

**BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON DC 20268-0001**

Rate and Service Changes To Implement)
Functionally Equivalent Negotiated Service) Docket No. MC2004-3
Agreement with Bank One Corporation)

**BANK ONE CORPORATION COMMENTS ON LIMITATION OF ISSUES
AND RESPONSE TO REQUESTS FOR HEARING
(refiled August 5, 2004)**

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Pursuant to Ordering Paragraph 5 of Presiding Officer's Ruling No. MC2004-3/1, Bank One Corporation ("Bank One") respectfully submits these comments on the limitation of issues in this proceeding. This pleading also constitutes Bank One's response to the requests for a hearing filed on July 23, 2004, by the Office of Consumer Advocate ("OCA") and Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (collectively "Valpak"). For the reasons explained below, the Commission should deny OCA and Valpak's requests for a hearing on all issues except those relating to the July 1 merger of Bank One and J.P. Morgan Chase, and should defer until August 17, 2004, a decision on whether to allow an evidentiary hearing on the merger issues.

I. THE GOVERNING LEGAL STANDARDS

In an ordinary rate and classification case, requests for hearings are generally unopposed and are normally granted unless clearly frivolous. This, however, is not an ordinary case. This is a case involving (1) an NSA with a private, unregulated business and (2) a functionally equivalent agreement. One of the proponents of an NSA is not the Postal Service but one of its ratepayers—typically, an unregulated private business, operating in competitive markets. For such a business, the costs of rate litigation are

not part of a regulated rate base or revenue requirement that can be recovered from the mailer's downstream customers, but a cost of doing business that is typically borne by the mailer's own shareholders. Moreover, when the proposed NSA is functionally equivalent to a baseline NSA previously approved by the Commission for the benefit of another mailer in the same industry, litigation expense and delay can have serious competitive implications.¹ For these reasons, the Commission has held that requests for approval of functionally equivalent NSAs will, to the extent "consistent with procedural fairness," be "subject to accelerated review." 39 U.S.C. § 3001.196(d). Hence, the requests for a hearing submitted by OCA and Valpak in this case warrant closer-than-usual scrutiny.

The Commission's NSA rules do not specify the standards for deciding when (and with respect to what issues) a hearing is warranted. See Rule 196(d). Nor do the Commission's general rules of procedure. See, e.g., Rules 20(b), 24(d) and (e). The Postal Reorganization Act provides, however, that the right to a hearing in rate and classification cases is subject to the standards of the Administrative Procedure Act for on-the-record adjudications. See 39 U.S.C. § 3624(a) (incorporating 5 U.S.C. §§ 556 and 557). The case law under the Administrative Procedure Act limits the right to a hearing to material issues of fact.² To justify a request for a hearing, a party must make

¹ See MC2002-2 Op. & Rec. Decis. ¶¶ 7017-21 (noting that Commission's recommendation of Capital One NSA was premised on assumption that competing mailers would have a "realistic chance" to qualify for a similar arrangement). "The purpose of proposing rules that expedite procedures for considering functionally equivalent negotiated service agreements is to assure that similarly situated mailers are given timely consideration and not placed at an undue disadvantage when seeking to secure a negotiated service agreement with the Postal Service." Docket No. RM2003-5, *Negotiated Service Agreements*, Order No. 1383, 68 Fed. Reg. 52546, 52551 (2003). There is no dispute that Bank One is a similarly situated competitor of Capital One, which is presently operating under a baseline NSA.

² See, e.g., *Costle v. Pacific Legal Foundation*, 445 U.S. 198, 219-20 (1980); *Cascade*

three showings. First, the party must make allegations of *fact* material to the Commission's determination. Disputes over law or policy are insufficient to warrant a hearing.³ Second, mere *allegations* of fact are insufficient to mandate a hearing: a party must make an adequate proffer of evidence to support them.⁴ Third, the material facts alleged must be *in dispute*. There is simply no justification for "an evidentiary hearing when the opposing presentations reveal that no dispute of fact is involved."⁵

Finally, in assessing the substantiality of the issues that have been proposed for hearing, the Commission should take recognize that no request for a hearing—on any issue—has been made by any mailer (or other private party) with a genuine economic stake in the rates proposed here. Valpak, the only intervenor to request a hearing, is not a bank or credit card issuer, and does not claim to be a competitor of Bank One. Rather, Valpak seems to be proceeding on the theory that, if the Postal Service loses

