

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

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

DOCKET NO. MC2002-2

**REPLY BRIEF
OF THE
NEWSPAPER ASSOCIATION OF AMERICA**

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The Newspaper Association of America (“NAA”), by its attorneys, hereby respectfully submits its reply brief in this proceeding.

In its initial brief, NAA demonstrated that the United States Postal Service’s proposal to give unique volume discounts and fee waivers to a single favored customer pursuant to a negotiated service agreement – one for which there are no published, objective criteria by which any other mailer could obtain the same rates -- is inconsistent with the Postal Reorganization Act. In addition, even if the NSA were otherwise lawful, which it is not, NAA also showed that the Postal Service had failed to prove that this NSA meets the standard articulated by this Commission.

Despite the shortcomings of the NSA approach, NAA pointed out that one positive development from this proceeding is that the Postal Service has apparently realized that there is a serious irrationality in its pricing of physical and electronic returns of Undeliverable As Addressed (“UAA”) First-Class Mail that gives rise to unnecessary costs by many First-Class mailers, not merely Capital One. NAA urges the Commission and the Postal Service to work on correcting this issue in a manner that allows First-Class mailers generally to participate in the cost-reducing solution, rather than the selective and piecemeal approach embodied in this NSA.

In general, NAA's initial brief addressed most of the issues raised in the briefs of other parties. NAA sees no need to respond to the policy arguments made by several initial briefs in support of NSAs, which are more properly addressed either to the Congress of the United States or to the President's Commission on the United States Postal Service.¹ NAA does, however, wish to address several points in certain parties' initial briefs that it has not previously addressed.

I. THE CAPITAL ONE NSA VIOLATES THE POSTAL REORGANIZATION ACT

In its initial brief, NAA demonstrated that negotiated service agreements, and this one in particular, are inconsistent with the Postal Reorganization Act. In particular NAA showed that:

- NSAs are incompatible with the structure of the Act, which presupposes that the Commission actively recommend rates, not passively review a deal previously negotiated between the Postal Service and a large customer, a fact that the Commission recognized in its rejection of contract rates in 1989;
- the NSA's volume discounts and fee waivers unreasonably discriminate in favor of Capital One to the detriment of other mailers, in violation of Section 403(c);
- the NSA improperly would substitute negotiating skill for the substantive criteria of the Act;
- NSAs would violate the "simplicity of rate structure" requirement of Section 3622(b)(7); and

¹ Capital One wrongly contends that NAA is a "competitor" of the Postal Service. COS at 3. NAA's members do not compete with the Postal Service. Indeed, they make major use of postal services. What they do compete with is other advertising media, including other mailers. NAA members firmly believe that the federal government has no legitimate interest in favoring some mailers over others in that downstream competitive market. Furthermore, NAA understands that anyone who mails can be hurt by poorly negotiated NSAs, and, as the testimony of National Newspaper Association witness Jeff David illustrates, it is likely not the smaller mailer that will enjoy the benefits of NSAs.

- the NSA’s volume discounts and fee waivers unfairly and inequitably rebate to a large mailer cost savings purportedly arising from its taking of certain mail hygiene steps for which other mailers pay.

For the most part, these points were not addressed in the initial briefs of other parties, so presumably they will address these issues on reply. However, NAA does wish to respond to certain other contentions that it has not previously addressed.

First, NAA urges the Commission to resist suggestions that it apply some lesser standard of review because this NSA may be regarded as an “experiment.” Such contentions are misplaced, as there is no “experimental” exception in the Act. See *United Parcel Service v. United States Postal Service*, 604 F.2d 1370, 1380 (3d Cir. 1979).

Second, the assertion by ANM *et al.* (at 9) that the criterion in Section 3623(c)(3) (the importance of classifications with extremely high degrees of reliability and speed of delivery) supports the NSA deserves no weight. That criterion refers to expedited services such as Express Mail and Priority Mail; it provides no support for an NSA that enables a First-Class mailer to reduce its return and forwarding rates by obtaining electronic address confirmation services for no charge, while other mailers must pay a fee for the same information and similar reductions in returns.

Third, ANM *et al.* suggest, but do not strongly argue, that the “other factors” language in Section 3623(c)(6) may provide a legal basis for the Commission to accept an NSA. ANM *et al.* at 9. Such “other factors” language cannot trump the more direct language in the Act, as well as its fundamental structure which, as NAA outlined in its initial brief, simply does not provide room for NSAs.

Fourth, as several proponents recognize, the rate provisions of Section 3622(b) apply to this case. These provisions are independent and cannot be conflated to an

inquiry as to whether the NSA would result in positive “net contribution” to the USPS.² ANM *et al.* at 9; OCA at 8 (whether NSA would generate “additional contribution” one of its two concerns). “Increasing contribution” – however desirable – is not itself a substitute for the specific considerations that Congress prescribed in Section 3622(b).

