Postal Rate Commission
Submitted 9/15/2004 1:59 pm
Filing ID: 41730
Accepted 9/15/2004

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

REPLY BRIEF
OF
DISCOVER FINANCIAL SERVICES, Inc.

September 15, 2004

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Pursuant to Presiding Officer's Ruling No. MC2004-4/3, issued August 25, 2004 Discover Financial Services, Inc. (DFS) submits this reply brief.

PRELIMINARY

Neither Valpak nor the OCA have shown that the Postal Service could lose money under the DFS contract, under any reasonable circumstances. As Valpak has said: "[T]his NSA 'works' financially . . . Over a range of foreseeable outcomes, the proposed NSA does appear likely to yield the Postal Service a positive, albeit modest, contribution to institutional costs." Valpak Brief at 14, 40. That is exactly the point. This NSA does "work financially," will yield increased contribution, and should be approved as is.

In terms of the its positions, the OCA has suggested that both major parts of the rate structure—thresholds and discounts—be modified. That was the essence of the negotiations. DFS has authorized its attorneys to state that, should this happen, it will reconsider its participation in the contract.

DFS and the Postal Service made a deal. As long as the deal will not lose money for the Postal Service, the Commission should approve it as presented and not accept the modifications proposed by the OCA and supported by Valpak.

The OCA suggests that the data plan be adjusted to document how DFS responds to the addressing data it will receive electronically. DFS will not accept that provision. This is supposed to be a ***data*** collection plan, not a collection plan of proprietary analysis. The data collection plan will pick up DFS return and forwarding ***data*** as the plan is presently drafted. Thus the OCA's suggestion is not necessary to the collection of additional data. DFS's analysis of the electronic addressing information will be highly proprietary.

Having said this, DFS does concur with three of the OCA's points. First, the OCA points out that the Postal Service's data collection plan did not include a requirement to gather DFS's "Volume of Standard Mail solicitations," and argues that it should. OCA Brief at 15. DFS and the Postal Service both accept this suggestion, and the Postal Service has attached a modified data collection plan to its reply brief.

Second, when the OCA calculated the Commission's Capital One type of stop-loss provision, it adjusted an assumption in the methodology about the mix of new volume, and assumed that volume above the forecast level is all acquisition volume. The OCA calculates that a stop-loss cap with this adjustment would be $11.6 million.

OCA Brief at 30. Although a stop-loss cap is not called for in the instant case,[1] if one had been necessary, the adjustment made by the OCA would be appropriate. See OCA brief at 28-30; see also DFS brief at footnote 10.

Third, in terms of DFS's volume projections and the need for a stop-loss cap, the OCA acknowledges that "there appears ample evidence to suggest that unlike Capital One, Discover's after rates marketing volumes are reasonable, and thus likely to occur." OCA Brief at 30. Further, the OCA states that "like the Postal Service, the OCA believes that the possibility of a financial loss from extensive 'anyhow' marketing mail rests on several unlikely assumptions." OCA Brief at 21.

Finally, although nothing was said of this issue in either the OCA's or Valpak's briefs, DFS urges the Commission to keep foremost in its mind the notion that the parameters of the functionally equivalent NSA approval process must be guided by a need to maintain balance among competitors if the NSA process is to flourish without disrupting markets.

[1] The Commission anticipated in its Capital One Decision that a stop-loss cap would be far less likely to occur in future NSAs. Capital One Decision at 151.

I.

THE ARGUMENTS OF VALPAK AND THE OCA GET LOST IN THE DETAILS OF THE CONTRACT AND LOSE SIGHT OF THE OVERALL BENEFITS TO THE POSTAL SERVICE.

There is an old saying that "where there is smoke there is fire." But if there is no fire, an old trick is to create so much smoke that everyone thinks there must be a fire there somewhere, even though no one can really find it. The OCA and Valpak briefs are of this ilk.

The OCA and Valpak strive to paint a picture of the DFS contract as unreasonable and risky. They have done so using broad brush strokes that build up, layer upon layer, one set of assumptions upon another, until it looks like something is wrong with the contract. Such an unflattering caricature of this contract is not warranted.

A. The Overall Picture Of The DFS NSA.

Both Valpak and the OCA have raised a number of questions concerning the cost estimates on which the proposed NSA is based. On the one hand, none of the questions raised are unimportant. On the other hand, none of the questions raised have much effect on the viability of the NSA, and the conclusions they reach are improbable and unreasonable.

This can see be seen when the questions are examined in view of the ***overall*** financial picture of the NSA, which is what is most important. A good way to show the overall financial impact is to start with the analysis done by the Commission in the Capital One case.

Specifically, the Commission's Figure 8-1, reproduced below, shows the benefit to the Postal Service that the Commission found in the Capital One NSA (ACS Savings) and the money paid to Capital One in discounts (Discount Leakage) plotted against volume, under the assumptions the Commission made. The vertical axis is in dollars. At any volume selected, the difference between the Savings line and the Discount line is the financial benefit to the Postal Service, a benefit that seems central to most of Valpak's and the OCA's analysis. Note that this graph and the following ones show a one year time frame for simplicity's sake.

