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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. MC2004-4

REPLY BRIEF OF THE UNITED STATES POSTAL SERVICE

UNITED STATES POSTAL SERVICE

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TABLE OF CONTENTS

I. Introduction

In accordance with Presiding Officer's Ruling No. MC2004-4/3 (August 25, 2004), the United States Postal Service hereby submits its reply brief, in support of its request for a recommended decision in the instant docket.

Five participants have submitted initial briefs in this case. *See* Initial Brief of the American Bankers Association (September 8, 2004) ("ABA Brief"); Initial Brief of Discover Financial Services, Inc. (September 8, 2004) ("DFS Brief"); Initial Brief of the Office of the Consumer Advocate (September 8, 2004) ("OCA Brief"); Initial Brief of the United States Postal Service (September 8, 2004) ("USPS Brief"); and Initial Brief of Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (September 8, 2004) ("Valpak Brief").

ABA, DFS, and the Postal Service have requested the Commission to issue a recommended decision approving the request as filed. ABA Brief at 2; DFS Brief at 23; USPS Brief at 20.

OCA has requested the Commission to vary the request by recommending two additions to the Data Collection Plan; by creating, for years two and three of the agreement, a stop-loss mechanism that could lower the negotiated discount levels of 2.5-4.5 cents to levels that, in OCA's view, would be needed to ensure a 2.0 cent net contribution after the highest discount (4.5 cents); and by eliminating what it refers to as "free riders" in the second and third years of the agreement. OCA Brief at 17, 43 and 52. OCA also suggests that the Commission could, but probably need not, impose a "stop-loss" cap on total discounts, calculated by OCA to be $11.6 million based on the Commission's methodology in Docket No. MC2002-2, supplemented with an assumption that any new First-Class Mail volume in excess of the Before Rates Forecast would be 100% marketing mail. OCA Brief at 30.

Valpak takes the position that "[o]ver 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 40. Valpak also states that it "does not oppose this NSA, but believes that it must be evaluated on its own merits . . ." Valpak Brief at 10. Valpak emphasizes that in the Capital One NSA, all additional First-Class Mail projected to be generated was new volume, whereas, for DFS, it is projected to be conversion from Standard to First-Class. Valpak Brief at 6-7.

In addition to making general comments on what it considers to be pricing anomalies that make this NSA attractive to the Postal Service, Valpak Brief at 26-39,[1] Valpak requests the Commission to set up some type of a "threshold" that assures that marginal rates will cover marginal costs, lending its support to a modified stop-loss

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[1] The Commission granted a request by Valpak to discuss two specific issues on brief -- "consideration of a niche classification" and a "system-wide fix to the UAA pricing problem" -- but stated that such discussions would not form the basis of the Commission's recommended decision on this NSA. Presiding Officer's Ruling No. MC2004/2 (August 11, 2004) at 5-6. Valpak has devoted portions of its brief to these issues. *See* Valpak Brief at 26-39.

The Postal Service stated in its initial brief that it "sees no need to discuss these issues in this docket, which concerns a functionally equivalent NSA, and agrees with the Commission's conclusion that such discussions will not form the basis for a recommended decision." USPS Brief at 4, n. 4.

Having reviewed Valpak's brief, the Postal Service has concluded that these issues are far too broad for discussion in this docket, but would be more appropriate as broad public policy discussions in an omnibus case. Moreover, the Postal Service believes that it is inappropriate to raise these types of issues in a functionally equivalent docket, where a baseline NSA already is in force, and it will not discuss those issues here. In no way should the Postal Service's silence in this brief be taken to represent acquiescence to the views expressed by Valpak.

provision such as the one proposed by OCA, or to an alternative provision that would make DFS pay for any costs that might arise from a high forwarding rate. Valpak Brief at 41-43.

No participant in this proceeding has asserted that the NSA with DFS will have a negative competitive impact on competitors of DFS, or on other users of the mail. No participant has pointed to a realistic set of facts where this NSA could fail to make a positive contribution to institutional costs.