Finally, several parties contend that the NSA, at least as amended by the proposed “settlement,” is fair to others because the Postal Service has expressed a willingness to discuss a similar NSA with other credit card companies, with a view to having any successful negotiation formalized in yet another similar, but different, NSA to be presented to this Commission.³ Not so. The Postal Service *still* has not committed to allow any other mailer to enjoy a similar arrangement. Nor is there any commitment to make a generally available offer to other mailers based on publicly defined eligibility criteria, just as are worksharing discounts and other rates. Expedited procedures for another case before the Commission is simply not the same as “available to others” on the basis of published, objective criteria, and leaves far too ample room for discrimination among mailers by the Postal Service.

II. THIS NSA IS NOT AN ISOLATED EXPERIMENT

In a beguiling passage of its brief, the Postal Service portrays this NSA as a simple experiment – a “small step in the direction of an elusive goal” and merely a “trial” of the concept. USPS at 2 & 7. After reading the Postal Service’s brief, one understandably might be under the impression that, if this NSA were somehow

² ANM *et al.* (6) appear to believe NSAs could be “fair and equitable” even if they were to produce a net loss in contribution.

³ No party addresses the implications of a series of such similar, yet different, NSAs on the rate simplicity criterion of Section 3622(b)(7).

approved, no more NSAs would be proposed for the next three years. The record suggests otherwise.

No one knows how many NSAs are likely to be filed during the course over the next three years. However, record evidence strongly suggests that the number would likely not be zero. In fact, at least 11 possible NSAs are identified on the record – the 8 to 10 with other financial services companies mentioned by Mr. Plunkett (Tr. 9/1890), and one involving Mr. Posch’s company. Tr. 10/1994-95. And those are only the ones on the record. Certainly the Postal Service’s oft-expressed willingness to talk about NSAs, and the support by intervenors that may seek NSAs of their own or for their members, gives reason to believe that the number easily could be greater.

No, this case is not “a small step” in the direction of what may variously be called “particularized pricing arrangements,” NSAs, or “contract rates.”⁴ It is the camel’s nose under the tent, with a herd likely to follow.

Nor, finally, are NSAs simply a natural evolution in postal ratemaking akin to the evolution in other regulated entities. Simply put, the Postal Reorganization Act differs materially from other regulatory statutes, and fundamental differences exist between the Postal Service and other regulated services that make such comparison inapposite.

III. HAVING ONE’S CAKE AND EATING IT TOO: THE USE OF AVERAGE COSTS TO SUPPORT AN NSA FOR A UNIQUE MAILER CANNOT BE DEFENDED

A major issue in this proceeding is the Postal Service’s use of average First-Class Mail costs (with slight adjustments) to estimate the cost savings likely to emerge from COS’s acceptance of eACS in lieu of physical returns. As NAA and Professor

⁴ The Postal Service implies that the different labels denote different arrangements. USPS at 2. What these all have in common, of course, is a negotiated (or “contracted for”) rate between the Postal Service and a mailer, arrived at by private negotiations, not public proceedings, and of limited availability.

Panzar pointed out, such is not the way that privately-owned firms in regulated industries approach negotiated prices. Such firms go to the trouble of determining the cost of serving the particular customer (and over the duration of the deal), and base negotiations on those costs, not average costs. Tr. 6/1010 (Kent); Tr. 8/2662-63 (Panzar).

Here, no one contends that the Postal Service has modeled the actual costs of handling COS's UAA mail. Instead, it defends the use of average costs on the grounds that its costing systems generate subclass level costs, not mailer-specific costs, and that determining the costs of handling COS's returns would be too difficult. Indeed, COS argues that the use of average costs "yields the most accurate results." COS at 14. As Val Pak points out, "Rarely has the Postal Service attempted to make the total absence of information about Postal Service costs and operating procedures sound so good." VP at 23 (quoting USPS response to NAA/USPS-10 at Tr. 5/904 which stated: "the actual handling practices were not relied upon to develop cost or savings estimates in this case").

At the same time, proponents of the NSA contend that COS's allegedly "unique" use of First-Class mail and above-average rate of physical returns of UAA mail justify the NSA in the first place.⁵ They cannot have it both ways: if the mailer is not an "average mailer" and demonstrably generates above-average costs, then the use of "average costs" is unlikely to produce reliable cost estimates.