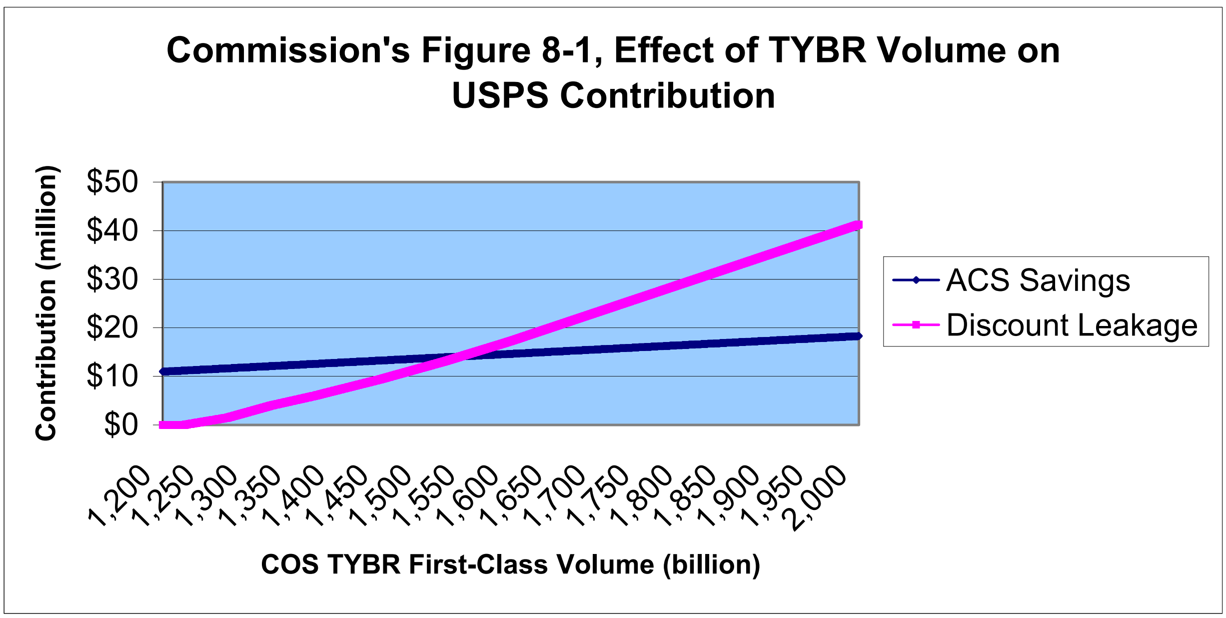

CHART ONE CAPITAL ONE

DFS's volumes are lower than those shown above, but the picture is the same, if one assumes ***no*** additional contribution from shifted or new volume. The point where the two lines cross is the basis for the cap recommended by the Commission. The Savings line, in the Capital One case, was limited only to savings realized by the Postal Service from not having to return undeliverable pieces. The Savings line in the Capital

One case did not include *any* additional contribution due to new First Class solicitation volume.

As noted in the beginning of this brief, the OCA has developed a calculation like this for the DFS contract with an adjustment to assume that volume above the forecast is all acquisition volume, an assumption that is both defensible and reasonable. Using the savings where the lines cross, the 95-percent cap for three years is, according to the OCA, $11.6 million. OCA Brief at 30. We agree and have plotted a chart for the first year, shown below. In Chart two, the slope of the savings line increases at the forecast level of 451 million, due to the assumption that all additional volume is acquisition volume.