As will be explained below, neither OCA nor Valpak have set forth any reason why the Commission should not recommend the proposed DMCS and Rate Schedule language, as requested by the co-proponents. OCA has, however, pointed to an issue regarding an omission in the proposed Data Collection Plan, which is addressed below and has prompted a modified data collection plan, attached hereto as Attachment A.

II. The Record Fully Supports a Recommendation to the Governors of the Proposed DMCS and Rate Schedule Language. The Record Does Not Support the Modifications Proposed by OCA and Valpak, Nor Does It Support the Concerns They Express With the Postal Service's Financial Model.

The Postal Service's Initial Brief explained how the record fully supports the proposed DMCS and Rate Schedule language, and those points will not be repeated here. As detailed in the following sections, the record does not support any of OCA's or Valpak's arguments that question the soundness of the Postal Service's projections, much less would the record support any alterations to the draft DMCS or Rate Schedule language.

A. OCA's and Valpak's Arguments That the Commission Should Focus on the Margins, Instead of the Value of the Whole Deal, Are Unrealistic When Evaluating a Negotiated Agreement, And Are Based on a Misreading of the Postal Reorganization Act.

Neither OCA nor Valpak have provided any foundation for a conclusion that this NSA has any reasonable likelihood of resulting in the Postal Service losing money. Indeed, neither party has set forth one concrete example where the deal will fail to contribute to institutional costs.

Instead, OCA and Valpak both seek to focus the Commission on what they call the "margin" -- which to them is the point where DFS is receiving the maximum discount of 4.5 cents. It should be noted, however, that according to witness Giffney's After Rates projections, the marginal discount DFS will be receiving every year is projected to be 3.0 cents. *See* Giffney Testimony (DFS-T-1) at 9. While her estimates are conservative, the increase in volume (above the After Rates forecasts) needed to reach the 4.5 cent discount threshold would have to be more than 50 million pieces each year.

An overriding theme of OCA's brief is that a "meaningful" or "satisfactory" "unit contribution" must be ensured "at the margin," where DFS is receiving the 4.5 cent discount. *See, e.g.,* OCA Brief at 1-2. According to the record, using OCA's methodology and definition of margin as "Net Contribution per Piece, after the 4.5 cent discount," *see* OCA Brief at 10, n. 22, *citing* Response to OCA/USPS-T1-41, the margins would be 2.3 cents for Year 1, 2.2 cents for Year 2, and 2.0 cents for Year 3.

See Response to OCA/USPS-T1-41(a) (as amended by errata on September 2, 2004).[2] This calculation is the minimum contribution per piece. *Id.*

OCA claims that "[a]t the highest discount levels, there is a serious risk that Discover's converted pieces will actually lose money . . .," OCA Brief at 45, resulting in a situation where "pieces might not cover their cost," which OCA alleges to be in violation of 39 U.S.C. § 3622(b)(3).

Valpak suggests that at the maximum discount level, the net unit contribution "could turn out to be negative." Valpak Brief at 7. Valpak states that the "projected net contribution at the maximum discount level is in the range of 2 cents per piece, assuming that none of [the Postal Service's] assumptions are overly optimistic." Valpak Brief at 9, citing Response to VP/USPS-T1-14. Valpak urges the Commission to focus on marginal profitability, and, like OCA, claims that profit at the margins is mandated by 39 U.S.C. § 3622. Valpak Brief at 14-15.[3]

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2 In its brief, OCA refers to the original response to that interrogatory, which stated that the figures would be 2.2 cents in year 1, 2.0 cents in year 2, and 1.8 cents in year 3 OCA Brief at 9-10, citing Response to OCA/USPS-T1-41. The response to that interrogatory was amended by errata that resulted from POIR Nos. 3 and 4 in Docket No. MC2004-3, on September 2, 2004. *See* Revised Response of the United States Postal Service Witness Ayub to Interrogatory of the Office of the Consumer Advocate (Errata) (OCA/USPS-T1-41) (September 2, 2004).