Several parties argue that mailer-specific returns costs are "not available." *E.g.*, USPS at 30. That is a flaw in the proposal, not a defense. The Postal Service offered

⁵ The Postal Service refers to a tension between large and smaller mailers, owing to the tendency of larger mailers to send "lower-cost mail." USPS at 2. This is odd because, in this instance, it is a very large mailer that imposes disproportionately large costs.

little, if any, evidence concerning how COS's return mail actually is handled, or its costs. See VP at 22-24. If determining the actual costs that one hopes to save is too much trouble, then that is a reason for not doing the NSA, not an excuse for doing it incorrectly.

This is not a minor point. Every contention in every brief that this NSA produces a "net contribution" to the Postal Service assumes that the Postal Service has estimated them correctly.⁶ That, in turn, assumes that average costs are an appropriate measure of the costs of handling this non-average mailer's returns. The Postal Service has failed to prove that these assumptions are correct, especially when the NSA is defended on the grounds that Capital One's mail has unique characteristics. Certainly this burden is not meant by sensitivity analyses that presuppose the accuracy of the cost figures in the first place.

IV. THE VOLUME DISCOUNTS CANNOT BE SALVAGED BY CAPITAL ONE'S DROP IN VOLUME

Several parties acknowledge discomfort that the agreed threshold levels for the declining block volume discounts in the NSA were below Capital One's recent historical volumes. However, they argue that any problems of inappropriate revenue leakage that this may cause have disappeared because Capital One now projects that its First-Class volumes in the current Fiscal Year will barely approach the threshold level, so the problem of discount leakage for mail that "would have been mailed anyway" essentially evaporates for purposes of this case. USPS at 15.

⁶ The Postal Service's assertion that the NSA will "increase the contribution from Capital One's mail" (USPS at 13) is curious. COS would pay less, not more, under the NSA, and avoid paying fees for eACS. The cost savings come from reduced UAA returns which, the USPS acknowledges implicitly in its next sentence, are borne by all First-Class mailers – which really suggests that in fairness and equity the savings should go to those mailers, not COS.

This simply illustrates why the Postal Service should not be trying to negotiate volume discounts. *All* estimates of COS's volumes are just guesses; Capital One witnesses testified that they do not forecast their mailing volumes two and three years in advance. At the same time, this is a case of asymmetric information; COS has a better idea of its plans than the Postal Service ever could. And the record does not provide a basis for estimating Capital One's likely volume based on *its* demand, rather than a subclass level proxy, because Capital One refused to allow discovery on its mailing algorithm.⁷

The decline in COS's estimated volumes for this fiscal year between September, when the case was filed, and February, when Dr. Elliott's rebuttal testimony supplied new forecasts, illustrates the risks in setting volume discounts. It is certainly possible that, in another five months, Capital One may change its forecast yet again. As matters now stand, the defense of the declining block volume discounts as inconsequential heavily depends on the decrease in COS's currently projected volumes. See OCA at 12. That is a slender reed indeed, and more generally indicates the problems with including volume discounts in NSAs.

Capital One devotes part of its brief to asserting that the volume discounts help to retain COS's mail in First-Class, arguing that if COS's mail were to convert to Standard Mail it would make less contribution to institutional costs because of Standard Mail's smaller unit contribution. COS at 26-27. While the Commission may wish to fix this in a future omnibus rate case by bringing the unit contributions of First-Class and Standard Mail closer together, three comments are appropriate now. First, the Postal

⁷ COS's "proposed finding" 9 (COS at 44) merits a chuckle. See *also* Pitney Bowes at 6. Of course it is difficult to forecast a specific mailer's volume when that mailer refuses to make relevant data available.

Service secured no commitment from Capital One of any particular level of volume, and the decline that Capital One has experienced suggests that the declining volume discounts are less important than the company's own business decisions. Second, the notion that COS mail would migrate en masse to Standard Mail is unsupported by the record. The Postal Service assumes that no such migration will occur, although COS's testimony was less clearcut. *Compare* Tr. 2/280 (Crum) *with* Tr. 2/66 (Jean). Third, the calculation upon which COS's brief relies (at 27) does not appear to include the costs that the Postal Service would avoid by not physically returning the UAA pieces (more than 50 cents per piece by Mr. Crum's calculation), offset to some amount by increased disposal costs. Thus, COS's estimated "net contribution" difference is greatly overstated.

V. CONCLUSION

For the foregoing reasons and for those expressed in our initial brief, the Newspaper Association of America respectfully urges the Commission to recommend rejection of the rates and changes to the Domestic Mail Classification Schedule that would implement the negotiated service agreement with Capital One. NAA does encourage the Commission and Postal Service to explore further the possible savings to the Postal Service from correcting the pricing irrationality of electronic and physical returns in First-Class Mail.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this date served the instant document on all participants requesting such service in this proceeding in accordance with section 12 of the Rules of Practice and the Presiding Officer's Rulings.

April 14, 2003

William B. Baker