

**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)

**RESPONSE OF BANK ONE CORPORATION
TO AUGUST 5 REPLY COMMENTS OF OCA AND VALPAK
(August 10, 2004)**

Bank One Corporation (“Bank One”) respectfully submits this response to the August 5, 2004, reply comments of Valpak Dealers’ Association, Inc. and Valpak Direct Marketing Systems, Inc. (collectively “Valpak”) and of the Office of Consumer Advocate (“OCA”).¹ The Valpak and OCA comments confirm the absence of any material dispute of fact requiring a hearing under 39 U.S.C. § 3624(a) and 5 U.S.C. §§ 556 and 557.²

(1)

The Valpak and OCA reply comments, despite their truculent tone, mark a welcome step toward narrowing the factual issues in this case. Valpak, in its July 29 comments, withdrew its request for a hearing on the policy issues of whether (1) the Postal Service should use niche classifications rather than NSAs to implement future arrangements that are functionally equivalent to the Capital One NSA, or (2) a “general fix” of the rate structure for address correction and physical returns of undeliverable

¹ Valpak Reply Comments on Limitation of Issues (filed Aug. 5, 2004); OCA Reply to Bank One Corporation Comments on Limitation of Issues (filed Aug. 5, 2004).

² This pleading does not discuss whether a hearing is warranted on the issues raised by the recent merger of Bank One and J.P. Morgan Chase. Bank One and the Postal Service have proposed that the question of a hearing on any merger-related should be deferred until August 17, 2004.

First-Class Mail should precede further consideration of functionally equivalent NSAs. Valpak Comments (July 29, 2004) at 3-4. Valpak's August 5 reply comments also indicate that it expects to withdraw its request for a hearing on the remaining issues upon receiving certain discovery responses that it "fully expects to receive" from the Postal Service. Valpak Reply Comments (Aug. 5, 2004) at 2. OCA, for its part, attempts to establish a material dispute of fact for only one of the issues identified in OCA's July 23 request for a hearing—*i.e.*, whether the risk that Bank One's actual Before Rates volume may exceed the Postal Service's rate case projections warrants a "stop-loss" cap on total discounts.³ Hence, OCA and Valpak's reply comments appear to have winnowed down greatly the list of potential issues for a hearing.

(2)

OCA's August 5 reply comments are also helpful in clarifying whether a hearing is warranted on the stop-loss cap issue itself. On pages 7-11 of those comments, OCA spells out, for the first time in this case, its theory of why the proposed discounts would reduce rather than increase the net contribution earned by the Postal Service from Bank One without a stop-loss cap. Now that OCA has explicitly stated its reasoning, it is possible to address the merits of OCA's concerns.

The gist of OCA's contribution-loss scenario is that (1) if Bank One's actual Before Rate volumes of First-Class Mail exceed projected Before Rates volumes by a wide enough margin, *and* (2) if the declining-block rate discounts offered by the NSA fail to induce Bank One to enter any additional First-Class Mail (*i.e.*, actual After Rates

³ Compare OCA Request for Hearing (July 23, 2004) (enumerating various issues that assertedly may require a hearing); OCA Reply Comments (Aug. 5, 2004) at 7-11 (attempting to demonstrate the existence of material issues of fact relating to the potential financial risks of the NSA).

volumes are identical to actual Before Rates volumes), the Postal Service would suffer a big reduction in institutional cost contribution. OCA Reply Comments at 8-9; see also OCA Interrogatory OCA-USPS-T1-35 (filed Aug. 2, 2004) (computing reduction in contribution under various Before Rate volume scenarios). While OCA's basic conclusion follows from these premises as a matter of arithmetic,⁴ the premises are unfounded and illogical.

