

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

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Solicitation of Comments on First Use of Rules  
Applicable to Negotiated Service Agreements

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Docket RM2005-2

Initial Comments of Discover Financial Services, Inc. (DFS)

February 28, 2005

These initial comments are submitted in response to the Commission's Notice of Advance Rulemaking in Docket RM2005-2, issued January 25, 2005.

On February 11, 2004, the Postal Rate Commission released final rules creating the procedures it would follow in considering requests to approve Negotiated Service Agreements.<sup>1</sup> Those rules recognized a distinction between "baseline" and "functionally equivalent" NSAs and created different procedural frameworks for each one.

The Commission first used its functionally equivalent rules last summer in proceedings for requests for approval of functionally equivalent NSAs with Discover Financial Services, Inc. and Bank One Corporation. The DFS NSA was the simpler of the two and proceeded more rapidly than the Bank One NSA. Thus the DFS case was truly the first test of the rules. On September 30, 2004 the Commission approved the DFS NSA. It became the second NSA and the first functionally equivalent NSA.

In the early stages of the DFS and the Bank One cases, the Commission noted that it would ask for comments on the first use of the new rules after both proceedings

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<sup>1</sup> PRC Order, No. 1391, issued February 11, 2004.

were done. On January 25, 2005, the Commission did just that, opened Docket RM2005-2, and released the instant Notice of Advanced Rulemaking.

As outlined below, DFS believes that its proceeding went relatively smoothly and urges the Commission not to modify the rules in any way. It is important for the Commission to continue to send a strong message to industry that functionally equivalent NSAs will be considered as expeditiously as possible and that transaction costs will be minimized. Keeping the rules as they are accomplishes this goal. DFS does suggest that the Commission clarify several matters, specifically what standard it will use in determining the need for an oral evidentiary hearings, and how it anticipates ruling on the breath and scope of discovery.

## PRELIMINARY

DFS would like to commend the Commission for its handling of the Discover NSA case. The case went smoothly, and the functionally equivalent rules worked well. While there were challenges during the case, that was only to be expected.<sup>2</sup> Overall, the Commission did an excellent job in properly balancing the interests of the public, the parties, and the Postal Service, while coming to an expeditious conclusion in a succinct and timely manner.

Most importantly, throughout the case, the Commission consistently and studiously recognized the fundamental need for expediency that functionally equivalent

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<sup>2</sup> Any time a new process is unveiled by a regulatory Commission, there is a period of adjustment during which the entities that typically participate in proceedings adjust to a new framework and a new paradigm.

NSA proceedings demand, and the critical need to keep transaction costs down. In terms of these two interests, it appropriately limited discovery to issues narrowly and directly related to the specific NSA at hand, and it maintained a relatively tight time frame. The issues of time frames and discovery are addressed below, as is the matter of a cap.

## TIME FRAMES

As the Commission points out in its January 25 Notice, the functionally equivalent NSA rules were intended to expedite Commission review by allowing proponents to rely on relevant record testimony from the baseline docket, and avoid repetitious and senseless re-litigation. It is important to note that the government interest at stake here is not merely governmental and procedural efficiency, nor conservation of scarce economic sector resources. Much more than that is at stake.

The reason that expedition is critical in the functionally equivalent NSA process is that NSAs present a case of the federal government negotiating a specific “deal” with one company. In order for the federal government to maintain competitive neutrality in the marketplace—a fundamental tenet of free enterprise fairness—competitors of the company receiving a baseline NSA must be able to partake of a like deal (a “functionally equivalent” deal) as rapidly as possible. Any delay could have severe competitive concerns, depending on the circumstances.

Thus, unlike a rate case, expedition in a functionally equivalent NSA proceeding has its own public policy value—in terms of fairness and government impartiality in the marketplace—and that value is significant. Indeed, protecting that value could well be *the key* to successfully maintaining a robust and successful NSA pricing mechanism.

In terms of the time frame of the Commissions rules, those rules call for a procedural schedule where a decision is released either within 60 days of a section 196 ruling of functional equivalency (no hearing) or within 120 days of a section 196 determination (with hearing). While the Commission did not release its decision until 72 days after its section 196 ruling, DFS believes that that was a reasonable development in the context of a first case and new rules, and in light of the initial requests for a hearing. Certain questions remain which should be addressed by the Commission, although no rule needs be changed.

