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UNITED STATES OF AMERICA
POSTAL RATE COMMISSION

*Before:*

Chairman Omas,
Vice Chairman Hammond,
and Commissioners Covington, Goldway,
and Tisdale*

Rate and Service Changes to Implement Functionally Equivalent Negotiated Service Agreement with Bank One Corporation

Docket No. MC2004-3

# OPINION AND RECOMMENDED DECISION APPROVING NEGOTIATED SERVICE AGREEMENT

Washington, DC 20268-0001
December 17, 2004

* Commissioner Tisdale did not participate in this decision.

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## I. INTRODUCTION AND SUMMARY

[1001] The Postal Rate Commission recommends that the United States Postal Service enter into a three-year Negotiated Service Agreement with Bank One Corporation (Bank One). Negotiated Service Agreements create opportunities for the Postal Service to reduce costs and increase revenues by tailoring its mail services to the unique characteristics of its mailers. The Bank One Negotiated Service Agreement is the third in a series of functionally equivalent Negotiated Service Agreements requested by the Postal Service and recommended by the Commission. The Commission supports the Postal Service's efforts in promoting Negotiated Service Agreements, which benefit all mailers, and is pleased to expand the development of this new classification through the recommendation of the Bank One Negotiated Service Agreement.

[1002] The Commission encourages the Postal Service to continue to enter into Negotiated Service Agreements which create "win-win" situations for both the Postal Service and the participating mailers. The Postal Service wins through successful Negotiated Service Agreements by creating opportunities to reduce costs and increase revenues. The participating mailers win through increased internal efficiencies, reduced postal costs, and the potential to share in cost savings realized by the Postal Service during the course of the Negotiated Service Agreement. When this occurs, all mailers benefit, including mailers that are not a party to the agreement. The Bank One Negotiated Service Agreement creates a win-win situation by providing Bank One with a direct economic benefit of up to $11.5 million in postage discounts, and provides the Postal Service with significant opportunities for cost savings and increased contribution, which benefit all mailers.

[1003] Creating win-win situations also reduces the risk of harm to mailers not party to the agreement. This is a particularly important consideration when involving monopoly services, where mailers not party to the agreement are dependent on the Postal Service.

[1004] The Bank One Negotiated Service Agreement is based on the same substantive functional elements that are central to the recently recommended Capital One Negotiated Service Agreement — an address correction element and a declining block rate volume discount element. These elements are also present in the recently recommended Discover Financial Services (DFS) Negotiated Service Agreement.

[1005] The Bank One Negotiated Service Agreement address correction element provides Bank One, at certain levels of volume, electronic address corrections without fee for properly endorsed First-Class Mail solicitations. Bank One will receive the services associated with Change Service Requested, Option 2, which include forwarding. In return, Bank One agrees to forgo physical return of undeliverable as addressed mail, which otherwise is provided under the existing service features of First-Class Mail.

[1006] The Bank One Negotiated Service Agreement declining block rate volume discount element provides Bank One with per-piece discounts on those portions of its First-Class Mail that reach specified volume thresholds. The initial volume threshold, which must be exceeded to receive any discount, is 535 million pieces yearly. The discounts range from 2.5 cents to 5.0 cents depending on the block volume. These discounts create price incentives for Bank One to generate new First-Class Mail.

[1007] While the Bank One Negotiated Service Agreement as recommended is functionally equivalent to the Capital One Negotiated Service Agreement, it is not, nor is it required to be, identical. The Bank One Negotiated Service Agreement is tailored to accommodate Bank One’s unique situation. For example, the Bank One Negotiated Service Agreement includes discounts and volume levels applicable exclusively to Bank One's mailing characteristics. It also includes contract terms and conditions, such as an annual threshold adjustment, enhanced mergers and acquisitions clause, and an annual limit on the mailing of flat-shaped mail, which were negotiated specifically to address Bank One’s interactions with the Postal Service. The necessity to tailor specific rates and classifications to a particular mailer is a characteristic of a Negotiated Service

Agreement classification, which might not be present with a more inclusive type of classification.

[1008] Just as the functional elements of the Capital One and Bank One Negotiated Service Agreements are similar, but not identical, the benefits or effects of each agreement on the Postal Service are comparable, but not identical. For example, the Bank One Negotiated Service Agreement does not rely on the generation of new First-Class Mail volume, but instead relies on a shift of mail volume from Standard Mail to First-Class Mail. Unlike previous Negotiated Service Agreements, the Bank One Negotiated Service Agreement contemplates the mailing of flat-shaped mail which generates greater per-piece savings than letters from the use of electronic notifications. Also, because of the operational differences between Capital One and Bank One, the Postal Service may experience different effects from each mailer's utilization of electronic return data.

[1009] Essential to creating win-win situations within the context of Negotiated Service Agreements are effective risk limiting mechanisms tailored to the unique circumstances of each agreement. The participants in this docket recognized risks associated with mis-estimation of forwarding, return and address correction success rates that were less of a concern while considering the Capital One Negotiated Service Agreement. The participants crafted a protective "trigger" mechanism designed to limit potential financial harm to the Postal Service, and presented this mechanism to the Commission in a Modified Stipulation and Agreement filed late in the proceeding. The Modified Stipulation and Agreement is unopposed and signed by a majority of the participants. The Commission compliments the participants for identifying and addressing these risks particular to this agreement and incorporates the trigger mechanism into its recommendation.

[1010] Central to the baseline Capital One Negotiated Service Agreement, the Commission recommended the addition of a stop-loss cap to protect against risks associated with the loss of revenue from discounts on mail that would have been sent without the agreement. This is a distinctly different risk than addressed by the trigger

mechanism discussed above. The DFS Negotiated Service Agreement also includes a stop-loss cap, although the value of the stop-loss cap is calculated differently than in the Capital One Negotiated Service Agreement. These stop-loss caps preserve the win-win situations by assuring that mailers not party to the agreements are not made worse off by limiting the potential discounts available to the participating mailers to the cost savings estimated to accrue to the Postal Service. It is the Commission's view that assuring that mailers not party to the agreement are not disadvantaged is an essential characteristic of agreements functionally equivalent to the Capital One Negotiated Service Agreement.

[1011] The request for the Bank One Negotiated Service Agreement did not include a stop-loss cap. However, the risk of losses from discounts on mail that would have been sent without the agreement, given the record in this docket, is a continuing concern. Bank One's recent merger with J. P. Morgan Chase furthers this uncertainty because, aside from presenting a hypothetical situation, the record does not demonstrate how the merged entity will implement its combined mailing strategy or how this mailing strategy may affect before-rates mail volumes. Therefore, consistent with the previous Capital One and the DFS Negotiated Service Agreements, and given that similar risks are present here, the Commission finds it appropriate to recommend the addition of a Capital One style stop-loss cap to the Bank One Negotiated Service Agreement. The addition of a stop-loss cap will preserve the win-win situation, and assure that mailers other than Bank One are not made worse off as a result of this Negotiated Service Agreement. The stop-loss cap also holds significance in the review of this request under the functional equivalency rules, with the Capital One Negotiated Service Agreement as the baseline.

[1012] The Postal Service will benefit by $11.6 million over the life of the Bank One Negotiated Service Agreement. This is based on estimates of $7.6 million in savings due to the address correction feature, $6.9 million in increased contribution due to increased First-Class Mail volume, and a net leakage of minus $2.9 million due to the discount feature of the agreement. The Commission's recommendation establishes a $11.5 million stop-loss cap over the life of the agreement.

[1013] The Postal Service will pursue a data collection plan with the Bank One Negotiated Service Agreement that is similar to the plan recommended for the Capital One Negotiated Service Agreement. Information from these data collection plans, along with data obtained from the DFS Negotiated Service Agreement, should prove useful for evaluating the benefits of pursuing this style of agreement with other mailers.

[1014] The Capital One Negotiated Service Agreement recommended by the Commission in Docket No. MC2002-2 and approved by the Governors on June 2, 2003 rests on the Postal Service's undertaking to make the essential features of that agreement available to similarly situated mailers. This was viewed as essential to complying with the statutory requirement that the Postal Service not "make any undue or unreasonable discrimination among users of the mails, nor shall it grant any undue preferences to any such user." The Bank One Negotiated Service Agreement, along with the recently recommended DFS Negotiated Service Agreement, are significant in that they demonstrate the Postal Service's continuing commitment and ability to offer the essential features of previously recommended Negotiated Service Agreements to other mailers willing to accept similar terms and conditions.

[1015] The Commission invites the Postal Service to develop and request new and innovative Negotiated Service Agreements which can be considered as new baseline agreements. The Commission also invites the Postal Service to seek modifications to previously recommended Negotiated Service Agreements, when new information becomes available to substantiate a change. The finalization of the merged Bank One and J. P. Morgan Chase mailing strategy might provide an opportunity for such a request.

[1016] This docket has been conducted using the Commission's new rules for functionally equivalent Negotiated Service Agreements. The rules provide the opportunity for expediting Postal Service requests for functionally equivalent Negotiated Service Agreements by allowing participants to rely on relevant record testimony from a previous docket and avoiding the need to re-litigate issues that were recently litigated

and resolved. Shortly after the conclusion of this docket, the Commission will solicit comments on the first use of the new rules.

[1017] The Commission includes a separate Concurring Opinion which discusses the challenging issues presented in this particular docket.

[1018] The Commission acknowledges the considerable efforts put forth by the participants toward rapidly resolving the unique issues presented in this docket and bringing this docket to a successful conclusion. The Postal Service's settlement coordinator and all of the participants that were involved in the settlement negotiations worked diligently to narrow and resolve issues without Commission involvement. The contribution by the parties to the Modified Stipulation and Agreement has resulted in an improved Negotiated Service Agreement. These efforts led to the development of the substantial record upon which this decision is based.

## II. PROCEDURAL HISTORY

[2001] On June 21, 2004, the United States Postal Service filed a formal request with the Postal Rate Commission seeking a recommended decision approving a mail classification and related rates and fees predicated on a Negotiated Service Agreement with Bank One Corporation.[1] The Postal Service contends that the proffered Negotiated Service Agreement is functionally equivalent to the Capital One Financial Services, Inc. Negotiated Service Agreement recently recommended by the Commission[2] and approved for implementation by the Governors.[3] See Docket No. MC2002-2.

[2002] The Postal Service identified Bank One, along with itself, as parties to the Negotiated Service Agreement. This identification served as Bank One's notice of intervention, and indicated that Bank One will be considered a co-proponent, procedurally and substantively, of the Postal Service's Request during the Commission's review of the Negotiated Service Agreement.

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[1] Request of the United States Postal Service for a Recommended Decision on Classifications, Rates and Fees to Implement Functionally Equivalent Negotiated Service Agreement with Bank One Corporation, June 21, 2004 (Request).

[2] Opinion and Recommended Decision, Docket No. MC2002-2, May 15, 2003 (Capital One Opinion).

[3] The Governors' decision announces that the Negotiated Service Agreement classification and related rates and fees shall be in effect from September 1, 2003, through September 1, 2006. Decision of the Governors of the United States Postal Service on the Opinion and Recommended Decision of the Postal Rate Commission Recommending Experimental Rate and Service Changes to Implement Negotiated Service Agreement with Capital One, Docket No. MC2002-2, June 2, 2003 (Governors' Decision).

[2003] The Request, which includes six attachments, was filed pursuant to Chapter 36 of the Postal Reorganization Act, 39 U.S.C. § 3601 et seq.[4] In support of the Request, the Postal Service filed Direct Testimony of Michael K. Plunkett on Behalf of United States Postal Service, June 21, 2004 (USPS-T-1).[5] Bank One separately filed Direct Testimony of Brad Rappaport on Behalf of Bank One Corporation, June 21, 2004 (BOC-T-1). The Request relies substantially on record evidence entered in the baseline docket, Docket No. MC2002-2. The Postal Service's Compliance Statement, Request Attachment E, identifies the baseline docket material on which it relies.

[2004] In contemporaneous filings, the Postal Service submitted a proposal for limitation of issues in this docket,[6] a request to establish settlement procedures,[7] and a motion requesting that if the Commission concludes that the submitted materials and incorporations are not sufficient, that requirements for additional materials be waived.[8]

[2005] The Commission issued Order No. 1409 to announce the filing of the Request; address the request for waiver of certain filing requirements; authorize settlement negotiations; appoint the Postal Service as settlement coordinator; designate the director of the Commission's Office of the Consumer Advocate (OCA) as the

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[4] Attachments A and B to the Request contain proposed changes to the Domestic Mail Classification Schedule and the associated rate schedules; Attachment C is a certification required by Commission rule 193(i) specifying that the cost statements and supporting data submitted by the Postal Service, which purport to reflect the books of the Postal Service, accurately set forth the results shown by such books; Attachment D is an index of testimony and exhibits; Attachment E is a compliance statement addressing satisfaction of various filing requirements; and Attachment F is a copy of the Negotiated Service Agreement.

[5] See also, errata filed on August 6, 2004, September 1, 2004, and September 14, 2004.

[6] United States Postal Service Proposal for Limitation of Issues, June 21, 2004.

[7] Request of the United States Postal Service for Establishment of Settlement Procedures, June 21, 2004.

[8] Statement of the United States Postal Service Concerning Compliance with Filing Requirements and Conditional Motion for Waiver, June 21, 2004. This motion was denied in PRC Order No. 1409 at 6-7.

representative of the interests of the general public; establish the deadline for intervention; and set the date and agenda for a prehearing conference.[9]

[2006] On June 28, 2004 Bank One filed a motion requesting late acceptance of the Direct Testimony of Lawrence G. Buc on Behalf of Bank One Corporation, June 28, 2004 (BOC-T-2).[10] There was no notice of this testimony in the Request, and because the late filing could be prejudicial, and affect the procedural and due process rights of current and potential intervenors, the Commission provided notice of late filing in the *Federal Register*.[11]

[2007] The prehearing conference was held on July 15, 2004. The Postal Service, acting as settlement coordinator, reported on the first settlement conference, held on July 14, 2004. Settlement discussions focused on functional equivalency and the appropriateness of proceeding under rule 196, the Postal Service's proposal for limitation of issues, the need for a hearing, and the timing of discovery. The settlement coordinator requested and was granted an additional week to further explore whether any participant wished to request a hearing. Additional time also was provided to allow participants to explore what issues were contested in this docket.

[2008] The settlement coordinator's report of July 22, 2004, indicated that two participants requested a hearing, although the settlement coordinator stated that it is unclear whether a hearing is warranted, or what issues would be covered in a hearing.

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[9] Notice and Order on Filing of Request Seeking Recommendation of Functionally Equivalent Negotiated Service Agreement, June 24, 2004, PRC Order No. 1409 (Order).

[10] Motion of Bank One Corporation for Late Acceptance of the Testimony of Lawrence G. Buc, June 28, 2004. See also, errata to Buc testimony filed August 16, 2004. This motion was granted. POR No. MC2004-3/1, July 23, 2004.

[11] Notice of Late Filing of Testimony of Lawrence G. Buc on Behalf of Bank One Corporation, July 2, 2004, PRC Order No. 1411. See also 69 Fed. Reg. 41311 (2004).

On July 23, 2004, Valpak and OCA filed requests for a hearing.[12] OCA's request also indicated an intent to file testimony.

[2009] Because of the emphasis on expedition of requests predicated on functionally equivalent Negotiated Service Agreements, the Presiding Officer issued a scheduling ruling to provide direction to the proceeding.[13] The ruling established that this docket would proceed under rule 196 for functionally equivalent Negotiated Service Agreements. It also tentatively scheduled a hearing for September 8 or 9, 2004 on the proponents' direct case. The Presiding Officer also noted that the July 1, 2004 merger of Bank One and J. P. Morgan Chase, and the need for relevant information in regard to the merger, could further complicate the timing of this docket.

[2010] The settlement coordinator kept the Commission informed of settlement discussions by filing periodic reports over the next several weeks. During this time the Commission also received extensive pleadings discussing the limitation of issues, and whether or not a hearing would be warranted in this docket. Upon review of the pleadings, the Presiding Officer issued a ruling limiting the issues in this docket to those specified in rule 196(a)(6).[14] He also allowed discussion on brief of a system-wide fix to the problem of undeliverable as addressed First-Class Mail and consideration of a niche classification to help the Commission deal with future similar requests, but he announced that this discussion would not form the basis of the recommendation in this docket.

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[12] Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Restated Request for Hearing and Preliminary Statement of Issues, July 23, 2004. Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. are collectively referred to as "Valpak" in this decision. Office of the Consumer Advocate Request for a Hearing in Docket No. MC2004-3, July 23, 2004.

[13] Presiding Officer's Ruling Establishing Procedural Schedule, POR No. MC2004-3/1, July 23, 2004.

[14] Presiding Officer's Ruling in Regard to Limitation of Issues, POR No. MC2004-3/2, August 13, 2004.

[2011] On August 18, 2004, OCA requested an extension of time to determine whether it still desired a hearing.[15] On August 20, 2004, Valpak withdrew its request for a hearing.[16] On September 2, 2004, OCA withdrew its request for a hearing,[17] and the previously scheduled hearing was cancelled.[18]

[2012] On September 13, 2004, the proponents filed motions requesting that the direct testimonies of Postal Service witness Plunkett, and Bank One witnesses Rappaport and Buc; the written cross-examination designated by the American Postal Workers Union, AFL-CIO, the OCA, and Valpak; and POIR Nos. 1 through 6 be entered into the record.[19] Bank One's motions were accompanied by the supporting declaration of witnesses Rappaport and Buc. The Postal Service separately filed the supporting declaration of witness Plunkett.[20] The testimonies, designated written cross-examination, and POIRs were entered into the record on October 21, 2004, and

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[15] Office of the Consumer Advocate Motion for an Extension to September 3, 2004 to Request Hearing, August 18, 2004.

[16] Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Withdrawal of Protective Request for Hearing, August 20, 2004.

[17] Office of the Consumer Advocate Statement Concerning the Need for a Hearing, September 2, 2004.

[18] Presiding Officer's Ruling Cancelling Hearing and Other Miscellaneous Matters, September 3, 2004, POR No. MC2004-3/4.

[19] United States Postal Service Motion for Inclusion of Direct Testimony, Designated Written Cross-Examination, and Responses to POIRs into the Record, September 13, 2004; Motion of Bank One Corporation to Enter Into the Record Testimony of Brad Rappaport, Designated Written Cross-Examination, and POIR Responses, September 13, 2004; Motion of Bank One Corporation to Enter Into the Record Testimony of Lawrence G. Buc, Designated Written Cross-Examination, and POIR Responses, September 13, 2004.

[20] Notice of the United States Postal Service Regarding Filing of Original Declarations of Authenticity of Witness Michael K. Plunkett, September 13, 2004.

the record was closed.[21]

[2013] Late in the proceeding, the Postal Service, Bank One, and OCA filed a joint motion indicating that a settlement had been reached.[22] The motion requested that the Commission consider a separately filed Stipulation and Agreement as the basis of its recommended decision.[23] The same parties also filed a motion to delay the briefing schedule to allow the Commission and other parties time to consider the Stipulation and Agreement.[24] The Stipulation and Agreement was initially signed by the Postal Service, Bank One, and OCA, and subsequently signed by Alliance of Nonprofit Mailers, American Bankers Association, American Postal Workers Union, AFL-CIO, Association for Postal Commerce, Discover Financial Services, Inc., Magazine Publishers of America, Inc., National Association of Postmasters of the United States, National Postal Policy Council, and Parcel Shippers Association. Valpak filed comments in opposition to the Commission basing its recommended decision on the Stipulation and Agreement.[25]

[2014] On October 4, 2004 the Postal Service, Bank One, Valpak, and OCA notified the Commission that agreement in principle had been reached on the terms of a modification to the September 15, 2004 Stipulation and Agreement.[26] The next day, the

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[21] Presiding Office's Ruling Placing Testimony into Evidence and Closing the Record, POR No. MC2004-3/7, October 21, 2004.

