

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

Rate and Service Changes to Implement )  
Functionally Equivalent Negotiated Service )  
Agreement with Bank One Corporation )

Docket No. MC2004-3

OFFICE OF THE CONSUMER ADVOCATE  
REPLY TO BANK ONE CORPORATION  
COMMENTS ON LIMITATION OF ISSUES  
(August 5, 2004)

Presiding Officer's Ruling No. MC2004-3/1<sup>1</sup> established dates for submitting comments on the question of the limitation of issues (July 29, 2004) and for reply comments (August 5, 2004). On July 29, 2004, Bank One submitted its Comments on Limitation of Issues and Response to Requests for Hearing.<sup>2</sup> The Office of the Consumer Advocate (OCA) hereby submits its reply.

Bank One's objective is to deny OCA (and Valpak) a hearing on significant factual issues, including denying OCA the opportunity to submit testimony on the calculation of a stop-loss cap for the Bank One NSA. Bank One believes this denial of due process is justified by the following allegations:

- "One of the proponents . . . is an unregulated private business operating in competitive markets."<sup>3</sup>

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<sup>1</sup> "Presiding Officer's Ruling Establishing Procedural Schedule," issued July 23, 2004.

<sup>2</sup> Hereinafter "Bank One Comments."

<sup>3</sup> *Id.* at 1.

- The mailer's own shareholders must pay for this as a cost of doing business.<sup>4</sup>
- There are competitive implications from litigation expense and delay.<sup>5</sup>
- The general public that OCA represents does not have a genuine economic stake in the rates proposed here.<sup>6</sup>
- The decision of other large mailers and trade associations not to intervene suggests that there are no substantial factual issues in the instant proceeding.

Each of Bank One's allegations is a recurring circumstance present (or potentially present) in nearly every case filed by the Postal Service with the Commission. It is typical of cases filed by the Postal Service that first, and foremost, Postal Service interests are intended to be advanced. In addition, however, sometimes private mailers benefit from a Postal Service proposal; frequently, private mailer interests are diminished by a Postal Service proposal; and in still other cases, competitor interests are diminished by a proposal. The fact that a single mailer – Bank One – stands to benefit from the instant NSA does not make its position critically different from a niche classification case, in which a relatively small number of uniquely situated mailers may stand to benefit from a classification change. Historically, the Commission has allowed open participation in those cases and most others. Bank One's emphasis on its single beneficiary status certainly does not single it out for exceptional procedural protections.

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<sup>4</sup> *Id.* at 2.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.* at 3.

Bank One's statement that its shareholders must pay the costs of litigation comes as no surprise in a postal classification proceeding. These very shareholders entered into the NSA for the purpose of profiting from the arrangement. Expecting them to pay the costs of litigating this case as co-proponents is an appropriate expenditure.

Bank One laments that litigation expense and delay can have serious competitive implications, but this hand-wringing rings hollow. The Commission issued its decision approving the Capital One baseline NSA nearly 15 months ago,<sup>7</sup> and rules applicable to functionally equivalent NSAs were proposed by the Commission nearly one year ago,<sup>8</sup> with final rules established in February 2004.<sup>9</sup> An additional 60 days for a hearing in the instant case pales in comparison to Bank One's prolonged delay in bringing this case before the Commission.

Bank One contends that Congress' charge to the Commission that it "shall not recommend a decision until the opportunity for a hearing on the record under sections 556 and 557 of title 5 has been accorded to the . . . users of the mails, and an officer of the Commission who shall be required to represent the interests of the general public," does not apply where a single private mailer is a co-proponent of a functionally equivalent NSA. According to Bank One, "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."<sup>10</sup> Bank One devises an economic test for active participation in the instant NSA that proceeds from the assumption that approximately one-250<sup>th</sup> of one

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<sup>7</sup> On May 15, 2003.

<sup>8</sup> On August 27, 2003.

<sup>9</sup> On February 11, 2004.