Natural Gas Corp. v. FERC, 955 F.2d 1412, 1425-26 (10th Cir. 1992); *Chicago Observer, Inc. v. City of Chicago*, 929 F.2d 325, 327-28 (7th Cir. 1991); *Woolen Mill Assocs. v. FERC*, 917 F.2d 589, 592 (D.C. Cir. 1990); *Altenheim German Home v. Turnock*, 902 F.2d 582, 584-85 (7th Cir. 1990); *Consolidated Oil & Gas, Inc. v. FERC*, 806 F.2d 275, 280 (D.C. Cir. 1986); *City of Centralia, Wash. v. FERC*, 799 F.2d 475, 485 (9th Cir. 1986); *Air Line Pilots Ass'n v. Dept. of Transportation*, 791 F.2d 172, 179 (D.C. Cir. 1986); *Oklahoma Bankers Ass'n v. Federal Reserve Board*, 766 F.2d 1446, 1452 (10th Cir. 1985); *City of Oakland v. FERC*, 754 F.2d 1378, 1380-81 (9th Cir. 1985); *Pacific Gas & Elec. Co. v. FERC*, 746 F.2d 1383, 1386-87 (9th Cir. 1984); *NLRB v. Chicago Marine Containers, Inc.*, 745 F.2d 493, 496, 500 (8th Cir. 1984); *Ohio Power Co. v. FERC*, 744 F.2d 162, 170 (D.C. Cir. 1984).

³ *Costle*, 445 U.S. at 219-20; *Cascade Natural Gas Corp.*, 955 F.2d at 1425; *Panhandle Producers & Royalty Owners Ass'n v. Economic Regulatory Administration*, 847 F.2d 1168, 1178 (5th Cir. 1988).

⁴ *Cascade Natural Gas Corp.*, 955 F.2d at 1425-26; *Woolen Mill Assocs.*, *supra*, 917 F.2d at 592; *City of Centralia*, 799 F.2d at 485.

⁵ *Cascade Natural Gas Corp.*, 955 F.2d at 1426 (quoting *Consolidated Oil & Gas, Inc. v. FERC*, 806 F.2d 275, 279 (D.C. Cir. 1986)).

money on this NSA, the institutional cost contribution borne by other mailers (including Valpak) will go up.

This is an extraordinarily attenuated interest. Bank One and the Postal Service conservatively estimate that their proposed NSA will generate a net benefit of \$11.6 million to the Postal Service over the three-year term of the NSA.⁶ Assuming for the sake of argument that the actual outcome of the NSA would be a net *loss* to the Postal Service of the same magnitude, a loss of \$11.6 million would equal approximately \$3 million per year—or approximately *one-250th of one percent* of the Postal Service's overall revenue. The impact of such a loss on Valpak's postal rates, after rounding, is likely to be zero.

The insubstantiality of Valpak's claims is underscored by the failure of any other intervenor to support them. The intervenors in this case are sophisticated, experienced and resourceful players in the postal arena.⁷ The mailer and labor intervenors, in particular, would have an obvious economic incentive to oppose the NSA if they believed that the agreement itself, or the cumulative effect of this and similar NSAs, posed a material threat to the Postal Service's revenues or institutional cost coverage. None, however, have done so, or have joined Valpak in seeking a hearing. Moreover,

⁶ Plunkett Direct (USPS-T-1) at 11-12; Rappaport Direct (BOC-T-1) at 8; Buc Direct (BOC-T-2).

⁷ They include a direct competitor of Bank One (Discover); the principal trade association of Bank One's competitors (the American Bankers Association); a major trade association of competitors of the Postal Service (Newspaper Association of America); six other trade associations of mailers, representing a broad spectrum of mail classes and subclasses (Alliance of Nonprofit Mailers, Association for Postal Commerce, Magazine Publishers Association, National Newspaper Association, National Postal Policy Council, Inc., and Parcel Shippers Association); and two major organizations of postal labor (American Postal Workers Union and National Association of Postmasters of the United States).

other large mailers and trade associations of mailers that normally participate in rate cases have not even intervened in this case. The failure of any major mailer group or labor union to oppose this NSA is clearly relevant in deciding whether the factual issues asserted by OCA and Valpak are substantial enough to warrant inflicting the costs and delays of a hearing on a mailer that merely seeks approval of a functionally equivalent NSA.

II. THE COMMISSION SHOULD DEFER DECIDING WHETHER TO HOLD A HEARING ON THE EFFECT OF BANK ONE'S MERGER WITH J.P. MORGAN CHASE.

OCA, in its July 23 request for hearing, states that the July 1 merger of Bank One with J.P. Morgan Chase presents an "important additional complication" that may warrant a hearing. OCA Request for Hearing at 2-3; see *also* Presiding Officer's Ruling No. MC2004-3/1 (July 23, 2004) at 3 (noting issue). Bank One is attempting to answer as fully and quickly as possible OCA's data requests concerning J.P. Morgan Chase volumes and practices. Bank One has had several meetings with OCA, has responded to several interrogatories concerning the merger, and is in the process of responding to additional interrogatories on the subject. Bank One believes, however, that the merger does not create an obstacle to approval of the NSA.

