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

Rate and Service Changes to Implement Functionally Equivalent Negotiated Service Agreement with Bank One Corporation	)))	Docket No. MC2004-3

OFFICE OF THE CONSUMER ADVOCATE
INITIAL BRIEF
October 6, 2004

Pursuant to Presiding Officer's Ruling MC2004-3/6, the Office of the Consumer Advocate (OCA) hereby submits its initial brief on the Negotiated Service Agreement (NSA) between Bank One Corporation (Bank One) and the United States Postal Service. The OCA is a signatory, along with Bank One, the Postal Service, and the two Valpak entities,[1] to the settlement filed October 5, 2004. The settlement includes a stop-loss mechanism that differs from the cap on total discounts that applies to Capital One.[2] This brief explains the analytical process by which the OCA concluded that a mid-course correction based on actual experience is a better stop-loss mechanism than an absolute cap on total discounts received by Bank One.

When this case was filed, the OCA was concerned that the proposed DMCS language contained no stop-loss mechanism of any kind, much less a Capital One discount cap. However, the OCA did not want to delay this proceeding by litigating a

[1] Valpak Dealers' Association, Inc., and Valpak Direct Marketing Systems, Inc.

[2] The Commission is evaluating the Bank One NSA as functionally equivalent to the Capital One NSA recommended in Docket No. MC2002-2, pursuant to section 196 of the rules of practice. *See* Presiding Officer's Ruling No. MC2004-3/1, July 23, 2004, at 2.

purely legal issue of first impression. Rather, the OCA devoted its resources to evaluating the Postal Service's claim that a Capital One stop-loss cap is more of a "stop-gain" cap.[3]

In order to estimate the likelihood that discounts paid to Bank One could exceed cost savings plus new contribution, the OCA first determined how much "anyhow" volume Bank One would have to mail in order to exhaust cost savings (assuming that Bank One's customer mail remained constant and no new marketing volume would be sent in response to discounts). This volume was 103,368,725 pieces of marketing mail letters (except for 43,000 flats), which was verified by witness Plunkett.[4] This volume was 3.5 times the Year One volume of marketing letters that Bank One expected to mail in the absence of discounts and 30 percent more than the highest marketing letter volume sent by Bank One since 2001.[5] Witness Plunkett testified that such a scenario—103.4 million "anyhow" pieces and zero discount-induced pieces—was "highly improbable."[6] The OCA agrees.

A much more likely scenario is one in which significant volumes of new (or switched) marketing letters appear in response to discounts. Both the law of demand and witness Buc's model[7] predict this result. Even if 103.4 million pieces of "anyhow" volume somehow appeared, every piece of discount-induced volume would represent positive contribution to the Postal Service. Even if Bank One's before-rates marketing volume returns to its 2001 level, the NSA as a whole is profitable for the Postal

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3 *See* Tr. 2/198-200; USPS-T-1 at 15-17.
4 Tr. 2/296-98.
5 *See* Tr. 2/205; USPS-T-1, App. A at 2 (Before Rates Marketing Mail Letter).
6 *Id.* at 298.
7 *Id.* at 52-53.

Service.[8] Unfortunately, the analysis of financial risks to the Postal Service from the Bank One NSA cannot stop here.

There are many variables other than volume estimates that affect the overall value of an NSA to the Postal Service. These other variables have uncertainty associated with them, just as volume estimates do.[9] Many of these variables were listed in the Commission's opinion in the companion Docket No. MC2004-4.[10] Some of these variables (*i.e.,* return, forwarding, and ACS success rates) can be controlled by the parties to the NSA. The actual future values of these variables are unknown. Changes in these variables could drive the value of the NSA negative, *even in the presence of a Capital One stop-loss cap.*

The Initial Brief of the OCA in the Discover case contains three tables showing how cost savings are affected by return, forwarding, and ACS success rates.[11] The values in the tables represent the difference between cost savings and discounts paid at various before-rates volumes. Each of these tables contains negative values at or below the volume associated with a Capital One stop-loss cap.[12] These negative numbers demonstrate that there are risks other than underestimates of before-rates volumes that can totally erode cost savings. The settlement agreement mitigates these risks without inhibiting the entry of new volume that generates new contribution to institutional costs.

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[8] Overall profitability is the Commission's standard for approving NSAs. *See, e.g.,* PRC Op. MC2004-4 at 51.

[9] "Every agreement could exhibit more than one form of risk, and for each risk there might be more than one acceptable form of stop-loss mechanism." *Id.* at 36.

[10] *Id.* at 39.

[11] Docket No. MC2004-4, Initial Brief of the OCA, September 8, 2004, at 34-38.

[12] Correcting Table 4-1 for the difficulties discussed by the Commission in the Discover case still leaves negative numbers in the table. *See* PRC Op. MC2004-4 at 30 n.22. *Any* increase in the forwarding (or return) rate will produce a negative value at the Capital One cap.

The record of this proceeding demonstrates that underestimates of before-rates volumes are not a significant risk to the overall value of the Bank One NSA to the Postal Service. The Commission should recommend the DMCS language and rate schedules contained in the settlement agreement. The Commission should not impose a cap on volumes eligible for discounts.

Respectfully submitted,

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