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

Rate And Services Changes To Implement Functionally Equivalent Negotiated Service Agreement With Discover Financial Services, Inc.	Docket No. MC 2004-4

INITIAL BRIEF

OF

DISCOVER FINANCIAL SERVICES, INC.

September 8, 2004

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STATEMENT OF DISCOVER FINANCIAL SERVICES, INC.

The NSA that has been negotiated between the Postal Service and Discover Financial Services, Inc. (DFS) is the first functionally equivalent NSA to reach this step in the approval process, and one of only two to have been negotiated to conclusion. DFS anticipates that this NSA will be the first functionally equivalent NSA to be approved by the Commission, and that it will be approved as negotiated and submitted by the parties.

This proceeding has been marked with an unusual concern for the speed with which the review process has advanced, and for the amount of the transaction costs that DFS, as a co-proponent of an NSA, will shoulder. The reason for this is that the tone set in this proceeding regarding these two issues will have a profound impact on the future viability of the NSA as a pricing tool for the Postal Service.

The concern for rapidity of process and level of costs is not just a question of time and money, however, but goes to the fundamental competitive issues raised by the Capital One NSA. Any time a company obtains an NSA, whatever competitive edge might be given by the NSA—however small or large—is mitigated in direct proportion to the speed with which the initial company's competitors obtain their own functionally equivalent NSAs. That is a prime reason to ensure speed and economy in these proceedings.

In this regard, DFS believes that both the Commission and the Postal Service have done all they can to expedite and simplify this proceeding, and DFS expresses its appreciation of those efforts. It is DFS's view that both institutions have consistently recognized the importance of an efficient and rapid process for Commission approval of functionally equivalent NSAs, and acted accordingly. That bodes well for the future of NSAs.

DFS also notes that both the Office of the Consumer Advocate (OCA) and Valpak have made a considerable effort to help advance this proceeding.[1] Both have shown an appropriate consideration and recognition for the importance of efficiency and economy in this type of proceeding, and have bent over backwards to avoid a hearing. DFS would like to express its appreciation for their efforts.

Further, DFS was pleased to see that there were no serious efforts to delve into proprietary information during the discovery period. As the Commission knows, this is the third area where the tone set in this proceeding will have an important impact on the future viability of NSAs. Again, DFS appreciates the sensitivity that both the OCA and Valpak ultimately demonstrated in this area.

Finally, there is the fourth area where the tone set in this proceeding will have a significant impact on the future viability of NSAs, and that is in the area of competitive concerns. To borrow an image from Commissioner Goldway's Concurring Opinion in the Capital One case, the competitive effect of some NSAs on an industry and the firms in that industry will be like throwing a pebble into the ocean. There is a brief ripple, which immediately disappears. In other cases it could be much more. The financial

[1] In this regard, DFS notes that in the early stages of discovery, it said that it appeared that certain Valpak interrogatories were designed to significantly increase the costs of obtaining a functionally equivalent NSA. DFS Objection to Valpak Interrogatories, July 27, 2004. Valpak's forbearance during subsequent discovery has shown that DFS's concern was unfounded, and DFS is pleased to retract that remark.

effect on the credit card industry of the Capital One NSA, the DFS NSA, and the Bank One NSA is in the pebble category.

The public policy questions posed in a competitive inquiry are not just limited to economics, however. The Postal Service is not a private entity, but a federal government entity and thus has the responsibility to treat all citizens fairly and equitably. In order for the NSA process to evolve in a healthy fashion, the Commission will need to recognize reasonable perceptions of fairness held by competitors, and act accordingly.

This is an area, DFS respectfully suggests, where perception will be as important as reality, if not more so. Specifically, DFS suggests that the Commission should not override reasonable negotiated provisions (i.e., not rebalance the benefits and risks of the deal), particularly those written out of competitive fairness and equity concerns.