The fundamental issue raised by the merger is whether integrating the J.P. Morgan Chase volumes into the NSA make the Postal Service worse off financially. Specifically, will the addition of volumes from J.P. Morgan Chase allow Bank One to receive discounts for mail that J.P. Morgan Chase would have entered in any event without the NSA block discounts?

The answer, for several reasons, is clearly no. First, the NSA (like the Cap One and Discover NSAs) contains elaborate structural safeguards specified by the Postal

Service to prevent such consequences.⁸ The NSA allows Bank One to credit J.P. Morgan Chase volume against the discount thresholds *only* after the Postal Service has reviewed the bank's volume data and address cleansing procedures, and has certified that those volumes may be been "integrated" with the volumes of the pre-merger Bank One. NSA ¶ IV.B.2.b. Ninety days before the date of integration of any J.P. Morgan Chase volumes, Bank One must notify the Postal Service of the proposed integration, and provide a variety of information about the mail, including the "monthly volume for the twelve (12) months prior to notice for the entire category of mail" and the "permit accounts through which the volume was mailed." *Id.*, ¶ IV.B.2.c. Upon integration, the volume thresholds for the declining block discounts "will be adjusted upward to add the [integrated] volume from the category of mail for the twelve (12) months prior to the date of integration." ¶ IV.B.2.e. Hence, Bank One has no means of gaming the discount thresholds to obtain discounts for former J.P. Morgan Chase volume that Bank One would have continued to mail in any event.

The merger provisions further provide that, before J.P. Morgan Chase can be integrated into the NSA, "Bank One must show the Postal Service that it has the quality processes in place to ensure that M&A [former J.P. Morgan Chase] volume will comply with" the address hygiene and other mail preparation requirements of the NSA. ¶ IV.B.2.d. Hence, the OCA's concerns about whether Bank One can update its J.P. Morgan Chase volumes within seven business days, and whether Bank One can run all First-Class Mail solicitation addresses against NCOA addresses within 60 days of

⁸ Mergers are common in the financial services industry, which has been undergoing a wave of consolidations in recent years. Indeed, it would be the exception rather than the rule for a given financial institution not to acquire, be acquired by, or otherwise consolidate with another financial institution over the three-year term of an NSA.

mailing, are misplaced. *Cf.* OCA Request for Hearing at 4. Until Bank One has these quality processes in place, the Postal Service will not integrate the mail under the NSA, and the mail will remain ineligible for the NSA discounts. NSA ¶ IV.B.2.d.

Finally, the management group responsible for marketing decisions for the combined entity will consist largely of managers who have been making marketing decisions for Bank One in recent years. Hence, there is every reason to believe that the former J.P. Morgan Chase volumes will respond to the discount incentives in a manner akin to the Bank One volumes.

Nevertheless, Bank One does not ask the Commission to rule yet whether a hearing is warranted on the financial effects of the merger for the Postal Service. As the Postal Service noted in its July 28 response to the motions of OCA and Valpak for a hearing, the OCA and Valpak have agreed to decide by August 17 whether they will even seek to cross-examine the co-proponents' witnesses. The question of whether to grant a hearing on financial implications of the merger can safely be postponed until then. In the meanwhile, Bank One will continue to develop responses to the discovery requests of OCA as expeditiously as possible.

III. THE OCA AND VALPAK HAVE FAILED TO DEMONSTRATE THE EXISTENCE OF ANY OTHER MATERIAL ISSUE OF FACT WARRANTING A HEARING.

A. Cap On Total Discounts

Both OCA and Valpak also seek a hearing on issues relating to the “stop loss” cap on total discounts imposed by the Commission in its recommended decision in the Capital One NSA case.⁹ The OCA requests a hearing on “whether a stop-loss cap can be calculated for Bank One in the same way the Commission calculated a stop-loss

⁹ MC2002-2 Op. & Rec. Decis. (May 15, 2003) at ¶¶ 8024-8031.

capital for Capital One.” OCA Request for a Hearing at 2. Valpak seeks a hearing on whether “the absence of any cap in the Bank One NSA violate [sic] the principles established by the Commission with its Capital One stop-loss provision.” Valpak Request for Hearing at 4 (Issue B.3). Neither issue justifies a hearing.

The OCA’s statement of the issue begs the question. Whether a cap on discounts “can be calculated” in a particular way is a material issue only if the record establishes that a discount cap is justified in the first place. If a cap is unwarranted, the question of how to compute a cap is academic. OCA has totally ignored this critical threshold issue.