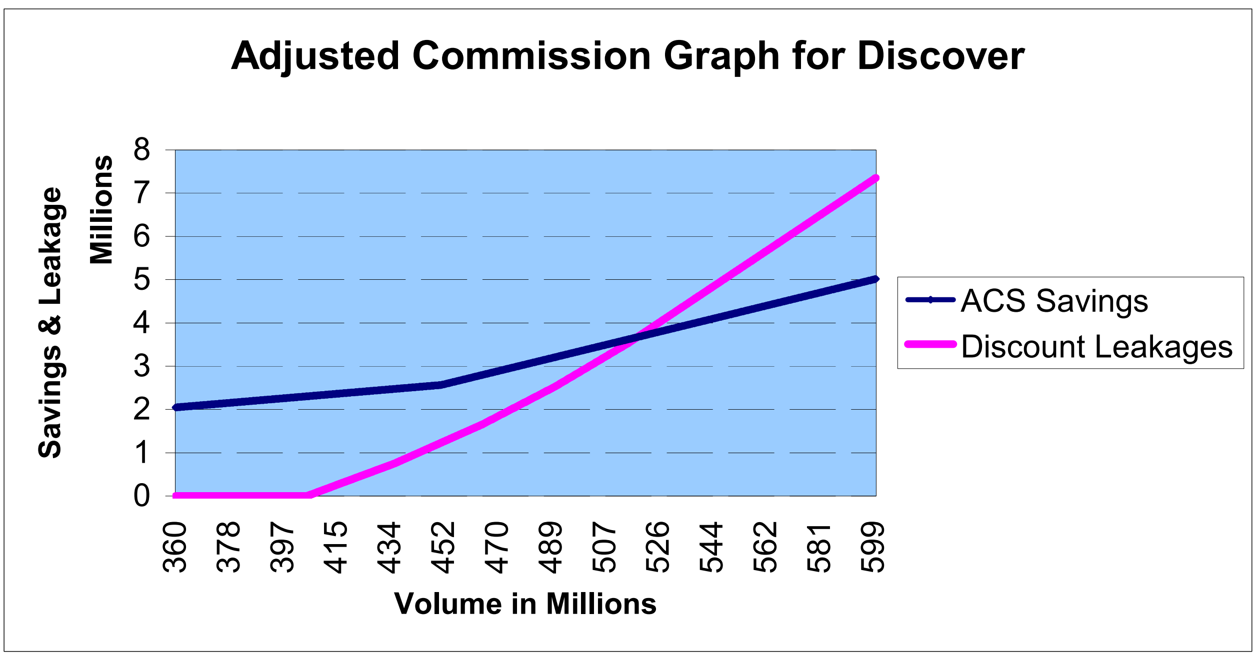

CHART TWO OCA ANALYSIS ADJUSTED FOR SOLICITATION VOLUME

Moreover, in the DFS case, some recognition is being given to the additional First-Class contribution from Standard acquisition volume that shifts to First Class, given the virtual certainty of the shift. When this contribution is recognized, the slope of the Savings line increases (while the volume is shifting) and then resumes its course. The lines cross at a higher volume, yielding even a higher cap. The Commission's chart for Discover, with this modification, is shown below, using the net contribution of 6.7 cents per piece from witness Ayub's revised response to OCA/USPS-T1-41.

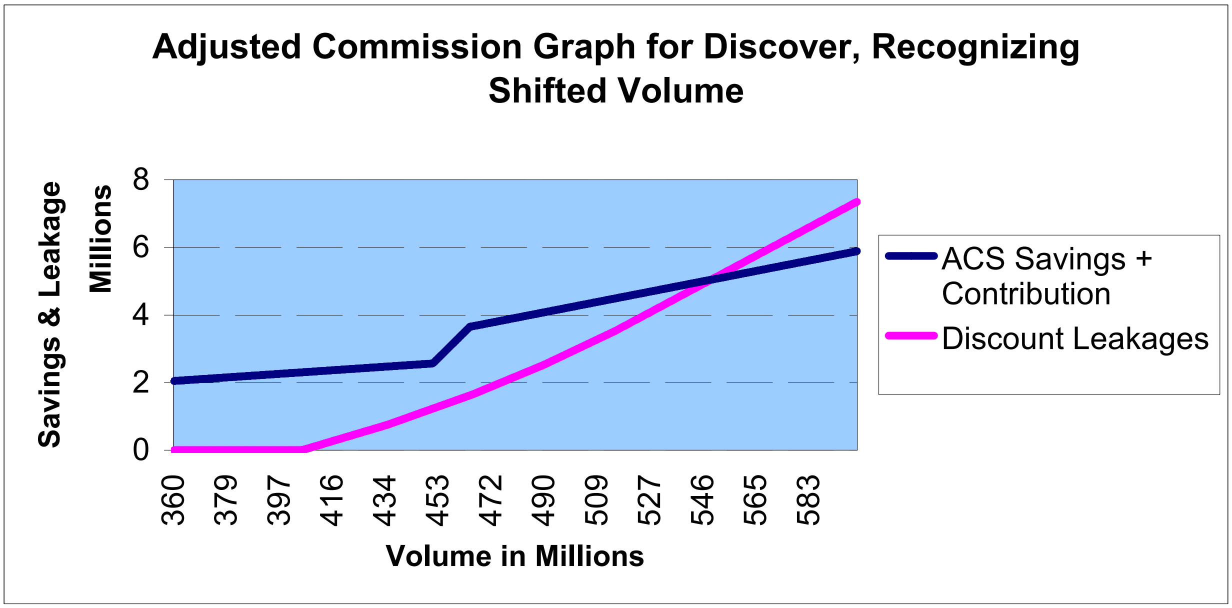

CHART THREE DFS RECOGNIZING SHIFTED CONTRIBUTION

Finally, if the volume beyond the forecast is ***all*** new First-Class volume, caused by the discounts, then the additional contribution would be much higher and the slope of the Savings line would be much steeper. In fact, the slope of the Savings line would be higher than the slope of the Discount line, and the two lines would ***never*** cross. Under such a scenario, the competitive cap as negotiated can be seen as a cap that maintains some limits but is not needed at all. For year one, assuming the new volume begins after the Standard volume has shifted, a chart is shown below, using the First-Class contribution of 15.8 cents from, again, witness Ayub's revised response to OCA/USPS-T1-41.