STATEMENT OF THE CASE

This is a case where the Postal Service and Discover Financial Services, Inc., a direct competitor of Capital One, have negotiated an NSA that is functionally equivalent to that of Capital One. Not only does the DFS NSA contain essentially the same terms and conditions as the Capital One NSA, modified to fit DFS's particular circumstances, but the DFS NSA is essentially the same contract as Capital One's.

Not everything is identical, however, for DFS does not run its business like Capital One, does not market like Capital One, and is not as large a mailer as Capital One. Hence there are differences in DFS's NSA. The discounts are different, the thresholds are different, the updating procedures are different, and various other matters, as identified in Attachment E, E-12-16 to the Postal Service's Request in this docket.

The Discover NSA is not complicated. Just as in the Capital One NSA, Discover will forgo its right to accept the physical delivery of First-Class undeliverable mail in return for accepting change of address information electronically.[2] That saves the Postal Service more than 21 cents per piece, an enormous savings. Testimony of Ali Ayub (USPS-T-1) (Ayub) at Appendix A, page 1, lines 5 and 6. The net savings to the

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[2] Moreover, Discover has accepted a contractual obligation to use that electronic information to mail more productively. Exactly how DFS will do so—when and how it will use suppression lists, merges, purges, etc.—will be determined after an analysis of the quality and nature of the data received. Having analyzed the details of DFS's level of technological sophistication, the Postal Service was more than satisfied with this commitment. In some ways this could be the most productive part of the contract for the information and analysis performed by DFS on this data could be worth an enormous amount to the Postal Service. The value of that analysis is not calculated into this NSA.

Postal Service from not having to physically deliver DFS's undeliverable mail (ACS Cost Savings) is $8.2 million over the course of the agreement. Ayub at 12.

To fully appreciate this contract, it is important to realize that under this NSA, the Postal Service starts accumulating savings (from not having to physically deliver DFS's undeliverable mail) immediately upon implementation of the NSA, and long before DFS starts to earn any discounts. It is also important to realize that DFS starts incurring new and significant data processing and other IT expenses immediately upon implementation of the NSA, just in order to receive, analyze, and use the Postal Service's electronic address data.

In fact, although DFS will need to incur significant expenses immediately upon implementation, it will not start seeing any return on its investment until it has mailed 405 million pieces. Only at that point will the Postal Service begin to share a portion of the savings that it has already accumulated.

As is obvious, since the parties negotiated a threshold of 405 million, which is lower than DFS's projected volume of 451 million, there is a certain portion of the money (that the Postal Service has already accumulated) that will be given back to Discover on pieces that Discover would have mailed anyway. Witness Ayub calculates that to be $3.2 million.[3] Ayub at 12. It is only fair that DFS get some return before it

[3] The $3.2 million that is shared with Discover is done so in recognition of the fact that the Postal Service has been accumulating these cost savings from the point at which DFS makes it first mailing under the NSA, and of the fact that DFS has been accumulating costs during the same time. Importantly, this is not $3.2 million "lost" to the Postal Service or "leaked" from the Postal Service for DFS would receive that $3.2 million in any circumstance. Had DFS and the Postal Service negotiated a threshold that was that was equal to with DFS projected volume level, then DFS would have negotiated deeper discounts. The net result would have been that the $3.2 million would have been shared with Discover one way or another.

reaches its projected volumes, for it will have incurred significant costs by then. Any other result would not have been acceptable to DFS.

Beyond the threshold and the DFS volume projection, the discounts will create incentives for DFS to choose mail over other marketing channels when making decisions for future marketing campaigns.[4] Both the savings returned and the volume incentives created are done through per-piece discounts, under the following schedule:

Volume Tiers (pieces)	Per Piece Discount
405 million to 435 million	(2.5 cents)
435 million (+1) to 465 million	(3.0 cents)
465 million (+1) to 490 million	(3.5 cents)
490 million (+1) to 515 million	(4.0 cents)
515 million and above	(4.5 cents)

DFS NSA at 4.