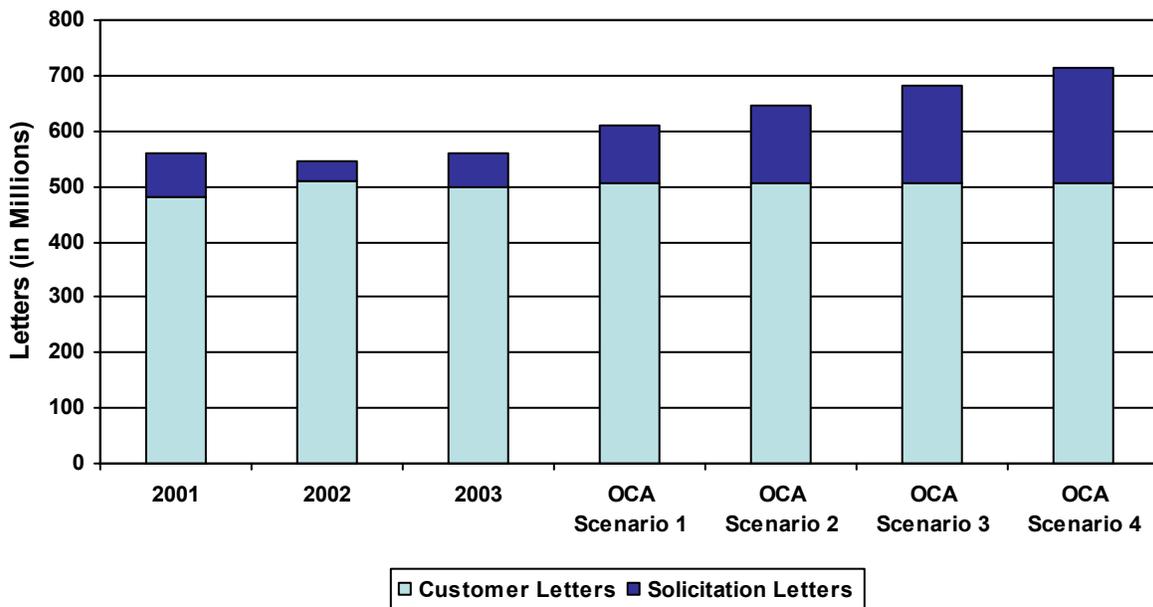
First, OCA's loss calculations assume that, even without the proposed NSA rate discounts, a radical and unprecedented increase will occur in the volume of Bank One's First-Class Mail. Specifically, OCA's calculation of a \$3 million loss in contribution assumes that Bank One's annual First-Class Mail volume will increase to 645 million pieces—an increase of 52 million pieces over Bank One's average actual volume (593 million pieces) in 2001-2003, and an increase of 222 million pieces over Bank One's projected Before Rates volume over the three years of the NSA. See OCA-USPS-T1-35, Table 4 (Scenario 1). OCA's loss scenarios of \$7.7 million, \$12.8 million and \$18 million rely on Before Rates volume assumptions that are even higher. *Id.* (Scenarios 2 through 4).

These extravagant Before Rates volume assumptions are clearly implausible. Bank One's First-Class volumes, unlike Capital One's, have been highly stable in recent

⁴ Some of the specific loss figures set forth in Table 4 of OCA-USPS-T1-35 are incorrect. In particular, the figure shown in the "Return Cost Savings" column of Table 4 for the "Plunkett" scenario misinterpret page 7 of Appendix A of Mr. Plunkett's testimony. The OCA table suggests that the ACS Savings figures on page 7 of Appendix A correspond to Before-Rates volumes of 590,135,000 in 2004, 670,135,000 in 2005, and 670,135,000 in 2006. This is mistaken. These savings correspond to a Before-Rates volume of 571,080,000 in each of these years, rather than to the After-Rates volumes cited by OCA. Bank One does not dispute, however, that the remaining scenarios calculated by OCA in Table 4 follow, as a matter of arithmetic, from OCA's premises.

years—ranging from 583 million pieces in 2001 to 600 million pieces in 2002 to 596 million pieces in 2003.⁵ Moreover, most of Bank One’s First-Class Mail (unlike Capital One’s First-Class Mail) consists of operational (or “customer”) mail—*i.e.*, monthly account statements and the like—not solicitation or marketing mail. In 2003, for example, solicitation letters represented only 60 million pieces—or *11 percent* of Bank One’s total First-Class letters in that year.⁶ Because the volume of operational or customer mail is largely nondiscretionary, OCA’s loss projections necessarily imply a veritable explosion in the volume of Bank One’s First-Class Before Rates solicitation letter volume:

Figure 1. Historical and OCA Scenario Bank One First-Class Mail Letter Volumes



Note: Because the volume of customer mail is largely nondiscretionary, the volume increases in the four OCA scenarios are treated as increases in solicitation letters.