3 Valpak suggests that the Commission should fear the fact that there is a large pool of DFS Standard Mail that could migrate to First-Class Mail, Valpak Brief at 15, calculating that 448 million pieces could migrate, versus the projected migration of only 36 million - Valpak Brief at 17. This is not a reason to be concerned about the margin, however, because DFS would have exhausted its discounts available under the negotiated competitive cap long before going so deeply into that pool. Specifically, if the cap is spread out evenly over the three years of the agreement, and DFS reaches it, its volume would have to be 532 million pieces per year, which would mean migrations of the magnitude of 80 million each year. *See* USPS Brief at 11.

OCA's and Valpak's emphasis on the margins is entirely misplaced in the context of evaluating this negotiated agreement. An NSA is a bargain. Obviously, the co-proponents could have negotiated a different structure for the block discounts. For example, they could have agreed with a structure where the highest discount was 4.0 cents, or even 3.5 cents. Common sense, however, would dictate that in order for a mailer, such as DFS, to agree to a structure where the highest discount is 4.0 or 3.5 cents, the mailer would insist that the thresholds be set lower, at least for the bargain to be of equal value to the mailer.

Indeed, a perfect negotiation might conclude with the last piece of mail having a profit margin of $0.01 and no further pieces of mail being mailed. It is a misplaced venture to explore the margins under the facts of this case, where there is no evidence that the deal can lose money.

The record in this docket clearly demonstrates that this NSA, overall, will result in a positive contribution, even if the inputs were to be off by an amount that diminishes the "net contribution minus discount" where the discount is 4.5 cents. In addition, as demonstrated below, there is no basis in the record for OCA's and Valpak's claims that these inputs are so far off.

Moreover, the Postal Reorganization Act does not require that this NSA result in a positive contribution at the margin. Title 39 U.S. Code, § 3622 (b)(3), requires that "each class or type of mail service bear the direct and indirect postal costs attributable to that class or type . . . ." OCA and Valpak have improperly expanded this language to include not only classes or types of mail, indeed not only every subclass of mail or rate category of each subclass, but every single piece of mail. This is a simple misreading of the statute. While the Postal Service does not wish to trivialize the issue of marginal profitability, in the context of the current NSA, where there is no evidence in the record to support a finding that it can fail to cover its costs, § 3622(b)(3) does not require the result suggested by OCA and Valpak.

The following two sections will address the two key inputs identified by OCA and Valpak -- the forwarding rate for DFS's First-Class Mail (which OCA claims can result in a loss at the margin in year three if it rises to 5.92 percent, as opposed to the expected average forwarding rate of 1.96 percent), and the undeliverable-as-addressed ("UAA") success rate (which OCA claims can result in a loss at the margin if it is 47 percent, rather than the expected 85%). OCA Brief at 11.

B. The Record Fully Supports the Postal Service's Assumption That DFS'S First-Class Solicitation Mail Will Have a Forwarding Rate Similar to the Systemwide Average Of 1.96 Percent. The Record Does Not Support Any Other Assumptions.

The Postal Service's systemwide average for forwarding UAA mail that is forwardable is 1.96 percent. *See* Response to VP/USPS-T1-3(b). Witness Ayub testified that he expects DFS's forwarding rate to be in line with the systemwide average, and that figure of 1.96 percent is incorporated in his calculation of the contribution of DFS's First-Class Mail solicitations. *See* Response to VP/USPS-T1-4(a).[4] This is supported by the record in this case, which includes the testimonies of witnesses Crum (USPS-T-3) and Wilson (USPS-T-4) in Docket No. MC2002-2, *see*

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[4] Witness Ayub also concludes that "[i]t is very likely given that DFS mails multiple times to a prospective customer, that an ACS notice may result in the elimination of a future piece from being forwarded," and that in the first year of the agreement, the benefit of elimination one forward (cost of $0.35) would cover the expense of providing 4.5 ACS notices for forwarded mail (cost of $0.066 cents each). *See* Response to VP/USPS-T1-14(e), as amended by errata on September 3, 2004;

Request, Attachment E at E-17, as well as the testimony of Postal Service witness Ayub (USPS-T-1) and DFS witness Giffney (DFS-T-1), which were prepared for this docket.