There are two differences between the DFS NSA and the Capital One NSA that bear mentioning. First, the DFS NSA contains a threshold adjustment mechanism that, essentially, acts to remove growth in additional customer mail from the threshold, thus ensuring that the additional mail that moves DFS up the ladder of discounts is solicitation mail, not customer mail. DFS NSA at 5. Second, the DFS NSA contains a negotiated cap of $13 million, intended to ensure competitive equity between DFS and its competitor, Capital One. DFS NSA at 4. Neither provision detracts from the status

[4] Thus, the discounts given DFS serve two different purposes. First, above the threshold and beneath the volume projection level, they give back to DFS some of the savings the Postal Service has accumulated. Second, above the volume projection level, they create the incentive to create new First-Class volume.

of the NSA as a functionally equivalent NSA, but simply adds a level of fairness and sophistication to the contract.

Finally, this is not a narrowly tailored classification that the Commission is reviewing. It is a contract, and it is the product of a bargaining process. The process of negotiating any large contract is a delicate and lengthy process. That process, if there is a "meeting of the minds," results in two delicate balances being created—one that balances interests and benefits, and one that balances assumption of duties and risks.

The process of making a good bargain is essentially one of compromise. That is how balances are created. One side gives one item up, but receives a concession somewhere else in return. Sometimes one side may very reluctantly give up something, without an exchange concession, but let it be known that that was the final straw. If the negotiators are good, both sides sense the balance and strive to keep it level, as each side focuses on meeting its particular needs and on assuming the duties and risks that it believes it can reasonably bear. When those concerns balance out, a meeting of the minds is reached, and a contract signed.

The negotiation of this contract took almost two years from start to finish, involved many phone calls, countless emails, and a number of face-to-face meetings. The course of the negotiations took several turns and a number of issues were considered. As in all bargaining, some propositions were accepted, some were rejected, some were countered, and some of the counters were in turn countered. Ultimately, there were compromises and rebalances. Some of the compromises deal with whose interest would be furthered, and how. Other compromises focused on who assumes what risks.

For the NSA process to succeed, the Commission must be careful not to upset either the balances of interests and benefits, or the balance of the assumption of risks. To do otherwise would be to rebalance the contract, redistribute the equities, destroy the actual bargain the parties reached, and substitute another bargain in its place.

I. THE DFS NSA IS FUNCTIONALLY EQUIVALENT TO THE CAPITAL ONE NSA.

In Order 1391, issued February 11, 2004, the Commission adopted rules under which it would consider Requests to approve NSAs. The Commission adopted the concepts of baseline and functionally equivalent NSAs in that Order, and set forth a test for determining whether an NSA is functionally equivalent to another. Postal Rate Commission Order 1391 at 50.

That test has two prongs. The first considers the literal terms and conditions of the two NSAs, and focuses on whether both agreements rest upon the same substantive functional elements. The second prong considers the comparative effects of the NSAs on the Postal Service and focuses on whether both agreements create comparable benefits. Order 1391 at 50-51. A "comparable benefit," the Commission carefully noted, does not mean an *identical* benefit, but a comparable one, when considered in the context of the characteristics of each participant and the terms and conditions of the NSAs. The DFS NSA passes both parts of the test.

A. The Commission's Test, Part One: Same Substantive Functional Elements.

In illustrating how the first part of the test would work in the Capital One context, the Commission observed that the Capital One NSA contained two elements: 1) an address correction element where the Postal Service would not physically return undeliverable mail but provide electronic information instead (thus saving the costs of the physical return of the piece), and 2) a declining-block rate element. A subsequent NSA would pass the first prong of its test, said the Commission, if it contained both of these elements.[5]

The DFS NSA contains both an address correction element where DFS forgoes its right to receive physical returns in exchange for the provision of electronic returns, and a declining-block rate element. This is outlined in detail in the Ayub Testimony (USPS-T-1) at 6-10. The DFS NSA passes this part of the test.[6]