⁵ Rappaport Direct (BOC-T-1) at 5. By contrast, Capital One’s First-Class mail volume was highly volatile during the three years of historical record in Docket No. MC2002-2. See Docket No. MC2002-2, 2 Tr. 207, 209-210.

⁶ Rappaport Direct (BOC-T-1) at 5.

OCA has not offered a scintilla of evidence—or even a theory—to suggest why Bank One’s Before Rates solicitation volume might surge so dramatically if Bank One’s existing First-Class rates remained unchanged.

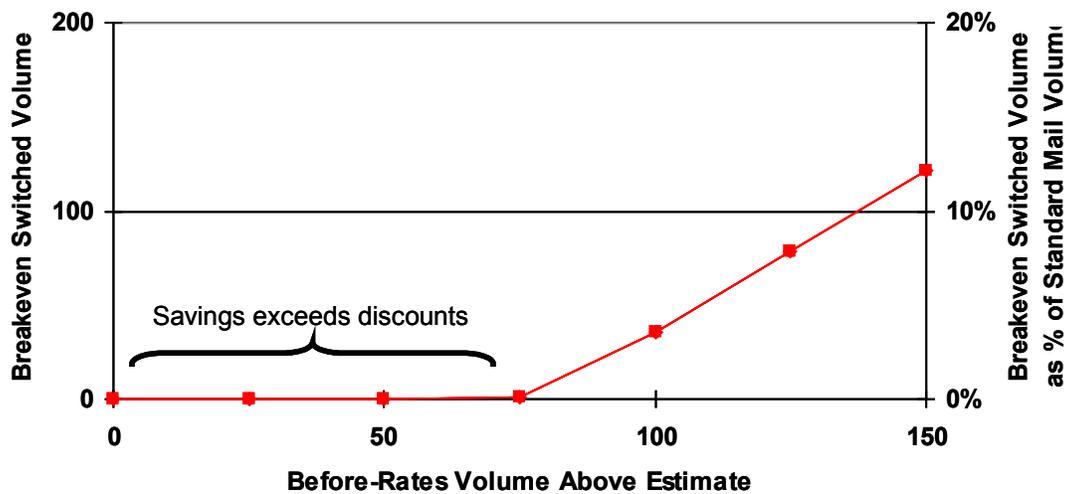
Second, OCA’s assumption that actual After Rates volume will be identical to actual Before Rates volume is also counterintuitive. As noted above, this is tantamount to assuming that the declining block discounts would have *no effect whatsoever* on the volume of First-Class Mail entered by Bank One. As OCA has acknowledged, however, it is a “well known axiom that reducing the price of a product tends to spur consumers of the product to buy more of it.” OCA Reply Comments (Aug. 5, 2004) at 8.

OCA tries to brush off the testimony of Bank One witness Buc quantifying this effect (BOC-T-2) on the ground that Mr. Buc based his assumptions about Bank One’s lift and response rates on general industry assumptions rather than proprietary Bank One-specific data. *Id.* at 7-8. OCA offers no reason, however, to indicate that Bank One-specific lift and response rates should differ materially from general industry values. Bank One clearly experiences positive lift (*i.e.*, a higher response rate) from using First-Class mail for solicitations; otherwise Bank One would enter *all* of its solicitation mail at Standard rates, which are lower than First-Class rates for this mail. And Bank One’s response rates are clearly in the same range as the industry average; if the rates were markedly higher or lower, one would expect Bank One to experience a noticeable gain or loss of market share in a very competitive industry.