<sup>10</sup> Bank One Comments at 3.

percent of the Postal Service's revenue (\$11.6 million) is at risk.<sup>11</sup> From that calculation, Bank One concludes that the adverse impact on Valpak's rates (and presumably those of any participant, including OCA) is so small as to be zero.

This minuscule effect on individual rates is common to many of the classification changes proposed by the Postal Service. Extending Bank One's logic to the numerous instances in which only tens of millions of dollars are involved in a classification or rate change would likely act as a bar to participation for most mailers in most cases. A sympathetic ruling by the Commission on this argument would bar OCA and nearly all mailers from actively litigating most small-impact classification and rate cases in the future. Bank One cites nothing in the legislative history of the Postal Reorganization Act (PRA) nor any past Commission ruling indicating that Congress (or the Commission) intended only high stakes mailers to be able to actively participate in postal rate and classification proceedings. OCA submits that the Bank One contention is flatly inconsistent with the letter and the spirit of the PRA. Furthermore, Bank One would render null and void the obligations imposed on the OCA by the Commission in the Commission's Mission Statement of the OCA.<sup>12</sup> In the OCA Mission Statement, the Commission has charged OCA with the mission of being a "vigorous, responsive, and effective advocate for reasonable and equitable treatment of the general public in proceedings before the Postal Rate Commission."<sup>13</sup> In Order No. 1409, issued on June

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<sup>11</sup> *Id.* at 4.

<sup>12</sup> Appendix to Part 3002 of the Commission's Rules and Regulations.

<sup>13</sup> These obligations include giving "a strong and consistent voice to the views of consumers, especially those that are not otherwise represented in Commission proceedings;" arguing for equity on behalf of individuals and small businesses;" utilizing "all means and procedures available under the Commission's rules and applicable law to present evidence and arguments on behalf of consumers in

24, 2004, the Commission designated Shelley Dreifuss to represent the interests of the general public. There was no indication in Order No. 1409, nor in Order No. 1391, “Order Establishing Rules Applicable to Requests for Baseline and Functionally Equivalent Negotiated Service Agreements,”<sup>14</sup> that OCA was expected to surrender its obligations in a (or in this particular) functionally equivalent NSA proceeding. OCA submits that its efforts in this proceeding have been moderate and appropriate in representing the interests of the general public.

The logic of Bank One’s argument points to a different (and ironic) conclusion. The potential positive impact of an NSA such as this — Bank One witness Buc testifies that institutional costs of \$12.5 million per year have a good chance of being realized<sup>15</sup> — has a symmetrically negligible positive impact on the Postal Service and other mailers. This raises a serious question about whether the Postal Service and the Commission should expend scarce resources on so trivial a potential benefit. Following Bank One’s reasoning to its logical conclusion, NSAs with single private mailers are bad policy for the Postal Service and the Commission. NSAs, therefore, should be subject to the high hurdle of proving substantial positive impact on the Postal Service before being considered.

Bank One attaches great significance to the fact that only a small number of trade associations have intervened in this proceeding. From this, Bank One leaps to the conclusion that no substantial factual issues are involved in the instant case. The

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Commission proceedings,” and assisting “in the development of a complete record on issues pending before the Commission.”

<sup>14</sup> Issued February 11, 2004.

<sup>15</sup> Witness Buc’s answer to interrogatory OCA/USPS-T1-24, partially redirected from witness Plunkett, filed July 26, 2004.

logic of this contention is so tortured that it does not call for an extended refutation. As Bank One well knows, actively intervening in a postal classification proceeding is a serious decision for private mailers. Generally they choose to intervene when a significant financial interest is at risk. The decision of most mailers not to intervene merely signals that a significant portion of their revenues are not at risk under this NSA. In the instant proceeding, Valpak stands as a laudable exception. Valpak's intervention and active participation should be commended, not criticized. Despite the fact that this specific NSA is not likely to have a large impact on its financial condition, Valpak *did* choose to undertake the expense of litigation, most likely for the purpose of establishing equitable principles and procedures that can be applied in future requests for functionally equivalent NSAs. While Valpak's interests may not be materially affected by this particular NSA, the principles and procedures determined by the Commission in the Bank One NSA could affect Valpak's interests directly and materially in future NSA cases. As before, Bank One has cited nothing in the legislative history of the PRA nor in Commission precedent to support the argument that limited intervention points to a lack of factual controversy.