[22] Joint Motion of the United States Postal Service, Bank One Corporation, and the Office of Consumer Advocate for Consideration of Stipulation and Agreement as the Basis for Recommended Decision, September, 15, 2004.

[23] Stipulation and Agreement, September 15, 2004.

[24] Joint Motion of the United States Postal Service, Bank One Corporation and the Office of Consumer Advocate for Adjustment of Briefing Schedule to Accommodate the Stipulation and Agreement, September 15, 2004. This motion was granted. POR No. MC2004-3/5, September 16, 2004.

[25] Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Comments on Commission Consideration of Proposed Settlement, September 27, 2004.

[26] Joint Statement of the United States Postal Service, Bank One Corporation, Valpak Direct Marketing Systems, Inc., Valpak Dealers' Association, Inc., and the Officer of Consumer Advocate Concerning Settlement, October 4, 2004.

Postal Service, Bank One, Valpak, and OCA filed a joint motion[27] requesting that the Commission consider a separately filed Modified Stipulation and Agreement as the basis of its recommended decision.[28] The Modified Stipulation and Agreement was initially signed by the Postal Service, Bank One, Valpak, and OCA, and subsequently signed by Alliance of Nonprofit Mailers, American Bankers Association, American Postal Workers Union, AFL-CIO, Association for Postal Commerce, Discover Financial Services, Inc., Magazine Publishers of America, Inc., National Postal Policy Council, and Parcel Shippers Association. Four participants, National Association of Postmasters of the United States, National Newspaper Association, Newspaper Association of America, and David B. Popkin, did not sign nor did they oppose the Modified Stipulation and Agreement.

[2015] Four participants filed initial briefs: American Bankers Association, Bank One, OCA, and the Postal Service.[29] No reply briefs were filed.

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[27] Joint Motion of the United States Postal Service, Bank One Corporation, Valpak Direct Marketing Systems, Inc., Valpak Dealers' Association, Inc., and the Office of Consumer Advocate for Consideration of Modified Stipulation and Agreement as the Basis for Recommended Decision, October 5, 2004.

[28] Modified Stipulation and Agreement, October 5, 2004.

[29] Initial Brief of American Bankers Association, September 20, 2004 (ABA Brief); Brief of Bank One Corporation, October 6, 2004 (errata filed October 8, 2004 and October 12, 2004) (Bank One Brief); Office of Consumer Advocate Initial Brief, October 6, 2004 (OCA Brief); and Initial Brief of the United States Postal Service (USPS Brief), October 6, 2004.

## III. BASELINE AGREEMENT

[3001] The Postal Service submits that the Bank One Negotiated Service Agreement, on which this Request is predicated, is functionally equivalent to the Capital One Negotiated Service Agreement (the baseline agreement) recommended by the Commission in Docket No. MC2002-2 and currently in effect. The Postal Service Board of Governors determined that the rate and service changes associated with the Capital One Negotiated Service Agreement will remain in effect from September 1, 2003 through September 1, 2006.

[3002] The Capital One Negotiated Service Agreement includes two significant mail service features that form the bases of the agreement — an address correction service feature, and a declining block rate volume discount feature.

[3003] The address correction service feature provides Capital One, at certain levels of volume, electronic address corrections without fee for First-Class Mail solicitations that are undeliverable as addressed (UAA). In return for receipt of electronic address correction, Capital One will no longer receive physical return of its UAA First-Class solicitation mail that cannot be forwarded. Capital One will also be required to maintain and improve the address quality for its First-Class Mail. PRC Op. MC2002-2, para. 2004.

[3004] Use of the address correction service feature is a prerequisite to use of the second feature of the NSA, a declining block rate volume discount. This feature provides Capital One with a per-piece discount for bulk First-Class Mail volume above an annual threshold volume. The per-piece discount varies from 3 to 6 cents under a "declining-block" rate structure. Should first-year mail volume decline under a predetermined quantity, a reduced threshold and lower initial discounts take effect. Id. para. 2005.

[3005] The Commission's analysis of the Capital One Negotiated Service Agreement focused on assuring that the agreement would not make mailers, other than Capital One, worse off. Id. para. 8006. To meet this condition, the Commission's recommendation of the Capital One Negotiated Service Agreement included the addition of a provision establishing a cumulative three-year stop-loss limit of $40.637 million. Id. para. 8011. The Commission found that the estimates of before rates volumes for Capital One were so unreliable that without a stop-loss provision there would be no reasonable assurance that the Postal Service would not lose money on the Capital One Negotiated Service Agreement. Id. para. 8013.

## IV. SUMMARY OF PROPOSAL

### A. Witness Plunkett's Testimony

[4001] Postal Service witness Plunkett reviews the importance of Negotiated Service Agreements, and functionally equivalent agreements, to the Postal Service. He states that Negotiated Service Agreements "represent one tool that can help to mitigate the risk that continued erosion of First-Class Mail volume will lead to higher-than-necessary rate and fee increases in the future." Tr. 2/185-186. "Functionally equivalent NSAs are important to the Postal Service because they extend the benefits of favorable baseline agreements to similar relationships with other customers." Id at 186.

[4002] Witness Plunkett's testimony discusses the relationship of the baseline Capital One Negotiated Service Agreement to the Bank One Negotiated Service Agreement. He then presents the Postal Service's financial impact analysis and competitive impact analysis, discusses the discount cap, and reviews the factors of the Act. Id. at 184-228.

[4003] *Functionally Equivalent.* Witness Plunkett asserts that the Bank One Negotiated Service Agreement fully meets the guidelines outlined in Commission Order No. 1391 for functionally equivalent Negotiated Service Agreements. He contends that the Bank One Negotiated Service Agreement contains the same functional elements as the baseline Negotiated Service Agreement, i.e., declining block rates and address correction elements. Id. at 188.

[4004] Witness Plunkett explains that the declining block rate discounts are applied only to the incremental volumes above a volume threshold of 535 million pieces. The incremental discounts versus the applicable volume blocks are shown in Table 1.

**Table 1. Incremental Discounts Versus Volume Block**

| Volume Block | Incremental Discounts |
|---|---|
| 535,000,001 — 560,000,000 | 2.5¢ |
| 560,000,001 — 585,000,000 | 3.0¢ |
| 585,000,001 — 610,000,000 | 3.5¢ |
| 610,000,001 — 645,000,000 | 4.0¢ |
| 645,000,001 — 680,000,000 | 4.5¢ |
| 680,000,001 — above | 5.0¢ |

Id. at 189.

[4005] Witness Plunkett refers to the description of the Address Correction Service (ACS) system described by witness Wilson in the baseline docket. See Docket No. MC2002-2, USPS-T-4 at 2-7. The address correction element allows the Postal Service to convert physical return of Bank One's undeliverable as addressed (UAA) marketing mailpieces into electronic address correction information through the computerized ACS system.

[4006] He contends that the functional elements in the Bank One Negotiated Service Agreement provide a benefit comparable to what the Postal Service expects to obtain with the baseline Negotiated Service Agreement. Tr. 2/190.

[4007] Witness Plunkett lists other notable terms and conditions of the Bank One Negotiated Service Agreement. The agreement:

- waives the seal against postal inspection of the mail;
- requires Bank One to prepare mail under applicable standards;
- requires Bank One to enhance its address management practices;
- includes a minimum payment;
- contains a provision for Bank One to make necessary records and data available to facilitate and monitor compliance; and

- enables the Postal Service to cancel for failure by the mailer to provide accurate data, to present properly prepared and paid mailings, to comply with a material term of the agreement, or to use the Negotiated Service Agreement.

Id. at 190–191.

[4008] In describing terms and conditions unique to the Bank One Negotiated Service Agreement, witness Plunkett notes that although the discount structure remains the same as in the Capital One Negotiated Service Agreement, the thresholds, incremental blocks, and starting discounts are unique to the Bank One Negotiated Service Agreement. Also, the Bank One Negotiated Service Agreement includes an annual threshold adjustment clause and a detailed mergers and acquisitions clause. Id. at 191–193.

[4009] *Financial Impact Analysis.* Witness Plunkett explains that there are three factors affecting the financial estimates: ACS cost savings, new volume contribution, and discount exposure (leakage). An ACS cost savings of $7.8 million accrues from elimination of the physical return of First-Class Mail marketing pieces, and substituting electronic return notice in its place. Bank One has agreed to convert both its letter and flat-shaped solicitations to ACS. The conversion of marketing mail from Standard Mail to First-Class Mail is expected to generate $6.8 million additional contribution to the Postal Service over the three-year agreement. This will be offset by $2.9 million of lost revenue as the result of discounts for volume that would have been sent without a price incentive. Witness Plunkett estimates that this results in a net benefit to the Postal Service of $11.7 million over the life of the Negotiated Service Agreement. Id. at 193–195.

[4010] Witness Plunkett's financial analysis model, with certain modifications, follows witness Crum's methodology from Docket No. MC2002-2. Modifications are made to present a financial analysis over the life of the agreement, versus the test year approach taken in the Capital One docket. Adjustments are made to account for the mailing of flats. In addition, Plunkett applies a 4 percent annual inflationary cost adjustment factor to estimate unit costs in each year of the agreement, and to account for cost increases since litigation of the Capital One Negotiated Service Agreement. Id. at 195–196.

[4011] *Competitive Impact Analysis.* Witness Plunkett relies on the competitive impact analysis presented in the baseline docket. He states that the Commission concluded that the impact on competition would be minor, and that it was significant that no competitors of Capital One opposed that Negotiated Service Agreement. Witness Plunkett estimates that the impact on competition due to the Bank One Negotiated Service Agreement should be even less than the effect from the Capital One Negotiated Service Agreement. Id. at 197-198.

[4012] *Discount Cap.* Witness Plunkett discusses the possible negative ramifications of applying a stop-loss provision. He argues that basing a stop-loss provision "solely on cost savings would tend to limit participation in the NSA process to only large volume mailers who can offer significant cost savings opportunities." Id. at 198. Also, stop-loss provisions (based on the Capital One 95 percent pass-through methodology) could foreclose potential contribution from increased volume. Id.

[4013] Witness Plunkett argues that the conditions cited to support the Capital One stop-loss provisions do not apply to Bank One. He contends that the concern in the Capital One docket was that mail volume would have grown in the absence of discounts so that discounts would exceed cost savings. In the case of Bank One, he argues that Bank One's volume history is stable, and even with an increase in volume, the agreement will be contribution-positive. Id. at 199.

[4014] *Criteria of the Act.* In Witness Plunkett's discussion of the factors of the Act, he contends that the arguments he made in the baseline docket are also applicable in this docket. He incorporates his baseline docket testimony into this docket, and argues that the Commission's findings and conclusions in the baseline docket also justify recommending the instant Request. See witness Plunkett's testimony at MC2002-2, USPS-T-2, page 9, line 36 through page 10, line 15. Witness Plunkett further argues that the customer-specific rates offered Bank One cover all Postal Service costs (criterion 3). Tr. 2/200-202.

## B. Incorporated Record Evidence

[4015] The Request relies upon the record evidence from previous dockets shown in Table 2.

**Table 2. Record Evidence From Previous Dockets**

| Witness | Reference | Docket | Transcript (Volume/Page) |
|---|---|---|---|
| Anita J. Bizzotto | USPS-T-1 | MC2002-2 | 3/411*; 3/410-530 |
| Michael K. Plunkett | USPS-T-2<br>USPS-RT-1 | MC2002-2 | 4/674*; 4/673-851<br>5/865-66; 9/1857-1961 |
| Charles R. Crum | USPS-T-3 | MC2002-2 | 2/254*; 2/252-400; 5/858-864 |
| James D. Wilson | USPS-T-4 | MC2002-2 | 3/532*; 3/531-666 |
| B. Kelly Eakin | USPS-RT-2 | MC2002-2 | 10/2060-2140 |
| Institutional Responses | USPS | MC2002-2 | 5/867-966 |
| John C. Panzar | JCP-T-1 | MC2002-2 | 8/1572-1790 |
| Donald Jean | COF-T-1 | MC2002-2 | 2/34-198 |
| Stuart Elliott | COF-T-2<br>COF-RT-2 | MC2002-2 | 2/198-251<br>9/1836-1872 |
| Robert Shippee | COF-RT-1 | MC2002-2 | 9/1797-1835 |
| **Other Sources** | **Reference** | **Docket** | **Source** |
| Library Reference | USPS | R2001-1 | J-58; J-60 (as revised 11/15/2001);<br>J-69 (as revised 11/5/2001) |
| Library Reference | PRC | R2001-1 | PRC-LR-2; PRC-LR-4; PRC-LR-7 |
| * Location where accepted into the record (Postal Service written direct testimony is referenced but not transcribed into the record.) | | | |

Request Attachment E-17.

C. Witness Rappaport's Testimony

[4016] Bank One Corporation witness Rappaport describes Bank One's business and mail characteristics, discusses its historical First-Class Mail volume, presents the before and after Negotiated Service Agreement First-Class Mail volume projections, and addresses address hygiene and return rates. Witness Rappaport also informs the Commission of the proposed Bank One / J. P. Morgan Chase merger. Tr. 2/114–122.

[4017] *Bank One Background and Mail Characteristics.* Rappaport describes Bank One as the nation's sixth-largest bank holding company. It also is the third-largest credit card issuer in the United States, a leader in retail and small business banking, and a leading investment company. Witness Rappaport contends that "this NSA will reduce the Postal Service's costs in handling undeliverable mail and will provide Bank One incentives to continue to mail large volumes of solicitation mail and even to switch some solicitation mail from Standard Mail to First-Class Mail." Id. at 114.

[4018] Witness Rappaport explains that Bank One's mail volume is composed of solicitation mail which is usually sent as Standard Mail, and customer mail which is sent as First-Class Mail. He characterizes Bank One as a direct competitor of Capital One. In contrast to Capital One which mails a significant amount of its solicitation mail as First-Class Mail, he asserts that Bank One typically mails about 90 percent of its one billion solicitations each year as Standard Mail. In discussing solicitation mail, Rappaport contends that First-Class Mail is generally of higher value because of forwarding and return service, and higher response rates. However, the increased incremental response or "lift" obtained by using First-Class Mail is not justified by the approximately 10 cents per piece in additional postage associated with this class of mail. He contends that reducing the First-Class Mail cost premium by 2.5 to 5 cents would justify using First-Class Mail for some solicitations, and cause Bank One to shift those solicitations from Standard Mail to First-Class Mail. Id. at 115-116.

[4019] Witness Rappaport states that Bank One's customer mail, which is used to communicate with existing customers, is sent as First-Class Mail. For example, it is used for statements for credit card and bank accounts, letters responding to customer inquiries, and mailing new or replacement credit cards. Id. at 116.

[4020] *Bank One's First-Class Mail Volume History.* Witness Rappaport characterizes Bank One's mail volume history, including its solicitation mail volumes, as relatively stable over the past three years. Table 3 summarizes the historical First-Class Mail volumes for customer mail and solicitation mail.

**Table 3. Bank One Historical First-Class Mail Volume (Millions of Pieces)**

| | 2001 | 2002 | 2003 |
|---|---|---|---|
| Solicitation | 104 | 92 | 96 |
| Letters | 79 | 39 | 60 |
| Flats | 25 | 53 | 36 |
| Customer | 479 | 508 | 500 |
| Total | 583 | 600 | 596 |

Id. at 116-117.

[4021] *Bank One's Before and After First-Class Mail Volume Projections.* Based on Bank One's relative stability in total First-Class Mail volume and his business judgment, Witness Rappaport does not expect Bank One's year one volumes to deviate significantly from 2003 volumes. His year one estimate uses actual 2004 volumes where available, and mail volume forecasts developed by Bank One's business managers used in the ordinary course of business planning for the remainder of the year. A downward adjustment to the solicitation mail forecast is made to reflect year end pressures to reduce costs by shifting solicitations volume from First-Class Mail to Standard Mail. Year

two and year three volumes are forecast to be the same as year one volumes. Bank One's three year forecast for "before" Negotiated Service Agreement First-Class Mail volume is shown in Table 4. Id. at 117-119.

**Table 4. Bank One "Before" First Mail Volume (Millions of Pieces)**

| | Year One | Year Two | Year Three |
|---|---|---|---|
| Solicitation | 64 | 64 | 64 |
| Letters | 29 | 29 | 29 |
| Flats | 35 | 35 | 35 |
| Customer | 507 | 507 | 507 |
| Total | 571 | 571 | 571 |

[4022] The three-year forecast for "after" Negotiated Service Agreement First-Class Mail volume is shown in Table 5. Witness Rappaport forecasts a year one volume increase of 19 million pieces. By year two, he expects the new rates to induce a considerable volume shift of solicitations from Standard Mail to First-Class Mail letters. His projections assume that all new First-Class Mail would be converted from Standard Mail. Id. at 117-120.

**Table 5. Bank One "After" First-Class Mail Volume (Millions of Pieces)**

| | Year One | Year Two | Year Three |
|---|---|---|---|
| Solicitation | 83 | 163 | 163 |
| Letters | 48 | 128 | 128 |
| Flats | 35 | 35 | 35 |
| Customer | 507 | 507 | 507 |
| Total | 590 | 670 | 670 |

[4023] *Address Hygiene and Return Rates.* Witness Rappaport states that under the Negotiated Service Agreement, Bank One will run NCOA on existing customer files and solicitation files every 90 days. In the future, Bank One plans on running NCOA every 60 days on all of its mail. Id. at 120. Witness Rappaport explains that when Bank One receives notification from ACS of a stale or invalid solicitation address, an entry will be placed in its internal database to ensure Bank One will not use this address again, even if included in externally generated mailing lists. Id. at 166. Bank One does not plan on providing feedback to the original source of external lists. Id. at 167.

[4024] Witness Rappaport explains that the historical Bank One return rate for non-solicitation First-Class Mail, including statements and letters, is 0.3 percent. Based on his experience from Bank One's last use of ACS, approximately 9 percent of First-Class Mail solicitation letters were returned. For First-Class Mail solicitation flats, approximately 11 percent were returned with occasional return rates as high as 13 to 14 percent. He estimates similar return rates for 2004, 2005 and 2006. Id. at 121; 174-175.

[4025] *Proposed Merger*. Witness Rappaport informs the Commission that Bank One has announced plans to merge with J. P. Morgan Chase. However, at the time the above testimony was filed, Bank One had not received all of the necessary approvals,

and the official closing date for the merger was not definite. The above testimony does not contain J. P. Morgan Chase volume data. Witness Rappaport notes that the Bank One Negotiated Service Agreement contains language specifying how volumes from a merged entity would be handled should a merger be consummated. Id.

D. Witness Buc's Testimony

[4026] Bank One Corporation witness Buc testifies that witness Rappaport's after rates volume projections are highly credible and consistent with a heuristic model of marketing decisions. He concludes that the volume block discounts proposed under the Bank One Negotiated Service Agreement will create incentives for Bank One to switch a substantial amount of solicitation mail from Standard Mail to First-Class Mail. Tr. 2/41-70.

[4027] Witness Buc postulates that "[a] firm rationally sends a solicitation to an individual only when the expected benefits of the solicitation exceed its costs." He explains that for any marketing campaign a firm must estimate the probability of response for each individual on the list (response rate) and the present value of the stream of profits over the duration of that individual's relationship with the firm (lifetime value). The expected value of an individual mailing is determined by multiplying the response rate by the lifetime value. The expected value then can be compared against the cost per individual of the marketing campaign to determine whether the economic benefit from the mailing is positive. Id at 41-42.