B. The Commission's Test, Part Two: Comparable Benefits.

In illustrating how the second part of the test would work, the Commission provided a hypothetical example of an NSA that was similar to the Capital One NSA but did not provide a comparative benefit. The Commission example posited an NSA that contained the same elements as that of Capital One—address correction with electronic information returns instead of the physical return of the piece and declining block

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[5] The Commission also noted that an NSA could be taken out of the functionally equivalent category if it contained the same two elements, plus other significant elements. Order 1391 at 50-51. The DFS NSA contains no other significant elements.
There are two provisions that are different about the DFS NSA. First, it has an adjustable threshold based on fluctuation in customer mail. Second, it has a different type of cap. Neither of these rise to the level of an "element."

[6] A comparison of the Capital One DMCS language and the proposed DFS DMCS language is also instructive, although not required by the Commission's test. Section 610 of the Domestic Mail Classification Schedule (DMCS) sets forth the basic elements of the Capital One NSA. A comparison of that section and the proposed DMCS language for the DFS NSA (Attachment A to the Postal Service's Request) show little differences, other than relative discount and threshold amounts. Both restrict the eligible mail to customer correspondence with established account holders and First-Class mail solicitations that bear the endorsement specified by the Postal Service. *Compare DMCS §610.1 with proposed DMCS § 611.1.* Both preclude Business Reply Mail and Cards, and Priority Mail. *Id*. Both waive address correction fees in exchange for a pledge to improve address quality and both include a minimum guaranteed threshold, with appropriate penalties for not reaching the threshold. *Compare DMCS § 610.2 with proposed DMCS § 611.2* Finally, both provide for the same type of declining-block discount structure, with minimum thresholds, threshold adjustments, and a discount limit. *Compare DMCS § 610.3 with proposed DMCS § 611.3*

discounts—but assumed a mailer who has a very low return rate. Indeed the Commission assumed a mailer with a return rate so low as to essentially eliminate the cost savings aspect of—and hence the benefit from—the physical return of the pieces, thus turning the NSA into a pure declining-block discount NSA. Such an NSA, the reasoning went, would not be functionally equivalent.

In the context of the DFS NSA, the Postal Service does receive a benefit from both elements of the NSA, comparable to that of the Capital One NSA. DFS's return rate of 9.3 percent is comparable to that of Capital One's return rate of 9.6 percent,[7] and DFS has agreed to forgo physical return of undeliverable mail in exchange for receipt of electronic address change information. That will save the Postal Service $8.2 million over the life of the contract. Ayub at 12. While this is not a benefit identical to that of the Capital One NSA, it is a comparable benefit. Moreover, it is a comparable benefit coming from the NSA of a direct competitor to Capital One.

In terms of the declining block discounts, those in the DFS NSA would work in the same fashion as those in the Capital One NSA, with different discounts and different thresholds, to reflect the different characteristics of DFS. With such comparable benefits, the DFS NSA also passes this prong of the test and thus qualifies as an NSA functionally equivalent to Capital One's.

[7] Docket MC2002-2, Issued May 15, 2003 at 155, Table 8-2, line 7 (Capital One Decision).

II. THE COMMISSION SHOULD APPROVE THE DFS NSA.

A. The DFS NSA Will Be Profitable For The Postal Service Under Any Reasonable Circumstances.

Under this NSA, the Postal Service will save approximately $8.2 million from not having to physically return DFS undeliverable mail. Ayub at 12.

Additionally, as it negotiated this NSA, DFS determined that it would upgrade to First-Class Mail certain segments of its Marketing Mail that it currently sent Standard Mail, and make those pieces more efficient from a marketing perspective. Those segments are known, the volumes calculated, and they will not change. That Standard to First-Class upgrade will yield an additional net contribution of $2.1 million, according to the Postal Service. Ayub at 12.