Bank One's position is to condemn the participation of OCA and Valpak because the impact on individual mailers is so slight and then read significance into the lack of participation of other mailers whose interests are also slightly affected. This position is flatly inconsistent with the Commission's holding in the Capital One baseline NSA proceeding. The view expressed by the Commission is that even mailers not participating in an NSA (with a potential slight adverse impact on their interests) must be

scrupulously protected. This is evident from the Commission's imposition of a stop-loss cap and the reason given for doing so:<sup>16</sup>

The decisional issue before the Commission is whether it can reasonably conclude that volume discounts paid to "free riders" (mail that would have been sent even absent the NSA) over the course of the NSA will not exceed the savings generated by the electronic address correction features of the agreement. Under the circumstances set out above, the Commission can not reasonably make that conclusion unless a stop-loss provision is added. To the contrary, the Commission finds that absent such a provision there is a serious risk that discounts given to "free riders" will exceed savings to the Postal Service, and *that other mailers will be worse off because of the NSA.*

Bank One challenges OCA's position that the calculation of a stop-loss cap for the Bank One NSA is a material issue. According to Bank One, a stop-loss cap cannot be justified because, "[T]he record overwhelmingly shows that the proposed NSA is likely to generate a massive positive contribution for the Postal Service."<sup>17</sup> Bank One touts witness Buc's financial analysis as "far more sophisticated and thorough than . . . the Capital One case."<sup>18</sup> Bank One adds that<sup>19</sup> witness Buc presents 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.

Bank One also states that, "It is telling that the OCA does not allege any error in Mr. Buc's model, inputs, other assumptions, or results." OCA has not expended

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<sup>16</sup> PRC Op. MC2002-2, para. 8016. (Emphasis added).

<sup>17</sup> Bank One Comments at 8.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at 9.

substantial effort refuting the Buc model<sup>20</sup> because it has virtually no probative value in the instant proceeding. It is little more than a mechanism for applying the well known axiom that reducing the price of a product tends to spur consumers of the product to buy more of it. Without the critical inputs that apply specifically to Bank One, namely Bank One's lift rate and Bank One's response rate, the Buc model has near-zero relevance and probative impact. Witness Buc has indeed presented a technically sophisticated model, but one that is merely generic and, therefore, irrelevant to the need for a stop-loss cap for Bank One.<sup>21</sup>

In footnote 10 of its pleading, Bank One presents a detailed analysis of upside financial potential for the Postal Service as a result of the Bank One NSA. For the moment, let us ignore the fact that witness Buc's model applies not to Bank One but to a generic, hypothetical solicitation mailer. Instead, let us examine what a new Buc-style analysis might look like if it addressed only downside risk.

The OCA, using data from witness Plunkett's testimony (USPS-T-1), has calculated the potential contribution losses from failure to impose a Commission-style stop-loss cap. Those calculations have been submitted to witness Plunkett as interrogatory OCA/USPS-T1-35. The calculations show that, although annual losses in contribution resulting from the lack of a cap would be relatively modest if after-rates volumes are treated as before-rates volumes—about \$3 million over three years—they would increase to \$7.7 million over three years at the fifth discount tier, \$12.8 million at

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<sup>20</sup> OCA does not suggest any lack of technical prowess on Mr. Buc's part in devising the model.

<sup>21</sup> OCA's interrogatory OCA/BOC-T2-4 requests information specific to Bank One that might make the Buc analysis relevant. If Bank One chooses not to provide this information, or is unable to do so, then the Buc analysis remains irrelevant.

35 million pieces into the last discount tier, and \$18 million at 70 million pieces into the last discount tier. In other words, failure to impose a stop-loss cap runs the risk of giving away \$18 million in discounts without gaining any new contribution.