In fact, the record overwhelmingly shows that the proposed NSA is likely to generate a massive positive contribution for the Postal Service. First, Bank One’s historical volumes, unlike those of Capital One, have been quite stable in recent years. Hence, there appears to be little chance that Bank One will mail large volumes of mail above its Before Rates estimates in the absence of an incentive. And as USPS witness Michael Plunkett points out in his testimony and calculates in his response to Presiding Officer’s information Request No. 1, Question 7, even if Bank One were to do so, there would be minimal financial risk to the Postal Service because the ACS savings that would be generated would be correspondingly greater. Finally, the annual threshold adjustment and merger adjustments protect the Postal Service in the event of a merger or an organic increase in customer mail.

Second, the proponents’ analysis of the financial effect of the proposed block discount schedule, including the effects of leakage, new contribution and ACS savings, is far more sophisticated and thorough than in the Capital One case. See Plunkett Direct (USPS-T-1), App. A; response of USPS witness Plunkett to OCA interrogatory

OCA-USPS-T1-15; Buc Direct (BOC-T-2). In particular, Mr. Buc's testimony provides a sophisticated model of the optimization analysis used by credit card marketers to choose between Standard Mail and First-Class Mail solicitations. Relying on publicly available data, Mr. Buc shows that the proposed discount blocks will, under an extraordinarily robust range of assumptions, elicit enough additional First Class volume to generate an enormous positive contribution to the Postal Service. Buc Direct (BOC-T-2).

Moreover, a stop-loss provision (or cap) would not eliminate financial risk for the Postal Service—it would instead substitute one risk for another. This is because a cap on total discounts creates the risk of choking off volumes that an incentive would induce. This is particularly true for the Bank One NSA: losses in contribution from the choked-off volume could be very large. Thus, imposing a cap would replace an insignificant risk with a substantial one. Mr. Buc's analysis, based on the model presented in his testimony (BOC-T-2), shows an 80 percent chance that imposing an annual \$2.5 million cap would reduce the contribution made by Bank One's mail to institutional costs by \$8.3 million per year. Over the three year term of the NSA, the lost contribution could total \$25 million.¹⁰

¹⁰ Bank One has calculated the potential contribution losses from a \$2.5 million annual cap using data from his testimony (BOC-T-2). Mr. Buc had earlier performed a Monte Carlo analysis to estimate the amount of mail that could switch from Standard Mail to First-Class Mail under a broad set of assumptions. This analysis can also be used to show the potentially "switched" volumes for each decile in his Monte Carlo analysis. One can calculate the contribution from the switched volume, as well as the net contribution after considering the incentive necessary to induce that switch. The analysis shows that, although annual losses in contribution resulting from a cap would be relatively modest at the 10th percentile volume estimate—about \$1.4 million annually—they would increase to \$8.3 million annually at the 20th percentile estimate, and \$12.47 million at the 90th percentile estimate. In other words, there is an 80 percent chance that imposing an annual \$2.5 million cap would reduce the contribution that Bank One's mail would otherwise make to institutional costs by \$8.3 million per year,

Another risk from capping discounts at ACS cost savings transcends this case. Limiting the discounts to the costs savings generated by solicitations currently mailed as First-Class Mail would have a chilling effect on future functionally equivalent NSAs. Very few (if any) other banks currently send enough First-Class Mail to justify the energy, time, and money needed to obtain a functionally equivalent NSA with discounts capped at ACS savings on Before Rates First-Class volumes. These same banks, however, have large quantities of Standard Mail solicitations. An uncapped discount incentive could enable the Postal Service to induce a large share of this volume to migrate to First-Class Mail, benefiting the Postal Service, banks, and other mailers.

Bank One's experts provided OCA's counsel and professional staff a lengthy hands-on demonstration of Mr. Buc's model on July 15, 2004, and have had several additional meetings and conversations about various cost and financial issues with OCA personnel. It is telling that the OCA does not allege any error in Mr. Buc's model, inputs, other assumptions, or results.

Valpak has likewise failed to justify a hearing on the discount cap issue. It is unclear whether Valpak is claiming that the Commission's recommended decision in the Capital One NSA case requires the imposition of a discount cap as a matter of law or policy, or whether Valpak is merely claiming that a cap is warranted in the particular circumstances of this case. See Valpak Request for Hearing at 4 (Issue B.3). As to the former, Valpak's claim can be resolved on brief without an evidentiary hearing. As noted above, the Administrative Procedure Act does not entitle parties to a hearing on pure issues of law or policy.

and that the foregone contribution could total \$25 million over three years.