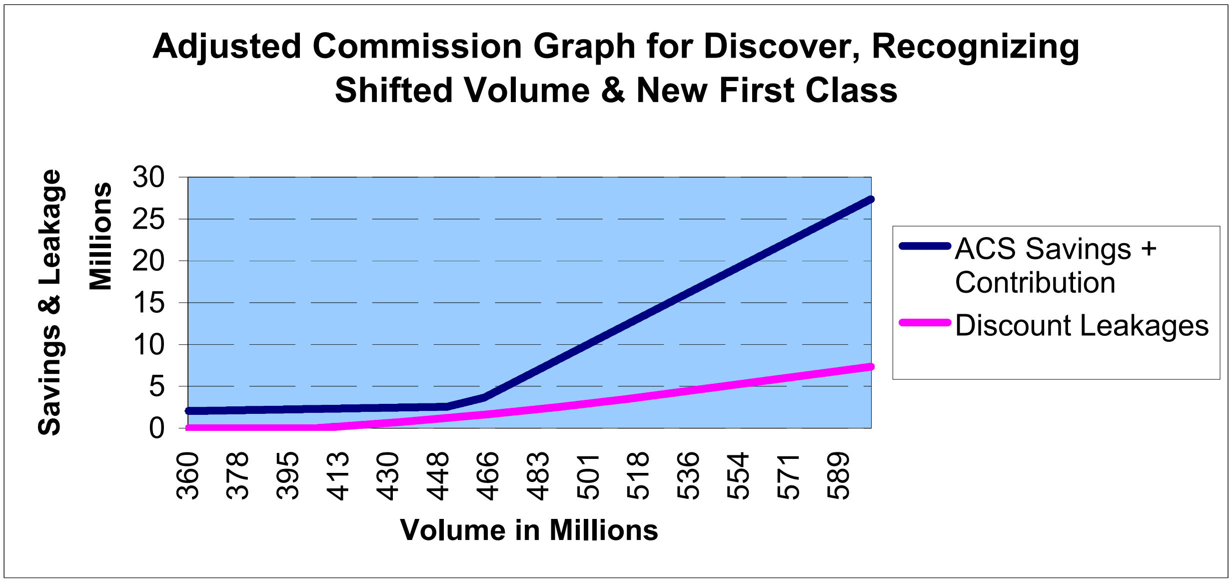

CHART FOUR ASSUMING ALL NEW VOLUME LINE ABOVE FORECAST

The question is, then, at what point would it be reasonable to assume that any new volume is truly new (as opposed to shifted) volume? DFS has already done its analysis on what volumes it would shift under the NSA and has provided those in its testimony. While it is possible that those figures could be slightly higher or lower, the record shows that they would not change very much.

In this regard, it is important to note that in the DFS NSA, the volume where the Savings line would cross the Discount line is ***far*** above projected volumes. According to the OCA analysis, the acquisition volume at the $11.7 million cap would be "5.2 times, 4.5 times, and 5.3 times its [DFS's] projected First-Class marketing mail in Year 1, Year 2, and Year 3, respectively." OCA Brief at 30.

Such volume levels are way beyond those that DFS said it would shift from Standard mail and any achievement of those volume levels would most certainly need to involve new First-Class volume due to the discounts. With such new First-Class volume, the Postal Service's gain would be even higher and the Savings line would climb above the Discount line.

B. In Light Of The Overall Picture Of The DFS NSA Presented Above, The Issues Raised by The OCA And Valpak Should Be Of No Concern.

Within the framework outlined above, several of Valpak's and OCA's specific concerns can be examined and comfortably set aside.

1. The Presence Of Shifted Volume Does Not Make This Contract Unprofitable.

Beginning on page 6 of its brief, Valpak says that an important difference between this NSA and the Capital One NSA is that Capital One would not shift Standard to First Class and DFS would. Valpak also points out that any additional volume for Capital One, therefore, would be new volume making a substantial contribution while DFS's shifted volume might make only a small additional contribution.

Two things should be noted. First, the Commission did not recognize in the Savings line any contribution from new First Class in the Capital One case. Therefore, whatever volume Capital One mails in response to the discounts—and wherever it came from—is irrelevant. Its contribution was not counted. As a consequence, any new volume that Capital One did mail would not affect the cap that the Commission recommended, the estimate of the financial effects on the Postal Service, or the profitability of the Capital One NSA under the Commission's cap.

Second, the recognition of shifted Standard volume in this case simply increases the slope of the Savings line, over a limited range, and increases the estimate of the financial benefits of the NSA on the Postal Service. See page 7 above.

It should be clear, then, that the role of shifted Standard volume does not make the DFS NSA all that different from that of Capital One; it just suggests an increase in the slope of the Savings line over a limited range of volume, to the benefit of the Postal Service.

