are mailed as First-Class Mail is significantly higher than it would be if those solicitations were mailed at Standard Mail rates. In fact, USPS witness Plunkett calculated that the unit contribution of Capital One's First-Class Mail solicitations was approximately seven cents more than its Standard Mail solicitations, 15.5 cents versus 8.6 cents. Tr. 9/1865.

VII. NAA, Val-Pak And GCA Claims Of Undue Preference Contrary To §403(c) Are Ill-Founded.

A. *The Capital One Deal Is Available On the Same Terms To Other Mailers.*

NAA claims that the NSA violates Section 403(c) because it is not available on the same terms to other potential users; that no one else can get the Capital One deal. NAA Brief at 29-30. NAA is simply incorrect. The classification proposal, as amended in the settlement with the OCA, explicitly calls for comparable NSAs to be entered into and implemented pursuant to Chapter 36 proceedings; and the Postal Service has provided the regulations that it intends to issue spelling out the procedures for similarly situated mailers to get the Capital One deal, if they meet the same terms and conditions as Capital One, and if the negotiated deal is found by the Postal Rate Commission to meet those conditions and to make the requisite contribution to overhead. The NAA complains that in order to get a similar deal as Capital One has, the mailer would have to go through the Postal Rate Commission. *Id.* at 30. It seems a strange contention that, because a mailer must seek the approval of the Postal Rate Commission, this somehow violates Section 403(c). Clearly, the Postal Service is not allowed to determine with finality on their own who is and who is not eligible for a negotiated service agreement. These NSAs are not like the international service agreements that were involved in the case of *UPS Worldwide Forwarding, Inc*. v. *United States Postal Service*, 66 F.3d. 621, (3rd Cir. 1995), cited by NAA. NAA Brief at 30. In those agreements there was no Postal Rate Commission to see that similarly situated mailers were treated equally.

B. *The Uniqueness of Capital One Does Not Create Discrimination As Asserted By Val-Pak.*

Val-Pak objects that this agreement seems to have been reached because there is something "unique" about Capital One. Almost by definition, the reason to have an NSA, rather than a niche classification, is that, to the best of the Postal Service's knowledge, the problem sought to be solved and the opportunity presented is unique to a particular mailer and is not perceived to be the circumstances of a number of other mailers. On the other hand, the proposed classification would allow any similarly situated mailer to demonstrate that they meet the conditions and terms of the classification that implements the agreement, and apply for and get their own. More particularly, the procedures spelled out in the Postal Service's intended regulations provide for a procedure for Capital One's competitors to get either the same deal, if that works for them, or to fashion their own agreement that is tailored to what may be their own unique circumstances. In fact, the Postal Service has been in discussions with all of the large competitors of Capital One about their own NSA. Tr. 9/1889-1890. Even more important, not a single competitor of Capital One has intervened in this proceeding to complain about this deal or to complain that undue preferences were being given. On the contrary, these mailers want to negotiate their own deal.

Val-Pak belittles the OCA's efforts to ensure fair and equal procedures for other similarly situated mailers. We disagree; we think that the OCA has made a real contribution in the changes they have negotiated. On the other hand, although it has not joined in the settlement, GCA does believe the OCA settlement incorporates improvements, that "it represents an ingenious and thoughtful effort to mitigate at least some of the fairness concerns that are inherent in any single-mailer NSA without discarding the NSA approach altogether." GCA Brief at 26.

C. *GCA's Brief Betrays A Misunderstanding Of the Different And Legitimate Uses Of NSAs And Niche Classifications.*

GCA persists in believing that we cannot have both NSAs and niches; this follows from their mistaken belief that no mailer is unique in its mailing circumstances and in the opportunity it presents for economies. GCA Brief at 8-12. No one disputes that if the Postal Service knows that there are 20 or 50 mailers all of whom have the same characteristics that would lend themselves to a niche classification, then that is the way to go. If there had been 20 Capital Ones who made extensive use of First-Class Mail for solicitations, and were sufficiently large to comfortably absorb the transaction costs of the negotiation, then a niche classification would have made sense. But, given the benefits both to the Postal Service, to Capital One and to other stakeholders, it seems perverse to argue that, because the Postal Service could not find 19 other mailers like Capital One, that it should not do the deal with Capital One.

VIII. Unlike Val-Pak's Unbundling Proposal, The Capital One NSA Is A Good Solution To Capital One's UAA Mail, And Is Not Unfair, As Argued By Val-Pak And NAA.