In the baseline case, Docket No. MC2002-2, one of the contentious issues was whether Capital One's forwarding rate for its new marketing First-Class Mail would be significantly higher that the nationwide average and, if so, what additional costs would be incurred by the Postal Service. PRC Op. MC2002-2 at ¶¶ 6042-49. Intervenors attempted, but failed, to establish a ratio between forwarding and return rates, such that a high return rate must yield a high forwarding rate.

Postal Service witness James D. Wilson testified that he expected Capital One's forwarding rate to be close to the average, because Capital One "processes its . . . solicitation mail addresses [through the National Change of Address (NCOA) data base] every 60 days," whereas for First-Class mailers who use NCOA to comply with the Move Update requirement, the Postal Service only required that databases be processed every 180 days." Docket No. MC2002-2, Tr. 3/552.

Also appearing in the record is the fact that the unaudited results for Capital One indicate a forwarding rate of 2.0 percent, which is only slightly higher than the systemwide average. *See* Response to POIR 1, Q2; Response to VP/USPS-T1-4(a). This proves that there is no *ipso facto* correlation between forwarding and high return rates.

The evidence in the record supports witness Ayub's testimony that DFS is likely to have a forwarding rate at or below the systemwide average. Under ¶ II.G of the NSA,

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Response to VP/USPS-T1-11(a). The cost of providing the electronic notice for forwards, however, is not included in the model, nor are any benefits from eliminating repeat forwards. *See* Response to VP/USPS-T1-11(a).

DFS has agreed that for its First-Class Mail, it will only use addresses that have been processed against NCOA/CASS databases within the 60 calendar days prior to mailing, just as Capital One did. The NCOA is an extremely powerful address cleansing tool because it contains records of address changes for four years after the change of address order is filed. Wilson testimony, Docket No. MC2002-2, Tr. 3/649. This is three times above and beyond the requirement of how often the list must be run. *See* Domestic Mail Manual ("DMM") § A030.1.1a.

OCA's and Valpak's assumptions that Discover's new First-Class Mail volume will have an extraordinarily high forwarding rate, because they are pieces that would otherwise have been mailed by Standard Mail, has no basis in the record. Standard Mail as a class would be expected to have a higher forwarding rate because Standard Mail does not require that the mailer update its databases with forwarding information. *See* DMM § A030.1.2. By comparison, First-Class Mail must comply with Move Update through NCOA or some other means. Even if DFS's switched mail volume has a higher rate of move-affected addresses, and there is no evidence that they do, then NCOA will correct many of them.

The Commission found that its lack of mailer-specific information about the current and expected forwarding rates of Capital One's First-Class Mail solicitations was not a serious problem. PRC Op. MC2002-2 at ¶ 6050. In fact, the Commission also indicated a belief that the Postal Service’s treatment of forwarding costs likely results in a slight underestimation of potential savings from the NSA. *Id*.

Thus, the record fully supports the Postal Service's assumption that DFS will have a forwarding rate similar to the national average for First-Class Mail, much more so than the record in Docket No. MC2002-2. Contrary to Valpak's urgings, this assumption is not "based solely" on "speculation" and "unsupported assumptions." Valpak Brief at 22-25. The record does not support any of OCA's or Valpak's arguments to the contrary, as set forth below.

In attacking the forwarding rate, OCA posits that it is "easy to imagine" that forwarding rates correlate with return rates, OCA Brief at 10-11, and argues that a ratio applicable to Standard Mail, based on a 1988 study, that the forwarding rate in Standard Mail is 1.471 times the return rate, should be applied to DFS's estimated return rate of 9.3 percent, to arrive at a forwarding rate with an upper limit of 13.6 percent. OCA Brief at 11-12. Valpak also suggests that this 13.6 percent figure is a worthwhile guide, suggesting that there is a "wide range of uncertainty" between 2.0 percent and 13.6 percent. Valpak Brief at 23. It should be noted, however, that because DFS's UAA rate or return rate is 9.3%, an additional 13.6 percent forwarding rate would mean that 22.9 percent are misaddressed.[5] It is hard to understand how a credit card company would continue to rely on mail as a marketing medium when more than one out of five pieces do not reach the intended recipient.