Finally, it is not true, though Valpak suggests it, that DFS does not expect any new (not shifted) First-Class Mail volume to be generated. See for example Valpak Brief at 4. Indeed, that suggestion is a complete misreading of the Giffney testimony. As was clear in the DFS testimony, DFS did not quantify any "new" First-Class volume, although DFS knew some would exist, simply because it was not able to accurately quantify the new volume and it was not going to guess. Thus, DFS made a conservative forecast by ***not*** counting any new First-Class Mail, even though it knew there would be some:

> While we are confident that the lower rates will incent us to use mail when we create new marketing campaigns, we believe that we cannot project the level of such new volume at this time. ***Hence, our projection is a minimum projection that encompasses only the Standard to First Class Upgrade.***

Giffney at 9 (emphasis added).

This increase, as noted in the previous section, will simply increase the slope of the Savings line.

*2. In Terms of Valpak's Emphasis On The Margin And OCA's On "Free Riders," The Issue Is The Profitibility of the Totality Of The Contract, Not the Margin Or Any Isolated Segment Of The Contract***.**

Valpak emphasizes, in an argument that begins on page 14 of its brief, that the behavior of costs and benefits should be evaluated at the margin instead of by averages. It says the Commission should focus "on whether each increment of volume that might arise under the NSA will make at least a minimal, meaningful contribution to the Postal Service's non-attributed institutional costs, and leave the Postal Service financially better off than it would be in the absence of the NSA." Valpak, Brief at 14-15.

We note that it is a strange construction to relate marginal profitability to whether the Postal Service would be better off absent the NSA, for the profitability of the NSA depends on totals and averages, and not on some marginal effect. Therefore, we assume that Valpak is concerned with whether the Postal Service is better off with the incremental piece than without the incremental piece.

It is true that behavior at the margin is important and that the totals are built up from a series of marginal changes. But it is unreasonable to require that *each* additional piece (assuming we know where the piece comes from) makes the Postal Service better off.[2] One needs to focus continually on the overall picture, and not lose sight of what is important. The goal is to make the Postal Service and the mailer better off *overall*, not to hold the mailer and the Postal Service hostage to some principle of helping the Postal Service in all steps.

[2] Valpak cites 39 U.S.C. Section 3622(b)(3) to support a contention that each additional piece should make a positive contribution to Postal Service overhead, stating that the section "requires that **all postal rates** cover attributable costs, **not just the average rate . . .."** Were that a correct interpretation of the law, rate averaging over classes and subclasses would be illegal. One could also list numerous situations in existing subclasses where additional pieces increase costs more than revenues.

A somewhat similar point is raised by the OCA who argues that "free riders" should not receive discounts. Let us take an example and see how Valpak's principle of the margin and OCA's principle of "no free riders" could play out.

Take a case where negotiations have progressed to the point where the deal on the table would, without question, make $10 million per year ($30 million over three years) for the Postal Service. However, the mailer is on the verge of backing out. In its last offer, the mailer says that it will accept the deal, but only on one condition—that the Postal Service allow the mailer to mail an additional 100,000 pieces per year at cost. Let us also assume that 1) 10 cents of contribution per piece would be lost on each piece and 2) all the mail would have been mailed anyway (and are thus "free riders").

Should the Postal Service accept? The condition that the mailer demands means that the Postal Service will receive *nothing* above attributable costs for those 100,000 pieces (300,000 over three years). If the Postal Service says yes, it would lose $10,000 per year ($30,000 over three years) on those free riders, but net out $9,990,000[3] per year ($29,970,000 over three years) on the contract.

Based on the reasoning in their briefs, the OCA and Valpak would have the Postal Service say no and walk away, leaving the $29,970,000 on the table. That is the effect of looking at margins and not totals or averages, and it is inconsistent with the nature and effect of the bargaining process.

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[3] $10 million minus $10 thousand.

*3. Effects Of UAA Costs On Other First-Class Mailers Is Nonexistent***.**

Valpak expresses a concern, beginning on page 18 of its brief, that the rates for other First-Class mailers might be increased by the forwarding and return costs of UAA mail that shifts from Standard to First-Class Mail under the DFS NSA. This argument is unpersuasive and strained. If it has any validity, it is probably based on a presumption that the forwarding and return rates for the mail in question have been underestimated in the analysis. But since the mail that shifts does ***not get returned*** under the provisions of the NSA, the issue appears limited to the forwarding rate, which is a different issue and is addressed below.

4. Valpak's Reliance On Standard Forwarding Ratio Makes No Sense.

Starting on page 21 of its brief, Valpak suggests that a forwarding ratio for selected Standard mail would be a constant that could be applied to all pieces of Standard mail, even to pieces with unusually high return rates. Thus, the logic goes, a piece with a high return rate would have, by applying the ratio, a high forwarding rate as well.