As to the latter, Valpak's request for a hearing founders on Valpak's failure to identify *any* deficiency in the Bank One/USPS financial analysis. Valpak has not challenged any aspect of the model of Lawrence Buc described above. Under the circumstances, Valpak's one-sentence allusion to the cap issue ("Does the absence of any cap in the Bank One NSA violate the principles established by the Commission with its Capital One stop-loss provision?") does not begin to create a material issue of fact.

B. Other Issues Concerning The Financial Effect Of The NSA On The Postal Service.

OCA and Valpak's remaining allegations concerning Postal Service contribution margins, and the potential effects of the NSA on First-Class Mail forwarding and return costs, are equally wide of the mark. We respond in turn to the allegations concerning contribution "on the margin," forwarding costs, return costs, and alleged differences in the costs and contributions of letters vs. flats.

1. Migration of Bank One mail volume from Standard Mail to First-Class Mail will increase the Postal Service's net contribution at every volume block.

Valpak asks rhetorically whether the migration of Bank One mail volumes from Standard Mail to First-Class Mail may reduce the Postal Service's net "contribution to institutional costs," both "on average and at the margin":

Both on average and at the margin, could the Postal Service actually suffer a reduction in contribution to institutional costs as a result of the migration from Standard Mail to First-Class Mail that is being encouraged by this NSA?

* * *

Stated differently, when Bank One achieves its maximum discount, will the **marginal** contribution to the Postal Service's overhead from First-Class solicitation mail that converts from Standard Mail be significantly less than the average contribution when mailed at Standard Mail rates? That is, at the margin, will the Postal Service suffer a

reduced contribution as a result of implementing the NSA? If so, by how much? And worse, will it suffer a reduced contribution to overhead even before the maximum discount is reached?

Valpak Request for Hearing at 3-4 (Questions A.1.c and A.3) (emphasis in original).

The testimony and workpapers submitted by the Postal Service and Bank One clearly answer these questions. The proponents' financial analysis shows that, even with a discount of five cents per piece—the deepest discount offered to Bank One under the NSA—the Postal Service will gain a net contribution of approximately two cents per piece for every piece of Bank One mail that migrates from Standard Mail to First-Class Mail as a result of the NSA:¹¹

	Contribution (\$ per piece)		
	Year 1	Year 2	Year 3
First-Class After Rates	0.166	0.161	0.155
Standard Rates	0.093	0.089	0.086
Difference Without Discount	0.073	0.072	0.069
Difference With 5¢ Discount	0.023	0.022	0.019

And this is the *least* profitable discount block. Additional volume below the threshold for the full five-cent discount will add a contribution greater than two cents per piece (because the discounts offered for those pieces will be smaller, or zero). Moreover, as discussed by Mr. Buc in response to Valpak interrogatory VP-USPS-T1-11, First-Class Mail volumes that represent net volume gains to the Postal Service, rather than migration from Standard mail, will provide gains of more than ten cents per piece (because there will be no partially offsetting loss in Standard Mail contribution).

Neither Valpak nor the OCA has raised any coherent challenge to the soundness of these margin projections.

¹¹ See Direct testimony of Michael K. Plunkett (USPS-T-1), App. A, p. 10. Differences obtained by subtraction.

2. The Postal Service has properly accounted for the forwarding costs of additional First-Class Mail volume from Bank One.

Both OCA and Valpak suggest that the Postal Service's financial analysis overlooks the additional mail forwarding costs that the Postal Service will incur because of the migration of Bank One mail from the Standard mail (which the Postal Service does not forward) to First-Class Mail (which is entitled to forwarding). See OCA Request for Hearing at 5; Valpak Request for Hearing at 3 (Question A.1.b) (asking whether it is "appropriate for the Postal Service model to omit the cost of free-forwarding . . . for forwarded mail").

In fact, USPS witness Plunkett's use of actual First-Class Mail costs (as adjusted for Bank One's mail mix and return rate) in his financial analysis (USPS-T-1, Appendix A at 5) implicitly includes the average forwarding cost of First-Class mail in the cost estimate for Bank One's First-Class Mail. The use of the average First-Class Mail forwarding rate is reasonable since Bank One's forwarding rate, just like Capital One's forwarding rate, is likely to be close to the average for First-Class Mail. See Response of USPS witness Plunkett to POIR 1, Question 2 (filed July 26, 2004) (noting, *inter alia*, that Capital One's forwarding rate, 2.0 percent, is only slightly above the national average of 1.96 percent).