A. *Unbundling Return Service Is Not A Workable Solution.*

Val-Pak argues that the NSA is an inappropriate way for the Postal Service to deal with the system-wide problem of undeliverable as addressed mail; that the Postal Service, rather, should have withdrawn the NSA and should have convened a classification proceeding to deal with the overall problem of returns. The Val-Pak Brief naively supposes that there is indeed a solution to the UAA problem, other than better address hygiene. The Val-Pak solution is to unbundle the services of both electronic and physical returns of Bulk First-Class Mail and separately charge Bulk First-Class mailers for those services. Val-Pak Brief at 16-17. Val-Pak does not explain why single piece First-Class mailers should continue to have their mail physically returned for free, particularly since there is no evidence that single piece mailers have a lower incidence of UAA mail than do Bulk First-Class mailers, certainly not on this record. On the contrary, the general understanding is that because Bulk Mailers are required to engage in rigorous address hygiene practices such as NCOA, and single piece First-Class mailers are not, there are more deliverable addresses for Bulk First-Class mailers. Consequently, it would on its face seem to be an unfair practice to charge Bulk First-Class mailers for a service that single piece First-Class mailers get for free, when there is a real probability that the single piece First-Class mailers impose, on a per piece basis, a higher cost burden to the Postal Service for their returns.

Contrary to the Val-Pak suggestion, there is no ready-made “solution” to the costs incurred by the Postal Service for providing one of the very valuable services of First-Class Mail - physical returns of UAA mail. One of the reasons that mailers are willing to pay more for First-Class service than for Standard is that service encompasses both forwarding and return. It is well documented that whatever the costs of the forwarding and return features are for First-Class Mail, the contribution made to institutional costs by First-Class compared to the contribution made by Standard Class Mail dwarfs the cost of such services.

Any proceeding that would seriously consider the unbundling of such services as return information and forwarding should weigh very carefully the consequences to volumes and revenues of USPS’ most profitable class of mail.

On the other hand, while there is no “solution” as such to the costs of returns, there indeed is an immediate solution at hand for the Postal Service to avoid the costs that it incurs in the processing of Capital One First-Class Mail because of the high number of returns for its First-Class solicitations, despite the fact that the record shows their address hygiene is exemplary. USPS-T-2 at 5. This is exactly what an NSA is designed for: to hand-tool a solution to a particular mailer’s problems and unique mailing characteristics, where a broader solution applicable to other mailers is not readily evident or available.

B. *Free eACS Service Under The NSA Is Not A Reward For High Returns And Is Not Unfair To Other Mailers.*

Val-Pak contends that rewarding Capital One for the fact that it has a high percentage of UAA returns is unfair to other mailers. The Val-Pak argument implicitly assumes that Capital One has a choice: that Capital One could improve its address hygiene and significantly reduce its UAAs for its solicitation mail. The evidence in the record is quite to the contrary: Capital One employs exemplary address hygiene, achieving certification that no other list mailer has USPS-T-2 at 5; their NCOA usage is already greater than that required of any other First-Class mailer; and the mandatory imposition of a 20 cent electronic address correction fee would simply cause Capital One to convert its First-Class solicitation mail to Standard Mail with the consequent loss of between $33 million and $56 million. Tr. 9/1873-74.

To suggest, as does Val-Pak, Val-Pak Brief at 36, that providing free electronic return service to a mailer such as Capital One is unfair to a mailer that does not have high returns is preposterous on its face. On the contrary, the mailer who has few returns is benefited by the provision of electronic notification to Capital One because it eliminates a significant cost from the pool of costs being charged to other First-Class mailers, including the First-Class mailer who has relatively few UAA pieces.

C. *The Possibility Of Future Proceedings To Solve The UAA Problem Is Not A Reason To Reject The Benefits Immediately Available From This NSA.*

Under the current classification system, all First-Class Mail has, in modern times, received free physical returns and free forwarding as an essential aspect of First-Class service. For many reasons, some statutory, First-Class is composed of widely differing cost-behaving types of mail, much of which goes at a uniform rate. To the extent that some of these standard services could be unbundled and separately charged for lawfully, that is a substantial policy question that the Postal Service and the PRC may wish to explore in the future. That possibility is no argument against the approval of the Capital One NSA, which holds out the immediate promise of making a contribution to Postal Service overhead with the prospect that no other mailer will be unfairly disadvantaged in seeking its own deal.

IX. The NSA Volume Discounts Are Not Unreasonably Discriminatory, As Contended By Val-Pal and NAA, Merely Because They Are Not Based On Work-sharing Cost Avoidance.

A. *Volume-Based Discounts Are Not Per Se Violative Of The Act.*

Val-Pak contends that the declining block discounts are not being granted because of any increased contribution to be expected from the discounts, but rather as a reward for the exchange of electronic returns for physical returns. Val-Pak Brief at 21.