Moreover, OCA fails to acknowledge how little additional First-Class volume the Postal Service would need to gain from the NSA discounts to offset any loss in

contribution resulting from any plausible variance between projected and actual Before Rates volume. As the following table shows, only a small percentage of Bank One's Standard Mail solicitation letter volume would need to migrate to First-Class Mail to offset even a large underestimate of Bank One's actual Before Rates First-Class volume. If actual Before Rates First-Class letter solicitation volume exceeded the Postal Service's projections by *100 percent*, for example, the migration to First-Class of only *four percent* of Bank One's After Rates Standard Mail solicitation letter volume would suffice to offset the loss in contribution:⁷

Figure 2. Switched Solicitation Letters to Offset Higher Before Rates First-Class Mail Solicitation Letters (in Millions of Pieces)



⁷ The horizontal axis in Figure 2 represents the volume by which actual Before Rates First Class letter solicitation volume is assumed to exceed the Postal Service's projections in this case. The vertical axis in Figure 2 represents the migration of After Rates letter solicitation volume to First-Class Mail from Standard Mail needed to ensure the NSA increases contribution based upon the higher Before Rates First-Class Mail letter solicitation volumes. This migration is displayed both in absolute terms (with the left-hand scale) and percentage terms (with the right-hand scale).

On July 15, Bank One’s consultants gave OCA’s lawyers and technical experts a hands-on demonstration of how Mr. Buc’s model could be modified to substitute alternative assumptions of OCA’s choosing in lieu of Mr. Buc’s assumptions concerning response rates, lift rates, and other relevant model parameters. It is telling that OCA has failed to identify *any* plausible set of model assumptions that would result in a net loss of contribution to the Postal Service.

Third, OCA’s risk analysis is one-sided and incomplete. OCA ignores the risk that a “stop-loss” cap would cause the Postal Service to forgo a potential net *gain* in contribution from Bank One. If “reducing the price of a product tends to spur consumers of the product to buy more of it,” (OCA Reply Comments at 8), a rational assessment of risk must give appropriate weight to the risk that a limit on total discounts would operate as a “stop-gain” cap rather than a “stop-loss” cap. This OCA has not done.

(3)

The insubstantiality of the contribution-loss scenario hypothesized by OCA and Valpak is further confirmed by the unwillingness of other stakeholders to embrace it. OCA’s rejoinder that it has standing to raise issues of this kind even when no intervenor does so (OCA Reply Comments at 3-4) misses the point. The question is not whether OCA has standing to assert the issue—of course OCA does⁸—but whether OCA has identified a material dispute of fact sufficient to warrant a hearing on the issue. On that question, the failure of any mailer association or labor union to seek a hearing or otherwise oppose the NSA, when those parties would have an economic interest in

⁸ See 39 C.F.R. § 3002.7 and 39 C.F.R. § 3002 (Appendix).

doing so if the NSA genuinely threatened to cost the Postal Service money, is evidence that the likelihood of financial loss to the Postal Service from the NSA is remote.⁹

OCA tries to brush off its lack of support from other postal stakeholders as evidence only of their unwillingness to “undertake the expense of litigation” when “a significant portion of their revenues are not at risk.” OCA Reply Comments at 6. OCA’s theory cannot explain the actions of the American Bankers Association, Association for Postal Commerce, or the National Postal Policy Council. ABA affirmatively *supports* the NSA and opposes the discount cap proposed by OCA. ABA Reply Comments (Aug. 5, 2004). PostCom also opposes a hearing on the discount cap issue. PostCom Reply Comments (Aug. 5, 2004). NPPC opposes a hearing because, *inter alia*, “None of the allegations advanced by either [OCA or Valpak] establishes a plausible reason to doubt that the NSA will improve the Postal Service’s net earnings.” NPPC Reply Comments (Aug. 5, 2004).¹⁰

⁹ As the Commission found in an analogous context in Docket No. MC2002-2, Professor Panzar’s concerns about the potential downstream competitive effects of the Capital One NSA did not “apply with much force” in that case because “Capital One’s competitors did not object to the NSA during the proceeding” and “the party most likely to represent direct competitors, the American Bankers Association,” supported the NSA. MC2002-2 Op. & Rec. Decis. (May 15, 2003) at ¶ 5048.