Neither OCA nor Valpak have offered any reason to believe that these values are understated. Indeed, there is considerable reason to believe that the Postal Service's financial analysis, by ignoring the effect of Bank One's commitment to use ACS data if the NSA is approved, has conservatively overstated Bank One's foreseeable mail forwarding costs. See Response of USPS witness Plunkett to OCA interrogatory OCA-USPS-T1-10 (filed July 19, 2004).

3. The Postal Service has properly considered the costs of providing additional First-Class Mail electronic returns to Bank One.

OCA and Valpak's allegations concerning the costs of additional First Class Mail returns are also unfounded. OCA and Valpak theorize that the Postal Service has overlooked the costs of additional electronic returns for undeliverable mail that the Postal Service will incur because of the migration of Bank One mail from Standard Mail (which is not returned to Bank One, either physically or electronically, when undeliverable as addressed) to First-Class Mail (most of which will be returned electronically under the NSA). See OCA Request for Hearing at 4-5; Valpak Request for Hearing at 2-3 (Questions A.1.a, A.1.b).

In fact, the Postal Service's financial analysis clearly reflects these incremental costs. See USPS-T-1, Appendix A at 5 (15). Even after accounting for these incremental return costs, the net result of the NSA is a substantial positive contribution to the Postal Service. See Response of Bank One witness Buc to Valpak interrogatory VP-BOC-T1-11 (filed July 26, 2004). Neither OCA nor Valpak have offered any reason to believe that these input values understate the return costs that the Postal Service is likely to incur. See Response of USPS witness Plunkett to POIR 1, Question 3 (explaining why Bank One return costs are unlikely to differ from the national average).

4. The OCA's miscellaneous criticisms of the Postal Service's financial analysis are also without merit.

OCA offers two additional criticisms of the Postal Service's financial analysis that warrant a brief response. First, OCA suggests that the Postal Service should have performed a separate analysis of the costs and contribution of Bank One's *flat*-shipped solicitation mail. OCA Request for Hearing at 4. The OCA fails to explain why this is a serious concern. The proposed NSA would limit the total number flats eligible to be

counted toward the volume thresholds to 35 million pieces—the number of flats that Bank One mailed in 2003 and is projected to mail with or without the NSA in 2004. See Request, Attachment A, ¶ 612.1. Because of this limit, the NSA will not incent an increase in flat-shaped First-Class Mail volumes and an analysis of the contribution from new First-Class Mail flats volume is unnecessary. Further, the Postal Service did appropriately include an analysis of the impact of electronic returns on the Postal Service costs for returning flats. USPS-T-1, App. A at 11.

OCA also suggests that because Bank One's First-Class Mail solicitation volumes are projected to be smaller than Capital One's volumes, "witness Crum's methodology for the baseline case (POIR 2, Question 7) [for showing that the cost savings from reduced forwards will exceed the USPS cost for providing ACS notices] will not work for the first year of the Bank One NSA" and perhaps may not work not for years 2 and 3 as well. OCA Request for Hearing at 5-6.

In making this argument, OCA notes that in year 1, Bank One's volumes are "roughly 11 percent of Capital One's First-Class Mail solicitation volumes." This suggests that the cost of providing Bank One with ACS notices would be in the ballpark of 11 percent of the cost projected by witness Crum, or less (and likely substantially less) than \$100,000 per year. Docket No. MC2002-2, POIR 2, Question 7 at 4-5. Therefore, the cost of providing ACS notices would be immaterial even in the extremely unlikely case that the cost was not fully offset by avoided costs. Assuming that Bank One' First-Class Mail after-rates solicitation volumes were higher, then according to OCA's logic, witness Crum's methodology would apply.

C. The Value To Bank One Of Electronic UAA Information

Valpak raises a series of questions concerning the value of electronic UAA information to *Bank One*:

2. The Capital One NSA involved mailer which maintained its own solicitation list, while Bank One apparently relies more heavily on rented lists, raising the issue of whether any use that Bank One could possibly make of the expensive electronic UAA information is of low value, far below the cost of providing the information. A number of other specific questions are presented by this fact, including:

- a. Is there any value whatsoever to the Postal Service or Bank One of Bank One obtaining UAA electronic return information, and, if so, what is that value, and how does it compare to the Postal Service's cost of providing this information?
- b. How have anticipated benefits to the Postal Service of Bank One obtaining the UAA electronic return information been incorporated into this NSA?

Valpak Request for Hearing at 3 (Questions A.2.a and A.2.b). Valpak's theory apparently is that Bank One relies heavily on one-time list rentals, and electronic UAA information for the names on one-shot rental lists is of no value because Bank One has no reason to correct addresses it will never use again. Hence, Valpak suggests, Bank One might have been better off by foregoing electronic return information entirely in exchange for deeper discounts. Valpak's speculation is both factually unfounded and legally irrelevant.