Seeming to contradict itself, Val-Pak argues that the Commission cannot approve volume discounts based solely on high volume, stating that approach "would be viewed as implementing a non-cost-based quantity or volume discount, and since passage of the Postal Reorganization Act it has been commonly agreed that such discounts are prohibited." Val-Pak Brief at 34-35. This appears to contradict Val-Pak's earlier statement that it does not believe declining block discounts are prohibited by the Act and moreover that "they could be a useful device for encouraging and rewarding increased mail volume and increased contribution to Postal Service overhead." Val-Pak Brief at 19. Additionally, the assertion that for some thirty years, it "has been commonly agreed" that volume discounts are prohibited is devoid of any authority. Notably, Val-Pak fails to cite even one Commission decision or court case to support its contention that there is such "common agreement". While it may be the case that most discounts in the past have been work-sharing discounts where the discount was exchanged for the avoidance of cost because the mailer performed a postal handling, there has never been any decision that discounts cannot be granted for additional volume where it can be demonstrated that such additional volume was influenced by the discount and that the additional volume increased contribution to overhead.

NAA argues that volume discounts are, in the absence of cost savings, an unreasonably discriminatory violation of Section 403(c), citing the Commission's decisions in Docket R87-1[13] and Docket R-90-1[14], where the Commission rejected non-cost-based volume discounts for express mail. In both of those cases the Commission's reasoning was grounded in the Postal Service's marketing justification for the discounts, that is, in order to meet competition, and the Commission's misplaced concern for Express Mail competitors. At the time of both of those decisions, First-Class Mail volumes continued to grow without any signs of faltering. The Postal Service was not faced with the prospect of a continuing decline in First-Class volumes and the destruction of the largest single source of contribution to institutional costs.

It appears that the Postal Rate Commission will sooner rather than later have to make a policy decision whether it wishes to approve certain volume-based discounts in classes of mail which are threatened as a justifiable means of either retaining those volumes or increasing them. The Commission need not reach that issue in this case.

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[13] Rate and Fee Changes *Docket No. R87-1, Opinion and Recommended Decision, 747,¶ 6020 (March 4, 1988)*
[14] Rate and Fee Changes *Docket No. R90-1, Opinion and Recommended Decision, V387, ¶ 6533 (January 4, 1991).*

B. *The Capital One NSA Generates Cost-Savings As A Cushion For Volume Discounts.*

The NSA under consideration is not three or four different NSAs; it is one NSA and each of its constituent parts are equally significant to the agreement. Consequently, because of the Postal Service's agreement to grant volume discounts as one of the considerations for entering into this agreement, Capital One has agreed to relieve the Postal Service of an obligatory service requirement thereby saving it far more monies in cost avoidance than the revenue it will lose from discounts. In that sense, this NSA meets the enunciated test that NAA wishes to impose, i.e. that volume discounts must be justified by "solid evidence of cost savings". NAA Brief at 9.

There is always the risk inherent in a pure volume discount that the discount will end up being given for mail that would have materialized in any event, in which case, there is not an increased contribution but a reduced contribution to overhead. What is significant about the Capital One agreement is that, not only is the discount threshold set at a level which is reasonably certain to preclude any significant "free rider" problem, but to the extent that it does, to the extent that discounts are given for some volume that would have materialized anyway, the other parts of the agreement have created sufficient amounts of savings for the Postal Service to afford to take that risk without suffering a loss of contribution to overhead. That is why in this particular NSA these two parts are quite logically related and one of the reasons they are indispensable to each other.

C. *The Difference Between Work-Sharing And Cost-Avoiding Discounts Is A Distinction Without A Difference.*

This agreement will directly afford the Postal Service many millions of dollars of cost avoidance in its handling of Capital One's First-Class Mail. The only difference between these discounts and the more customary work-sharing discounts the Commission routinely approves is that nothing like 100 percent of the cost savings is being passed along in the form of discounts.

X. GCA's Contention That An NSA Cannot Include More Than One Element Because Other Mailers May Only Be Able To Qualify For One Element Is Unsound Logic, And Bad Postal Policy.

The GCA argues that NSAs should not combine independently usable but unrelated elements, such as electronic address correction in lieu of physical returns and declining block rates. Its objection this time proceeds from the false assumption that the parties would be willing to negotiate separate deals for the individual elements. GCA Brief at 14-15. But GCA does admit that an agreement combining two such elements would be

> "distinguished from the quite different circumstance of one party 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 eACS absent the provision for declining blocks 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." GCA Brief at 15.