OCA then calculates a hypothetical forwarding rate of 8.82 percent for DFS's First-Class advertising mail as follows: (1) it lists DFS's return rate for statement mail (0.25%); (2) it then ignores that figure in favor of an unweighted average of the return rates for Capital One, Discover, Bank One, and Morgan Stanley (0.56%); (3) it doubles

[5] By the way, even if there were any possibility that DFS had a forwarding rate of 13.6 percent, the NSA would still result in a net benefit to the Postal Service, calculated at more than $4 million by witness Ayub. *See* Attachment B (the xls spreadsheet is being filed as an attachment to this brief).

the 0.56% figure it because it is "reasonable" to be used as a forwarding rate for bill-related mail; and (4) it then employs algebra to calculate a forwarding rate for First-Class Mail that is not bills, statements, and bill payments, such that the national average would equal 1.96%. OCA Brief at 13-14. Neither the elements, nor the conclusion, of the hypothetical exercise, however, are supported by the record.

Both OCA and Valpak fail to appreciate the impact NCOA has on keeping forwarding rates at or below the systemwide average, particularly when NCOA cleanup occurs three times more frequently than postal requirements. NCOA will correct addresses for four years after a move, far longer than any forwarding order.

The record in this functionally equivalent docket fully supports a conclusion, identical to the conclusion the Commission accepted in the baseline docket, that the forwarding rate for this national mailer will be similar to the national average.

C. There Is No Basis in the Record To Support a Conclusion That the Estimated 85% Success Rate For Electronic ACS Is Inaccurate.

OCA frets that the electronic ACS success rate may fall significantly below 85%, cutting profitability at the margin. OCA Brief at 10. OCA points the Commission to a recent article published in the Postcom Bulletin, which suggested that, prior to the commencement of the Capital One NSA, much less than 85% of ACS mail was being directed to CFS units. OCA Brief at 10, n. 26, citing *Postcom Bulletin* 35-04, August 12, 2004 at 3-4.

The Postal Service regrets the fact that it had no opportunity to address this issue in discovery, as it was never asked by OCA to provide any information for the record about the electronic ACS rate.

There is no evidence in the record to support OCA's assumption that the rate will be significantly below 85%. To the extent that the Commission wishes to review the extra-record article cited by OCA, said article, at page 4, points out that the success rate has climbed to 86.7%. The Postal Service is content, however, to advocate the 85% figure in this case.[6]

D. The Data Collection Plan Should Be Amended As Explained Herein.

OCA accurately points out that the Postal Service neglected to include, in its proposed data collection plan, a provision that was not included in the Capital One stipulation and agreement, but was recommended by the Commission. OCA Brief at 15-16. This provision would require the reports to include "Volume of Standard Mail solicitations by rate category in eligible [DFS] permit accounts." *See* PRC Op MC2002-2 at ¶ 9029 n. 12.

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6 There is no support for Valpak's bald accusation that the Postal Service has "[c]herry-picked costs mailer-specific in some instances, but sometimes us[ed] systemwide data," using "whichever was more helpful to achieve its desired objective," Valpak Brief at 8. The Postal Service has not ignored the best available data on any inputs to its model.

Witness Charles L. Crum testified in Docket No. MC2002-2 that Capital One's status as a national mailer, with a mail mix that closely approximates the average, enhances the reliability of using average figures as proxies for Capital One's costs. *See* Docket No. MC2002-2, Tr. 2/325, 328, 331. In this docket, witness Ayub testified that the mail mix and profile of Discover, a national mailer, should reflect national averages, just like Capital One. *See* Response to POIR 1, Q3.

When this case was filed, the Postal Service had ten months experience with the Capital One NSA. To suggest that witness Ayub would rely on 85% without reference to the Capital One experience implies misconduct on the part of the Postal Service witness. Clearly, witness Ayub would have used the ACS capture rate from the Capital One experience had it been far less than 85%.