Finally, as noted above, since the Postal Service immediately starts to accrue benefits from this contract, and DFS immediately starts to incur expenses, the contract is set up to return to DFS some of the accrued postal savings *before* it reaches its projected volumes. That totals $3.2 million. Ayub at 12.

The total benefit for the Postal Service, according to its calculations, is thus $7.17 million—$8.2 million in cost savings, plus $2.1 million additional contribution, minus the $3.2 million given back to DFS for volumes mailed under its volume projection ($8.2 + $2.1 – $3.2 = $7.1). Ayub at 12.

Most importantly—and this is an absolutely critical fact for the Commission to recognize—these calculations include ONLY the mail to be upgraded, and do not include ANY contribution from ANY new First-Class Mail pieces that DFS will decide to create. In economic terms, these calculations have assumed a DFS price elasticity of ZERO.

Whatever the price elasticity is for DFS, it is not zero. There will be some increased new volume that is not included in these calculations. DFS will react to the lower prices,[8] and its reaction will cause new volume and new contribution. Yet none of that contribution is figured into this NSA, and that volume could be considerable. Thus, the $7.1 million is not merely a projected "profit" for the Postal Service, but a projected *minimum* "profit" which will be higher and could be much higher.

Two other points bear mentioning.[9]

First in terms of analyzing the costs of the deal, the Postal Service has enhanced its analytical approach as compared its approach in Capital One. The Postal Service's financial model, which is attached to Witness Ayub's testimony, is far more sophisticated and comprehensive than that used in Capital One. That model has shown, as Witness Ayub has testified, that "even at maximum discounts, all NSA volumes would make substantial contribution to institutional costs." Ayub at 10. This is not an NSA that could lose money for the Postal Service under any reasonable circumstances.

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[8] DFS did not calculate any new volume simply because it did not have a reliable way to do so. The DFS negotiators were business men and woman who have no interest in "constructing" a projected figure, nor did they see any reason to do so. This deal would allow the Postal Service to make a minimum of seven million dollars, and have the potential to make a great deal more. As business men and women, they thought that should be sufficient.

[9] There have been suggestions in discovery that under some scenarios, this NSA could result in a loss for the Postal Service. None of these scenarios have used realistic assumptions. Should any party suggest that any of these scenarios are realistic, DFS will respond appropriately in its Reply Brief.

Second, that model assumes a *four percent* annual cost adjustment rate in the out years. Ayub at Appendix A, page 1, line 4. That is a conservative figure that probably overstates the Postal Service's cost increases, particularly given recent productivity gains. The use of that figure thus understates that value of the NSA for the Postal Service.

B. The DFS NSA Is Fair And Equitable To Other Users And To Competitors.

Any NSA that results in a net financial gain for the Postal Service—whether from net cost savings or increased contribution—benefits, at least to some degree, all mailers. As the Postal Service's financial analysis demonstrates, the DFS NSA will have a positive financial effect on the Postal Service, under any reasonable circumstances. Ayub at Appendices A and B. The DFS NSA is thus fair and equitable to the other users of the mail.

Turning to the competitive question, DFS is a competitor of Capital One who did not intervene in the Capital One case. Many have speculated why banks did not intervene in that case. DFS can say that, for its part, it did not see itself as being disadvantaged, so long as it was able to obtain a proportionate deal—a like and equivalent deal— from the Postal Service. The Postal Service is, after all a federal government agency and the government has a duty to treat citizens fairly and equitably. As explained below, DFS's notion of fairness and equity turn on the competitive cap.

DFS does not anticipate its NSA having any negative effect on its competitors. As noted above, the competitive effect of some NSAs will be that of a pebble dropped into the ocean. This NSA, along with the Bank One NSA, falls into the pebble category.

III. THE COMMISSION SHOULD ACCEPT THE PARTIES' NEGOTIATED COMPETITIVE CAP.

In the Capital One case, the Commission created a $40.6 million cap that limited the benefits that could be realized under the NSA. As explained below, the conditions that led the Commission to create such a cap in the Capital One case do not exist in the Discover case. DFS nevertheless negotiated a "competitive cap" of $13 million that voluntarily caps its NSA, and tracks Capital One's cap on a proportionate dollar basis. The Commission should approve this NSA with that $13 million cap.

