

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

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

**DOCKET No. MC2002-2**

**REPLY BRIEF OF POSTCOM ET AL.**

The Association for Postal Commerce (PostCom) writes briefly to respond to some of the arguments in some of the briefs filed in the initial round of briefing in this proceeding.

The substantive issues in the case may have been overrun by the proposal for settling the matter. We write briefly to support the settlement and then take up issues that should be decided if the case is not settled. Several parties advanced suggestions in their briefs as to how the Commission should generally deal with Negotiated Service Agreements (NSAs). This reply brief will offer PostCom's views on some of the suggestions. One party argued that NSAs are flatly forbidden. See Initial Brief of the Newspaper Association of America (NAA brief) at 5. ("The Postal Reorganization Act does not allow for single-customer negotiated contract rates for domestic services.") Because PostCom believes this position to be dangerously wrong, we address that issue before taking up the question of how the Commission should generally deal with NSAs.

**I. The Commission Should Approve The Settlement Agreement**

This is a case that cries out for settlement. As the OCA correctly observes:

The stipulation and agreement addresses issues raised by the Commission, OCA and Witness Panzar.

Initial Brief of the Office of the Consumer Advocate at 11. This trenchant observation advocates powerfully in favor of endorsement of the settlement agreement. PostCom joins in the conclusion advocated by the OCA brief.

## **II. The NAA Brief Errs in its Assertion that Valid Rates can never be Established through Bilateral Contracts**

The NAA analysis begins with the assumption that the Commission will engage in an "... essentially passive review of a negotiated service contract..." NAA brief at 6. No explanation for NAAs belief that this will be so is offered and there is no warrant for it.

The testimony of Robert Posch, sponsored by PostCom, urges that a somewhat relaxed evidentiary standard be applied to NSAs because omnibus rate case-quality data will not be available to these highly particularized arrangements and would likely be so costly to produce as to confute the flexibility of NSAs:

While it might be theoretically possible for mailers to supply raw data to the Postal Service and have the Postal Service do the modeling, many mailers do not collect or retain the data that the Postal Service would need to perform modeling and forecasting at the level of specificity expected in omnibus rate cases. Further, even if the data are available or could be collected in a form suitable for modeling with rate case specificity, the transaction costs to the Postal Service and the private sector NSA participant would be such as to completely wipe out the benefits that both parties arrangement to realize.

Tr. 3/1976-77. Mr. Posch's testimony recognizes a totemic hierarchy of rate proceedings, the omnibus rate cases that have been a regular diet of Commission consumption for more than 30 years, the "niche" classifications that have been recognized by the Commission as appropriate vehicles for establishing rates that apply to the specialized mailing needs of a relatively small population of mailers and bilateral agreements recognizing unique relationships between the Postal Service and one of its customers

(NSA's). As Mr. Posch's testimony advocates, each of these categories of rates has a legitimate and important purpose that should be recognized and accepted by the Commission. Each also requires a different level of scrutiny by the Commission. As rates become applicable to smaller populations, Commission scrutiny should be less intense. This is the more true when marked mechanisms serve as a partial surrogate for regulatory policing.

As Mr. Posch testified in response to a question from Commissioner Goldway, it is imperative that NSA's be subjected to the scrutiny of this Commission. Tr. 10/2051-52. It will remain the province of the Commission to establish that rates, whether applicable to all mailers, a small group of mailers or a single mailer, do not impermissibly discriminate against (or in favor of) one or more mailers to the unacceptable benefit (or detriment) of other mailers. That always has been and will continue to be this agency's function. Mr. Posch does urge that the quality of proof legitimizing NSA rates ought to be tempered by the reasonable availability of empirical evidence concerning volumes and costs associated with the NSA.

To assess the evidentiary standards that the Commission should apply in adjudicating requests for NSA rates, one must first understand that concept of NSA's and how they are meant to work in the environment of regulated rates. As the term NSA twice implies (by the words "negotiated" and "agreement") NSA's are essentially bilateral contracts, agreements such as those that govern most commercial transactions, business arrangements for the purchase and sale of goods and services in environments that are not subject to rate regulation. The threshold analysis of NSA's must begin with the assumption that one has in hand a contractual arrangement freely arrived at by the consensual undertakings of two unrelated business entities. The theories of free markets teach that such transactions should be fair to both sides. Indeed, the quasi-monopoly power that the Postal Service has over First Class Mail leads to the conclusion that if there is any imbalance of fairness in a bargained transaction between the Postal Service and one of its customers, the balance will tilt in favor of the Postal Service. This consideration helps further to insure that other Postal customers are not substantially at risk as a result of consummation of a bargained agreement.

Although these considerations counsel a somewhat relaxed Commission review of NSA's than of rates unilaterally proposed by the Postal Service, they certainly do not call out for "passive" participation of the Commission in the rate-making process.

The conventional rate-making process can be thought of as tripartite: The Postal Service proposes rates, its customers support or oppose the rates in litigation before the Commission and the Commission adjudicates a recommended decision. NSA's add one further check to the process. A mailer has participated with the Postal Service through the process of contract negotiation in arriving at the rates to be proposed.

None of this stands in the way of the Commission conducting "... on the record adjudication required by the Act" leading to the Commission "actively mak[ing] a rate recommendation...." NAA brief at 6.