The Postal Service admits this oversight, and requests the Commission to add this type of provision to the data collection plan. A copy of the data collection plan, as modified, is attached hereto as Attachment A. The reference to "eligible . . . permit accounts," however, is not included in Attachment A because there are no eligible DFS permit accounts for Standard Mail (which was equally true for Capital One).

OCA also requests the Commission to make additional changes with the general intent to provide "a report by Discover of the practices it will adopt to utilize eACS notices it receives for returned pieces, but also, especially, for forwarded pieces." OCA Brief at 15. DFS has pointed out that its use of lists that it purchases is proprietary. *See* Response to VP/DFS-T1-6; Response to OCA/USPS-T1-40, Objection of Discover Financial Services, Inc. to Valpak Interrogatories VP/DFS-T1-6, 7, 9, and 11 (filed July 27, 2004). The language suggested by OCA, OCA Brief at 17, is entirely unnecessary.

While OCA posits that "[m]aking prompt, thorough use of such information so that costly future returns and forwards can be avoided is the primary merit of Capital One's baseline NSA," OCA Brief at 17, the Postal Service respectfully submits that any NSA needs to be looked at as a whole. The data collection plan, as it exists, will provide data that enables one to calculate the forwarding rate and return rate for DFS after each year, so the success of its efforts already will be determined.

The Data Collection Plan will collect enough information to calculate DFS's forwarding rate and return rate. Those are the figures that can affect the value of this deal. There is no need to probe into the proprietary use that DFS makes of the lists it purchases. The Postal Service understands that DFS will address the proprietary nature of this information in its brief.

E. There Is No Need for a Stop-loss Cap.

OCA makes some general statements, as a preliminary introduction to its calculation of a stop loss cap, such as "[u]nforseen factors could cause Discover's actual First-Class Mail marketing volumes to differ from plausible projections," OCA Brief at 19, and "[s]uch factors always exist and can never be completely known. Nor can the effect of such factors be fully or accurately incorporated into any projection of future volumes." OCA Brief at 19.

However, OCA acknowledges that it "does not consider excessive 'anyhow' volumes to be the most likely cause of financial loss to the Postal Service from the Discover NSA. More significant is the narrow contribution margins . . ." OCA Brief at 26. Indeed, it admits that Discover's After Rates volumes are "reasonably certain." OCA Brief at 30.

Nonetheless, OCA decided to calculate, for the Commission's benefit, what the stop-loss cap would be under the methodology employed in MC2002-2, with a change to assume that 100 percent of the new volumes above the Before Rates forecast are marketing mail.

As stated in its initial brief, the Postal Service opposes stop-loss caps in general, as they could choke off new volumes and possibly discriminate against many smaller mailers. USPS Brief at 15-16. Moreover, even under the criteria announced in Docket No. MC2002-2, there is be no need for such a cap in this case. USPS Brief at 16-18. Nonetheless, the Postal Service does agree with OCA that it is far more accurate to assume, as OCA has done, that the mix of marketing mail versus operations mail will not remain constant, and that most, if not all, new volume above the forecasts will be marketing mail. *See* Response to OCA/USPS-T1-35(a).

F. OCA's Stop-loss Mechanism, As Applied to This Case, Is an Unacceptable and Unnecessary Attempt to Alter the Bargain Which the Co-Proponents Have Struck.

OCA expresses fears that uncertainty caused by "unexpected changes" in return rates, forward rates, or eACS success rates could drive DFS's profit margin negative at high discounts. OCA has not expressed any concern with contribution during the first year of the agreement. However, OCA proposes that, for years two and three of the agreement, the discounts be adjusted, if necessary, to maintain the contribution of year one, as OCA estimates it. OCA Brief at 31, 33. As detailed above, OCA's primary concern is for forwarding rates, calling them "[t]he most troublesome unmodeled factor." OCA Brief at 34, 39. Also as detailed above, OCA expresses concern that cost savings will decline if the percentage of Discover's First-Class UAA pieces that will be directed to a forwarding center, where notices of electronic address correction, falls short of the expected 85%. OCA Brief at 37.