A. The Reasons For Adopting A "Stop-Loss" Cap That Existed In The Capital One Case Do Not Exist In This Case.

1. The "Stop-Loss" Cap In The Capital One Case Was Predicated Upon Capital One's Evidence Of Its Pre-NSA Volumes Not Being Credible. Those Conditions Do Not Exist In This Case.

In the Capital One Case, the Commission approved the NSA as negotiated and submitted, with one exception. Because "the evidentiary record contains no plausible estimate of the volume of First-Class Mail that Capital One would send during the terms of the NSA if no discounts were made available," the Commission determined that a "significant risk exists that discounts to Capital One could exceed costs avoided by the Postal Service." Capital One Decision at 2, 148.

In order to ensure that this development did not occur, the Commission created a "stop-loss" provision that capped the discounts at 95% of USPS savings, at the volume point where the discounts began to exceed those savings, under Commission assumptions.[10] That cap was $40.6 million.

There were three facts upon which the Commission based its conclusion that "the estimates of 'before rates' volumes for Capital One are so unreliable that without a stop-loss provision there is no reasonable assurance that the Postal Service will not lose money on this NSA." Capital One Decision at 148. They are:

- Capital One has a history of rapidly increasing First-Class Mail Volume.
- It did not project its volumes more than six months in advance.
- In the last complete year, it mailed record levels of First Class Mail.

None of those facts are present in the DFS case.

First, DFS has a history of modestly rising and then modestly *declining* mail volume, as well as a history of increasingly using other marketing channels at the expense of mail, as the unchallenged record explicitly indicates. Testimony of Karin Giffney (DFS-T-1) at 4-5, 10 (Giffney). The lack of rapid increases in DFS's volumes is shown in the following chart:[11]

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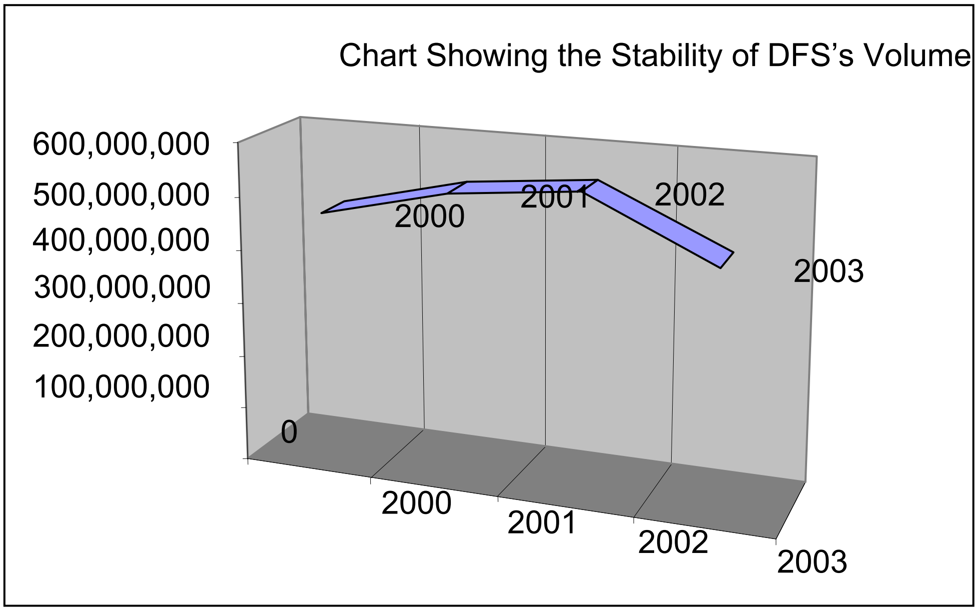
[10] The Commission actually made an implicit assumption that, upon further review, probably should be adjusted. The Commission assumed that any new volume would have the same customer statement/solicitation mail ratio as Capital One's existing mail volume. That is not a valid assumption. New volume of statement mail is directly tied to the number of new customers a credit card company obtains and (unfortunately) those numbers do not increase rapidly. Moreover, it takes many pieces of solicitation mail to generate a new account. Thus, the new volume coming in due to an NSA will be almost entirely solicitation mail.