First, Bank One does not, contrary to Valpak's assumption, rely primarily on one-use list rentals. Rather, Bank One

often sends a solicitation mailing to the same list of non-customers more than once. Bank One may make multiple mailings to the same list during the same campaign cycle. Or Bank One may obtain the same list several times for different campaigns over the course of a year or other extended period.

Answer of Bank One witness Rappaport to Valpak Interrogatory VP-BOC-T1-4(a) (filed July 26, 2004).

Moreover, ACS address correction information received under the NSA will have value for Bank One even when the list containing the incorrect address is used only once. When Bank One receives notification from ACS that an address is stale or otherwise invalid, an entry will be placed in the databases to ensure that the address is purged from any future solicitation mailing. This process will ensure that Bank One will not use the address again even if it is included in other existing Bank One lists, or in other lists purchased, rented or otherwise acquired by Bank One in the future. Answer of Bank One witness Rappaport to Valpak Interrogatory VP-BOC-T1-8(a) (filed July 26, 2004).

The Commission need not resolve these factual issues, however, because they are legally irrelevant. The cost savings offered as justification for this NSA are the savings projected for the Postal Service, not Bank One. Whether Bank One might be better off by waiving electronic returns entirely in exchange for deeper discounts is an interesting question, but not germane to this case. The NSA before the Commission is the product of lengthy arms' length negotiations between Bank One and the Postal Service. Like most business contracts, it contains many compromise provisions that fall short of what either side would have preferred. The question before the Commission is whether the resulting bargain, in actual operation, is likely to make the Postal Service financially better off than the existing rate and classification structure. If so, there is no basis for disapproving the NSA on grounds that a better deal could have been struck.

The Commission has recognized that its role is limited to ascertaining that "postal customers benefit generally" from the proposed NSA and "no postal customer is

disadvantaged.” MC2002-2 Op. & Rec. Decis. ¶ 3058 (quoting APWU reply brief with approval). “The Commission has no intent of acting as a bargaining party, or in renegotiating the terms and conditions of a Negotiated Service Agreement. . . . Nor does the Commission view its role as ensuring that the Postal Service has made the best possible deal.” Docket No. RM2003-5, *Negotiated Service Agreements*, Order No. 1391, 69 Fed. Reg. 7574, 7580 (Feb. 18, 2004). Hence, the Commission’s task in practice will often be to “apprais[e] whether agreements with rate and classification elements it regards as less than optimal nonetheless pass muster under the Reorganization Act’s standards.” MC2002-2 Op. & Rec. Decis. at ¶ 3058; *accord*, MC2002-2 Op. & Rec. Decis. ¶ 8006 (Commission is concerned not with determining the “most appropriate division of costs, revenues or contributions” between the Postal Service and its NSA partner, but with “assuming that the NSA will not make mailers other than [the NSA partner] worse off.”).

D. Policy Issues Previously Raised Unsuccessfully By Valpak in the Capital One NSA Case

1. Nationwide fix of UAA pricing problem.

Valpak also asks for a hearing on the “factual” issue of whether “implementation of this NSA makes a systemwide fix of the UAA pricing problem more difficult for the Postal Service, and hence, less likely.” Valpak Request for Hearing at 4 (Question B.1). This issue does not merit briefing, let alone a hearing.

First, the issue is not a “factual” one, but a question of policy. Valpak’s position is, in essence, that the current bundling of free physical return service with the other attributes of First-Class Mail creates incentives for inefficiency better resolved through a comprehensive unbundling of these elements, rather than through NSAs. Whatever the

merits of this position, it is a policy issue that does not require an evidentiary hearing to present. See p. 3, n. 4, *supra*.

Second, the Commission has already considered and rejected Valpak's position in the Capital One NSA case. MC2002-2 Op. & Rec. Decis. ¶¶ 3041-3051. The Commission held that, while a comprehensive solution to the pricing of physical returns might be ideal, the issue was beyond the scope of an NSA case, in which the Commission's task is merely to determine whether the proposed NSA represents an incremental improvement over the status quo:

In the interim, the Commission finds that the NSA, as recommended, would not violate the standard of equity advanced by Valpak, as it will not increase the burden of contribution that must be borne by other First-Class Mail users. As Capital One asserts, the rate benefits it receives will be exceeded by the amount of physical return costs driven out of First-Class Mail, to the benefit of all users. Further, as the Postal Service observes, to the extent the declining block rates stimulate volumes Capital One would not otherwise have entered as First-Class solicitation mail, the additional contribution to institutional costs would also benefit all other mailers. Thus, if the Service's agreement with Capital One is implemented according to this schematic, no user of First-Class Mail is likely to suffer negative impact rate as a consequence.

