

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

RATE AND SERVICE CHANGES TO IMPLEMENT
FUNCTIONALLY EQUIVALENT NEGOTIATED
SERVICE AGREEMENT WITH HSBC NORTH
AMERICA HOLDINGS INC.

Docket No. MC2005-2

INITIAL BRIEF OF THE
UNITED STATES POSTAL SERVICE

UNITED STATES POSTAL SERVICE

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TABLE OF CONTENTS

	<i>Page</i>
I. Procedural History	1
II. The Commission Should Recommend the DMCS and Rate Schedule Language Implementing the NSA Between the Postal Service and HSBC.....	4
A. The HSBC NSA Is Functionally Equivalent to the Capital One NSA.	4
B. The HSBC NSA Will Have a Positive Economic Effect on the Postal Service and Will Benefit Other Mailers As Well.....	7
C. The Proposed NSA Presents No Concerns of Fairness or Equity Relative to HSBC’s Competitors.....	8
III. Conclusion	10

In accordance with Presiding Officer's Ruling No. MC2005-2/1 (March 29, 2005), the United States Postal Service hereby submits its brief in support of its request for a recommended decision in the instant docket.

I. Procedural History

On February 23, 2005, the United States Postal Service filed with the Postal Rate Commission ("Commission") the Request of the United States Postal Service for a Recommended Decision on Classifications, Rates and Fees To Implement Functionally Equivalent Negotiated Service Agreement With HSBC North America Holdings Inc. ("Request"). The Request was filed in accordance with 39 U.S.C. §§ 3622 and 3623.

The Postal Service requested that the Commission issue a recommended decision to the Governors of the Postal Service regarding proposed new language in the Domestic Mail Classification ("DMCS") and Rate Schedule to implement the terms of a Negotiated Service Agreement ("NSA") that the Postal Service signed with HSBC North America Holdings Inc. ("HSBC"). The Postal Service pointed out that this new NSA shared material terms and conditions with the baseline NSA with Capital One Services, Inc. (Capital One), recommended by the Commission in Docket No. MC2002-2.¹ The Postal Service requested the Commission to find the HSBC NSA to be "functionally equivalent" to the "baseline" Capital One NSA under its recently promulgated rules. See PRC Order No. 1391 (February 11, 2004)), and Rule 196, 39 C.F.R. § 3001.196.

¹ Pursuant to Postal Service Board of Governors Resolution No. 03-8, the rates, fees, and classifications recommended by the Commission in Docket No. MC2002-2 were formally implemented on September 5, 2003.

The Postal Service supported its Request with the written direct testimony of witness Jessica Dauer (USPS-T-1) and other documents, submitted pursuant to the Commission's Rules of Practice and Procedure, especially Rules 193 and 196. Also on February 23, 2005, HSBC, as a co-proponent, filed a notice of appearance, along with the written direct testimony of witness John Harvey (HSBC-T-1).

Noting that the rules for consideration of functionally equivalent NSAs provide opportunities for limitation of issues, and comparatively rapid resolution, compatible with participants' sufficient exercise of their due process rights, the Postal Service filed concurrently with its request a Proposal for Limitation of Issues that outlined its expectations regarding the issues presented by its Request. See United States Postal Service Proposal for Limitation of Issues. The Postal Service also conditionally requested establishment of settlement procedures. See Conditional Request of United States Postal Service for Establishment of Settlement Procedures. In that Conditional Request, the Postal Service noted there was a distinct possibility that no party would identify any need for hearings, as the agreement was likely to be found functionally equivalent to the Capital One NSA, and was similar to the two other agreements already litigated using the Capital One NSA as the baseline.

By Order No. 1431, issued on February 28, 2005, the Commission noticed the Postal Service's Request and designated the instant proceeding as Docket No. MC2005-2. The Commission gave interested parties until March 16, 2005, to intervene in the proceeding, requesting that notices of intervention indicate whether the participant was seeking a hearing. The Commission designated Shelley S. Dreifuss, the Director of its Office of the Consumer Advocate ("OCA"), to represent the general public. The

Order also named Postal Service counsel as settlement coordinator, and set March 24, 2005 as a date for the first settlement conference, if such a conference were to prove necessary. March 24, 2005 was the date set for the prehearing conference as well.

Five parties have participated in this proceeding as intervenors -- American Postal Workers Union, AFL-CIO ("APWU"), Discover Financial Services, David B. Popkin ("Popkin"), and Valpak Dealers' Association, Inc. ("VPDA") and Valpak Direct Marketing Systems, Inc. ("VPDMS") (collectively "Valpak").