This is particularly true in DFS's case where the DFS NSA has a threshold adjustment provision that adjusts the threshold to take into account solicitation mail growth. Thus, any true stop loss cap, to be consistent, would have to be focused only on solicitation mail and would be proportionately much larger than that in Capital One.

[11] This chart graphs the annual levels of DFS total First Class Mail and is a chart of the data in the Appendix to the Giffney testimony, which had been entered into the record. The same data is shown, on a per month as opposed to per year basis, on page 7 of the Giffney Testimony.



Second, DFS does project its mail expenses more than six months in advance, and provided those projections—which have not been challenged—for the record. The first year projection is its *actual* budget figure—a figure that has undergone all the rigors of the DFS/Morgan Stanley budget process. Its second and third year volume projections are flat, which is perfectly consistent with Giffney's testimony that states that DFS has been increasingly using other marketing channels at the expense of mail. Giffney at 8.

Third, DFS's last year's volume did not increase, much less set record highs. Indeed, as the record shows, DFS's volume decreased last year. Further, as the DFS testimony makes plain, there is little change of the occurrence of any set of events that would prompt record levels of DFS mailings, because of the competition from other marketing channels:[12]

> DFS uses a variety of marketing channels in its marketing mix and our First-Class Marketing Mail volume, which recently has been relatively flat, reflects that. This trend continues in our first year's forecast, which is an actual budgeted figure. Moreover, unless the cost structure for mail becomes more attractive, this trend will continue in years two and three, as alternate channels increasingly are considered by DFS.

Giffney at 10; see Giffney at 4, 7-9; see Ayub at 5 ("Specifically, Discover has a history of declining First Class Mail Volume, and the NSA is expected to help to reverse this trend.")

2. The Record Evidence In This Case Concerning DFS Volume Projections Is Not only Credible, But Unchallenged. There Is No Record Basis For A Stop-Loss Cap.

Of the nearly 90 interrogatories that have been propounded to the co-proponent witnesses, not one has questioned the before-rate projections of DFS witness Giffney. Further, not one has questioned witness Ayub's independent assessment—built up over two years of analysis and negotiations—that those volume projections are reasonable. Ayub at 2.

Witness Giffney has not only given a valid three-year projection but she has explained why the three year projection is essentially flat. That reason is that the mail

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[12] This is in sharp contrast to the Capital One case. There the Commission found significant that fact that Capital One could "not rule out the occurrence of a set of events that might prompt a similar [record volume] mailing pattern." Capital One at 148. Also, as evidence of the instability of Capital One's volume estimates, the Commission focused on the fact that "Capital One's estimate of its First-Class volume in the current year has fluctuated markedly while this case has been in progress." Capital One Decision at 149. DFS's projections have not changed.

as an advertising medium is coming under increasing competition from other marketing channels. Giffney at 4.

It is telling that among the plethora of factual issues initially raised by both the OCA and Valpak as possible grounds for a hearing, the issue of the credibility of Giffney's volume estimates never was mentioned. Giffney was prepared to come before the Commission to answer questions at length about the validity of budget numbers and projections. That turned out not to be necessary, since no one questioned her projections.

The net result of this is that no record basis exists upon which the Commission could override the negotiated competitive cap and substitute its own "stop-loss" cap. This is because the all the uncontested evidence on the record shows that, unlike Capital One, there will not be a "loss" to "stop."