During informal discussions, the OCA has urged the Postal Service to provide an analysis demonstrating that the downside risk described above is more than offset by upside potential. Unfortunately, the Postal Service to date has simply recited its mantra, “conservative,” without recognizing that the “conservative” volume estimates of Bank One are so “conservative” that they could easily be forthcoming without the carrot of discounts.

In the absence of any meaningful analysis of financial risk, the OCA suggests that downside risk be substantially reduced by setting the Year-1 discount threshold at the before-rates volume estimate plus the “conservative” Year-1 switched volume. In other words, set the Year-1 threshold at the after-rates volume estimate. If, as the Postal Service claims, the after-rates volume estimates are “conservative,” then there should still be plenty of new volume induced by discounts—just as witness Buc has suggested.

To gain some perspective on just how “conservative” are the after-rates volume estimates used by the Postal Service, let us examine what kinds of volumes are implied by witness Buc’s estimated “contribution from the switched volume.” An additional contribution of \$9 million in Year-1 requires an additional volume of over 385 million pieces,<sup>22</sup> almost 20 times the Postal Service’s “conservative” estimate of 19 million additional pieces. An additional contribution of \$9 million in Year-2 implies an additional

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<sup>22</sup> Answer of witness Buc to OCA/USPS-T1-24 (partially redirected from witness Plunkett), Attachment, part III, “Sensitivity Analysis,” 20<sup>th</sup> percentile [80 percent probability].

volume almost four times the Postal Service's "conservative" estimate. An additional contribution of \$9 million in Year-3 implies the same additional volume. An additional contribution of \$12.5 million (90th percentile or 10 percent probability) requires a volume of more than 567 million pieces.

If Bank One (or the Postal Service) believes that new volumes of these magnitudes are within the realm of plausibility, then raising the discount threshold to before-rates volumes should not be an issue and should avoid the "free rider" issue addressed by the Commission in PRC Op. MC2002-2.

Bank One rests its claim that "the proposed NSA is likely to generate a massive positive contribution for the Postal Service"<sup>23</sup> on a razor-thin contribution margin of 2.3 cents in Year One of the NSA, that declines to 1.9 cents in Year Three. In fact, these contribution figures have been revised downward to 2.0 cents in Year One, 1.9 cents in Year Two, and 1.7 cents in Year Three.<sup>24</sup> This is in stark contrast to the contribution that the Capital One NSA was likely to make, i.e. 10.4 cents per piece for the most highly discounted solicitation pieces.<sup>25</sup> OCA must continue to review the answers to discovery questions to be assured that this margin does not turn negative.

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<sup>23</sup> Bank One Comments at 8.

<sup>24</sup> See witness Plunkett's response to interrogatory OCA/USPS-T1-27(b), dated August 5, 2004, in which he states that Errata relating to the contingency will be filed this week.

<sup>25</sup> [1] \$0.2910 Capital One FCM Revenue per Piece  
[2] \$0.1266 TYAR Unit Cost, Capital One  
[3] = [1] - [2] \$0.1644 TYAR Contribution per Piece  
[4] \$0.0600 Discount, "1,600,000,000 to Above" Tier  
[5] = [3] - [4] \$0.1040 TYAR Contribution per Piece less Discount  
Notes & Sources:  
[1] USPS-T-3 (Crum), Attachment A, Page 1, Col. (3)  
[2] USPS-T-3 (Crum), Attachment A, Page 2, Line (25)  
[4] Request, Attachment B, Rate Schedule 610A (Capital One)

Bank One concludes its Comments by asserting that OCA (and Valpak) have waived any right to a hearing of issues not raised in the July 23 pleading. This is patently inconsistent with the agreement of the parties that OCA and Valpak will make a final declaration of the need for a hearing, and to present testimony, on August 17, 2004. It is clearly a denial of due process to bar OCA and Valpak from pursuing factual disputes that come to light during the course of discovery. At best, the July 23 pleading was a then-current statement of the issues that had been identified up to that point.

Respectfully submitted,

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