[4028] Witness Buc uses the above principles to develop his model. In general, the model does not project an overall level of mailing, but rather determines how a given mailing could be split between First-Class Mail and Standard Mail based on incentive discounts. The model shows that for some combinations of lifetime values and response rates, it does not make economic sense to mail at all. When it does make sense to mail, the model indicates which class of mail would be used both with and without an incentive discount of a given amount. Id. at 71. Witness Buc has not developed specific volume

estimates for combinations of Bank One Standard Mail and First-Class Mail solicitation pieces. Id. at 72.

[4029] Witness Buc's model assumes a Standard Mail response rate of 0.1 to 0.7 percent, with 0.4 percent as a mean value. He explains that the incremental response from sending solicitations as First-Class Mail rather then Standard Mail is called "lift." His model assumes lifts ranging from 5 to 10 percent. The model uses lifetime customer values that range from $50 to $250. Witness Buc estimates production and mailing costs of 25 cents per piece for Standard Mail and 35 cents per piece for First-Class Mail. Id. at 42-44. Actual response rates, lifts, and lifetime values for Bank One are not provided; however, witness Buc contends that the range of values used in the model are appropriate. Id. at 74-85.

[4030] After analyzing the outputs of his model, witness Buc concludes that postage discounts ranging from 2.5 cents to 5.0 cents, as proposed in the Bank One Negotiated Service Agreement, will provide significant incentives to switch mail from Standard Mail to First-Class Mail, and thus witness Rappaport's after rates projections are highly credible. Id. at 51-53.

[4031] Witness Buc also addresses the concern of unknown before rates volumes and the unknown response to discounts. He states that Bank One before rates First-Class Mail marketing letter volume (assumed to be the only real discretionary volume) would have to increase by nearly 300 percent before leakage from the discounts would outweigh ACS cost savings. He asserts that an unanticipated increase of before rates volume of this magnitude is extremely unlikely. He states that the proponents of this Negotiated Service Agreement have submitted a far more sophisticated and thorough financial analysis than submitted in the Capital One case. Witness Buc contends that applying a stop-loss provision would not eliminate financial risk, but only substitute one risk for another by creating the risk of choking off volumes that the incentive otherwise would induce. He also contends that a stop-loss provision based on ACS savings will act as a disincentive for future Negotiated Service Agreements. Id. at 87-91.

E. J.P. Morgan Chase Related Discovery

[4032] On July 1, 2004, within two weeks of the filing of this Request, Bank One and J. P. Morgan Chase merged. Tr. 2/140. The credit card and checking account services of J. P. Morgan Chase will generate sufficient First-Class customer and solicitation mail, if the decision is made to integrate this mail with Bank One's mail under the Negotiated Service Agreement, to trigger the threshold adjustment provisions of the agreement. Id. at 141. The new initial threshold for the merged entity has not been established because a date for integration has not been set. Id. at 144.

[4033] In 2003, J. P. Morgan Chase had First-Class Mail volumes of 220 million pieces related to credit card accounts and 127 million pieces related to retail financial service accounts. In addition, there were 116 million pieces of First-Class Mail solicitations almost entirely related to credit cards. Id. at 142-143. Witness Rappaport also provides J. P. Morgan Chase historical First-Class Mail volume in the same format as for Bank One. See table 6.

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**Table 6. J.P. Morgan Chase Historical First-Class Mail Volume (Millions of Pieces)**

| | 2001 | 2002 | 2003 |
|---|---|---|---|
| Solicitation | unavailable | 179 | 112 |
| Letters | unavailable | 179 | 112 |
| Flats | unavailable | 0 | 0 |
| Customer | unavailable | 317 | 346 |
| Total | unavailable | 496 | 458 |

Id. at 176.

[4034] Witness Rappaport estimates a physical return rate for J. P. Morgan Chase First-Class operational/statement letter mail of less than 1 percent with a best estimate of approximately 0.6 percent. The weighted average for the merged entity is estimated at less than 0.5 percent based on 2003 volumes. Witness Rappaport estimates a J. P. Morgan Chase return rate for First-Class marketing letter mail of 4.0 percent. The weighted average for the merged entity is estimated at approximately 6 percent based on 2003 volumes. J. P. Morgan Chase did not mail a material number of marketing mail flats. The weighted average return rate for First-Class Mail flats for the merged entity is estimated at approximately 11 percent, although witness Rappaport indicates that the Bank One First-Class Mail return rate for flats has recently been running above 11 percent. Id. at 147-148.

[4035] Witness Rappaport estimates J. P. Morgan Chase "before" agreement First-Class Mail volume (table 7) and "after" agreement First-Class Mail volume (table 8). Because J. P. Morgan Chase does not yet have official 2005 and 2006 customer mail volume forecasts, Rappaport applies the 2002-2004 annual growth rate of approximately 6.3 percent to 2004 volumes to estimate 2005 and 2006 volumes. To estimate First-Class Mail solicitation letters volumes, he starts with an estimate of 2004 before rates First-Class Mail solicitation letters volume. He then applies the 2002-2004 annual growth rate discussed above. Finally, he applies the Bank One First-Class Mail solicitation letters to total solicitations ratios of 6.1 percent for before rates and 15.4 percent for after rates to determine the final estimates. He contends that using the Bank One ratios is appropriate "because post-merger marketing decisions for the merged corporate entity will be the responsibility of a company-wide marketing department composed primarily of former Bank One marketing employees." Id. at 153-156.

**Table 7. J.P. Morgan Chase "Before" First-Class Mail Volume (Millions of Pieces)**

| | Year One | Year Two | Year Three |
|---|---|---|---|
| Solicitation | 112 | 38 | 41 |
| Letters | 112 | 38 | 41 |
| Flats | 0 | 0 | 0 |
| Customer | 358 | 381 | 405 |
| Total | 471 | 419 | 445 |

**Table 8. J.P. Morgan Chase "After" First-Class Mail Volume (Millions of Pieces)**

| | Year One | Year Two | Year Three |
|---|---|---|---|
| Solicitation | n/a | 97 | 103 |
| Letters | n/a | 97 | 103 |
| Flats | n/a | 0 | 0 |
| Customer | n/a | 381 | 405 |
| Total | n/a | 478 | 508 |

[4036] Witness Plunkett presents a financial analysis of a hypothetical scenario in which integration of all J. P. Morgan Chase mail volumes into the Bank One Negotiated Service Agreement occurs on January 1, 2005, the beginning of year two of the agreement. The threshold volume would increase from 535 million pieces to 1,005.5 million pieces upon integration of the J. P. Morgan Chase mail volumes. An ACS cost

savings of $8.4 million accrues from elimination of the physical return of First-Class Mail marketing pieces, and substituting electronic return notice in its place. A new volume contribution of $13.1 million accrues from the conversion of a percentage of marketing mail from Standard Mail to First-Class Mail. A discount exposure of $1.2 million is created as the result of price incentives applied to any volume that would have occurred without a price incentive. Plunkett estimates that this would result in a net benefit to the Postal Service of $20.3 million over the life of the Negotiated Service Agreement. Id. at 306–329.

## F. Domestic Mail Classification Schedule (DMCS) Provisions

[4037] The Postal Service proposes to add a new DMCS section 612, to specify the general parameters of the Bank One Negotiated Service Agreement. See Request at Attachment A. The Modified Stipulation and Agreement proposes additional language to be incorporated into the new section 612. See Modified Stipulation and Agreement, Attachment A. The Postal Service also proposes the addition of two new rate schedules to the DMCS: 612A and 612B. Rate Schedule 612A specifies the initial volume block incremental discounts. Rate Schedule 612B specifies the adjusted threshold volume block incremental discounts. See Request at Attachment B.

## V. STIPULATION AND AGREEMENT

[5001] The Stipulation and Agreement filed September 15, 2004 proposes to modify the Domestic Mail Classification Schedule (DMCS) language proposed in the Request by adding a protective mechanism to terminate the Negotiated Service Agreement if at the end of two years the cumulative financial impact of the agreement on the Postal Service is negative. The Stipulation and Agreement specifies that the determination of the cumulative financial impact will be based on Postal Service witness Plunkett's model appearing at Appendix A of his direct testimony. The model will be adjusted solely to reflect actual return, forwarding, and ACS success rates experienced during the first two years of the Negotiated Service Agreement. In the agreement, OCA, Bank One, and the Postal Service request that the Commission not impose a stop-loss cap, or any other constraint, other than that proposed in the Stipulation and Agreement. The Stipulation and Agreement also corrects an omission from the Bank One Negotiated Service Agreement data collection plan by adding a requirement to report on Bank One's "[v]olume of Standard Mail solicitations by rate category."

[5002] The Modified Stipulation and Agreement filed October 5, 2004 builds upon the Stipulation and Agreement filed September 15, 2004. The Modified Stipulation and Agreement provides that if the two-year cumulative financial impact of the agreement on the Postal Service is negative, then an additional analysis would be performed to determine whether the incremental financial impact of the mail entered under one or more of the discount blocks is also negative. If any discount block produces a negative financial impact, then that discount would be unavailable. However, unlike under the terms of the Stipulation and Agreement filed September 15, 2004, the Negotiated Service Agreement would not terminate. The determination of the cumulative and incremental financial impact will be based on Postal Service witness Plunkett's model appearing at Appendix A of his direct testimony. The Modified Stipulation and

Agreement also corrects an omission from the Bank One Negotiated Service Agreement data collection plan by adding a requirement to report on Bank One's "[v]olume of Standard Mail solicitations by rate category."

[5003] Both the Stipulation and Agreement and the Modified Stipulation and Agreement address substantially the same issue. Each agreement proposes a different approach to protect the Postal Service and other ratepayers from the risk of receiving less contribution from the First-Class mailpieces sent at a discount than would have been received if the same mailpieces had been sent as Standard Mail, based upon errors in estimating forwarding, return, and ACS return rates. The majority of participants signed both agreements, with the Modified Stipulation and Agreement being unopposed. Although the original Stipulation and Agreement was not withdrawn from consideration, the Commission will consider it superseded by the Modified Stipulation and Agreement. Thus, the Joint Motion of the United States Postal Service, Bank One Corporation, and the Office of Consumer Advocate for Consideration of Stipulation and Agreement as the Basis for Recommended Decision, September, 15, 2004, is moot.

[5004] A joint motion also was filed to request consideration of the Modified Stipulation and Agreement as the basis for recommended decision. As will be explained further below, the Commission will incorporate many of the provisions of the Modified Stipulation and Agreement into its recommended decision. However, the Commission will not base its recommended decision on the Modified Stipulation and Agreement. Thus, the Joint Motion of the United States Postal Service, Bank One Corporation, Valpak Direct Marketing Systems, Inc., Valpak Dealers' Association, Inc., and the Office of Consumer Advocate for Consideration of Modified Stipulation and Agreement as the Basis for Recommended Decision, October 5, 2004, is granted only in so far as it is consistent with this Opinion and Recommended Decision.

[5005] *Summary of Modified Stipulation and Agreement filed October 5, 2004*. The Modified Stipulation and Agreement submitted by the Postal Service on behalf of all signatories consists of 16 numbered paragraphs in two parts. The agreement includes

four attachments. The attachments propose DMCS changes, rate schedule changes, a data collection plan, and a financial analysis model.

[5006] Part I, captioned Background, includes paragraphs 1 through 5. Paragraph No. 1 identifies the authority for filing the Request with the Commission, and the filing date. It also asserts that the grounds for the request are as stated in the testimonies of Postal Service witness Plunkett, and Bank One witnesses Rappaport and Buc, including their responses to POIRs and discovery requests, which have been designated.

[5007] Paragraph No. 2 notes that the Commission docketed this Request as Docket No. MC2004-3. It also asserts that the Presiding Officer ruled that the proposed Negotiated Service Agreement would be considered under Rule 196 as functionally equivalent to the Capital One Negotiated Services Agreement.[30]

[5008] Paragraph No. 3 list the parties that have intervened in this docket and notes that no participant (except for Valpak and OCA which later withdrew their requests) requested a hearing.

[5009] Paragraph No. 4 notes that a [different] Stipulation and Agreement was filed on September 15, 2004, and lists the signatories to that agreement.

[5010] Paragraph No. 5 states that Valpak filed an opposition to the September 15, 2004 Stipulation and Agreement, but is willing to settle this case on the terms of the Modified Stipulation and Agreement. The Postal Service, Bank One, and OCA also indicate they are agreeable to the modified settlement terms.

[5011] Part II, captioned Terms and Conditions, includes paragraphs 6 through 16. Paragraph No. 6 states that the settlement agreement represents a negotiated settlement of all issues raised in the instant request.

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[30] The Presiding Officer has stated that "[u]ntil such time that new information is presented which requires a change of direction, the Commission will consider the Postal Service's request as a request for a functionally equivalent Negotiated Service Agreement, and proceed under rule 196." POR No. MC2004-3/1. This statement provides procedural direction only. The Presiding Officer has not ruled on whether the Bank One Negotiated Service Agreement is functionally equivalent to the Capital One Negotiated Service Agreement. On brief, Bank One also erroneously states that the Commission has found the Bank One Negotiated Service agreement to be functionally equivalent to the Capital One and the DFS Negotiated Service Agreements. Bank One Brief at 1, 8-9.

[5012] Paragraph No. 7 states that the Postal Service and Bank One have agreed to modify the originally proposed DMCS language by adding a trigger mechanism to eliminate one or more of the rate discounts provided by the Negotiated Service Agreement if, two years after its implementation: (1) the cumulative financial impact to the Postal Service after the first two years of the NSA is negative, and (2) the incremental financial impact of the mail entered under one or more of the discount blocks is also negative. The specific requirements are set forth in Modified Stipulation and Agreement, Attachment A.

[5013] The financial analysis associated with the trigger mechanism is to be performed with a model based on the financial analysis submitted into the record as Appendix A to USPS-T-1. The inputs to the model are to be adjusted solely to reflect the return, forwarding and ACS success rates actually experienced by the Postal Service on eligible letter-shaped solicitations (as defined in DMCS Section 612.1) entered as First-Class Mail during the first two years after implementation. The model is set forth in Modified Stipulation and Agreement, Attachment D.

[5014] Paragraph No. 7 notes that the originally proposed Rate Schedules have not been modified. The Rate Schedules are replicated in Modified Stipulation and Agreement, Attachment B.

[5015] Paragraph No. 7 also states that the signatories agreed to a modification of the originally filed data collection plan to add the requirement to report on the "[v]olume of Standard Mail solicitations by rate category." The modified data collection plan is set forth in Modified Stipulation and Agreement, Attachment C.

[5016] Paragraph No. 8 states that OCA, Valpak, Bank One, and the Postal Service request the Commission to not impose a stop-loss cap, or any other constraints different from the constraints set forth in the attached DMCS language. It expresses satisfaction that the Postal Service is protected against significant financial loss, and that the potential for providing additional contribution through generation of new First-Class Mail volume is preserved.

[5017] Paragraph No. 9 provides that, for purposes of this proceeding only, certain referenced materials provide substantial evidence supporting and justifying a decision recommending the additions to the Domestic Mail Classification Schedule and the associated rate schedules as reflected in attachments to the Modified Stipulation and Agreement, and that the changes set forth in the attachments are in accordance with the policies of title 39, United States Code and, in particular, the criteria and factors of 39 U.S.C. §§ 3622 and 3623. The signatories also agree that the Bank One Negotiated Service Agreement is functionally equivalent to the Capital One Negotiated Service Agreement.

[5018] Paragraph No. 10 provides that the settlement agreement is offered in total and final settlement of this proceeding. It further states that the signatories agree that they will file no further pleadings or testimony with the Commission in this proceeding, with the exception of: (a) pleadings or testimony explicitly requested by the Commission or in reply to such pleadings; (b) pleadings or testimony opposing pleadings or testimony filed in opposition to the settlement agreement; or (c) pleadings, testimony or comments in support of this settlement agreement.

[5019] Paragraph No. 11 reserves to each signatory a right to withdraw from the settlement agreement, and addresses the terms and effect of exercising this right.

[5020] Paragraph No. 12 states that the settlement agreement pertains only to the instant proceeding. It further provides that signatories shall not be considered as necessarily agreeing with or conceding the applicability of any ratemaking principle, any method or principle of classification, any terms and conditions of service, any method of cost of service determination, any principle or method of rate or fee design, the validity or use of any data relied upon by the Postal Service or Bank One in this docket for any other purpose or in any other classification or ratemaking proceeding, or the application of any rule or interpretation of law, that may underlie, or be thought to underlie, the settlement agreement. In particular, the execution of the agreement shall not be considered an agreement or admission that the net contribution less discount block is, or is not, a relevant factor in determining the reasonableness of a Negotiated Service

Agreement that is expected to generate a positive net contribution to the Postal Service in the aggregate.

[5021] Paragraph No. 13 provides that signatories shall not be bound or prejudiced by the settlement agreement in any future negotiation or proceeding (other than any proceedings involving the honoring, enforcement, or construction of the agreement).

[5022] Paragraph No. 14 states that the signatories agree to the extent that matters presented in the Docket No. MC2004-3 Request, in any Commission recommended decision on that request, or in any decision of the Governors of the Postal Service in this proceeding have not actually been litigated, their resolution will not be entitled to precedential effect in any other proceeding.

[5023] Paragraph No. 15 sets forth the signatories' request that the Commission expeditiously issue a recommended decision recommending adoption of the proposed DMCS and Rate Schedule provisions appended to the settlement agreement.

[5024] Paragraph No. 16 provides that the settlement agreement represents the entire agreement of the signatories, and states that it supersedes any understandings or representations not contained herein.

[5025] The specific provisions of Modified Stipulation and Agreement, Attachment A, are incorporated into DMCS § 612.35. See Appendix Two of this Opinion and Recommended Decision.

## VI. FINDINGS AND CONCLUSIONS

### A. Functional Equivalency Overview

[6001] A request for a Negotiated Service Agreement that is functionally equivalent to a Negotiated Service Agreement previously recommended by the Commission and currently in effect (a baseline agreement) affords the opportunity for expedited review by allowing proponents of the agreement to rely on relevant record testimony from a previous docket. This expedites the proceeding by avoiding re-litigation of issues that were recently litigated and resolved.

[6002] In Docket No. MC2004-4, the Commission found the DFS Negotiated Service Agreement functionally equivalent, but not identical, to the Capital One Negotiated Service Agreement. This finding allowed the Commission to conclude that record evidence specified from Docket Nos. MC2002-2 and R2001-1 could be relied upon in Docket No. MC2004-4.

[6003] There were significant differences between the DFS agreement and the Capital One baseline agreement. For example, the DFS agreement had to consider the migration of mail from Standard Mail to First-Class Mail, whereas this was not a characteristic of the baseline agreement. The DFS agreement also calculated the stop-loss cap by a different methodology than applied by the Commission in the baseline agreement. However, the differences and their associated effects on the Postal Service did not rise to the level of causing the overall DFS agreement to be removed from the functionally equivalent category. There also was ample record evidence to thoroughly analyze and support each difference. Acknowledging that differences exist, the DFS Negotiated Service Agreement provides a good example of a close nexus between a proffered functionally equivalent agreement and a baseline agreement, and represents

the appropriate application of the rules for functionally equivalent Negotiated Service Agreements.

[6004] The analysis of functional equivalency is more complex in regard to the Bank One Negotiated Service Agreement because its nexus with the baseline agreement is not as close as the nexus that existed between the DFS Negotiated Service Agreement and the baseline agreement. The Bank One Negotiated Service Agreement, as the DFS Negotiated Service Agreement, requires consideration of the migration of mail from Standard Mail to First-Class Mail. However, there are additional significant differences.

[6005] First, the Bank One Negotiated Service Agreement does not include a stop-loss cap as recommended by the Commission in the baseline docket.

[6006] Second, the Bank One Negotiated Service Agreement is predicated on a different financial basis then argued for the Capital One Negotiated Service Agreement. The primary source of anticipated financial benefit to the Postal Service with the Capital One (and the DFS) Negotiated Service Agreement rests in the cost savings from the substitution of electronic notification for physical return of undeliverable mail. In the Bank One Negotiated Service Agreement, the estimated additional contribution resulting from growth in First-Class Mail volume incented by the volume discounts is nearly as much as the contribution realized from the address correction element savings.[31] This alters the financial basis of the agreement.