When all is said and done, OCA states that it "views [a 2.0 cent] contribution as the absolute minimum necessary to serve as the margin of error." OCA Brief at 42. It therefore proposes DMCS language that would provide that a particular analysis be performed at the end of each year, and discounts would be lowered, if necessary, to ensure a 2.0 cent net contribution per piece after the 4.5 cent discount. OCA Brief at 47. If this "[annual] analysis was late or failed to show actual unit contribution at each discount tier, discounts at all tiers would fall to the discount for the first tier: 2.5 cents." OCA Brief at 43.

Uncertainty unsupported by record evidence does not justify altering a negotiated bargain. The co-proponents have negotiated a deal embodying realistic expectations and trade-offs by both parties. Not only does the record support a conclusion that this deal will to contribute to institutional costs, there is no record evidence to support a conclusion that the margins will fall below 2.0 cents in the first place. In addition, there is no support in the record for OCA's assertion that a net contribution of 2.0 cents at the margin is "sufficient" or, by implication, that anything under 2.0 cents is not sufficient.

OCA's stop-loss discount adjustment mechanism is unacceptable to the co-proponents, as it represents a significant restructuring of the bargain. This type of a provision should not be added to any bargain without a return to the negotiating table. Here, it could prompt DFS to exercise its right to cancel the NSA. As detailed above, it also is unnecessary, given the record evidence that this NSA will contribute to institutional costs.

G. There Is No Basis For OCA's Request To Eliminate So-Called "Free Riders."

OCA objects to what it calls "free riders," -- "First-Class Mail solicitation volumes that would have been mailed anyway." OCA Brief at 9. Relying on witness Smith (OCA-T-1) in Docket No. MC2002-2, whose testimony is not in the record of this case, OCA Brief at 9, OCA warns against "the payment of an incentive where none is necessary" as "the pieces would have been mailed absent an incentive." OCA Brief at 48. Using witness Giffney's Before Rates forecasts, OCA calculated the dollar values resulting from free riders as $1.2 million for year 1, $1.1 for year 2, and $0.9 million for year 3. OCA Brief at 49.

OCA considers the first year to be acceptable, so that DFS can recover "the regulatory and associated costs being incurred by Discover in pursuit of this NSA." OCA Brief at 50. Nonetheless, OCA objects to any free riders in the second and third years. OCA Brief at 51-52.

This is yet another one-sided attempt to restructure the deal, ignore the ACS savings, and view the functional elements of the NSA in isolation. As is the case with the annual stop-loss adjustment proposed by OCA, it could prompt DFS to exercise its right to cancel the contract. It also is unnecessary.

As witness Dr. B. Kelly Eakin described, in the baseline docket, setting a threshold below forecasted volume is economically efficient, because it reduces the mailer's marginal price of First-Class Mail relative to other forms of solicitation, and reduces the gap between marginal price and marginal cost of the mailer's First-Class Mail. (MC2002-2,USPS-RT-2 at 4-5, Tr. 10/2069-70). This testimony, which is in the record in this case, fully supports setting the threshold at which discounts begin to a point lower than the Before Rates projections.

III. Conclusion

In essence, OCA and Valpak are trying to rewrite the NSA to make it certain that each distinct element benefits the Postal Service. The Commission should not allow this practice, especially in functionally equivalent cases. In promulgating the NSA procedural rules, the Commission in Order No 1391 stated:

> The Postal Service contends that the benefits of a NSA need to be considered as a whole . . . . The Commission anticipates that negotiating a multi-element Negotiated Service Agreement will involve some give and take for the parties to reach agreement. Requiring each element to benefit the Postal Service could hinder this give and take process, and eliminate many possible arrangements from consideration. The

> Commission will review each element of an agreement, and integrate each element into a review of the agreement as a whole. **The overall agreement must benefit the Postal Service.** An individual element that does not benefit the Postal Service or that presents a high risk may receive added attention, and potentially could prevent a positive Commission recommendation. However, **the OCA's policy proposal to require at the outset every element to benefit the Postal Service, without looking at the element's relationship to the overall agreement is too restrictive.** It will not be incorporated in the final rule. 69 Fed. Reg. 7574, 7578 (Feb. 18, 2004) (emphasis added).