¹⁰ Valpak gains nothing by claiming that it is entitled to a hearing on the grounds that (1) the proposed NSA may be “discriminatory to other mailers” and (2) “the principles resolved in a proposed NSA are precedential to the consideration and approval of future NSAs that would affect other mailers.” Valpak Reply Comments at 5. Valpak did not request a hearing on any discrimination issue in its July 23 and July 29 comments, and, in any event, has failed to explain how it would have standing to assert such a claim. Valpak is not a bank, credit-card issuer, or competitor of Bank One. The two intervenors in this case that do represent competitors of Bank One—ABA and Discover—*support* the NSA. And Valpak is not entitled to a hearing merely to argue over “precedent” for future NSA cases. Disputes over law or policy do not entitle a party to a hearing. See Bank One Comments (July 29, 2004) at 3 n. 3 (citing cases). Valpak can address such issues in its briefs.

(4)

Unable to identify any material issue of disputed fact, both OCA and Valpak argue instead that requiring them to satisfy the material-issue-of-fact standard before getting a hearing would violate their “due process rights.” Valpak Reply Comments at 2-4; OCA Reply Comments at 11. As Bank One noted in its July 29 comments, however, the procedural right to a hearing in a rate or classification case is not absolute, but is limited to material disputes of fact.¹¹ Moreover, mere “allegations of facts are insufficient to mandate a hearing; ‘petitioners must make an adequate *proffer of evidence* to support them.’”¹² Neither OCA nor Valpak deny the existence of these restrictions.

Valpak asserts that it cannot be expected to satisfy these procedural hurdles at this stage of the case because the issues are too complicated and discovery is too time-consuming. Valpak Reply Comments at 3-4. Nothing in 39 U.S.C. § 3624(a), 5 U.S.C. §§ 556 and 557, or the Commission’s rules suggests, however, that NSA cases are exempt from the normal preconditions for a hearing. To the contrary, Rule 196(c) of the Commission’s Rules of Practice specifically 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 balance of the interests of NSA proponents and intervenors. Order No. 1391 at 7592.

¹¹ Bank One Comments (July 29, 2004) at 2-3 & nn. 2-5 (discussing 39 U.S.C. § 3624(a), 5 U.S.C. §§ 556 and 557, and judicial precedent under those sections). *Accord*, PostCom Reply Comments (Aug. 5, 2004) at 1 n. 1 (citing Commission precedent).

¹² *Cascade Natural Gas Corp. v. FERC*, 955 F.2d 1412, 1425-26 (10th Cir. 1992) (quoting *Cerro Wire & Cable v. FERC*, 677 F.2d 124, 129 (D.C. Cir. 1982) (emphasis added); *Woolen Mill Assocs.*, *supra*, 917 F.2d at 592; *Pennsylvania Public Utility Comm’n v. FERC*, 881 F.2d 1123, 1126 (D.C. Cir. 1989); *City of Centralia, Washington v. FERC*, 799 F.2d 475, 485 (9th Cir. 1986).

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.*

Bank One does not contend that a participant must, as a condition for obtaining a hearing, submit anything approaching full-blown responsive testimony as part of request for a hearing. But it is not unreasonable to expect an intervenor or the OCA, before asking that the co-proponent of a functionally equivalent NSA incur the six-figure litigation expense of a full-blown hearing, to identify the critical factual links in the proponents’ case-in-chief that the participant seeking the hearing believes are incorrect or unsupported. This is precisely the kind of showing that OCA has attempted to make for its stop-loss cap proposal. See OCA Reply Comments at 7-11. By laying its cards on the table in this fashion, OCA has now enabled the participants and the Commission to engage in an intelligent debate over whether a hearing is really warranted on this issue.

(5)

Finally, Valpak asserts that Bank One has failed to be responsive to the formal and informal discovery requests of Valpak or OCA, or has otherwise impeded their efforts to identify material issues of fact. Valpak Reply Comments at 2 (suggesting that Bank One has made no “efforts to conduct informal discovery”); *id.* at 4 & n. 2 (asserting that Bank One has been nonresponsive to Valpak’s formal discovery requests). These claims are false and misleading.