[6007] These two features, combined, represent a significant departure from the baseline agreement. They convert the underlying savings based relationship which unites the two prominent elements of the baseline agreement into a two-part agreement. In the instant Request, the Postal Service is relying almost equally on cost savings and rate-based volumes to generate benefits.

[6008] The Postal Service could have requested a recommendation predicated on a Negotiated Service Agreement that included a pure volume based discount element

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[31] Bank One Brief at 5-6.

separate from the address correction element under rule 195. This rule allows for development of the record in regard to new baseline Negotiated Service Agreements. However, the Bank One Request was filed under rule 196 for functionally equivalent Negotiated Service Agreements. The Commission did not recommend a volume based discount of this nature in the baseline Capital One agreement, nor does the record in the Bank One docket fully develop or support a predominantly volume based discount.

[6009] The Bank One Negotiated Service Agreement has other distinguishing features. The agreement is substantially dependent on the impact of flat-shaped mail with its associated cost and revenue characteristics. The Modified Stipulation and Agreement proposes a new protective mechanism. Finally, the unknowns associated with Bank One's recent merger with J. P. Morgan Chase cast a new level of uncertainty over the effect of the Bank One Negotiated Service Agreement on the Postal Service. The Commission must consider each feature.

[6010] The Bank One Negotiated Service Agreement serves as an example of where the differences and the associated effects between the proffered functionally equivalent and the baseline agreements are significant. These differences are so substantial that they lead to the conclusion that the Bank One Negotiated Service Agreement as proposed is not functionally equivalent to the baseline agreement. The differences are problematic because the further apart the proffered functionally equivalent agreement is from the baseline agreement, the less appropriate it is to rely on record evidence from the baseline agreement for development of the record in the functionally equivalent docket.

[6011] As the differences between a proffered functionally equivalent and a baseline agreement increase, additional due process and notice problems are created. At the extreme, a request might be filed that is obviously not functionally equivalent. Rule 196(c) should rectify this case by directing that the request proceed under rule 195 for new baseline agreements. Effectively, this would deny reliance on the baseline docket record and require the proponents to file additional testimony to develop a new, complete record. The Bank One Request does not reach this extreme. The Bank One

Negotiated Service Agreement as proposed can be described as resembling, but not functionally equivalent to, the baseline agreement.

[6012] Filing a request under the rules for a functionally equivalent Negotiated Service Agreement that proposes an agreement that resembles but is not functionally equivalent to the baseline agreement creates the notice problem mentioned above. Interested persons will base intervention decisions on the Postal Service's representation that a new request is predicated on a functionally equivalent agreement. The concept of expedited review of requests for functionally equivalent Negotiated Service Agreements rests on allowing the public to assume that issues relevant to the proposal were resolved in the baseline docket.

[6013] The Commission developed rule 196(b)(2) to provide potential intervenors with information upon which to base a decision on whether or not to intervene. Rule 196(b)(2) requires the Postal Service Request to inform all potential participants of how the proposed Negotiated Service Agreement is different from the baseline agreement. In this docket, the Postal Service did not fully comply with rule 196(b)(2) by not mentioning that the Bank One agreement does not include a stop-loss cap as recommended by the Commission in the baseline agreement.[32] In this docket, the Commission's recommendation modifies the agreement and resolves this potential deficiency. However, the importance of filing under the proper rule and complying with filing requirements must be stressed for future requests.

[6014] The Commission finds that one of the differences, the absence of a stop-loss cap, does not preserve the win-win situation that is present in the baseline agreement. This is inconsistent with the requirements of the Act because the interests of mailers not party to the agreement are not protected from harm. The Commission

[32] The Commission rejects the Postal Service's reasoning that it was not required to disclose this fact because the "proposed" Capital One Negotiated Service Agreement contract did not contain this provision. Tr. 2/422. The intent of rule 196(b)(2) is to fully inform potential participants of differences between a proposed agreement and a baseline agreement such that they may expeditiously evaluate their proper course of action. The baseline agreement is the agreement as recommended by the Commission and approved by the Governors, and which is currently in effect.

employed similar reasoning in its findings and conclusions in the Capital One decision. Following logic consistent with the Capital One decision, the Commission recommends the addition of a stop-loss cap to the Bank One Negotiated Service Agreement. This recommendation will bring the Bank One Negotiated Service Agreement into compliance with the requirements of the Act by assuring that mailers other than Bank One will not be made worse off as a result of the agreement.

[6015] The addition of the stop-loss cap modifies the characteristics of the agreement, and in particular how it affects the Postal Service. It makes the agreement functionally equivalent to both the DFS and the Capital One Negotiated Service Agreements. Without this addition, the Bank One Negotiated Service Agreement is not functionally equivalent to the baseline agreement, or in accord with the requirements of the Act. Thus, the reliance on record evidence from previous dockets would be inappropriate. With this addition, the Commission finds the Bank One Negotiated Service Agreement to be sufficiently equivalent to the Capital One Negotiated Service Agreement, which is currently in effect, that record evidence specified from Docket Nos. MC2002-2 and R2001-1 may be relied upon by this Request.[33]

## B. Analysis of Functional Equivalency

[6016] The criteria for determining whether a proposed Negotiated Service Agreement is functionally equivalent to a previously recommended Negotiated Service Agreement were developed in Docket No. RM2003-5.

> "Functional equivalency" focuses on (1) a comparison of the literal terms and conditions of one Negotiated Service Agreement with the literal terms

[33] A corollary to this finding is that the Commission shall rely on relevant portions of its analysis and many of its conclusions formulated in the previous dockets.

> and conditions of a second Negotiated Service Agreement, and (2) a comparison of the effect that each agreement has upon the Postal Service.

PRC Order No. 1391 at 50. The two-part analysis of functional equivalency, which follows, demonstrates that with the addition of a stop-loss cap provision, the Bank One Negotiated Service Agreement is functionally equivalent to the baseline Capital One Negotiated Service Agreement.

1. Literal Terms and Conditions

[6017] "The first part of the analysis is an examination of the literal terms and conditions of each Negotiated Service Agreement." Ibid. The Capital One Negotiated Service Agreement and the Bank One Negotiated Service Agreement include two functional elements that are similar. Each agreement provides a declining block rate volume discount on those portions of First-Class Mail that reach specified volume thresholds. Each agreement provides, as a major cost savings element, electronic address corrections without fee for properly endorsed First-Class Mail solicitations in place of physical return of undeliverable First-Class solicitations mail for mail that cannot be forwarded.

[6018] However, the Commission found that these two elements alone could not support the Capital One Negotiated Service Agreement. Therefore, a stop-loss mechanism to limit the risk to the Postal Service and protect the interests of mailers not party to the agreement was added. That mechanism is an essential aspect of that agreement. The stop-loss mechanism was designed to address the risks associated with uncertainties with before rates volume estimates. The instant Request does not include a stop-loss mechanism or any other adequate method for protecting against these risks.

[6019] A different protective mechanism is provided in the Modified Stipulation and Agreement currently before the Commission. It proposes the addition of a "trigger" mechanism tailored to limit the risks associated with uncertainties in forwarding rates, return rates, and ACS success rates. The Bank One Negotiated Service Agreement also

proposes an annual threshold adjustment, an annual limit on the number of flats mailed, and an enhanced mergers and acquisitions clause. The significance of the different risks that each protective mechanism guards against will be further discussed and contrasted in the second part of the analysis where the effects upon the Postal Service are considered.

[6020] The mechanisms proposed to limit the risk to the Postal Service and protect the interests of mailers not party to each agreement are essential provisions in each agreement. The Postal Service claims that each proposed mechanism is tailored to the unique relationship between the mailer and the Postal Service, yet argues that this does not alter the functionally equivalent status of the agreement. USPS Brief at 18-19. It states: "the settlement parties believe that the stop loss mechanism embodied in the modified settlement agreement, as well as the other protective mechanisms in the NSA itself, serve as superior alternatives to a cap to protect the Postal Service and other mailers against adverse financial consequences, within the context of the Bank One NSA." Id. at 17. The Commission does not agree.

[6021] The Modified Stipulation and Agreement trigger mechanism, and the stop-loss cap as recommended in the baseline agreement are designed to protect against different risks. The Modified Stipulation and Agreement trigger mechanism addresses the financial risk associated with uncertainties in forwarding rates, return rates, and ACS success rates. The stop-loss cap appearing in the baseline agreement addresses the financial risk associated with uncertainties with before rates volume estimates. The Commission concludes that one mechanism is not a substitute for the other. The mechanisms do not address the same risks.

[6022] With the addition of a stop-loss provision, the comparison of the terms and conditions of the Bank One Negotiated Service Agreement with the terms and conditions of the Capital One Negotiated Service Agreement reveals two substantially similar, but not identical, agreements. The differences tailor the specific agreement to the specific mailer. Allowing such differences is contemplated as a general characteristic of

Negotiated Service Agreement classifications. The differences presented do not change the overall functionality of the agreements.

2. Effect Upon the Postal Service

[6023] The second part of the functional equivalency analysis shifts focus from the terms and conditions of the agreement, to incorporating mailer-specific factors and analyzing the effect that the Negotiated Service Agreement has on the Postal Service. "For the second part of the analysis, the Commission will go beyond the literal terms and conditions of the agreements and compare the effect that the baseline and proffered functionally equivalent agreements have on the Postal Service." PRC Order No. 1391 at 51. This requires the Commission to evaluate whether both Negotiated Service Agreements provide a comparable benefit to the Postal Service. "A comparable benefit does not mean an identical benefit, but instead will be placed into context by the terms and conditions of each agreement, and the characteristics of each participant." Ibid.

[6024] *Declining Block Rate Element.* The declining block rate volume discount element in each agreement share the same structure, but they are not identical. Each agreement establishes a volume threshold, block levels, and discounts which are unique to each mailer. Bank One's anticipated year one before rates volume is above the initial threshold level. This allows a discount to be received for mail that would have been mailed anyway absent the discount. The Capital One Negotiated Service Agreement did not exhibit this characteristic because the initial threshold was set below the anticipated year one volume. The Bank One Negotiated Service Agreement expects an increase in First-Class Mail volume through migration of Standard Mail pieces to First-Class Mail pieces. Thus, any additional contribution attributable to the Bank One agreement is due to the difference between the higher First-Class Mail contribution and the lower Standard Mail contribution. The added contribution from a large volume migration from Standard Mail to First-Class Mail has a significant effect upon the financial analysis supporting the agreement. The Capital One Negotiated Service Agreement was not premised on the benefits of potential new volume; however, any increase in First-Class Mail volume

would accrue from new mail pieces, which create new contribution. Unique to the Bank One agreement, Bank One anticipates the mailing of up to 35 million flats per year. This requires that the cost and revenue characteristics of flat-shaped mail be considered when performing the financial analysis.

[6025] These differences do not prevent the agreements from being functionally equivalent. They do imply that further financial examination of each agreement is necessary to determine whether the declining block rate volume discount elements have a comparable effect upon the Postal Service. Although some of the differences are significant, after reviewing the financial implications of the differences the Commission concludes that the declining block rate volume discount element in each agreement serves a similar purpose, and has a similar effect upon the Postal Service.

[6026] *Electronic Address Correction Element.* The electronic address correction element in each agreement similarly provides, at certain levels of volume, electronic address corrections without fee for properly endorsed First-Class Mail solicitations in place of physical return of undeliverable First-Class solicitations mail that cannot be forwarded. The address correction element present in each agreement acts as the main cost savings element. Cost savings are realized by substituting lower cost electronic return service for high cost manual return service. To this extent, the address correction element present in each agreement produces a comparable net benefit for the Postal Service. However, the net financial benefit due to the address correction element is not as dominant in the Bank One Negotiated Service Agreement as it was in the Capital One Negotiated Service Agreement because of the benefit the Postal Service expects from additional contribution generated by the migration of Standard Mail to First-Class Mail in the Bank One agreement.

[6027] The consideration of the mailing of flats in the Bank One Negotiated Service Agreement also changes the effect of the address correction element on the Postal Service because the majority of the cost savings accrued is due to the mailing of flats. The Postal Service has protected itself against the associated risks of mailing an excessive volume of flats. However, the Commission notes that mailing a reduced

number of flats could significantly reduce the cost savings associated with this agreement.

[6028] Because of differences in each mailer's mailing list practices and how each mailer will utilize electronic address correction information, the Postal Service will experience a different effect from each agreement's electronic address correction element. For example, the Capital One Negotiated Service Agreement is with a mailer that maintains its own internal solicitations lists. The Bank One Negotiated Service Agreement is with a mailer that predominately relies on rented lists. This difference, combined with how each mailer utilizes the electronic address correction information, could influence each mailer's return and forwarding rates, and the resulting effect on the Postal Service.

[6029] The Commission has considered the different characteristics of each mailer and their respective mailing practices, and believes that the electronic address collection element in each agreement will provide a comparable benefit to the Postal Service. This, in part, is based on the additional record evidence presented in this docket which allows the Commission to thoroughly analyze the differences between the proposed and the baseline address correction elements.

[6030] The differences discussed above influence the value of the Bank One Negotiated Service Agreement to the Postal Service. The detailed effects of these factors are presented in the financial analysis portion of this opinion. The Commission finds that even with these differences, the combination of electronic address correction and declining block rate volume discount elements present in each agreement have a comparable potential for increasing net contribution to the Postal Service.

[6031] *Protective Mechanisms.* The annual threshold adjustment, annual limit on the number of flats mailed, enhanced mergers and acquisitions clause, the Modified Stipulation and Agreement trigger mechanism, and the recommended stop-loss cap produce a comparable effect of limiting risk to the Postal Service, assuring that mailers not party to each agreement are not made worse off. Each mechanism is designed to

protect against a specific risk, and may be analyzed separately. Each mechanism also has a unique effect on the overall characterization of the Negotiated Service Agreement.

[6032] *Protective Mechanisms —Trigger Mechanism.* The trigger mechanism proposed in the Modified Stipulation and Agreement applies a formula to determine whether the cumulative financial impact to the Postal Service after the first two years of the agreement is negative based solely on return, forwarding, and ACS success rates. If the result is negative, the incremental financial impact of the mail entered under each discount block is then analyzed based on these same factors. If any discount block will produce a negative result in year three, the volumes of mail in the discount blocks that produce a negative financial impact shall instead only be eligible for the deepest block discount that produces a positive incremental financial impact during the third year of the agreement.

[6033] Although this mechanism protects against a different risk than the stop-loss cap recommended in the Capital One docket, the proponents of this mechanism sought to provide some financial protection to the Postal Service without limiting the potential for volume growth which could occur with a Capital One style stop-loss cap. The Postal Service asserts that "the parties agree that this stipulated stop-loss mechanism is an attempt to move in the direction of designing a stop loss mechanism that prevents the Postal Service from suffering losses without reducing potential gains for the Postal Service and the NSA partner." USPS Brief at 3.

[6034] The Postal Service argues that "[d]espite the extensive discovery on the forwarding, return, and ACS success rates, nothing in the record indicates that witness Plunkett's assumptions about these factors were not valid." USPS Brief at 8 fn. 13. Bank One argues that:

> Not only are the actual values for these three variables unlikely to vary significantly from the values assumed in the models of financial impact submitted by the Postal Service herein, but the likely profitability of the NSA for the Postal Service is so great that an unfavorable variance in return,

> forwarding or ACS success rates would have to be unrealistically large to cause the Postal Service to lose money on the NSA.

Bank One Brief at 23. The three input variables discussed above are the sole inputs to the Modified Stipulation and Agreement stop-loss mechanism model which could cause the protective mechanism to trigger. Based on a sensitivity analysis of the model, and the record in this docket, the Commission agrees with the Postal Service's and Bank One's conclusions. It is unlikely that the return, forwarding or ACS success rates will deteriorate to the point that this protective mechanism will be triggered.

[6035] Consideration was given to minimize the risk that the trigger mechanism might constitute an unlawful delegation of rate-setting authority to the Postal Service. Id. at 34-35. The Commission addressed similar concerns when discussing a protective mechanism that was not adopted in Docket No. MC2004-4. PRC Op. MC2004-4 at 40-42. The Commission would prefer to see this issue more fully developed on the record if similar mechanisms are proposed in the future. However, the trigger mechanism will at most cause a minimal intrusion on the Commission's authority. The mechanism is unlikely to be triggered, and if triggered it will be limited in duration to one year. It is used to protect against an unforeseen event and not as a normal rate setting procedure. Assuming compliance with the data collection plan, proper use of the mechanism can be verified. The Commission does not find any other indication that the Modified Stipulation and Agreement trigger mechanism could harm or disadvantage any mailer not party to the agreement, or otherwise not conform to the requirements of the Act.

[6036] The Modified Stipulation and Agreement trigger mechanism shall be incorporated into the Commission's recommendation. The proposal to add this mechanism addresses a specific risk identified by the participants in this docket. It is

supported by the proponents of the Request, and it is not opposed by any participant.[34] The detailed analysis appearing in section C demonstrates that the mechanism is reasonably designed to protect against the financial risk associated with uncertainties in forwarding rates, return rates, and ACS success rates. The trigger mechanism does not alter the functional equivalency characterization of the Bank One Negotiated Service Agreement.

[6037] *Protective Mechanisms — Stop-Loss Cap.* The stop-loss cap as recommended in the Capital One baseline agreement does not appear in the Bank One Request. The parties signing the Modified Stipulation and Agreement, including the proponents of the Bank One Negotiated Service Agreement, request that the Commission not impose a stop-loss cap as a protective mechanism. However, the Commission finds that a stop-loss cap is necessary because the risks that existed with the Capital One Negotiated Service Agreement continue to be present with the Bank One Negotiated Service Agreement. Recommending a stop-loss cap brings the Bank One Negotiated Service Agreement into compliance with the requirements of the Act by assuring that mailers not party to the agreement are not made worse off because of the agreement. It also makes the Bank One Negotiated Service Agreement functionally equivalent to the Capital One Negotiated Service Agreement.

[6038] The Commission discussed the importance of a stop-loss cap in the recently issued DFS opinion:

> The association of the cost savings element with its discount element is one factor the Commission must weigh when examining whether a proposed agreement (and its stop-loss mechanism) is functionally

[34] As a caveat, the Postal Service notes that it does not concede future Negotiated Service Agreements necessarily should be subject to review of marginal profitability. The Postal Service asserts the Commission found, in PRC Op. MC2004-4, that marginal profitability analysis is not required. USPS Brief at 7-8, fn. 12; see PRC Op. MC2004-4 at 52. In fact, what the Commission actually discussed was the relationship between § 3622(b)(3) and marginal profitability analysis. What the Commission concluded was that § 3622(b)(3) is not applicable to an individual rate cell of a multi-cell rate schedule. In the context of general rate setting and rate schedule design, marginal profitability analysis often is a valuable tool, especially when arguing the fairness and equity of a proposed rate schedule design.

> equivalent to the Capital One Negotiated Service Agreement. Two agreements might not be considered functionally equivalent if comparable associations did not exist. A comparison of stop-loss mechanisms also is important from the perspective of fairness and equity between two mailers. For example, a more advantageous stop-loss mechanism from the perspective of the recipient of a functionally equivalent Negotiated Service Agreement may discriminate against the recipient of the baseline agreement and leave that mailer competitively worse off.

PRC Op. MC2004-4 at 25.

[6039] The Commission described a similar situation to what is being faced in this docket in the rulemaking which developed rules for functionally equivalent Negotiated Service Agreements, Docket No. RM2003-5.