MC2002-2 Op. & Rec. Decis. at ¶ 3051. Valpak has failed to identify any new reasons for reconsidering this holding.

Third—and most important—rejecting an NSA on the theory that comprehensive reform of the physical return “anomaly” would be a better approach would be particularly inappropriate here, where the proposed NSA is functionally equivalent to the NSA already approved for Capital One, a direct competitor of Bank One. In both the Capital One NSA case and the subsequent rulemaking proceeding in RM2003-5, the Commission expressed concern that approval of the Capital One NSA could result in

competitive injury for Capital One's competitors unless functionally equivalent NSAs were made readily available to those competitors.¹² Hence, the intent of Rule 196 is to

shift the procedural focus from consideration of the general, functional, and operations aspects of the agreement, which are assumed to have been fully litigated in the previous (baseline) docket, to the *mailer-specific issues* pertinent to consideration of the functionally equivalent docket.

Docket No. MC2003-5, *Negotiated Service Agreements*, Order No. 1383, 68 Fed. Reg. 52546, 52551 (Sept. 4, 2003) (emphasis added). The outcome sought by Valpak would cause precisely the kind of competitive injury that the Commission sought to avoid through Rule 196: While one competitor, Capital One, enjoyed the cost savings of its Commission-approved NSA, Valpak's quest for perfection would impose a competitive handicap on Capital One's competitors for an indefinite period.

2. Niche classification

Valpak's attempt to relitigate the merits of a niche classification in this docket (Valpak Request for Hearing at 4, Question B.2) should be rejected on similar grounds. The Postal Service has made clear that it still regards the one-size-fits-all mold of a niche classification as too crude to accommodate the varying volume profiles and other mail characteristics of individual mailers.¹³ Whether this concern is still a valid reason to offer block discounts through individual NSAs rather than a niche classification is at most a policy issue for briefing, not a factual issue for hearing.

Moreover, Valpak's position on the niche classification issue, like Verizon's demand for a comprehensive solution to the physical return rate issue, was considered and rejected by the Commission in the Capital One NSA case. MC2002-2 Op. & Rec.

¹² See MC2002-2 Op. & Rec. Decis. ¶¶ 7014-7021.

¹³ Response of USPS witness Plunkett to Interrogatory VP-USPS-T1-9 (filed July 26, 2004).

Decis. at ¶¶ 3034-3040. To hold Bank One and other credit card issuers to a more onerous legal standard than Capital One would be unfairly discriminatory, and would engender the very kind of competitive injury that the functionally equivalent rules were designed to avoid. See Order No. 1391, 68 Fed. Reg. at 7578.

IV. OCA AND VALPAK HAVE WAIVED ANY RIGHT TO A HEARING OF ISSUES NOT RAISED IN THEIR JULY 23 PLEADINGS.

The Commission should also find that any issues not raised by OCA and Valpak in their July 23 requests for hearing have been waived. Rule 196(c) requires each participant at the initial prehearing conference in an NSA case to “identify any issue(s) that would indicate the need to schedule a hearing.” The Commission adopted this deadline as a reasonable accommodation of the interests of NSA proponents and intervenors. Order No. 1391 at 7592. In doing so, the Commission specifically found that the deadline would “provide adequate time for potential participants to study a new Postal Service request, determine whether or not to intervene, receive answers to discovery requests, and file pleadings identifying the issues to be contested.” *Id.* Moreover, Rule 24(a) specifically directs that the prehearing procedures set forth in the rules “shall be rigorously pursued by the presiding officer and all participants” to the end of “expediting the proceeding.”

In this case, however, OCA and Valpak have already received far more time to identify issues for hearing than contemplated by the expedited procedures for functionally equivalent NSAs: the two participants filed their requests for hearing on July 23—eight days after the July 15 prehearing conference, and over a month after the filing of testimony and initial interrogatory requests. It is critical that the Commission not allow OCA and Valpak to continue to generate additional issues, not yet identified, and thus further delay this expedited proceeding.

CONCLUSION

For the foregoing reasons, the Commission should deny the requests of the OCA and Valpak for a hearing on any issues other than those relating to the July 1 merger of Bank One and J.P. Morgan Chase. A decision on whether to hold a hearing on the merger issues should be deferred until August 17, 2004.

Respectfully submitted,

/s/

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(refiled July 30, 2004)

CERTIFICATE OF SERVICE

I hereby certify that I have today caused the foregoing document to be served in accordance with Section 12 of the Commission's Rules of Practice

/s/

David M. Levy

July 30, 2004