At the prehearing conference conducted on March 24, 2005, pursuant to Rule 196(c), no party requested hearings. Since no party requested hearings, there was no need to engage in settlement discussions, or pursue any Stipulation and Agreement.

On March 29, 2005, the Presiding Officer issued Ruling No. MC2005-2/1, determining that this case would proceed under Rule 196 for functionally equivalent NSAs. The same Ruling addressed the proposal for limitation of issues, and found that the issues to be addressed would be limited to those identified in Rule 196(a)(6) as under consideration in any NSA proceeding. Those three issues are the financial impact on the Postal Service, fairness and equity in regard to other users of the mail, and fairness and equity with regard to competitors of the NSA partner.

The OCA, APWU, and Valpak requested discovery from one or both co-proponents. In addition, both co-proponents responded to Presiding Officer's Information Requests. As required by Presiding Officer's Ruling No. MC2005-2/1 (March 29, 2005), participants have designated direct testimonies and written cross-examination, which have been supported by appropriate declarations for inclusion in the

evidentiary record. That Order also set today as the deadline for filing initial briefs, with April 27 as the date designated for reply briefs.

The Postal Service appreciates the efficient manner in which this docket has been handled. In order for Negotiated Service Agreements to reach their full potential as innovative mechanisms for postal ratemaking to meet the needs of individual diverse mailers, functionally equivalent cases need to be handled expeditiously. The cost of litigation is a major upfront expense for any mailer signing an NSA with the Postal Service, especially a smaller mailer. The precedents set in this docket will be taken into consideration by mailers who seek to negotiate NSAs with the Postal Service in the future.

II. The Commission Should Recommend the DMCS and Rate Schedule Language Implementing The NSA Between the Postal Service and HSBC.

For all of the reasons set forth in the testimony and discovery responses of witnesses Dauer and Harvey, as well as those set forth below in this brief, the Postal Service submits that the Commission should recommend the DMCS and rate schedule provisions proposed by the Postal Service and HSBC in this proceeding.

A. The HSBC NSA Is Functionally Equivalent to the Capital One NSA.

As explained in the testimony of witness Dauer at pages 6-8, the HSBC NSA is based on the same two key substantive functional elements that are central to the Capital One NSA -- an address correction element and a declining block element. As to the first element, like in the previous three NSA cases, the Postal Service would provide to HSBC, at certain levels of volume, electronic address corrections without fee for solicitations sent by First-Class Mail that are undeliverable-as-addressed and cannot be

forwarded under existing regulations. In return, HSBC would agree to forgo requiring the Postal Service to return such undeliverable mail, a service otherwise included within the existing service features of First-Class Mail. As to the second element, HSBC would be eligible for per-piece discounts on those portions of its First-Class Mail solicitation volume that exceed specified volume thresholds. Considering these discounts, and the testimony of witness Harvey (HSBC-T-1) regarding the volume response of HSBC to the proposed discount structure, the Postal Service expects HSBC's use of First-Class Mail to increase, resulting in additional net contribution to the Postal Service. In all, the NSA is expected to result in 56 million new pieces of First-Class Mail. HSBC-T-1 at 8.

The HSBC NSA incorporates other terms and conditions found in the Capital One NSA. The agreement waives the seal against postal inspection of mail; requires HSBC to prepare mail under applicable standards and to enhance its address management practices; includes a transaction penalty; and contains a provision for HSBC to make necessary records and data available to the Postal Service to facilitate and monitor compliance. It also 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 NSA, or to use the NSA. See Request, Attachment F.

The Request's Compliance Statement (Attachment E) contains a part-by-part analysis of differences between the functionally equivalent HSBC NSA and the baseline Capital One NSA. These differences do not, in any way, detract from the functional equivalency of the two NSAs. To the contrary, the Commission and the Postal Service

anticipated that there would be differences between baseline and functionally equivalent agreements, even if they shared the same terms and conditions. Functionally equivalent agreements would likely include provisions that recognize the unique mailing characteristics of each company, because of the differences in how individual companies conduct business, solicit customers, and make business decisions. See PRC Op., MC2002-2, at 31-40, 136-42. See *also* DMCS § 610.12; DMM G911.

To be comparable to the Capital One NSA, an agreement need not contain identical terms, such as the level of First-Class Mail volume. PRC Op., MC2002-2, at 141. A review of Attachment E to the request reveals that while there are differences in wording between the HSBC NSA and the Capital One NSA, the differences fall well within the parameters of DMM G911. HSBC is a direct competitor in the same industry as Capital One, Discover, and Bank One.

Two types of customer-specific terms and conditions, not found in the Capital One NSA, merit special mention. One is a series of provisions relating to the volume thresholds, and the other is a negotiated cap. These proposals are discussed in the testimony of witness Dauer at pages 8-14. As explained below, neither alters the functionally equivalent status of the HSBC NSA.