> For example, again assume the Capital One NSA is proposed as the baseline agreement (an address correction element and a declining-block rate element). The proposed subsequent agreement contains identical terms and conditions to the terms and conditions contained in the Capital One NSA. Thus far, because the literal terms and conditions of both agreements are identical, the first condition of functional equivalency has been met. However, the second mailer, Mailer Two, does not approach the return rate of Capital One to the point that the address correction element is essentially irrelevant, and most if not all of the potential Postal Service cost savings are eliminated. (In reality, the agreement consists solely of a declining-block rate discount.) The Postal Service will not obtain a comparable benefit from such an agreement. The Commission would therefore not consider Mailer Two's agreement to be functionally equivalent to the Capital One Negotiated Service Agreement.

PRC Order No.1391 at 51. In this example, the cost savings element was de-emphasized to the point where the agreement became solely a declining-block rate discount. Thus, no tie existed between the Postal Service cost savings element and the discount element. The Commission indicated that it would not find this style of agreement functionally equivalent to the Capital One Negotiated Service Agreement.

[6040] In this docket, Bank One argues that the Bank One Negotiated Service Agreement is different than the Capital One Negotiated Service Agreement.

> The most important difference between the Bank One NSA and the latter two NSAs involves the source of the anticipated financial benefits to the Postal Service. The added annual contribution resulting from growth in Bank One's First-Class Mail volume incented by the proposed volume discounts is projected to be in the range of $2.83 million—nearly as much as the projected contribution from ACS savings. By contrast, the primary source of the anticipated financial benefits of the Capital One and Discover NSAs rests in the cost savings from the substitution of electronic notification for physical return of undeliverable mail. For Discover and Capital One, the expected additional contribution from increased First-Class solicitation volume that the Postal Service expects these NSAs to generate is less than the value of the discounts that the Postal Service expects to pay for First-Class volume that the mailer would have entered even without the NSA rate discounts.

Bank One Brief at 5-6. Arguing the significance of growth in First-Class Mail volume incented by the proposed volume discounts also is the basis for later arguing that the recommendation of a stop-loss cap would harm the Postal Service by cutting off the potential for additional volume growth.

[6041] If the contribution generated by First-Class Mail volume incented by the proposed volume discounts were to dominate the financial basis of the agreement, and if Postal Service cost savings were not linked to the discounts, the Bank One Negotiated Service Agreement could be considered to include essentially a volume based discount. This implies that the Bank One Negotiated Service Agreement does not have the same financial basis as the Capital One Negotiated Service Agreement, and thus would not be functionally equivalent. It would be factually similar to the Docket No. RM2003-5 example discussed above.

[6042] The ripple effect of such a conclusion would require rejection of this Request. Because the agreement would not be functionally equivalent, parties would not be able to rely on record evidence from previous dockets under the expedited rules. Potential intervenors would not have been provided with adequate notice that the Request was in fact not functionally equivalent. The record that has been created would not support the new economic basis for an agreement.

[6043] Negotiated Service Agreements are tools to create win-win situations between the Postal Service and the participating mailers. The Postal Service wins by reducing its costs, increasing its revenues, or providing improved service. The mailer wins by increasing its internal efficiencies, reducing postal costs, sharing in the Postal Service's cost savings, or benefiting by the improved service. With a successful win-win situation even the mailers not party to the agreements win through greater Postal Service efficiencies. The foundation for the win-win situation in the baseline docket was the link between Postal Service cost savings and the discounts created below the stop-loss cap. Associating the Postal Service's potential cost savings with the discounts being offered to the mailer helps assure that mailers not party to the agreement are not made worse off because of the agreement. To be functionally equivalent, the Bank One Negotiated Service Agreement must share this same characteristic.

[6044] Bank One attempts to shift the win-win foundation of the baseline agreement by arguing a new risk reward situation, i.e., a foundation not functionally equivalent to the baseline agreement.

[6045] For example, "Bank One respectfully submits, however, that the Commission cannot shelter the Postal Service from all financial risk, and should not try to do so." Id. at 39. While it is true that the Commission cannot shelter the Postal Service from all financial risk, when a specific risk has been identified, and a mechanism to reduce or eliminate that risk has been developed for an arguably functionally equivalent agreement, the Commission would be remiss to ignore that risk, especially when monopoly assets are at risk.[35]

[6046] Bank One continues by citing Docket No. MC2004-2, Experimental Priority Mail Flat Rate Box, as setting a precedent for the Commission (and the Postal Service) to accept the balance of a reasonable risk against a potential reward in making its recommendations. Id. at 41. The Commission extensively discussed the experimental

[35] The analysis would be different if the agreement was not proffered as functionally equivalent or if the mechanism had no direct effect on functional equivalency. It then would be appropriate to ask if the mechanism was necessary or required by a provision of the Act.

nature of Negotiated Service Agreements in the baseline docket. PRC Op. MC2002-2 at paras. 4001-42. In general, Negotiated Service Agreements are not experiments, although they may contain an experiment. An experiment is limited in duration, quantifiable in effect, and should not be replicated until the success or failure of the experiment is analyzed. Recommending a Negotiated Service Agreement sets precedent, which may be replicated ad infinitum prior to determining its success or failure, to the possible unquantifiable detriment of the Postal Service and its mailers. Thus, the Commission does not find "[t]he same risk/reward logic warrants approval of the instant NSA as well." Bank One Brief at 38.

[6047] Bank One further argues "the risk-reward tradeoff inherent in the design of an NSA discount structure clearly falls within the class of managerial judgments that the Commission should refrain from overturning unless clearly imprudent or unreasonable." Id. at 42. The Commission's role in reviewing classifications and in setting rates is well established. This includes analyzing the "risk-reward tradeoffs" especially where those tradeoffs have an impact on mailers not party to the agreement. The Commission is not persuaded by Bank One's arguments to accept a new baseline foundation for this agreement.

[6048] Absence of the stop-loss cap raises both procedural and statutory issues. Procedurally, the Commission opts to recommend modification to the agreement such that it can consider the Bank One Negotiated Service Agreement functionally equivalent to the baseline agreement. This is based on the presumption that because the Postal Service filed a request under the rules for a functionally equivalent agreement, the Postal Service's intent was to in fact obtain the recommendation of a functionally equivalent Negotiated Service Agreement. The Postal Service has the option of filing a new request under rule 195 for a new baseline agreement, if it decides to pursue an agreement that is not functionally equivalent to the Capital One Negotiated Service Agreement. This way, a complete record can be developed upon which a decision would be based. If the Postal Service chooses to follow this path, the Commission would entertain requests to

incorporate portions of the record in this case, to supplement this record where appropriate.

[6049] The participants in the Bank One docket, including Bank One and the Postal Service, prefer that the Bank One Negotiated Service Agreement not include a stop-loss cap, and assert that a stop-loss cap is not necessary. Setting aside the functional equivalency procedural issue, whether or not a stop-loss cap is necessary is resolved by determining whether or not a stop-loss cap is required for compliance with the requirements of the Act. The statutory question raised by this issue in the Bank One docket parallels the statutory question raised in the baseline docket. The Commission finds that important aspects of the Bank One record are sufficiently similar to the Capital One baseline record that the recommendation of a stop-loss cap is required. The risk that the stop-loss cap was designed to protect against in the baseline docket continues to be present in the Bank One Negotiated Service Agreement.

[6050] In the baseline agreement, the Commission's focus was on assuring that the Capital One Negotiated Service Agreement would not make mailers other than Capital One worse off.

> [8005] The Commission has determined that it should approach its duties in this case a little differently than it would in an omnibus rate case. The comments in the APWU Reply Brief at 5, are particularly helpful in this regard. In most cases, the Commission must exercise its discretion on behalf of users and potential users of postal services. In this case, all potential users are represented, and support the proposal on its terms.
>
> [8006] Therefore, the Commission is not so concerned with determining the most appropriate divisions of costs, revenues or contributions. The two participants in the NSA have already done that to their satisfaction. Furthermore, it can be assumed that both Capital One and the Postal Service consider the agreement beneficial to themselves as institutions. Instead, the Commission's focus in this case is on assuring that the NSA will not make mailers other than Capital One worse off.
>
> [8007] This focus is consistent with the Efficient Component Pricing standards that the Commission applies in setting rate discount levels. There too, the goal is to assure that third parties are not made worse off by rates

> that benefit the Postal Service and a category of mailers. See also, discussion of Pareto Improvement, Tr. 8/1580-81, 1727-37, 1763-64 (Panzar).

PRC Op. MC2002-2, para. 8005-7. To comply with this requirement, the Commission recommended application of a stop-loss cap. This was based on a finding that the estimates of before rates volumes for Capital One were so unreliable that without a stop-loss provision there was no reasonable assurance that the Postal Service would not lose money on the agreement. Id. para. 8013. Capital One typically did not make volumes projections beyond a six month period. Volume projections also were subject to revision during the course of the proceeding. This brought into question the reliability of Capital One's volume projections and led to the recommendation of a stop-loss cap. With the stop-loss cap, which is a central element of the Commission's recommendation, the Commission found the Capital One Negotiated Service Agreement in compliance with the requirements of the Act. Mailers not party to the agreement were protected through linking Postal Service cost savings to the availability of discounts. This is an important characteristic of the baseline agreement that does not exist in the Bank One agreement as proposed.[36]

[6051] Bank One's before rates volume projections are based on witness Rappaport's business judgment, taking into account Bank One's volume history and business plans. See Table 4. Rappaport asserts that based on Bank One's relative stability in First-Class Mail volumes, he does not expect year one before rates volumes to deviate significantly from Bank One's 2003 volumes. Witness Rappaport incorporates actual mail volumes for 2004 where available, supplemented by 2004 mail volume forecasts developed by business managers and used in the ordinary course of Bank One's business planning. He also makes a downward adjustment to the solicitations forecast to reflect the fact that historically budget pressures to reduce cost force volumes from First-Class Mail to Standard Mail at years' end. He asserts that this may occur

[36] It is also a fundamental concept that the Commission employs in a related area when developing worksharing discounts.

again absent an agreement. After reviewing a list of possible counterbalancing factors, witness Rappaport estimates that year two and three before rates volumes should be about the same as the estimated year one before rates volumes. Tr. 2/118-19.

[6052] Bank One emphasizes that it has a stable volume history, and that this infers accurate before rates volume forecasts. Accurate before rates volume forecasts would reduce risk and reduce the need for a stop-loss cap. The historical 2001-2003 range of First-Class Mail volumes range from 583 million to 600 million pieces. Without an agreement, the First-Class Mail volume is estimated to drop to 571 million pieces per year.[37] Customer mail volumes are estimated to be flat at 507 million pieces both with and without an agreement.[38]

[6053] The more significant volume projections (as regarding volume stability) are for solicitations mail. The historical 2001-2003 range of First-Class Mail solicitations volumes range from 92 million to 104 million pieces. Without an agreement, the First-Class Mail solicitations volume is estimated to drop to 64 million pieces per year.[39] If the hypothetical J. P. Morgan Chase volumes presented by witness Rappaport are included, the before rate First-Class Mail solicitations volume drops are magnified.

[6054] A logical argument could be made that when a mailer has a stable volume history, in the absence of changed circumstances this same mail volume is likely to continue into the future. A similar argument could be made that absent changed circumstances, a historical trend either of increasing or decreasing volume will continue into the future. A factor, for example a significant change in business plans, could be presented to explain a future deviation from such volume projections.

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[37] With an agreement, the First-Class Mail volume is estimated to grow to 590 million pieces in the first year and 670 million pieces in the second and third years.

[38] To the extent that there could be large variations in Customer Mail volumes, this factor is mitigated by threshold adjustment provisions elsewhere in the agreement.

[39] With an agreement, the First-Class Mail volume is estimated to first drop to 83 million pieces in the first year, and then rise to 163 million pieces in the second and third years.

[6055] However, Bank One's argument that past volume stability infers accurate future volume projections is counterintuitive. Although Bank One asserts its volumes have been stable in the past, Bank One is predicting a significant drop in its First-Class Mail solicitations volume in the future absent an agreement. This does not represent the continuation of a trend.

[6056] Bank One asserts that "historically" budget pressures to reduce cost force volumes from First-Class Mail to Standard Mail at year ends is justification for a downward adjustment to the solicitations volume forecast. Historical pressures are applicable to historical, as well as future volume projections. Bank One has not presented a persuasive argument that Bank One's past volume history is indicative of the reliability of its First-Class Mail solicitations volume forecasts.

[6057] Furthermore, the business climate in which witness Rappaport developed his volume estimates is already undergoing substantial change. On July 1, 2004, Bank One merged with J.P. Morgan Chase, a significant user of First-Class Mail for statements and solicitations. Id. at 140. Several key factors (e.g., timing, integration volume estimates) need to be finalized before the expected effects of the merger on the financial results of the Negotiated Service Agreement can be determined.

[6058] Some historical information about the First-Class Mail recently sent by J. P. Morgan Chase is on the record. See section III.-E. In response to interrogatories, Postal Service witness Plunkett provides a hypothetical estimate of the effects of the merger. Witness Plunkett's estimate shows a net benefit to the Postal Service that is higher than the pre-merger benefit estimated in his testimony. The hypothetical estimate for the merger is based on Bank One witness Rappaport's unsubstantiated assumption that J. P. Morgan Chase will adopt mailing practices currently used by Bank One.[40] Based on this assumption, witness Rappaport estimates that absent the Negotiated Service Agreement, First-Class solicitations mail sent by J. P. Morgan Chase will decline

[40] Specifically, witness Rappaport assumes that J.P. Morgan Chase will adopt Bank One's current distribution of marketing mail between First-Class Mail and Standard Mail.

by 67 percent, from 116 million pieces in 2003 to 38 million pieces in the second year of the forecast. Id. at 153-157, 306-329.

[6059] The merger of Bank One with J. P. Morgan Chase creates uncertainty about the eventual volumes that will be subject to the Negotiated Service Agreement and the effect that the volumes will have on the financial analysis. Because of the hypothetical or speculative nature of the available information, the Commission does not rely on the post-merger estimates to determine the financial effects of the merger on the Postal Service. Assuming that integration of J. P. Morgan Chase volume occurs, the volume forecasts upon which the financial analysis supporting the proposal relies will be rendered obsolete. Given that the pre-merger Bank One and J. P. Morgan Chase mail volumes are comparable, if and when a decision is made to integrate J. P. Morgan Chase and Bank One mail, the effect on the Negotiated Service Agreement is likely to be significant. There is no persuasive evidence on the policies that the merged entity will follow, or that the pre-merged entities followed similar policies to begin with. The Commission concludes that the probable effect that the merger will have on volume estimates, and ultimately on the financial analysis of the Negotiated Service Agreement, is uncertain.

[6060] The Postal Service was asked to provide any independent analysis it had done to evaluate the reasonableness of the mailer-provided forecasts of before rates volumes, after rates volumes, and estimated return rates. The Postal Service replied with regard to before rates volumes:

> Just as witness Crum described in his response to POIR1-Question 4 and POIR2-Question 4 in Docket No. MC2002-2, the Postal Service did not develop a parallel estimate of Bank One's mail volume using distinct data sources or methodologies. The Postal Service did, however, analyze and evaluate Bank One's estimates and reconciled Bank One's volume information with data contained in the PERMIT system.

Id. at 424.

[6061] The Postal Service notes that in the Capital One Governors' Decision, the Governors disagreed with the imposition of a cap, but determined that it had no practical

effect since it would cap discounts at a volume level that exceeded the after rates volumes that Capital One forecasted. The Postal Service additionally notes that the stop-loss cap calculated in the DFS docket also would have limited the potential for new growth but still would have capped discounts at a volume that exceeds the actual after rates volume forecasted by Discover.

[6062] The Postal Service argues that the facts of the Bank One Negotiated Service Agreement are different. It argues that if the Commission were to calculate a stop-loss cap for Bank One as it did in the DFS docket, and in addition pass through 95 percent of the cost savings, the discounts would be capped at a volume below the after rates forecast, taking effect in the third year of the agreement. Citing witness Buc's testimony, the Postal Service argues that the Bank One forecasts are conservative, and thus any stop-loss cap would foreclose potential additional new volume contribution. As a consequence, the settlement parties sought to fashion a substitute mechanism to protect against the loss of new volume contribution. USPS Brief at 8-10.

[6063] The Commission recognizes the Postal Service's concern that a stop-loss cap means the new discount eventually ceases to attract potential volume growth. The Commission calculates the Bank One Negotiated Service Agreement stop-loss cap at one hundred percent of cost savings, which makes the discount applicable to all of the forecast after rates volume. However, absent other innovations or "improved" estimates, the stop-loss cap remains necessary to protect mailers not party to the agreement from losses generated from providing discounts to mail that would have been mailed anyway.

[6064] The Commission sponsored the testimony of Professor John C. Panzar to discuss pertinent economic issues relevant to declining block rate volume discounts in the Capital One docket. Docket No. MC2002-2, Tr. 8/1572-1790. Professor Panzar's testimony identifies and discusses risks associated with volume projections and declining block rate volume discounts. This discussion was instrumental in the Commission's decision to recommend a stop-loss cap to limit the risk to the Postal Service associated with before rates volume estimates. Professor Panzar's testimony, which the Postal Service has incorporated into the record in the instant docket, is as

relevant to the Bank One Negotiated Service Agreement as it was to the Capital One Negotiated Service Agreement.

[6065] The Capital One decision also discusses what is termed a "moral hazard." This same concern is relevant to the Bank One decision.

> Elliott takes the TYBR volumes used to make the first two estimates from the testimony of Capital One witness Jean. The estimates were produced by 'asking business managers to provide estimates of their anticipated volumes'. Tr. 2/41. It is clear from Jean's testimony that Capital One does not normally forecast its mail volumes beyond six months, and probably has little idea how accurate the TYBR forecasts are. However, a more serious problem with judgmental estimates of this kind is 'moral hazard.' The estimates have been produced by a party with an interest in the outcome of the proceeding. The business managers supplying the responses may have conceived an interest in reporting anticipated volumes that are optimistic or pessimistic. When this happens the derived estimates of net revenue are biased. Smith cites this problem with Capital One's TYBR forecast as one of the reasons for preferring an objective means for making such a forecast. 'A major drawback of a poll of operating personnel is that the poll may be inaccurate or subject to gaming.' Tr. 7/1258.

PRC Op. MC2002-2, para. 5094.

[6066] In the Capital One opinion, the Commission concluded that "[a] primary Commission role in reviewing NSAs is to assure adherence to the statutory prohibitions against unduly discriminatory or inequitable rates, and that the general mailing public is not harmed." Id. para. 1008. To assure this condition, the Commission recommended the addition of a stop-loss cap provision to the agreement.

> This additional provision is necessary to comply with the basic fairness standard for postal rates that finds expression in several provisions of the law. See, for example, 39 U.S.C. §§ 101(d), 3622(b)(1), 3623(c)(1). The requirement that rates and classifications be fair and equitable would be violated if the Commission were to recommend a special low rate for one mailer likely to result in higher rates for other mailers. Essentially, this

> would constitute the sort of unreasonable preferences between mailers that must be avoided. § 403(c).

Id. para. 8012. Assuring this condition also had implications in regard to unfairly disturbing the distribution of institutional cost established by the previous omnibus rate case.

> The requirement that the costs of each class of mail and type of service recover an appropriate share of total Postal Service costs, § 3622(b)(3), is easily met by this recommendation. The stop-loss provision added by the Commission assures that the Postal Service will not be made worse off by the NSA, so no mailers will be disadvantaged by having to contribute a larger portion of institutional costs than previously found justified.

Id. para. 8043. This discussion also is directly applicable to the Bank One Negotiated Service Agreement.