Apparently, the GCA is unaware that Mr. Plunkett testified under oath that he made exactly that proposal to Capital One and Capital One said they were not interested in a deal that only involved the swapping of eACS for physical returns, but rather insisted that the deal also include volume discounts. Tr. 4/848. So, the GCA Brief is simply mistaken when it says: "On this record, however, no such evidentiary showing has been made." GCA Brief at 15. GCA continues in its error by arguing that, since the new ACS option 2 service is available, and the NSA was entered into before it became available, the record does not let us know "whether and to what extent [Capital One] would join 819 other mailers (Tr. 3/571) in using it, absent the NSA. *Id.* at 16. There were not 819 mailers using Option 2 at the time that testimony was given. The 819 mailers are those who were provided the old ACS service for a 20¢ fee in 2001. The grand total volume of pieces receiving ACS were 2,783,320 pieces, an average of 3,398 pieces per participating mailer. Revenues were less than $600,000. (Tr. 3/571). Clearly, this was a little used service by a relative handful of mailers. Paid eACS service was and is doomed as a solution to the UAA problem. The 20¢ fee that was charged then and would be charged for Option 2, absent the NSA, is a service and fee that Mr. Plunkett said Capital One would not use and would not pay. Tr. 4/847, 9/1873-74.

GCA argues that it is unjust discrimination to couple these two provisions together in the same agreement because it would preclude another mailer, who could only use one of the two elements, from being able to get a deal involving just one element. GCA Brief at 17-18. There is no evidence in this record that the Postal Service is willing to take the risks of giving volume discounts to mailers where there is no prospect of the mailer undertaking to do something or foregoing some service that will result in substantial cost savings for the Postal Service. Nor is there any evidence that the Postal Service is interested at this point in giving free eACS service to all First-Class mailers, or even to all large First-Class mailers who do not use First-Class Mail for solicitation purposes. In fact, the Postal Service's testimony was that it was not ready to entertain such a proposal because it had not fully studied the consequences and effects of providing free eACS service to First-Class mailers who had low percentage returns. Tr. 3/487. No such data exists as it does about the value to the Postal Service of trading free eACS to Capital One for physical returns. Those savings are well documented in this record.

XI. NAA'S Arguments About Lobbying And The Simplicity Criterion Border On Silliness.

A. *NAA's Argument That negotiating NSAs Is Akin To "Lobbying" Is Absurd And Inaccurate.*

NAA faults NSAs because they are dependent upon the negotiating skills of the participants, characterizing such negotiations as "lobbying", as though everyone will understand that term in the pejorative sense. Stealing a page from an old United Parcel Service filed comment, it claims that "lobbying and influence" would reappear if the Postal Service could negotiate with anyone it wants. NAA Brief at 11-13. This is so far fetched that it merits no response except to note that negotiating results are no more influenced by "lobbying" than are rates issuing from a general rate proceeding by skilled lawyers and economists. More particularly, the NAA seems to forget that, unlike the "old days" to which NAA fears we may return, there is now a Postal Rate Commission to make sure that, if there is "lobbying", the fruits of those efforts will be beneficial to all stakeholders, not just the big, bad, special interests so feared by the newspapers, which, of course, are not a special interest.

B. *The Capital One NSA Does Not, As Contended By NAA, Contravene The Simplicity Criterion of §3622(b).*

In what has to stand as the most simplistic reading of the meaning of the simplicity criterion, NAA seems to argue that one must count the number of pages a classification and rate change takes to determine whether it accords with the criterion of simplicity in the rate structure. NAA says that since the NSA adds three pages to the DMCS it fails the simplicity test. Obviously, the meaning of criterion 7 has little to do with counting the number of pages in a change. For authority, NAA cites the *United Parcel Service* case, supra, p.1, where there is language about proliferating special rates for every cost savings no matter how small the group. NAA Brief at 15. Clearly, the Capital One NSA is not the creation of a special rate for a tiny part of the mailstream. This is a new classification and rate which could affect as much as 1% of the entire First-Class mailstream, bearing in mind the anticipated billion plus pieces of First-Class Mail Capital One is predicted to mail.

CONCLUSION.

After a lengthy hearing process this proceeding has established substantial evidence that the Capital One NSA will make a net contribution to institutional costs, and help sustain and increase First-Class Mail volumes. The record also shows Capital One is receiving no undue preference; that Capital One's competitors have not complained of unfairness, but, rather, are seeking their own deal; and that, particularly with the OCA changes in the stipulated settlement, there are fair and reasonable opportunities for other mailers to seek NSAs.

The Capital One NSA is a good first effort at negotiated service agreements. It comports with the strictures of the Act; will lead to modernization of business methods by the Postal Service; and reflects sound postal policy. The Commission should recommend its adoption.