**Standard for a Hearing.** The Commission had not clearly indicated what standard it will use to determine whether a hearing is required. In order for the NSA process to thrive, the Commission should clarify its position on this issue now.

As DFS argued several times during its NSA proceedings, the practical standard of a “typical” rate case does not work in a functionally equivalent NSA context. In a rate case, as a practical matter, a hearing is held any time any party wants to explore the facts of any matter, or the significance of a particular issue in the context of the evolution and develop of the operation of postal system as a whole, even though the existence of none of the underlying facts is truly at issue. Where \$70 billion dollars is at stake, and one already has a ten month statutory limitation on the proceeding, one can argue that this type of “exploratory” standard for a hearing is appropriate.

That type of “exploratory” standard is not appropriate, however, in the context of a functionally equivalent NSA proceeding, where significant public policy concerns dealing with competitive fairness are inexorably intertwined with expedition.

The law states that hearings are necessary only to resolve a disputed *question of fact*. See authorities cited in both the July 29, 2004 Comments of Discover Financial Services, Inc. (DFS) in Docket MC 2004-4 and the July 29, 2004 Comments of Bank One in Docket No. MC 2004-3. That is the legal standard for when a hearing is required, and DFS believes that the Commission should adopt this as its standard for when it is will require a hearing.<sup>3</sup>

**Start of Discovery and Determination of Functional Equivalency.** Obviously, before one can make a determination about disputed questions of fact, one must determine the facts, and one needs sufficient time to do so.

During the DFS case, once the filing was made, DFS strove to be as open as possible with all parties and to set forth and explain the facts as quickly, sharply, and clearly as possible. In that respect, DFS and the Postal Service took the initiative to schedule very early meetings with the OCA and VALPAK in order to help both understand the case, answer any questions, and provide any information they would need.<sup>4</sup> DFS believes that Bank One did the same, and we feel that such an approach should be standard operating procedure.

A critical question in any case will be when discovery begins. In the Commission's rules, development of the facts through discovery is clearly contemplated, as of the date of filing of the NSA. Further, the Commission rules clearly intend that sufficient discovery be completed by the time of the pre-hearing conference,

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<sup>3</sup> By a hearing, DFS means an oral evidentiary hearing. DFS would contemplate that reasonable discovery, starting at the date of the Postal Service's initial filing would always be appropriate, as would a briefing schedule for the filing of briefs in support and in opposition, as well as reply briefs.

<sup>4</sup> Notwithstanding its willingness to be as open as possible, DFS did draw a very sharp line at producing irrelevant and tangential information, particularly when that information was of a confidential nature. See Objection of Discover Financial Services, Inc. to Valpak Interrogatories VP/DFS-T1-1, 3-7, 9, 11-12 dated July 27, 2004 in Docket MC2004-4.

so that participants, as rule 196 states, can address “whether or not it is appropriate to proceed under § 3001.196, and to identify any issues(s) that would indicate the need to schedule a hearing.” Commission Rule 3001.196(c). Not only is this intent plainly embodied in the Commission’s rules, but also it was strongly reemphasized in the Commission’s initial Notice and Order of June 24, 2004 in the DFS proceeding:

A prehearing conference will be held July 15, 2004 at 11:00 a.m. in the Commission’s hearing room. Participants shall be prepared to address whether or not it is appropriate to proceed under rule 196 [39 CFR § 3001.196], on the Postal Service’s proposal for limiting issues, and any issue(s) that justify scheduling a hearing. Rule 196(c) [39 CFR § 3001.196c].

The Commission strongly urges participants intending to object to proceeding under rule 196 [39 CFR § 3001.196] to file supporting written argument in advance of the prehearing conference. It would also greatly assist the Commission if participants file supporting written argument in advance of the prehearing conference in regard to the identification of any issue(s) that would indicate the need to schedule a hearing, and any objection to the Postal Service’s proposal for limiting issues. The Commission intends on deciding upon these issues shortly after the prehearing conference.<sup>5</sup>

Unfortunately, despite the clear language of the rule and the specific call to arms in the Commission’s initial Notice and Order, no party came to the prehearing conference prepared to discuss the specifics of why a hearing was necessary and what facts were in dispute. That was, primarily, because no party had yet started serious discovery, as a look at the relevant dates show. The Postal Service/DFS filing occurred on Monday June 21. The Commission noticed it three days later, on Thursday June 24, and set Thursday July 15 as the date for the prehearing conference, thus giving everyone three full weeks to conduct discovery before the prehearing conference.