There are at least three problems with this analysis. First, the ratio for Standard mail was developed from a sample of Standard pieces that had the endorsement "Forwarding and Return Postage Guaranteed." Therefore, it does *not* apply to *all* Standard mail, even on average. This was explained by the Postal Service in response to VP/USPS-T1-12(a), which was referenced by Valpak but not acknowledged.

Second, the use of that endorsement is subject to adverse selection. That is, mailers tending to have few forwarded pieces relative to their returns would not use it (just as DFS once used it and stopped) and mailers believing they have many forwarded pieces relative to their returns would use it. Therefore, mailers not using the endorsement, which certainly includes DFS, would tend to be mailers with few forwards relative to their returns.

Third, there is a fundamental problem in attempting to relate the number of returns to the number of forwards, because the return proportion and the forwarding proportion are affected by different factors. The number of forwards is affected only by the number of recipients that move. The number of returns is affected by much different factors that cause addresses to be undeliverable. These include (*but are not limited to)*:

- Name simply matched with the wrong address (i.e., Postal Rate Commission, 1101 17th Street, N.W. Suite 300, Washington, D.C. 20036).
- Names matched with the right address, but containing errors in the numbers (i.e., 1330 H Street. N.W. Washington, D. C. 20268 instead of 1333).
- Names matched with the right address, but lacking directional indicators or having the wrong directional indicators (i.e., 1333 H St. N.E. 20002 instead of 1333 H Street N.W. 20268).
- Names matched with the right address but the wrong city (i.e., 1333 H Street N.W., Suite 300 Bethesda, District of Columbia 20036)
- Names matched with the right address and city but the wrong state. (i.e., 1333 H Street, N.W. Suite 300, Washington, Maryland 20817).
- Names matched with the right address, city, and state, but the wrong zip code (i.e., 1333 H Street, N.W. Suite 300, Washington, D.C. 20266).
- Names matched with a correct but very old address (i.e., Postal Rate Commission, 2000 L St. Suite 500, Washington, D.C. 20268)
- Apartments with no apartment number in extremely large buildings (i.e., Susan Jones, 4448 42nd Street, New York City, 10169)
- . Names missing the correct post office box number in large areas. (i.e., Susan Jones, Post Office Box 1, New York New York 10169
- Names matched with a correct address but incorrect suite number (i.e., Postal Rate Commission, 1333 H St. N.W. Suite 800, Washington, D.C. 20268).
- Substitute Carriers.

The list could, and does, go on.

There is no rational reason, much less record evidence, why a list with a high proportion of bad addresses would tend to contain a high proportion of addresses needing forwarding. There are many more reasons (see above) why a piece needs to be returned and there is only *one* reason why a piece needs to be forwarded. More specifically, the number of forwards is affected only by the number of addressees that have submitted a Change of Address Form to the Postal since the date the mailer processed their list against NCOA. Within the DFS NSA, NCOA processing is required within 60 days prior to mailing. As a result, DFS is likely to have a lower forwarding rate than the average mailer due to the fact that it is NCOA processing it's lists more frequently than average.

Moreover, as mentioned above, the factors influencing forwards and UAA mail are totally different. One would think that the factors affecting forwarding would be the same for many if not most mailers while those affecting returns would vary considerably.

There is simply no rational nexus between the two, and the idea of a fixed relationship between forwards and returns makes no sense.[4]

5. The OCA's And Valpak's Academic Assumptions That DFS Would Have A High Forwarding Rate Are Purely And Highly Speculative.

To support its assertion that the forwarding rate for DFS would be higher than that of Capital One, Valpak points on page 7 of its brief to the fact that Capital One maintains an address database (which Valpak refers to as an "internal solicitation list') and then emphasizes: "By contrast, DFS relies exclusively on rented lists." The

[4] Valpak's suggestion that DFS could have a forward rate of 13.7 percent is ridiculous.

implication is that a mailer mailing from lists would have a higher forwarding rate than one mailing from a solicitation database. For DFS, not only is there no evidence to support such an implication, but the evidence in the record goes the other way, as explained below.

As a preliminary matter, Capital One does not just mail from an address database. A review of the Capital One record shows that Capital One does considerable purchasing of lists. See, for example, witness Jean's responses to OCA/COS-T1-23, ANA/COS-T1-18, and ANA/COS-T1-22.

In any case, in regard to the forwarding rate for DFS, both Valpak and the OCA point to a statement by witness Giffney to the effect that DFS selects lists in line with its marketing goals and not their address quality. DFS-T-1 at 13, line 15. The implication is that this is unusual and that other companies select lists based on address quality and not marketing goals. There is nothing in the record to support such an implication.

Moreover—and this is an important point—both the OCA and Valpak give the impression that DFS does not care a great deal about list quality. See for example OCA Brief at 6, 11. That is just dead wrong. DFS cares very much about list quality and takes great pride in the high quality of its address hygiene processes, which are some of the *very best* in the business.