### **III. The Val-Pak General Criteria Are Overly Rigid**

Much of Val-Pak's brief is devoted to enunciating "principles" that it believes should apply not just to the Cap One NSA, but to all future potential NSAs. Some, such as a showing that an NSA does not result in a net financial loss to the Postal Service, are generally sound. However, the Commission should avoid the temptation offered by Val-Pak to lay out broad principles that go beyond the scope of the Cap One proposal. Each NSA that may be presented for the Commission's consideration will, to some extent, have unique characteristics or circumstances, and must be judged on its own merits. The Commission should not -- and, as a practical matter, cannot at this time -- anticipate every variation of NSAs that might be submitted in the future. A principle that may seem sound when applied to the Cap One NSA might not make sense for some future NSA.

Indeed, even Val-Pak's "no net financial loss" principle could be subject to valid exceptions. For example, if the Postal Service faced the loss of a mailer's existing volumes, the approval of an NSA which enabled it to retain those volumes through a reduced rate would leave it better off than it would otherwise be. Retaining a reduced contribution from such mail would be better for the Postal Service (and other mailers) than the alternative of losing the entire contribution. A preferable way of stating this principle is simply that an NSA "must be beneficial to the Postal Service."

Val-Pak's discussion of volume discounts is another example of the problem with broad principles that go beyond the scope of the Cap One NSA. Val-Pak acknowledges that declining block discounts are not prohibited by the Act, and that properly employed, they could be a "useful device for encouraging and rewarding increased mail volume and increased contribution to Postal Service overhead." Val-Pak Br. at 19. We agree.

Later in its brief, however, Val-Pak argues that NSAs "must not provide discounts based solely on high volume" on the ground that "since passage of the Postal Reorganization Act it has been commonly agreed that [non-cost-based quantity or volume discounts] are "prohibited." *Id.* at 34, 35. We disagree that the Act prohibits such volume discounts. Indeed, declining block discounts that Val-Pak agrees are permissible under the Act are a form of volume discount. Val-Pak's blanket proscription of NSAs with high-volume discounts also ignores that such discounts might come in a variety of forms and be made subject to conditions (such as volume or revenue guarantees, or penalty clauses) that ensure a net benefit for the Postal Service. So long as an NSA satisfies the criterion that it provide a net benefit to the Postal Service, such as by

generating an increased contribution or avoiding a lost contribution, it should not matter whether the NSA rate is in the form of a block discount (which Val-Pak finds unobjectionable) or some other type of volume discount.

Similarly, Val-Pak's principle that NSAs must not provide "rewards for high-cost mailers discontinuing high-cost behavior" (Br. at 36) is over-broad. In the case of Cap One, for example, its First Class solicitation mail (advertising) is clearly serving a different market than its First Class transactional mail with its banking customers. For the transactional mail such as credit card bills, accurate and timely delivery to the named customer – including address correction and forwarding – is absolutely essential. First-Class service is not only required but highly valuable to the mailer. On the other hand, for the advertising solicitation mail, the value of accurate delivery and even First Class service is arguably quite lower. The fact that Cap One has a lower-priced alternative for this solicitation mail – namely, Standard mail – may further lessen the relative value of First Class mail for this segment of its business, and implies a correspondingly higher price sensitivity for the advertising segment.

Ironically, the systemic "remedy" favored by Val-Pak – unbundling First Class rates and charging Cap One a higher rate for its First Class solicitation mail due to its higher return rates (Br. at 16-17) – might well have the opposite effect that Val-Pak supposes. To the extent advertising mail is more price sensitive than the transactional customer mail, Cap One (and other First Class advertising mailers) might well respond to such a First Class surcharge by shifting a portion of their First Class volume to Standard mail, producing a net *reduction* in contribution. In that event, Val-Pak's preoccupation

with “cost-based charges” on higher-cost First Class advertising mail – without regard to price sensitivity or marketplace factors – would leave the Postal Service and other mailers worse off.

In this respect, Val-Pak’s claim that “[t]he ‘low cost’ mailers implicitly support the ‘high cost’ mailers” (*Id.* at 11) might in some circumstances be backwards. If, because of market factors and the availability of alternatives, the high-cost First Class advertising mailers are more price sensitive than the low-cost First Class transactional mailers and can switch to a lower-priced alternative, then it could well be they who, by virtue of their discretionary choice to use First Class, are helping to support the low-cost mailers by maximizing the total contribution to the postal system. Stated another way, in considering any rate proposal, whether an NSA or a traditional rate proposal, the Commission must take into account not only cost but also market factors.

Val-Pak’s final proposition, that NSAs must “anticipate and avoid unintended consequences,” is by its own concession a factor that “admittedly the Commission may have difficulty giving [ ] much weight.” *Id.* at 40. Unintended consequences are, by definition, always something that one should try to anticipate and avoid. The problem is that they are also often conjectural. A case in point is Val-Pak’s speculation that “resistance created” by the Cap One NSA will cause other mailers to forgo electronic returns. *Id.* at 39. An equally if not more likely outcome is that (1) transactional mailers will continue to opt for electronic correction because of the high value they place on accurate delivery to customers, and (2) other advertising mailers might opt for an arrangement similar to Cap One.

Another “unintended consequence” of the Cap One NSA that cuts the other way is that it has focused attention on potential future rate and classification changes, including possible reassessment by the Postal Service of its fees for electronic correction. In this respect, subsequent NSAs might in some cases serve as testing grounds for new ideas – either new cost savings features or new service or rate concepts – that could later be more broadly incorporated into the general rate and classification scheme.

Indeed, an “unintended consequence” of Val-Pak’s quest to prescribe broad “principles” that proscribe future NSAs could be to preempt beneficial NSAs and to stifle future innovations in Postal Service rates, classifications, and service offerings.

Respectfully submitted,

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