Given DFS’s willingness to work with any party, that should have been sufficient time to establish whether any facts were in dispute and identify what they would be. However, the first set of Interrogatories from VALPAK did not appear until several days

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<sup>5</sup> Notice and Order on Filing of Request Seeking Recommendation of Functionally Equivalent Negotiated Service Agreement, issued June 24, 2004 at 8.

*after* the prehearing conference was set, and more than three-quarters of the OCAs interrogatories were served after the prehearing conference date. Thus, just about a month went by between the time of filing and the time that the OCA and VALPAK truly started the process of developing the facts. Had that process started immediately after the NSA was filed, as contemplated by the Commission's rules and as called for by the Commission in its initial Notice and Order, all parties could have been prepared to discuss a hearing at the prehearing conference, and the Commission easily could have met its sixty day window, even with preliminary questions being raised of whether there should be a hearing.

DFS wishes to make it perfectly clear that in pointing out this time sequence and in making these statements, it does not wish to criticize the OCA's or VALPAK's actions. DFS believes that both acted reasonably, under the circumstances. This is, after all, a new paradigm and a new procedure with a new set of rules.

DFS simply wishes to point out that if all interested parties start discovery on the next functionally equivalent NSA immediately after it is filed,<sup>6</sup> then the Commission's rules provide for a more-than-satisfactory time frame for identifying the issues and for determining whether sufficient questions of fact exist that would justify a hearing.

In terms of the Bank One case, DFS realizes that there were a series of facts in the Bank One case that seriously complicated matters—notably the merger with J.P. Morgan Chase—and resulted in that docket being extended. The bottom line was that that Docket was extended because Bank One made a decision to go along with an extension, and to negotiate with other parties. The Commission was more than

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<sup>6</sup> Since a request for approval of another functionally equivalent NSA has just been filed, one would hope that anyone interested in intervening would start its Discovery on that request immediately.

reasonable in to accede to Bank One's wishes. Those developments are not a reason to change the rules.

Finally, the Commission in its advanced Notice stated that "The rules for functionally equivalent Negotiated Service Agreements should provide adequate expedition without the need to file Stipulations and Agreements. Stipulations and Agreements should not be used as a procedural mechanism to expeditiously conclude a docket." Notice at 4. DFS agrees with that statement and, going somewhat beyond that, believes that the settlement process, while important to the conduct of rate cases, appears less helpful in the context of NSA proceedings.

## DISCOVERY

In terms of discovery, there were movements during the case when, from DFS' perspective, intervenors started to pursue extremely broad, wide-ranging lines of questions that went not to the NSA at hand. The Interrogatories probed DFS' general mailing and marketing practices and how DFS values mail. They also addressed the degree to which the Postal Service had considered niche classifications, and otherwise was developing its operations. While such questions might be of academic interests to outside experts, they were irrelevant to the matter at hand, which was whether this NSA should be approved.

DFS strongly objected to such lines of inquiry, and the parties propounding the interrogatories wisely let the matters drop. The Commission should make clear that, in the interests of expedition and keeping transactions costs down, it will take a "tougher"

stance towards questions of relevancy in NSA proceedings than it does in rate cases, and it will simply not allow interrogatories not directly related to the specific NSA at hand. Each NSA should be judged on its own merits, in the context of the baseline NSA, and with the need to maintain competitive equality between competitors foremost in the Commission's mind. Litigation costs are simply too high at this time for smaller companies to participate, and the Commission should consciously try to minimize them.

## CAPS

In negotiating its NSA, DFS realized that it would not be unreasonable for the Commission to insist that any NSA that was functionally equivalent to that of Capital One should have a cap, and thus it negotiated a cap. That proved to be a wise decision, as the Commission has since held that the Capital One NSA needed a cap to be considered an NSA that is functionally equivalent to Capital One. That is not an unreasonable position, particularly in light of the fact that NSAs are so new. However, the Commission should think long and hard about imposing caps all the time.

## CONCLUSION

For the reasons stated above, DFS urges the Commission not to amend its rules for considering functionally equivalent NSAs. They worked well.

Respectfully submitted,

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