But, as witness Giffney testimony states, DFS does not look to list quality *when it buys a list*. It looks to list quality *after it buys the list.* It is only *after the purchase* that it and its list processor start their work on a list. This is typical. Lists are bought for demographic and psychographic reasons, not for address quality reasons.[5] DFS, like every other credit card company, buys lists on the basis of a variety of factors. The identity and mix of those factors, that is the demographic and psychographic selection, make up the proprietary marketing strategy of each company.

Once DFS buys a list, the list undergoes *extensive* data processing, focusing on hygiene, as DFS told Valpak:

> When DFS buys a list, it generally does not mail to the entire list, but does analysis on the lists, selects names from the list, and ultimately mails to a selected portion of the names. Further, DFS "de-dups" (removes duplicate names) among all its lists each month so that it generally does not mail multiple pieces of the same solicitation to any particular individual.
>
> DFS also "repurchases" a number of lists on a monthly basis. Lists that provide positive results are very likely to be repurchased for future use.
>
> After analyzing the list in order to select which names may be most beneficial to mail to, the lists are forwarded to our list processing vendor for further analysis. The list processor provides information relating to the quality of the address so that DFS can make decisions regarding which names should be ultimately included on the final mailing lists.

DFS Response to VP/DFS-TA-6.

As anyone with a rudimentary knowledge of direct marketing practices would realize from this answer, DFS is far more sophisticated than the majority of mailers. Consequently, DFS was disappointed to see the following remark:

> It must be borne in mind, however, that Capital One's mailing list and address hygiene practices were cited as among the best in First Class. Discover, on the other hand, has frankly stated that it focuses on high quality credit prospects, not address accuracy.

[5] Demographics are the average or typical characteristics of the people who buy your products or services. They include age, income, education, status or type of occupation, region of country and household size. Demographics can also include the age of children, home ownership, home value and urban or rural location. Psychographics take this a step further: these include people's lifestyles and behaviors—where they like to vacation, the kinds of interests they have, the values they hold and how they behave. When evaluating lists, there are the areas considered above everything else. See for example, http://www.abacon.com/pubspeak/analyze/psych.html

OCA Brief at 11.

Does the OCA really think that *any* credit card company would do differently? Or for that matter, that *any* direct mailer would care more about the address accuracy of a list than about the psychographics or demographics of a list? Of course, with two lists otherwise being equal, any rational marketer would buy the one with a better address hygiene since it would produce better results at a lower price. That assumes, of course, that one knows the address quality of a list. In any case, this is really academic since two lists are almost never "otherwise equal."[6]

The OCA's and Valpak's allegations in this area are unsupported by logic, knowledge, and record evidence.

6. The OCA's Discount Adjustment Scheme Is, In Principle, An Inappropriate Suggestion For An NSA Because It Rebalances And Revalues The Contract.

As noted above, Valpak has a concern with the profitability at the margin of each additional First-Class piece, assuming it shifted from Standard, at the high and unlikely volume levels associated with the highest discount levels and to the neglect of the overall profitability of the NSA. That concern is raised to a new level by the OCA, beginning at page 31, in its suggestion that the discounts in the NSA should be adjusted each year in accordance with new cost studies so that the additional contribution of these marginal pieces does not fall below two cents.

[6] It is interesting to consider that DFS repurchases lists that produce positive results. Positive results tend to be measured in response rates. The better the postal hygiene of a list, the more pieces arrive at the targeted household, and the higher response rate the list would get, all other things being equal. The higher the response rate of a list, the more DFS uses a list. Thus, DFS marketing strategy would tend to select lists with a higher address hygiene, all other things being equal.

Viewed in terms of the Commission's graph, this amounts to a statement that the Savings line should have its slope increased slightly to recognize the additional contribution of shifted volume, and if this increase is not appropriate to the two-cent level, the slope of the Discount line should be reduced.

These adjustments would be complex, would reduce the prospective discounts available, which are needed to induce volume, and would be unlikely to have any meaningful effect on a cap calculation or on postal finances, unless it is through volume "discouragement". Most importantly, such adjustments would involve a modification of the agreement reached by the parties involved, and an inappropriate realignment of the contract. Indeed it would create a completely different contract.

II.

THE OCA AND VALPAK REFUSE TO ACCEPT THAT THE NSA PROCESS IS DESIGNED TO APPROVE A <u>CONTRACT</u>.

In the way that they have structured their arguments and recommendations, neither the OCA nor Valpak recognize and treat the DFS NSA for what it is, a tightly negotiated ***contract***.[7] They appear to treat the DFS NSA more like some easily modifiable tariff, and they simply show no respect for the bargaining process that formed it.

An enormous effort was made to negotiate this contract—hundreds of hours and hundreds of emails. It took a significant corporate focus, and the time of four vice-presidents, among others. Both parties ultimately arrived at a classic contractual

[7] Section 5(r) of the Commission's Rules is quite explicit: "*Negotiated Service Agreement* means a written ***contract***, to be in effect for a defined period of time, between the Postal Service and a mailer, that provides for customer-specific rates or fees and/or postal services in accordance with the terms and conditions of the ***contract***." (emphasis added).