[6067] The Commission finds the uncertainties presented with the Bank One volume estimates produce a similar effect as the uncertainties presented by the Capital One volume estimates. The recent Bank One merger with J. P. Morgan Chase adds to these uncertainties. The risks associated with misestimation of before rates volume estimates identified in the testimony of witness Panzar, and discussed in the Capital One Decision continue to be present with the Bank One Negotiated Service Agreement. Without the addition of a stop-loss cap, the win-win situation important to Negotiated Service Agreements is not preserved. Mailers not party to the agreement would not be adequately protected from the risk of harm. On this basis, the Commission recommends the addition of a stop-loss cap.[41]

[6068] The recommendation of the stop-loss cap preserves the win-win situation, and protects mailers not party to the agreement. It provides Bank One with a direct economic benefit of up to $11.5 million in postage discounts, and the potential to create

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[41] Stop-loss caps are not a prerequisite to the recommendation of a Negotiated Service Agreement. Stop-loss caps might not be appropriate in other baseline Negotiated Service Agreements that contain different elements than presented in any of the preceding requests. Alternatively, volume projections might be sufficiently reliable to make the application of a stop-loss cap unnecessary.

its own internal benefits. It also provides the Postal Service with significant opportunities for cost savings and increased contribution, which benefit all mailers.

[6069] *Protective Mechanisms — Annual Threshold Adjustment.* The annual threshold adjustment is designed to focus the Negotiated Service Agreement on increasing First-Class Mail marketing volumes, and avoid the unintended consequence of diminishing the incentives for new marketing mail volumes due to statement volume growth. This mechanism also protects against greater discount leakage by adjusting the thresholds in the years following the first year of the agreement. Tr. 2/191-2. The Commission recommended a similar mechanism as proposed in the DFS Negotiated Service Agreement. This mechanism reduces uncertainties due to projection of customer mail volumes, and should have a positive effect on protecting mailers not party to the agreement without changing the functional equivalency characteristics of the agreement.[42]

[6070] *Protective Mechanisms — Flats Limitation.* The proposal includes a provision to limit the number of flat-shaped First-Class Mail solicitations eligible for block discounts to 35 million pieces per year. This is roughly equal to the volume sent by Bank One in 2003 and the before rates volume estimate for each year of the agreement. The justification for limiting the annual number of flats that qualify for block discounts lies in pricing differences between First-Class Mail and Standard Mail with respect to shape.

[6071] Because of rate design issues, the increase in contribution that would result from the migration of flat-shaped Standard Mail to First-Class Mail is substantially less than the expected increase in contribution from the migration of letter-shaped Standard

[42] The agreement states that the Postal Service "may" annually adjust the volume threshold. The proposed Domestic Mail Classification Schedule language states that the Postal Service "shall" annually adjust the volume threshold. The Commission presumes that the Postal Service "will" adjust the volume threshold to protect its own interests. Not adjusting the volume threshold would defeat the intent of the provision and increase the uncertainties related to volume and leakage.

Mail to First-Class Mail.[43] The relatively small increase in unit contribution from the migration of flats could, after deduction of the appropriate block discount, become a net *decrease* in contribution. Restricting the volume of First-Class marketing flats eligible for block discounts to the amount that would have been sent absent the agreement greatly reduces the risk of this undesirable outcome.

[6072] The baseline Negotiated Service Agreement does not include any limit on the number of flat-shaped pieces eligible for discounts. Capital One does not mail a significant amount of First-Class Mail flats, and increases in Capital One's First-Class Mail marketing mail were not expected to come from Standard Mail volume. Therefore in the baseline agreement there was no discernable risk of lost contribution from the migration of flat-shaped Standard Mail to First-Class. Limiting the eligibility of Bank One First-Class Mail flats for block discounts makes the Bank One agreement equivalent in this regard.

[6073] *Protective Mechanisms — Enhanced Mergers and Acquisitions Clause.* Merger and acquisition clauses protect the Postal Service from the unintended consequences of a participating mailer merging with or acquiring another entity. The Capital One mergers and acquisitions clause adjusts the volume threshold at which discounts become available based on the merged or acquired entity's eligible First-Class Mail volume for the 12 months preceding the merger or acquisition. This provision is triggered if Capital One merges or acquires a single entity with an eligible First-Class Mail volume in excess of 10 million pieces, or if Capital One merges or acquires, on a fiscal year basis, multiply entities with a combined eligible First-Class Mail volume in excess of 25 million pieces.

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[43] Unlike Standard Mail, letter-shaped and flat-shaped worksharing rate categories in First-Class Mail share a common benchmark (undiscounted) rate. To avoid an anomalous rate structure (i.e., lower rates for flats than for letters), worksharing discounts for First-Class Mail automation presort flats reflect very low passthroughs of avoided costs. One result is relatively small rate differentials between otherwise identical First-Class Mail letters and flats, as compared to the rate differentials between Standard Mail letters and flats.

[6074] The enhanced mergers and acquisitions clause presented in the Bank One Negotiated Service Agreement provides substantially more detail as to the steps to be taken to integrate the merged or acquired entity's mail volume into the Negotiated Service Agreement. Separate clauses are provided for mergers or acquisitions that involve entities with First-Class Mail volumes in excess of 10 million pieces but less than 300 million pieces annually (this clause also is applicable to portfolio purchases in excess of 10 million First-Class Mail pieces), and for mergers or acquisitions that involve entities with First-Class Mail volumes in excess of 300 million pieces annually. There is an additional clause for losses and sales of portfolios of at least 10 million pieces.

[6075] Witness Plunkett asserts that the enhanced mergers and acquisitions clause was designed to adjust for the possibility of the merger with J. P. Morgan Chase. Assuming that the events that trigger the enhanced mergers and acquisitions clause are unforeseen, this mechanism provides some level of protection to the Postal Service. However, it does not act as a substitute for actual information when a merger is about to occur or has already occurred. The effects of a merger or acquisition could significantly change the effect that a Negotiated Service Agreement has on the Postal Service. Early in this docket, Bank One completed its merger with J. P. Morgan Chase. The mail volume of each pre-merger company is on the same order of magnitude. Because it has not been determined if and how the J. P. Morgan Chase mail will be integrated into the Negotiated Service Agreement, nor is it known what the post-merger J. P. Morgan Chase mailing practices will be, additional uncertainties have been created as to volumes that reasonably can be expected to be mailed under this Negotiated Service Agreement. This has influenced the Commission's decision to recommend the addition of a stop-loss cap.

[6076] It is still possible that Bank One could merge with or acquire another entity. The enhanced mergers and acquisitions clause affords a level of protection to the Postal Service from the unintended consequences of Bank One merging or acquiring additional entities and remains a useful provision of the agreement. It does not change the functionally equivalent characterization of the agreement.

[6077] *Conclusion.* The comparison of the literal terms and conditions of each Negotiated Service Agreement, and the comparison of the effect that each agreement has upon the Postal Service (with the addition of a stop-loss cap similar to that recommended in the baseline docket), demonstrates that the Bank One Negotiated Service Agreement is functionally equivalent, although not identical, to the Capital One Negotiated Service Agreement. Therefore, the Commission finds that limiting issues and relying on record evidence specified from Docket Nos. MC2002-2 and R2001-1 is consistent with the due process obligations applicable to this proceeding.

## C. Modified Stipulation and Agreement Trigger Mechanism

[6078] Stop-loss mechanisms are employed to reduce or eliminate financial risk associated with uncertainties, which can be due to either the inability to accurately forecast into the future, or other exogenous factors beyond the control of the participants. To some extent, uncertainty of forecasts will exist with any Negotiated Service Agreement.

[6079] The proposed Modified Stipulation and Agreement includes a trigger mechanism designed to provide protection for the Postal Service against losses that could occur if Bank One shifts large quantities of undeliverable mail from Standard Mail to First-Class Mail. The mechanism is implemented through a spreadsheet model into which: (a) the percentage of First-Class Mail solicitations actually returned; (b) the percentage of First-Class Mail solicitations actually forwarded; and (c) the percentage of undeliverable First-Class Mail solicitations that are successfully processed through the Address Correction Service (ACS) are entered. Holding all other inputs and assumptions fixed, the model calculates the two-year cumulative change in contribution to the Postal Service and the marginal changes in unit contribution expected in year three for Standard Mail migrating to each of the First-Class declining block rates. If the year one and two cumulative change in contribution estimated by the model is negative, then any discount for which the marginal change in unit contribution is projected to be

negative in year three is cancelled for the remainder of the Negotiated Service Agreement. Any pieces that would have received an unprofitable discount instead receive the largest remaining discount that generates an increased contribution.

[6080] The potential for a loss of contribution resulting from the migration of Standard Mail to First-Class Mail was not given much consideration in the baseline agreement. That is because in that case any increase in First-Class Mail volume was assumed to be completely new volume, rather than migration. In contrast, the current proposal assumes that increased First-Class Mail volume would come directly at the expense of lower Standard Mail volumes. Therefore, the increased contribution is partly offset by the contribution lost when the piece leaves Standard Mail. This increases the possibility that, if enough of the migrating mail requires forwarding or return, the Postal Service could actually be worse off as a result of the migration to First-Class Mail.

[6081] Through the discovery process and settlement negotiations, OCA and Valpak shed light on this potential problem, and successfully designed a mechanism to address it that is acceptable to the proponents. The Commission commends the participating parties for their efforts to identify and work together to develop solutions to all potential risks associated with Negotiated Service Agreements.

[6082] The Commission agrees with Bank One's conclusion that the three inputs into the trigger model are unlikely to vary from the forecast enough to result in losses from the shift of undeliverable Standard Mail to First-Class Mail. Bank One Brief at 19-24. However, the mechanism is also very unlikely to cause any harm, the signatories to the Modified Stipulation and Agreement support it, and no party opposes its incorporation into the terms of the agreement. Therefore to protect against potential harm from misestimated return, forwarding and ACS success rates, the Commission includes the trigger mechanism in its recommendation.

## D. Stop-Loss Cap

[6083] *Calculation of Stop-Loss Cap in Baseline Agreement.* The Capital One Negotiated Service Agreement calculates the stop-loss cap dollar value by finding the point where the ACS savings (added contribution) equals the volume discount leakage (lost contribution) during the test year. At this point, the net contribution as a result of the Negotiated Service Agreement is zero. PRC Op. MC2002-2, paras. 8024–31. The dollar value represented by this point is then multiplied by three to provide for a cumulative limit over the three years of the agreement. Finally, the Commission applies a 95 percent pass-through which results in a cumulative three-year stop-loss limit of $40.637 million for the Capital One Negotiated Service Agreement.

[6084] *Parties' Positions.* The proponents in this case oppose the addition of a stop-loss cap to the terms of the agreement. This position is based on their conclusion that the limitations a stop-loss cap would place on potentially favorable deviations from the expected outcome outweigh the benefit of preventing potentially harmful deviations from the expected outcome. Participants signing the Modified Stipulation and Agreement agree that the addition of a stop-loss cap is likely to be counterproductive. Modified Stipulation and Agreement at 4.

[6085] C*ommission Analysis.* The analysis of the financial impact of the proposal is based on assumptions about the future volumes of Bank One's First-Class marketing mail, both in the absence and presence of the Negotiated Service Agreement. The volume estimates presented by Bank One provide a point of reference for evaluating the expected financial effects of the agreement. However, the estimates implicitly incorporate assumptions for myriad non-price factors that affect mailing behavior far into the future and the record provides no means of evaluating the sensitivity of the estimates to changes in exogenous factors. In this case, the recent merger with J. P. Morgan Chase has created a situation that is not represented by the volume estimates on the record. Therefore, it is prudent for the Commission to consider the possible effects of deviations from the volume estimates, and ultimately to evaluate the proposal

independent from them. The Commission believes that some form of stop-loss mechanism is necessary to account for these possibilities. The trigger mechanism in the proposed Stipulation and Agreement addresses a different source of risk, and does not protect against any potential misestimate of before rates volume, nor is it possible to modify it to do so.

[6086] The stop-loss cap recommended by the Commission in the Capital One Negotiated Service Agreement provides a means of protecting mailers from potential adverse effects of lost contribution without the need to rely on volume forecasts. The same methodology, slightly modified, can be applied to the Bank One Negotiated Service Agreement using inputs specific to Bank One. After making the modifications, as explained below, the Commission calculates a stop-loss value of $11.5 million. See Table 9.

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## Table 9. Calculation of Stop-Loss Cap

| | Year 1 | Year 2 | Year 3 | Total NSA |
|---|---|---|---|---|
| **A. Effects of ACS (Savings Estimate)** | | | | |
| **First-Class Mail Marketing Letters:** | | | | |
| Before Rates Avg. Cost | 0.1425 | 0.1482 | 0.1542 | |
| Avg. Savings from Returns | 0.0161 | 0.0168 | 0.0174 | |
| Avg. Savings (Cost) from Forwards | 0.0000 | 0.0000 | 0.0000 | |
| Total Avg. Savings from ACS | 0.0161 | 0.0168 | 0.0174 | |
| After Rates Avg. Cost | 0.1264 | 0.1315 | 0.1367 | |
| Before Rates Volume | 101,983,246 | 107,312,790 | 112,870,232 | |
| **Net Letter Savings** | 1,643,602 | 1,798,675 | 1,967,496 | 5,409,772 |
| **First-Class Mail Marketing Flats:** | | | | |
| Before Rates Volume | 35,043,000 | 35,043,000 | 35,043,000 | |
| Savings from Returns | 1,953,448 | 2,031,586 | 2,112,849 | |
| Savings (Cost) from Forwards | 0 | 0 | 0 | |
| **Net Flat Savings** | 1,953,448 | 2,031,586 | 2,112,849 | 6,097,884 |
| **Net Contribution Gain from ACS (Savings)** | **3,597,050** | **3,830,261** | **4,080,345** | **11,507,656** |
| **B. Effects of Lost Contribution (Revenue Leakage)** | | | | |
| Before Rates First-Class Volume | 643,676,246 | 649,005,790 | 654,563,232 | |
| Volume Threshold for Discounts | 535,000,000 | 535,000,000 | 535,000,000 | |
| Before Rates Volume Eligible for Discounts | 108,676,246 | 114,005,790 | 119,563,232 | |
| Average Discount on "Exposed" Volume | 0.0331 | 0.0336 | 0.0341 | |
| **Total Discounts on Before Rates Volume (Leakage)** | **(3,597,050)** | **(3,830,261)** | **(4,080,345)** | **(11,507,656)** |
| **Net Increase in Contribution (BR Volume)** | **0** | **0** | **0** | **0** |
| Savings from ACS at Break-Even Volume | 11,507,656 | | | |
| Pass-through Percentage | 100% | | | |
| **Stop-Loss Cap Amount** | **11,507,656** | | | |

[6087] The mechanism in the agreement to adjust the discount thresholds in response to changes in the number of customer accounts virtually eliminates any uncertainty with respect to the estimated volume of statement mail. Assuming that changes in customer account volume are highly correlated with changes in statement mail volume, it can be assumed that increases in before rates statement volume will not result in additional leakage, because the increases will be offset by the upward adjustment of the discount thresholds. Thus, where the stop-loss cap in the baseline agreement was calculated assuming a constant mix of customer and solicitation mail, the stop-loss cap for the Bank One Negotiated Service Agreement is calculated by holding statement mail volume at the forecasted levels.

[6088] The other modification to the baseline methodology adopted in this case is the application of 100 percent pass-through of savings, as opposed to the 95 percent pass-through used in setting the stop-loss amount for the Capital One Negotiated Service Agreement. There are two main justifications for the higher pass-through: (a) the potential for significant additional contribution from the migration of Standard Mail to First-Class Mail in response to the discounts, and to a lesser extent, (b) reduced risk of harm from misestimated key inputs as a result of the trigger mechanism.

[6089] The primary justification for setting the stop-loss cap equal to 100 percent of estimated savings is the evidence supporting the proponents' assertion that Bank One is likely to shift a significant volume of Standard Mail to First-Class Mail in response to the declining block rate schedule. Bank One witness Buc presents an illustration of how, over a given range of lift rates and lifetime values for customers, large shifts between classes can result from relatively small changes in the marginal price difference between First-Class Mail and Standard Mail. While the inputs (and therefore the results) are not specific to Bank One, the analysis does lend a level of support to the theory that large volumes may be induced to shift to First-Class Mail that did not exist before.

[6090] The stop-loss cap recommended by the Commission allows Bank One and the Postal Service to achieve all of the benefits anticipated in their testimony. If the proponents' estimates are correct, Bank One will mail more than three times as many

First-Class Mail marketing letters as it would have otherwise during the three years of the agreement. In doing so, Bank One will receive just over $11.1 million in discounts — an amount permitted by the stop-loss cap.[44] Likewise, if the forecast is correct the Postal Service will realize a net increase in contribution of roughly $11.6 million. The Commission recognizes the potential for the stop-loss cap to limit unforeseen outcomes that are more favorable than the estimate. However, given the evidence in this case, a cap is necessary to provide protection against unforeseen outcomes that are less favorable than the estimate.[45] Without a stop-loss cap, there is no reasonable assurance that the mailers not party to the agreement will be adequately protected. As in the baseline agreement, the addition of the stop-loss cap assures that the agreement is a "win-win."

E. Other Mechanisms for Limiting Risk

[6091] The Bank One Negotiated Service Agreement contains three other notable risk limiting mechanisms: an annual threshold adjustment, a flats volume limit, and an enhanced mergers and acquisitions clause. The Commission finds these provisions to represent appropriate tailoring of the Bank One Negotiated Service Agreement to the specific relationship between the Postal Service and Bank One.

[6092] The annual threshold adjustment allows the Postal Service to annually adjust the volume threshold at which postage discounts begin based on the percentage change in the sum of the number of Bank One credit card and checking accounts, as listed in Bank One's annual report. The number of accounts must either increase or decrease by greater than 5 percent before this provision is triggered. The threshold will be adjusted upward or downward based on the percentage change in accounts minus

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[44] Compare $11,116,875 total discounts in Table 10 with $11,507,656 stop-loss cap in Table 9.

[45] For a full discussion of the benefits and limitations of the stop-loss cap, see PRC Op. MC2002-2, paras. 5061-5074.

3 percent. The Capital One Negotiated Service Agreement did not contain a similar provision, whereas the DFS Negotiated Service Agreement contained a similar but less sophisticated provision. The provision adjusts for uncertainties in estimated customer mail volume on an annual basis. It also focuses the discount incentive on growth in marketing mail volume, and away from changes in customer mail volume.

[6093] The flats volume limit specifies that no more than 35 million flat-shaped solicitation mailpieces will be counted annually toward the discount threshold or be eligible for discounts. This provision limits the financial impact of too many flat-shaped Standard Mail solicitation pieces migrating to First-Class Mail. Flat-shaped pieces would provide less additional contribution than letter-shaped pieces when they migrate to First-Class Mail. The flats volume limit is unique to the Bank One Negotiated Service Agreement because neither the Capital One nor the DFS Negotiated Service Agreement provided for the mailing of flats.

[6094] The enhanced mergers and acquisitions clause safeguards against volume-related risks associated with mergers and acquisitions, and portfolio purchases. Witness Plunkett notes that the expanded merger clause has been designed to adjust for possibilities such as the recently announced merger with J. P. Morgan Chase. Tr. 2/192-93. The Capital One and DFS Negotiated Service Agreements contain similar, but less sophisticated mergers and acquisitions clauses. The Commission considers merger and acquisition clauses a necessary component of this style of Negotiated Service Agreement to protect the Postal Service. However, such clauses are a poor substitute for actual data and analysis where a merger or acquisition is either imminent or has already taken place. There was significant discovery attempting to ascertain the effects of the J. P. Morgan Chase merger, and there continues to be much uncertainty about whether this Negotiated Service Agreement will help or hurt the Postal Service, if or when eligible J. P. Morgan Chase mail volume is integrated with Bank One mail volume.