The Postal Service encourages the Commission to look at this entire agreement, in light of the record, and not rewrite particular terms merely because they may not seem to be beneficial enough to either co-proponent. This NSA is an arms-length bargain, and should be looked at as a whole.

WHEREFORE, the Postal Service reiterates its request that the Commission submit a recommended decision in accordance with its Request.

Respectfully submitted,

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Attachment A

DISCOVER FINANCIAL SERVICES NSA
PROPOSED DATA COLLECTION PLAN

The Postal Service plans to collect the following data pertaining to the NSA with Discover Financial Services, Inc. (DFS):

1. The volume of First-Class Mail solicitations by rate category in eligible DFS permit accounts;

2. The volume of First-Class Mail customer mail by rate category in eligible DFS permit accounts;

3. The amount of discounts paid to DFS for First-Class Mail by incremental volume block;

4. The volume of First-Class Mail solicitations bearing the ACS endorsement that are physically returned to DFS;

5. The number of electronic address correction notices provided to DFS for forwarded solicitation mailpieces, including the number of notices processed by CFS units and separately for PARS (when fully operational).

6. The number of electronic address correction notices provided to DFS for solicitation mailpieces that would otherwise be physically returned, including the number of notices processed by CFS units and separately for PARS (when fully operational).

7. Monthly estimate of the amount of time spent on compliance activity and a description of the activities performed.

8. For each First-Class Mail solicitation mailing list run against NCOA, DFS will provide NCOA contractor reports that separately identify the number of address records checked and the number of corrections made.

9. For each Change of Address record that is used to forward a piece of DFS solicitation mail through ACS under the Agreement, the Postal Service will provide the date the record was created, its move effective date, whether it was for a family or individual move, and each date that the record was used to forward a mail piece. No other information from the record would be provided.

10. Volume of Standard Mail solicitations by rate category.

As part of each data collection plan report, the Postal Service will provide an evaluation of the impact on contribution. It will also provide an assessment of trends of DFS' First-Class Mail volume as compared to overall First-Class Mail volume.

Data collected under the plan shall be reported annually following the end of the fiscal year, with the first report being made available at the end of FY2004. The Postal Service shall provide the data in a PC-available format.

Attachment B
If DFS has a forwarding rate of 13.6 percent

Discover Model
Negotiated Service Agreement
Appendix A, page 11

		Year 1	Year 2	Year 3	Total
ACS Savings					
(1)	Statement Mail	$ -	$ -	$ -	-
(2)	Marketing Mail Letter	$ 2,641,965	$ 2,747,643	$ 2,857,549	**8,247,157**
Contribution from New Volume					
(3)	Statement Mail	$ -	$ 178,527	$ 347,956	**526,483**
(4)	Marketing Mail Letter	$ 891,000	$ 1,198,971	$ 1,097,748	**3,187,718**
(5) Total Exposure		$ 1,230,000	$ 1,080,000	$ 930,000	**3,240,000**
(6) Total Incremental Discounts		$ 390,000	$ 570,000	$ 600,000	**1,560,000**
(7) Total USPS Value		**$ 1,912,964**	**$ 2,475,141**	**$ 2,773,253**	**7,161,358**
(8)	UAA Rate	9.30%	9.30%	9.30%	**-**
(9)	Increase in AR Marketing Volume	13,000,000	18,000,000	18,000,000	**49,000,000**
(10)	Marketing Volume Not UAA	11,791,000	16,326,000	16,326,000	**44,443,000**
(11)	Forwarding Rate	13.50%	13.50%	13.50%	**-**
(12)	Number of Pieces Forwarded	1,591,785	2,204,010	2,204,010	**5,999,805**
(13)	Cost of Fowarding + ACS Notice	$0.419	$0.436	$0.453	**-**
(14)	Total Cost of Fowarding	666,958	960,419	998,836	**2,626,213**
(15)	Total USPS Value at higher fowarding rate assuming no elimination of repeat forwards	**1,246,006**	**1,514,722**	**1,774,416**	**4,535,145**

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

Brian M. Reimer

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1134
September 15, 2004