"meeting of the minds" where their respective interests were satisfactorily balanced. Key to this result was that each side examined its respective ability and desire to assume responsibilities and risk, and each agreed to assume very specific responsibilities and risks, based on that ability and desire.

The OCA and Valpak, in a very cavalier fashion, urge the Commission to throw those hundreds of hours of work out the window, rebalance the equities of the contract, and shift risk and burden to DFS. Moreover, they are doing so even though the contract will make money for the Postal Service in the most likely foreseeable circumstances. See Valpak Brief at 40. Had DFS agreed to accept the type of responsibilities that the OCA and Valpak would impose on it, it would have negotiated additional benefits, or there would not have been a contract.

The Commission is at an important crossroads. The NSA process is on the verge of proving itself, and mailers and their competitors in all sorts of industries are watching, and waiting. They are waiting to see how one question is answered. Will a company that negotiated a reasonable, functionally equivalent contract get the same bargain it successfully negotiated? If the OCA and Valpak have their way, the answer will be no.

III.

IF THE APPROVAL PROCESS FOR FUNCTIONALLY EQUIVALENT NSAs EVOLVES IN THE WAY THAT THE OCA AND VALPAK ENVISION, THE PROCESS WILL NOT WORK.

These proceedings have been discouraging for DFS. It came to the Commission with a fairly straightforward and simple NSA, perhaps the most simply and straightforward one that this Commission will see. From the prehearing conference on, however, it was evident that both the OCA and Valpak were determined to find *something* wrong with the contract, so they could urge the Commission to modify it. At times it has not been clear what they think the Commission should change, but it has been very clear that they think the Commission should change *something.*

Judging by their attitudes both the OCA and Valpak seem to find abhorrent the notion of the Commission approving, without modification, a contract submitted to it for approval. Valpak and the OCA appear to envision a process where both will intervene in functionally equivalent NSA proceedings, pick apart the contracts to find provisions they don't like, and then try to get the Commission to modify the contracts to reflect their views.[8]

In this way an NSA co-proponent gets to negotiate twice. It first gets to negotiate with the Postal Service, and participate in a bargaining process where the Postal Service's and the co-proponents' views of what is best for both parties dominate. It then gets to negotiate again with the OCA and Valpak and participate in a bargaining process where the OCA's and Valpak's views of what is best for the Postal Service and the co-proponent[9] dominate.

If this process evolves in this way, it is not going to work. Such an approach refuses to recognize the public policy benefits of bargaining and demeans the negotiating experiences of the parties. It also creates absolutely no incentives for the Postal Service and potential NSA contractees to engage in the type of long, hard, and

[8] E.g., "The NSA fails to reflect a good balance between the value that mailers derive from return information and the cost that Postal Service [sic] incurs to provide such information." Valpak Brief at 37.
[9] E.g., "the Postal Service needs to tailor the services provided under NSAs in ways designed to assure that the value mailers derive from those services will exceed the costs that the Postal Service incurs to provide those services." Valpak Brief at 38. With all due respect to Valpak, that is an incredibly paternalistic statement, and good bargaining and good bargains are not built on paternalism.

sophisticated bargaining that makes a good contract—which is ultimately what the Commission wants the Postal Service and NSA contractees to do.

Just to make it clear, DFS acknowledges that both the OCA and Valpak have the right to participate in this process and test NSAs. The OCA and Valpak have done so and have raised interesting issues. But even though they have fundamentally failed to meet their burden of showing that the contact would lose money, they have nevertheless urged the Commission to break the contract and realign and risks and responsibilities. This is ***exactly*** what the Commission said it would not do, in response to Comments filed by DFS in response to the Commission's rulemaking proposing regulations for its consideration of NSAs.[10]

The Commission should send a loud and clear message to the postal community that reasonably negotiated NSAs will be approved as negotiated, and that potential NSA contractees need not fear the Commission rebalancing and rewriting reasonable contracts.

CONCLUSION

Of all the interested parties in the postal community—including many opponents of NSAs—only a few have seen fit to intervene in this proceeding and only two have participated actively. The participation of these two was in opposition in one form or another from the prehearing conference on. Yet neither has shown that the DFS contract would lose money for the Postal Service. Further, there is no need of a stop-

[10] As the Commission said in Order 1391, in response to Comments filed by DFS: "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.

loss cap. DFS's volume forecasts are accurate and uncontested. No party has demonstrated a need for any other cap. Even if they had, the DFS NSA contains a negotiated one.

Finally, DFS urges the Commission to keep foremost in its mind the notion that the parameters of the functionally equivalent NSA approval process should be guided by a need to maintain balance among competitors so that the NSA process can flourish without disrupting markets. Should the Commission engage in the type of extensive redrafting that the OCA and Valpak suggest, it will be difficult to establish that type of balance through this process.

For these reasons, the Commission should approve the DFS NSA as submitted.

Respectfully submitted,

______/S/________________
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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 15, 2004