F. Financial Analysis

[6095] *Address Correction Element.* Postal Service witness Plunkett estimates that providing electronic Address Correction Service (eACS) in lieu of physically returning Bank One's undeliverable as addressed (UAA) First-Class marketing letters that cannot be forwarded will save a total of $7.8 million in Postal Service costs over the term of the agreement. Approximately $1.5 million of the savings is from marketing letters, and the remaining $6.3 million is from marketing flats. The estimate for letters is developed using essentially the same technique recommended in Docket No. MC2002-2. As in the baseline recommendation, the inputs include the before rates volume of First-Class marketing letters, the return rate for the marketing mail, the ACS success rate, and the average costs of a physical return and an "electronic return." In contrast to the method adopted by the Commission in Docket No. MC2002-2, witness Plunkett applies a contingency factor to the costs that form the basis of the savings estimate. The proxies for Bank One's ACS success rate and return costs are taken directly from Docket No. MC2002-2 with one modification — the return costs are projected to increase at an assumed 4 percent annual rate of inflation. The return rate and volume forecasts are provided by Bank One witness Rappaport. Witness Rappaport bases his estimates of before rates marketing volume on Bank One's budget for the first year of the agreement and the assumption that absent the Negotiated Service Agreement, marketing volume will remain flat for years two and three. Id. at 117-19. His return rate estimate is based on a compilation of data from 2000 to May 2001. Id. at 174-5. The estimate for flats savings uses the same methodology and inputs with the exception of the return rate and the cost of physical and electronic returns. Witness Rappaport provides the flats return rate based on Bank One's recent experience, and witness Plunkett develops unit costs for the physical and electronic return of flats. Id. at 215-6, 222, 224-5.

[6096] *Participant's Argument in Regard to the Address Correction Element.* Bank One's UAA First-Class marketing mail that would have been forwarded in the absence of the Negotiated Service Agreement will continue to be forwarded, and in addition, an

electronic notification will be sent to Bank One. Each such notification will cause the Postal Service to incur costs that it would not have incurred otherwise. As in Docket No. MC2002-2, the Postal Service excludes the cost of ACS notices for forwarded mail from its analysis on the grounds that such costs are likely to be offset by savings from reducing the number of "repeat forwards."

[6097] Valpak and OCA show concern about the Postal Service's treatment of costs related to forwarding, as well as other costs that could affect the change in the contribution that will result from the shift of Standard Mail to First-Class Mail. OCA Brief at 3; Valpak Comments on Commission Consideration of Proposed Settlement at 4-10. Bank One argues that the return, forwarding and ACS success rates, as well as the unit costs used in the model are reliable, and that the financial results are not very sensitive to changes in these variables. Bank One Brief at 19-25.

[6098] *Commission Analysis.* While physical forwarding costs are relevant to the evaluation of the contribution effects of Standard Mail migrating to First-Class, the record provides no reason to suspect that the physical forwarding costs incurred by "anyhow" marketing letters will be adversely affected by the Negotiated Service Agreement. On the contrary, physical forwarding costs are likely to decrease due to reduced repeat forwards (as in the baseline agreement).

[6099] The only additional costs related to forwarding incurred by "anyhow" volume as a result of the Negotiated Service Agreement are the costs of providing Bank One with electronic ACS notices of mail that is forwarded. The cost of an electronic notice is small enough that even a relatively high forwarding rate does not have a significant effect on the net savings resulting from the agreement. Given the low sensitivity of the results and the potential for savings from the avoidance of repeat forwards, the Commission

follows the precedent of the baseline agreement and assumes the agreement will have a neutral effect on the costs related to forwarding.[46]

[6100] The Postal Service's estimate of the unit cost of the electronic return of flats is based on the assumption that notifications will be processed on non-mechanized terminals. This is a reasonable assumption, as mechanized operations designed to process letters may be unable to process flat-shaped mail. Likewise for the physical return of flats, it is reasonable to assume the exclusive use of non-mechanized operations in the estimate of Computerized Forwarding System (CFS) costs.

[6101] However, the Postal Service's estimate of computerized forwarding system costs uses the *ACS* non-mechanized terminal costs as opposed to the *non-ACS* non-mechanized terminal costs. This is in contrast to the treatment of computerized forwarding system costs for letters, where non-ACS costs are used for both mechanized and non-mechanized terminal costs. Presiding Officer's Information Request Number 6 asked about this apparent inconsistency.[47] The Postal Service's explanation that some undeliverable flats would be handled manually as nixies is unsatisfying given that the weighted nixie clerk costs ($0.1327) are itemized separately from computerized forwarding system costs in the summary of the costs of physical returns. Id. at 216, 434-5; See also docket MC2002-2, USPS-LR-1 at 1.

[6102] While not fully satisfied with the rationale for the selection of ACS costs as a proxy for computerized forwarding system costs for physically returned flats, the Commission uses the cost estimate for the physical return of flats employed by the Postal Service. It is the only estimate on the record, the Postal Service continues to support it in its response to POIR 6, and no party opposes its use.

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[46] Preliminary data from the operation of the Capital One Negotiated Service Agreement indicates a forwarding rate of only 2 percent, supporting the Postal Service's assertion that high return rates are not necessarily associated with high forwarding rates. Tr. 2/417.

[47] It can be noted that employing the alternative method of estimating computerized forwarding system costs for physically returned flats presented in POIR 6 would reduce the estimated benefit of the negotiated service agreement by approximately $1 million over the term of the agreement.

[6103] The Commission applies the same methodology for estimating the financial effects of the ACS provisions as it used in the baseline agreement, modified to incorporate the Postal Service's 4 percent inflation assumption and the development of costs for the physical and electronic return of flats. The Commission's estimate differs slightly from the Postal Service's estimate because the Postal Service rounds some inputs and adds a 3 percent contingency to the underlying cost estimates. The exclusion of contingency from the estimation of cost savings is consistent with Commission precedent for the calculation of worksharing cost avoidances and with the method employed in the baseline agreement. The resulting savings estimates are $2.4 million, $2.5 million, and $2.6 million in years one, two, and three of the agreement, for a total savings of $7.6 million over the term of the agreement. See Table 10.

[6104] *Declining Block Rate Volume Discount Element.* There are two components to the financial analysis of the declining block rate discount element — the additional contribution generated by solicitations mail converting from Standard Mail to First-Class Mail, and the loss of contribution from discounts awarded to First-Class Mail that would have been sent even absent the discounts. Witness Plunkett estimates the Postal Service will sustain a loss of $2.9 million in contribution due to discounts on First-Class Mail that would have been sent anyway absent the discount. This is based on witness Rappaport's estimates of First-Class Mail volumes in the absence of the Negotiated Service Agreement.

[6105] Witness Plunkett estimates that the conversion of a percentage of Bank One's marketing mail from Standard Mail to First-Class Mail will generate an additional $6.8 million in contribution for the Postal Service. The increase in per-piece contribution for new First-Class Mail is less in the Bank One Negotiated Service Agreement than in the Capital One Negotiated Service Agreement. Since in the Bank One Negotiated Service Agreement the new First-Class Mail volume is migrating from Standard Mail, the increase in contribution per piece reflects the loss of the Standard Mail per-piece contribution that otherwise would have been generated. Based on witness Plunkett's estimates, pieces receiving the highest discount would generate an increase in

contribution of 2.2 cents per piece in the first year of the agreement, shrinking to 1.8 cents by the third year of the agreement. In the Capital One Negotiated Service Agreement, the new volume was composed entirely of new mailings, which generated an estimated 10.4 cents of contribution per piece at the highest discount level.

[6106] In this case, as in the Discover case,[48] OCA and Valpak show concern about the size of the expected increase in unit contribution from the shift of Standard Mail to First-Class Mail. They point out that if the migrating mail requires more forwarding or returns than expected, the Postal Service could potentially lose contribution as a result of the migration to First-Class. The Postal Service and Bank One join 10 parties (including OCA and Valpak) in supporting a proposed Modified Stipulation and Agreement that includes a trigger mechanism designed to address the risk posed by the potential for migrating mail to be more costly than expected.

[6107] *Commission Analysis.* The Commission recognizes the potential for the increase in contribution from the migration of Standard Mail to First-Class Mail to be less than calculated and it commends the parties for their diligence in examining this risk. The Commission also appreciates the efforts of parties to devise mechanisms to reduce or eliminate forms of risk associated with this and other Negotiated Service Agreements.

[6108] As discussed in the PRC Op. MC2004-4, the analysis of forwarding rates used by OCA in that case appears to overestimate its impact on the net contribution of the Negotiated Service Agreement. PRC Op. MC2004-4 at 29-30. The risk of losses resulting from the cost of mail migrating to First-Class exceeding expectations does not seriously threaten the overall profitability of the Negotiated Service Agreement. In addition, the trigger mechanism included in the proposed Modified Stipulation and Agreement provides some protection against this risk. Moreover, the Commission does not require that the increase in contribution be positive for every piece, and the basis of

[48] MC2004-4 and the current case were filed on the same date, and both were presented as functionally equivalent to the Capital One Negotiated Service Agreement.

the Commission's recommendation is not dependent on contribution from the migration of Standard Mail to First-Class Mail.

[6109] The Commission estimates that the conversion of a percentage of Bank One's marketing mail from Standard Mail to First-Class Mail will generate an additional $6.9 million in contribution for the Postal Service. See Table 10. The discounts provide a means for Bank One to participate in the savings realized by the Service from the ACS portion of the Negotiated Service Agreement. They also provide Bank One with an incentive to generate additional First-Class Mail volume.

[6110] The Commission estimates the Postal Service will sustain a loss of $2.9 million in contribution from discounts on First-Class Mail that would have been mailed anyway absent the discount. See Table 10. The reliability of the estimated revenue leakage is a concern. The potential for mis-estimated before rates volume forecasts to lead to Postal Service losses from higher than expected discounts on mail that would have been sent absent the agreement underlies the recommended stop-loss cap described above. The addition of the stop-loss cap eliminates this risk.

[6111] *Overall Financial Impact.* The Commission estimates that the net financial effect of the Bank One Negotiated Service Agreement will benefit the Postal Service by an increase in contribution of $11,599,072 over the three-year life of the agreement. The net effect of the address correction service element is a Postal Service cost savings of $7,576,312 — with $2,427,060 occurring in year one, $2,524,143 occurring in year two, and $2,625,109 occurring in year three. There will be a net loss of $(2,872,200) to the Postal Service because of discounts paid on before rates volumes, i.e., leakage — with $(957,400) occurring in each year of the agreement. The Postal Service will realize a net increase of $6,894,960 in contribution from the migration of Standard Mail to First-Class Mail — with $777,018 occurring in year one, $3,148,501 occurring in year two, and $2,969,440 occurring in year three. These results are summarized in Table 10.

## Table 10. Estimated Financial Effects of Negotiated Service Agreement at Forecast Volumes

| | Year 1 | Year 2 | Year 3 | Total NSA |
|---|---|---|---|---|
| **A. Effects of ACS (Savings Estimate)** | | | | |
| **First-Class Mail Marketing Letters:** | | | | |
| Avg. Savings from Returns | 0.0161 | 0.0168 | 0.0174 | |
| Avg. Savings (Cost) from Forwards | 0.0000 | 0.0000 | 0.0000 | |
| Total Avg. Savings from ACS | 0.0161 | 0.0168 | 0.0174 | |
| BOF Estimate of Before Rates Volume | 29,387,000 | 29,387,000 | 29,387,000 | |
| **Net Letter Savings** | 473,612 | 492,557 | 512,259 | 1,478,428 |
| **First-Class Mail Marketing Flats:** | | | | |
| BOF Estimate Before Rates Volume | 35,043,000 | 35,043,000 | 35,043,000 | |
| Savings from Returns | 1,953,448 | 2,031,586 | 2,112,849 | |
| Savings (Cost) from Forwards | 0 | 0 | 0 | |
| **Net Flat Savings** | 1,953,448 | 2,031,586 | 2,112,849 | 6,097,884 |
| **Net Contribution Gain from ACS (Savings)** | **2,427,060** | **2,524,143** | **2,625,109** | **7,576,312** |
| **B. Effects of Lost Contribution (Revenue Leakage)** | | | | |
| Before Rates First-Class Volume | 571,080,000 | 571,080,000 | 571,080,000 | |
| Volume Threshold for Discounts | 535,000,000 | 535,000,000 | 535,000,000 | |
| Before Rates Volume Eligible for Discounts | 36,080,000 | 36,080,000 | 36,080,000 | |
| Average Discount on "Exposed" Volume | 0.0265 | 0.0265 | 0.0265 | |
| **Total Discounts on Before Rates Volume (Leakage)** | **(957,400)** | **(957,400)** | **(957,400)** | **(2,872,200)** |
| **Net Increase in Contribution Before New Volume** | **1,469,660** | **1,566,743** | **1,667,709** | **4,704,112** |
| **C. Effects of New Volume** | | | | |
| BOF Estimate of Volume Upgraded from Standard | 19,055,000 | 99,055,000 | 99,055,000 | |
| **Standard Mail (Before Rates)** | | | | |
| Average Revenue | 0.1770 | 0.1770 | 0.1770 | |
| Average Cost (incl. contingency) | 0.0868 | 0.0902 | 0.0938 | |
| Average Contribution | 0.0902 | 0.0867 | 0.0831 | |
| **First-Class Mail Marketing Letters (After Rates)** | | | | |
| Average Revenue (Undiscounted) | 0.2925 | 0.2925 | 0.2925 | |
| After Rates Avg. Cost (incl. contingency) | 0.1302 | 0.1354 | 0.1408 | |
| Average Contribution (Undiscounted) | 0.1623 | 0.1571 | 0.1517 | |
| Increase in Avg. Contribution (Undiscounted) | 0.0721 | 0.0704 | 0.0686 | |
| Total Increase in Contribution (Undiscounted) | 1,374,343 | 6,972,176 | 6,793,115 | |
| Marginal Discount | 0.0350 | 0.0450 | 0.0450 | |
| Marginal Increase in Contribution (Discounted) | 0.0371 | 0.0254 | 0.0236 | |
| Average Discount | 0.0313 | 0.0386 | 0.0386 | |
| Average Contribution (Discounted) | 0.1310 | 0.1185 | 0.1131 | |
| Average Increase in Contribution (Discounted) | 0.0408 | 0.0318 | 0.0300 | |
| **Increase in Contribution from New Volume** | **777,018** | **3,148,501** | **2,969,440** | **6,894,960** |
| **Net Increase in Contribution (BOF Volume Est.)** | **2,246,679** | **4,715,244** | **4,637,149** | **11,599,072** |
| Total Discounts Awarded | 1,554,725 | 4,781,075 | 4,781,075 | **11,116,875** |

## G. Competitive Issues

[6112] Every request predicated on a functionally equivalent Negotiated Service Agreement is required to address the fairness and equity of the agreement in regard to other users of the mail, and the fairness and equity of the agreement in regard to the competitors of the parties to the agreement. See Rule 196(a)(i) and (ii). In this docket, witness Plunkett relies substantially on the competitive impact analysis presented in Docket No. MC2002-2. He argues that any competitive impact on competitors should be less in this docket than in Docket No. MC2002-2.

[6113] The Commission closely examined competitive issues in baseline Docket No. MC2002-2. It considered competitive issues of such import that the Commission's focus in Docket No. MC2002-2 was "on assuring that the NSA will not make mailers other than Capital One worse off." PRC Op. MC2002-2, para. 8006. The Commission independently sponsored Professor John C. Panzar as a witness to examine the economic aspects of the agreement. The Postal Service sponsored rebuttal witness B. Kelly Eakin to address and further develop many of the issues raised in witness Panzar's testimony. After the addition of one modification to the agreement, the Commission found that there was not a sufficient indication of competitive harm to prevent recommendation of the Capital One Negotiated Service Agreement. The Commission recommends a similar modification to the Bank One Negotiated Service Agreement. The Commission has not been presented with additional record evidence in this docket, MC2004-3, to conclude that the competitive effects of this agreement will be different from the competitive effects of the Capital One agreement.

[6114] The Commission's Docket No. MC2002-2 recommendation also rests, in part, on the Postal Service's express intent "to make the essential features of the Capital One agreement available to other similarly situated mailers." Id. para. 7021. Preventing similarly situated mailers from obtaining functionally equivalent agreements is potentially discriminatory. As a first step, the Postal Service recently made a functionally equivalent agreement available to DFS. By making a functionally equivalent agreement available to

Bank One, the Postal Service has taken another important step in reducing the potential for competitive harm caused by this style of agreement.

[6115] The Commission provided notice in the Federal Register of Docket No. MC2004-3 on June 30, 2004. 69 Fed. Reg. 39520 (2004). Two parties intervened that appear to have interests in the same industry segment as Bank One — American Bankers Association and DFS. American Bankers Association asserts that its membership is composed of banks located in each of the 50 states and the District of Columbia. Neither intervenor commented on negative competitive aspects of the proposed agreement. Capital One Services, Inc., a competitor of Bank One and a proponent of the baseline Negotiated Service Agreement, did not intervene.

[6116] With adequate notice provided, and the portion of the industry represented providing no negative comment, the Commission has no basis for finding any adverse competitive effect due to the Bank One Negotiated Service Agreement as modified by the Commission, other than what is already discussed in Docket No. MC2002-2. A negative competitive effect could still exist, but there is no record evidence to support this conclusion. The Commission would welcome comments related to the competitive nature of Negotiated Service Agreements in future proceedings.

## H. Statutory Criteria

[6117] In every rate and classification decision the Commission is required to evaluate how the criteria of sections 3622 and 3623 apply to the pending proposal. The Commission has reviewed each of the applicable factors and determined that on balance, its recommended decision is consistent with those policies.

[6118] This conclusion relies heavily on the Commission's findings and conclusions in Docket No. MC2002-2. See PRC Op. MC2002-2, paras. 8032-47. This reliance is justified because the proposed Bank One Negotiated Service Agreement as modified by the Commission is functionally equivalent, although not identical, to the Capital One Negotiated Service Agreement. General considerations, such as the legality and

desirability of Negotiated Service Agreements, also were comprehensively examined in Docket No. MC2002-2. Id. paras. 3001-63.

[6119] Every request predicated on a functionally equivalent Negotiated Service Agreement is required to consider the financial impact of the agreement on the Postal Service, the fairness and equity of the agreement in regard to other users of the mail, and the fairness and equity of the agreement in regard to the competitors of the parties to the agreement. These items directly relate to the fairness and equity requirements of § 3622(b)(1) and § 3623(c)(1).

[6120] The Commission's analysis of competitive issues discussed above concluded that there is no indication that the Bank One Negotiated Service Agreement as modified by the Commission is either not fair or not equitable in regard to other users of the mail, or in regard to the competitors of the parties to the agreement. The Commission finds that the Bank One Negotiated Service Agreement complies with the fair and equitable standards of the Act.

[6121] The Commission has considered the effect of the proposed rates on the general public, business mail users, and enterprises in the private sector in accordance with § 3622(b)(4). The agreement benefits other users of the mail by increasing contribution to the Postal Service while having no adverse effect on the rates of other mailers. Furthermore, no participant contends that the Bank One Negotiated Service Agreement rates will cause any competitive harm to other users of the mail.

[6122] The Bank One Negotiated Service Agreement should reduce Postal Service costs by not requiring the manual return of undeliverable as addressed solicitations mail that can not be forwarded. The electronic return information received by Bank One can be used to better prepare its mailings and reduce the introduction of undeliverable as addressed solicitations into the postal system. Both of these benefits address the § 3622(b)(6) requirement to consider the degree of preparation of mail by the mailer and its effect upon reducing Postal Service costs.

[6123] The Postal Service would not be receiving these benefits unless it was able to tailor rates and classifications to the specific characteristics of its relationship with

Bank One. The Negotiated Service Agreement classification allows the Postal Service to do this. Thus, the Negotiated Service Agreement classification is highly desirable from the point of view of both the user and the Postal Service. See § 3623(c)(5).