Shortly after OCA entered its appearance in this case, counsel for Bank One contacted OCA to offer to respond informally to any questions that OCA might have

about the proponents' case-in-chief. Since then, Bank One's lawyers and experts have met with their OCA counterparts on three occasions (including a hands-on meeting to demonstrate Mr. Buc's financial model), have participated in additional teleconferences with OCA and the Postal Service, have responded to multiple discovery requests from OCA, and have worked with the Postal Service to develop its answers to OCA's separate discovery requests to the Postal Service. OCA has welcomed such informal meetings in a spirit of cooperation.

Bank One has also tried to open similar lines of communication with Valpak. On July 13, 2004—the day after Valpak filed its notice of intervention and the day before the first settlement conference—one of Bank One's lawyers, David Levy, contacted Valpak's lead counsel, William Olson, to ask whether Valpak would like to meet or talk to review any aspect of the proponents' case. Mr. Olson replied that he had been on vacation and was unprepared to discuss the case, but might be interested in doing so later.

On or about July 18, Bank One's counsel phoned Mr. Olson to invite him and Valpak's expert, Dr. John Haldi, to a demonstration of Mr. Buc's model at Mr. Olson's offices in Tysons Corner, or another location of his choosing. Mr. Olson declined the offer by e-mail the following evening on the ground that Dr. Haldi adequately understood the model and had no questions at that time. The undersigned counsel responded as follows:

Bill --

You're welcome. Let me know if you change your mind, or if you and John think of other issues that might be explored more efficiently through an informal conference.

David

E-mail from David M. Levy to William J. Olson (July 19, 2004, 6:19 pm).

Mr. Olson did not respond to this further invitation. On July 22 and 23, however, Dr. Haldi had two phone conversations about the case with Mr. Buc. Also on July 23, Mr. Olson and Dr. Haldi had a 75-minute conference call with lawyers and experts for Bank One and the Postal Service to discuss cost and financial issues of concern to Valpak. Bank One has also responded to Valpak's formal discovery requests, and worked with the Postal Service to develop answers to Valpak's discovery requests to the Postal Service.

Valpak's only specific criticism of Bank One's responsiveness in discovery—that Bank One filed “many objections” to Valpak's formal discovery requests—is baseless. The “many objections” involved a set of Valpak interrogatories that requested a welter of detailed information on Bank One's solicitation and list management practices. Bank One objected to these questions on the grounds that the requested information constituted some of the most proprietary and commercially sensitive information in the credit card industry, and that the entire line of questions rested on a mistaken assumption that Bank One relied primarily on one-use list rentals, or otherwise would be unable to use ACS information to avoid future mailings to bad addresses.¹³ Mr. Buc elaborated on these concerns in a phone conversation with Dr. Haldi a day or two later. Moreover, Bank One, notwithstanding its objections, filed substantial answers to each of the questions within the Commission's deadline for doing so.¹⁴ Shortly before filing the

¹³ See Objections of Bank One Corporation to Valpak Interrogatories VP/BOC-T1-1-9 (filed July 21, 2004); Objections of Bank One Corporation to Valpak Interrogatory VP/BOC-T1-14 (filed July 22, 2004).

¹⁴ See Answers Of Bank One Corporation To Valpak Interrogatories VP/BOC-T1-1-11 (filed July 26, 2004); Answers Of Bank One Corporation To Valpak Interrogatories VP/BOC-T1-12-15 (filed July 26, 2004).

answers, Bank One counsel asked Valpak to contact Bank One as soon as possible if Mr. Olson or Dr. Haldi desired any additional information:

Notwithstanding our objections, we have already drafted answers to your first and second sets of questions, and plan to file the answers on Monday as due. We are hopeful that those answers, coupled with our informal expert-to-expert discussions yesterday and today, will dispel your remaining concerns about the NSA proposal. If you or John would like any follow-up sessions, please let Joy [Leong] or me know as soon as possible.

E-mail from David M. Levy to William J. Olson (July 23, 2004, 6:28 pm). Valpak never responded.¹⁵

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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August 10, 2004

¹⁵ Nor did Valpak seek relief from the Commission by filing a motion to compel as authorized by Rule 26(d).

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

August 10, 2004