B. The Commission Should Defer To Reasonable Negotiated Competitive Provisions Where Those Provisions Represents Competitive Parity To that Party

As the Commission noted in its Order adopting its NSA rules: "The Commission has no intent of acting as a bargaining party, or is its interest 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." Order 1391 at 21.

In that Order, the Commission further stated that its role was not limited to just providing a positive or negative recommendation, but that 1) when it found an NSA that did not meet the provisions of the Act, it would recommend modifications that would bring it into compliance with the Act, and b) in other cases it would feel free to express its views and suggestions (as opposed to making formal recommendations) about potential changes as a guide to the Postal Service and the Governors. Order 1391 at 21. It is important the Commission stick to this position, and only override proposed contract provisions where the proposed NSA is plainly not in compliance with the Act.

1. The Area Of Competitive Issues Is The Most Delicate Of The NSA Process.

Negotiated Service Agreements (otherwise known as "contract rates") have been long debated in postal circles. The driving concern behind the opposition to NSAs was that competitors would be harmed by the government giving a deal to one but not another. Proponents of NSAs always assured competitors that they would get a deal of equal value.

The sharp concern during the debates was never on the question of harming other mailers, but was focused on competitors. The reason for that is that the Postal Service and mailers come out ahead so long as the vast majority of NSAs are profitable. The dynamic is not the same where the issue is the effect on competitors. In that situation, significant public policy issues would exist if just one company were seriously harmed by the government's action of granting an NSA to its competitor. For this reason, the Commission must pay particular attention to competitive concerns, and begin to set the appropriate groundwork for dealing with competitive concerns now, before the competitive pressures manifest themselves.

2. The Commission Should Give Deference To DFS's Views Of What Constitutes Competitive Parity And Should Approve Its Negotiated Cap.

The issue at the core of the competitive concern is fairness—the fair and equitable treatment of all competitors, which are by definition similarly situated companies, by the government. DFS's view of a fair and equitable deal *turns on the notion of its ability to receive an opportunity proportionate in size and scope to that which was afforded Capital One, as measured in dollars and cents.* It is for this reason that DFS negotiated and the Postal Service accepted the "competitive cap."

There are several important elements in the language italicized above.

First, there is the element of opportunity. That means giving a competitor the chance to partake of a benefit tailored to its needs. So long as a competitor can make that choice, and the opportunity is "real," the process is fair. If the competitor decides not to take full advantage of the opportunity, so be it.

Second, there is the notion of proportionality. The Postal Service and the Postal Rate Commission do not have to give all of Capital One's competitors the opportunity to make $40 million on an NSA. The Service and the Commission, however, do have to give Capital One's competitors a proportionately equal opportunity. That should be dictated not only by general principles pf government fairness and equity, but by the nondiscrimination terms of the Postal Reorganization Act.

Thirdly, the opportunity that should be afforded Capital One's competitors should be one that is proportionately equal in *terms of dollars and cents* if this process is to thrive. Notions of fairness where the government is offering competitors proportionately equal deals are only going to be widely accepted by the business community, if the bottom line effect on the business is proportionately equal in financial terms—proportionate dollars and cents. Any other approach, based on other ratios, data, or whatever, runs the risk of being viewed by the business community as overly technical and divorced from the real world. Creating such a perception would be tragic and put the evolution of the NSA process at risk.

DFS is a smaller mailer than Capital One, about one third the size of Capital One. It is only fair that DFS have an opportunity to enjoy a deal proportionate to Capital One. DFS has negotiated a cap proportionate to that of Capital one and urges the Commission to recommend it. The imposition of any cap lower than the competitive cap would not be giving DFS a proportionate opportunity.

CONCLUSION

For the reasons stated above, the Commission should approve the DFS NSA as negotiated and submitted to the Commission

Respectfully submitted,
Discover Financial Services, Inc.

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September 8, 2004

Certificate of Service

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

______/S/_______________
Robert J. Brinkmann
September 8, 2004