[6124] A substantial portion of the Docket No. MC2004-3 record is devoted to the financial analysis of the Bank One Negotiated Service Agreement. The Commission's independent financial analysis concludes that the Bank One Negotiated Service Agreement covers its direct and indirect attributable costs, and provides a reasonable contribution to other Postal Service costs in compliance with the § 3622(b)(3) requirement of the Act.

## I. DMCS Language

[6125] The Commission recommends the addition of section 612 to the Domestic Mail Classification Schedule. The language recommended by the Commission is based on the language proposed by the Postal Service in its Request at Attachment A, with three major modifications. Section 612.35 "Third Year Discounts" is incorporated from the Modified Stipulation and Agreement, Attachment A, section 612.35. Section 612.36 "Discount Limit" is added as a result of the Commission's recommendation of a stop-loss cap. Section 612.5 "Expiration" is modified to specify the termination date of the Negotiated Service Agreement without having to refer to additional documents. Also, minor technical corrections were incorporated that should have no effect on the intended meaning.

[6126] The Commission also recommends the addition of Rate Schedules 612A and 612B, as proposed by the Postal Service. Minor technical changes were incorporated to improve the presentation of the data.

## J. Data Collection Plan

[6127] The Commission recommends the data collection plan as proposed by the Postal Service with the addition of three provisions. See Tr. 2/226–27. Rule 193(g) requires the data collection plan to compare the "planned" or estimated mailer-specific costs, volumes, and revenues with the "actual" mailer-specific costs, volumes, and revenues. The Postal Service shall report this comparison as a provision of its data collection plan. Presenting this information as a comparison should provide a succinct indication of the Negotiated Service Agreement's progress toward reaching its goals.

[6128] The Modified Stipulation and Agreement proposes the addition of a requirement to report "[v]olume of Standard Mail solicitations by rate category." Modified Stipulation and Agreement, para. 7 and Attachment C. A similar requirement appears in both the Capital One and the Discover data collection plans. The Commission recommends the addition of this reporting requirement, but modifies the language to specify the volume of Bank One's Standard Mail. The reporting requirement shall specify: "Volume of Bank One Standard Mail solicitations by rate category."

[6129] The Commission has incorporated the Modified Stipulation and Agreement trigger mechanism into its recommendation. The financial analysis model associated with the trigger mechanism requires data on forwarding rates, return rates, and ACS success rates, for solicitation letter-shaped mail. Items 4, 5, and 6 of the data collection plan have been modified to require separate reporting of this information for letter-shaped and flat-shaped mail.

[6130] The data collection and reporting required during the Negotiated Service Agreement are set out below.

1. The volume of First-Class Mail solicitations by rate category in eligible Bank One Permit accounts.

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

3. The amount of discounts paid to Bank One 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 Bank One, reported separately for letter-shaped and flat-shaped mail.

5. The number of electronic address correction notices provided to Bank One for forwarded solicitation mailpieces, including the number of notices processed by CFS units and separately for PARS (when fully operational), reported separately for letter-shaped and flat-shaped mail.

6. The number of electronic address correction notices provided to Bank One 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), reported separately for letter-shaped and flat-shaped mail.

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, Bank One 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 Bank One 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 mailpiece. No other information from the record would be provided.

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

11. Volume of Bank One Standard Mail solicitations by rate category.

12. A comparison of the estimated mailer-specific costs, volumes, and revenues with the actual mailer-specific costs, volumes, and revenues.

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 FY 2005.[49] The Postal Service shall provide the data in a PC-available format.

## K. Conclusion

[6131] Having made the above determinations, the Commission has reviewed the evidentiary record pursuant to its statutory obligation under chapter 36 of title 39 of the U.S. Code. This includes an independent review of the testimony of Postal Service witness Plunkett, the testimonies of Bank One witnesses Rappaport and Buc, the designated written cross-examination, the designated responses to Presiding Officer Information Requests, and the designated testimony from previously concluded dockets MC2002-2 and R2001-1. This review leads to the conclusion that the record supports the proposed classification changes and the related discounts set out in the June 21, 2004 Request as modified by the Commission to incorporate select provisions of the Modified Stipulation and Agreement and the addition of a stop-loss cap, and that these changes are consistent with the policies of the Postal Reorganization Act. The Commission therefore recommends to the Governors of the Postal Service that the DMCS be amended as set forth in Appendices One and Two of the accompanying Recommended Decision.

[49] Each report is to be provided within 120 days after the end of each fiscal year during which the Negotiated Service Agreement is in effect. Items 1, 2, 4 through 7, and 11 are to be reported as monthly data for the previous fiscal year.

UNITED STATES OF AMERICA
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

*Before Commissioners:*

George Omas, Chairman;
Tony Hammond, Vice Chairman;
Dana B. Covington, Sr.;
Ruth Y. Goldway; and
Dawn A. Tisdale*

Rate And Service Changes To Implement Functionally Equivalent Negotiated Service Agreement With Bank One Corporation

Docket No. MC2004-3

RECOMMENDED DECISION

(Issued December 17, 2004)

The Commission, having considered the Postal Service Request, the Stipulation and Agreement, and the Modified Stipulation and Agreement has issued its Opinion thereon. Based on that Opinion, which is attached hereto and made a part hereof,

IT IS ORDERED:

1. The Commission's Opinion and Recommended Decision shall be transmitted to the Governors of the Postal Service and the Governors shall thereby be advised that the proposed discounts (set forth in Appendix One) and the proposed amendments to the Domestic Mail Classification Schedule (set forth in Appendix Two) are in accordance with the policies of title 39, United States Code, and the factors set forth in §§ 3622(b) and 3623(c) thereof; and they are hereby recommended to the Governors for approval.

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* Commissioner Tisdale did not participate in this decision.

2. Joint Motion of the United States Postal Service, Bank One Corporation, and the Office of Consumer Advocate for Consideration of Stipulation and Agreement as the Basis for Recommended Decision, September 15, 2004, is moot.

3. Select provisions of the Modified Stipulation and Agreement are incorporated into the Commission's Opinion and Recommended Decision. However, the Modified Stipulation and Agreement does not form the basis of this Opinion and Recommended Decision. Joint Motion of the United States Postal Service, Bank One Corporation, Valpak Direct Marketing Systems, Inc., Valpak Dealers' Association, Inc., and the Office of Consumer Advocate for Consideration of Modified Stipulation and Agreement as the Basis for Recommended Decision, October 5, 2004, is granted only in so far as it is consistent with this Opinion and Recommended Decision.

4. Except to the extent granted or otherwise disposed of herein, all motions, exceptions, and other outstanding requests filed in Docket No. MC2004-3 hereby are denied.

By the Commission.
(S E A L)

_____
Steven W. Williams, Secretary

CONCURRING OPINION OF CHAIRMAN OMAS, VICE CHAIRMAN HAMMOND, COMMISSIONER COVINGTON AND COMMISSIONER GOLDWAY

This case presents the Commission with a particularly difficult decision. In order to encourage the Postal Service to continue to pursue beneficial negotiated service agreements (NSAs) and to recognize the extensive efforts of participants in developing an unopposed settlement, we would have liked to have been able to recommend the Bank One NSA supported by the Postal Service without modification. For the reasons set forth at some length in the Opinion, we are not able to do so.

Despite the existence of an unopposed stipulation supported by a majority of participants, the Commission has had to again add a provision to a proposed NSA to assure that users of monopoly services will not be harmed. By adding this "stop-loss cap" provision, the Commission is able to recommend an NSA that is expected to provide both the Postal Service and Bank One Corporation with benefits of at least $11 million over the three-year life of the agreement.

The Commission strongly supports NSAs between the Postal Service and mailers. NSAs allow the Postal Service to take advantage of special situations where it is beneficial for a mailer to alter its practices (or accept altered service) and thereby reduce the Postal Service's costs. In such circumstances the mailer can benefit, the Postal Service can benefit, and no other mailers are disadvantaged. This presents a win-win-win situation, in which everyone benefits.

Informal statements by mailers and the Postal Service over the years have left the impression that there are numerous situations where mailers and the Postal Service could cooperate through an NSA to the benefit of all. We urge the Postal Service to continue to pursue opportunities for new baseline NSAs that allow the Postal Service and mailers to share the benefits of avoiding unnecessary expenses.

The Commission also encourages participants to settle contested issues whenever possible. Participants worked diligently to arrive at a proposed stipulation and agreement in resolution of issues in this case. The signatories offer a “trigger mechanism” to protect against certain misestimates, and believe that there is no need for an additional stop-loss provision.

Unfortunately, the Commission finds that it can not agree.

When the prospect of negotiated rate agreements between the Postal Service and individual mailers was first suggested, there was considerable concern that NSAs might be used unfairly to give special deals to favored mailers. Both the Commission and the Postal Service responded with public statements, including testimony before Congress, emphasizing the win-win nature of NSAs, and assuring that non-participants would not be disadvantaged. As a result, the opposition to NSAs has gradually diminished.

The first Postal Service NSA, with Capital One Financial Services, Inc., was requested in September, 2002. The Postal Service and Capital One sponsored testimony showing how both would benefit from the NSA. The Commission and the Postal Service sponsored expert testimony to clarify the potential impact of NSAs on non-participating mailers. Relying on this testimony, the Commission recommended the NSA so long as a stop-loss cap was added to protect against the risks associated with quite speculative volume estimates. That recommendation assured the win-win-win result that NSAs should achieve.

The Commission then immediately moved to establish rules to assure that mailers similarly situated to the parties to existing NSAs could rapidly obtain a functionally equivalent agreement with the Postal Service. The Capital One NSA became effective on September 1, 2003, and the Commission finalized its rules to facilitate functionally equivalent agreements in February, 2004.

The Postal Service submitted requests for two NSAs it described as functionally equivalent to the Capital One NSA on June 21, 2004. One of the proposed NSAs was with Discover Financial Services, Inc., and the other was with Bank One.

The Commission recommended the proposed Discover NSA in slightly more than three months, on September 30, 2004. The NSA with Discover was not identical to the earlier Capital One agreement, as the mailing practices of Capital One and Discover were not identical. One of the differences was that the Postal Service and Discover negotiated a stop-loss cap on rate discounts to protect mailers not party to the agreement. The cap was not computed with the formula used by the Commission in the Capital One case, but the Commission found that the result was sufficiently similar to support a recommended decision.

The Postal Service and Bank One contend that the volume projections provided in this case are more reliable than those presented by Capital One, and thus the risk of harm to other mailers has been alleviated. The Commission finds that the largely unexplained projection of a precipitous decline in before rates marketing volume, coupled with the dearth of reliable evidence on the impact of the merger of Bank One with J.P. Morgan Chase, leave an unacceptable level of risk. For that reason, a stop-loss cap is made a part of the recommended NSA.

The addition of a stop-loss cap in this case should not be construed as establishing a precedent that all NSAs, or even all NSAs functionally equivalent to the Capital One agreement must include a stop-loss cap. That is not the Commission's view. The reliability of before rates volume estimates is a factual issue that must be evaluated by the Commission, but this does not bar an NSA without a stop-loss cap. The consummation of a merger two weeks after a request is filed with the Commission presents an unusual fact pattern.

Finally, Bank One has argued that it might send even more First-Class Mail than it currently forecasts if unlimited discounts are available to it. This potential benefit is insufficient to justify providing special discounts to any individual mailer.

The Commission and the Postal Service have been directed by Congress both to preserve the financial health of the postal system and to treat all mailers fairly and equitably. There must be compelling justification before a few mailers are granted rate reductions for their current volume in hopes of attracting more volume in the future. The evidence in this case does not support such a step.

For these reasons, we recommend approval of an NSA with provisions that assure the public that this NSA will benefit all concerned.

George Omas, Chairman

Tony Hammond, Vice Chairman

Dana B. Covington, Sr., Commissioner

Ruth Y. Goldway, Commissioner

## RECOMMENDED CHANGES IN RATE SCHEDULES

The following changes represent the rate schedule recommendations of the Postal Rate Commission in response to the Postal Service's Docket No. MC2004-3 Request. The changes require the addition of two new rate schedules — 612A and 612B. The underlined text signifies that the text is new, and shall appear in addition to all other rate schedule text.

**BANK ONE NSA**
**RATE SCHEDULE 612A**

| Volume Block | Incremental Discounts |
|---|---|
| 535,000,001 to 560,000,000 | 2.5¢ |
| 560,000,001 to 585,000,000 | 3.0¢ |
| 585,000,001 to 610,000,000 | 3.5¢ |
| 610,000,001 to 645,000,000 | 4.0¢ |
| 645,000,001 to 680,000,000 | 4.5¢ |
| 680,000,001 and above | 5.0¢ |

**BANK ONE NSA**
**RATE SCHEDULE 612B**
**FOR ADJUSTED THRESHOLD (A.T.)**

| Volume Block | Incremental Discounts |
|---|---|
| A.T. to A.T. + 25,000,000 | 2.5¢ |
| A.T. + 25,000,001 to A.T. + 50,000,000 | 3.0¢ |
| A.T. + 50,000,001 to A.T. + 75,000,000 | 3.5¢ |
| A.T. + 75,000,001 to A.T. + 110,000,000 | 4.0¢ |
| A.T. + 110,000,001 to A.T. + 145,000,000 | 4.5¢ |
| A.T. + 145,000,001 and above | 5.0¢ |

# RECOMMENDED CHANGES IN DOMESTIC MAIL CLASSIFICATION SCHEDULE

The following material represents changes to the Domestic Mail Classification Schedule recommended by the Postal Rate Commission in response to the Postal Service's Docket No. MC2004-3 Request. The underlined text signifies that the text is new, and shall appear in addition to all other Domestic Mail Classification Schedule text. Information to be added upon approval by the Board of Governors appears in brackets and is underlined.

# NEGOTIATED SERVICE AGREEMENTS
# CLASSIFICATION SCHEDULE

## 612 BANK ONE NEGOTIATED SERVICE AGREEMENT

### 612.1 Eligible First-Class Mail

Eligible First-Class Mail under this section is defined as: (1) all Bank One letter shape First-Class Mail customer account mail (statements and correspondence) related to credit and banking products and services account holders; and (2) First-Class Mail solicitations for credit and banking products that bear the endorsement specified by the Postal Service, except that no more than 35 million flat shape solicitation pieces will be counted annually toward the discount threshold or be eligible for discounts. Eligible First-Class Mail does not include Business Reply Mail, Qualified Business Reply Mail, Cards, or Priority Mail.

### 612.2 Waiver of Address Correction Fees

The fees for address correction in Fee Schedule 911 are waived for those First-Class Mail solicitations on which Bank One uses the endorsement specified by the Postal Service.

In exchange for a waiver of ACS fees, Bank One will update any databases it maintains for solicitation mail, other than First-Class Mail customer correspondence related to account holders, and use the information in all future marketing campaigns.

If, during the first year after implementation, Bank One Corporation mails fewer than 25 million pieces of eligible First-Class Mail, Bank One agrees to pay $200,000.

### 612.3 First-Class Mail Discounts

**612.31** **Discount Threshold.** The Discount Threshold is set at 535 million pieces of eligible First-Class Mail for the first year of the agreement.

**612.32** **Discounts.** Bank One's Eligible First-Class Mail is subject to the otherwise applicable First-Class Mail postage in Rate Schedule 221 less the discounts shown in Rate Schedule 612A, for the first year of this Agreement if Bank One meets the Discount Threshold. The discounts apply only to volume above the Discount Threshold. Each incremental discount applies only to the incremental volume within each volume block.

**612.33** **Annual Threshold Adjustment.** The Postal Service shall annually adjust the Discount Threshold based on the percentage change from year to year in the sum of the number of Bank One's credit card and checking accounts, as listed in Bank One's annual report. This adjustment shall be determined as follows: if the percentage change is an increase or a decrease of greater than 5%, the threshold shall be adjusted upward or downward by the difference between the percentage change and 3%. No adjustment shall be made for a percentage change of 5% or less. If the percentage change is more than 5%, Rate Schedule 612B would apply in lieu of Rate Schedule 612A.

**612.34** **Threshold Adjustment for Mergers and Acquisitions; and Portfolio Purchases.** In the event that:

a. Bank One merges with and/or acquires an entity and/or purchases a portfolio with annual First-Class Mail volume in excess of 10 million pieces but less than 300 million pieces, the discount threshold will be adjusted to add the volume of First-Class Mail sent by the merged or acquired entity, or on behalf of the purchased portfolio during the 12 months preceding the merger, acquisition, or purchase. In that event, beginning in the succeeding fiscal quarter immediately following the date that mail volumes due to the merger, acquisition, or purchase begin to be mailed through the threshold permit accounts, Rate Schedule 612B would apply in lieu of Rate Schedule 612A.

b. Bank One merges with, or acquires, another banking entity that has an annual First-Class Mail volume of over 300 million pieces, the discount threshold will be adjusted upward to add the volume of the merged or acquired entity for the 12 months prior to the date the mail of the merged entity is first mailed through the threshold permit accounts. In that event, beginning in the succeeding fiscal quarter immediately following the date the mail of the merged entity is first mailed through the threshold permit accounts, Rate Schedule 612B would apply in lieu of Rate Schedule 612A.

c. Bank One loses or sells a portfolio with annual First-Class Mail volume of at least 10 million pieces, the discount threshold will be adjusted downward by the product of the number of active accounts lost or sold multiplied by 12. In that event, beginning in the succeeding fiscal quarter immediately following the date that the mail volumes due to the loss or sale will no longer be mailed through the threshold permit accounts, Rate Schedule 612B will apply in lieu of Rate Schedule 612A.

**612.35** **Third Year Discounts.** In the third year of the agreement, availability of the discounts in Rate Schedules 612A or 612B will be subject to the following provisions:

a. If the cumulative financial impact of section 612 on the Postal Service at the end of the second year after implementation is positive, then the discounts in Rate Schedules 612A or 612B will be available.

b. If the cumulative financial impact of section 612 on the Postal Service at the end of the second year after implementation is negative, and the incremental financial impact for volume entered under any rate discount block under section 612 is also negative, then mail that otherwise qualified for that discount shall instead be eligible for the deepest block discount that produces a positive incremental financial impact.

c. Determination of the cumulative financial impact within the meaning of paragraph (a) shall be based on the financial analysis submitted into the record as Appendix A to USPS-T-1 by the Postal Service in Postal Rate Commission Docket No. MC2004-3, adjusted solely to reflect the return, forwarding and ACS success rates actually experienced by the Postal Service on eligible letter-shaped solicitations (as defined in section 612.1) entered as First-Class Mail under this provision during the first two years after implementation.

d. Determination of the incremental financial impact for volume entered under each rate discount block within the meaning of paragraph (b) shall be based on a financial analysis comparable to that specified in paragraph (c), except that the analysis shall report separately the net incremental contribution per piece for volume within each rate discount block, rather than the cumulative financial impact of section 612 in the aggregate, and shall be based on inputs from the second year only.

e. The Postal Service shall submit its determination under this section, along with the Postal Service's supporting analysis, within two years and three months from the implementation date of this provision.

f. If the Postal Service fails to submit the analysis described in this subsection within 2 years and 3 months after implementation, this provision (section 612) will expire 2 years and 3 months from the implementation date set by the Board of Governors, rather than at the end of the third year, as otherwise provided by section 612.5.

**612.36** **Discount Limit.** The maximum cumulative discount available to Bank One Corporation over the duration of this negotiated service agreement shall not exceed $11.508 million.

**612.4** **Rates**

The rates applicable to this Agreement are set forth in Rate Schedules 612A and 612B.

**612.5** **Expiration**

The provisions of section 612 expire on [insert date three years from implementation date set by the Board of Governors.]

**612.6** **Precedence**

To the extent any provision of section 612 is inconsistent with any other provision of the Domestic Mail Classification Schedule, the former shall control.

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