A series of elements of the proposal relate to the volume thresholds. First, in order to satisfy both the needs of the Postal Service and HSBC's circumstances, separate volume thresholds were negotiated for each year of the agreement. USPS-T-1 at 9. Second, in order to avoid distorting the incentives for new First-Class Mail volumes, the negotiated thresholds for the second and third years of the agreement can be adjusted based on the relationship between forecast and actual volumes in previous

years. These adjustments can be either upward or downward. *Id.* at 9-12. Lastly, the proposed DMCS language includes an implementation date adjustment mechanism, which would operate to adjust the thresholds based on the proportion of the year 2005 which passes before the agreement is implemented. *Id.* at 13-14.

The second type of customer-specific term is a negotiated cap. The HSBC NSA stipulates a discount cap of \$9 million over the life of the NSA. This cap is the maximum amount of discounts that the Postal Service will give over the three year agreement. The Postal Service evaluated the negotiated cap and found it acceptable, as explained by witness Dauer. USPS-T-1 at 12-13. Acceptance of the negotiated cap would put HSBC on the same general footing as the three mailers that have NSAs already recommended by the Commission and approved by the Governors. Of course, broader issues regarding such caps are currently pending before the Commission in its reconsideration of the Bank One case. In proposing a negotiated cap with HSBC, the Postal Service is not retreating from the positions it has taken in the Bank One case. Rather, the Postal Service merely recognizes that, regardless of how the broader issues are ultimately resolved, potential uncertainty about the necessity of a cap should not delay HSBC's efforts to obtain the same benefits currently available to similarly situated NSA partners.

B. The HSBC NSA Will Have a Positive Economic Effect on the Postal Service and Will Benefit Other Mailers As Well.

The overall cost, volume, and revenue effects of the proposed HSBC NSA are relatively modest, both in the first year of the agreement, as well as later years. The changes would apply to only one, discretely-positioned mailer. The duration of the rates, fees and classifications would be limited to three years by the terms of the NSA.

The changes would apply to the rates, fees and classifications for Address Correction Service and First-Class Mail. No other mail classes or special services would be affected.

The impacts of this proposal are described fully in the testimony of Postal Service witness Dauer (USPS-T-1) at 14-18, Appendices A and B. The Postal Service estimates it will benefit by \$6.3 million over the life of the NSA -- \$6.6 million in ACS Cost Savings plus \$4.1 million in increased contribution, minus \$4.4 million in discounts. As in some of the previous NSA cases, HSBC has estimated that 100 percent of incremental volume would be converted from Standard Mail. HSBC-T-1 at 9. Witness Dauer testifies why these projections are conservative. USPS-T-1 at 17-18.

To the extent that the NSA generates positive contribution for the Postal Service, other mailers will benefit. Their benefits accrue in a lower total amount of contribution that will need to be recovered, through their rates, in order to allow the Postal Service to achieve breakeven. Other mailers also benefit because the proposed classifications will further the general policies of efficient postal operations and reasonable rates and fees enunciated in the Postal Reorganization Act. See 39 U.S.C. §§ 101(a), 403(a), and 403(b). As explained by witness Dauer, the requested changes also conform to the criteria of 39 U.S.C. §§ 3622(b) and 3623(c). USPS-T-1 at 21-23. Consideration of all of these factors has ensured that recommendation of the proposed NSA would not be unfair or inequitable, relative to other users of the mails.

C. The Proposed NSA Presents No Concerns of Fairness or Equity Relative to HSBC's Competitors

Witness Dauer also estimated that the HSBC NSA will have minimal impact on HSBC's competitors. USPS-T-1 at 18-19. In providing her analysis of the competitive impact, she relied upon the extensive evidence in the Capital One case. In its Opinion

and Recommended Decision in the Capital One case, Docket No. MC2002-2, the Commission determined that the Capital One NSA's effect on competition was a minor concern, particularly since no participant alleged that the Capital One NSA would cause competitive harm. PRC Op., MC2002-2, at 79, 159. The Postal Service considers that the competitive impact of extending the same terms and conditions to HSBC, a competitor of Capital One, should garner a similar level of concern. The converse is not true, however. Failure to permit HSBC, a similarly situated competitor, access to the functionally equivalent NSA could give rise to allegations of unreasonable discrimination contrary to the Postal Reorganization Act. See PRC Order 1391, Docket No. RM2003-5, at 52.

III. Conclusion

WHEREFORE, the Postal Service requests that the Commission submit a recommended decision in accordance with the proposed rate schedules and DMCS provisions (as amended on March 11, 2005) accompanying its Request.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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

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