

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

RATE AND SERVICE CHANGES TO IMPLEMENT
FUNCTIONALLY EQUIVALENT NEGOTIATED
SERVICE AGREEMENT WITH BANK ONE
CORPORATION

Docket No. MC2004-3

UNITED STATES POSTAL SERVICE RESPONSES TO NOTICE OF
INQUIRY NO. 1 REGARDING STATUS OF SETTLEMENT
(October 14, 2005)

In its Order No. 1443, Order Establishing Procedural Framework for Reconsideration, the Commission lauded the Governors for using the statutory mechanism of reconsideration as a means to foster meaningful dialogue between the Postal Service and the Commission. Specifically, the Governors asked the Commission to reconsider the imposition of the stop-loss cap on the discounts available to Bank One under the NSA. If the Commission again recommended the cap, then the Governors requested that the Commission clarify and further explain the evidentiary standard it applied in reaching its decision. They also sought further input on Commission's policies towards risk in NSAs and the role of settlement in uncontested cases. The Commission found that some of the issues raised are not directly within the ambit of reconsideration but it signaled its willingness to consider them. "The Commission agrees that additional dialogue and clarification in these areas can only be beneficial, and it intends to review these issues carefully and provide responses." Order No. 1443 at 2.

Specifically, the Commission interpreted the Governors' Decision as requesting the Commission to provide guidance on NSAs that have a volume discount element even when those NSAs lack a cost-savings element, such as the one in the Bank One case. Describing this issue of "pure" volume discounts new and groundbreaking, the Commission was concerned that addressing this issue in the Bank One case would raise due process concerns. Order No. 1443 at 9. Now that Bank One, through its successor entity JP Morgan Chase & Co., has petitioned to reopen the record in the Bank One case, the Commission has renewed its due process and procedural concerns about addressing "pure" volume discounts in the Bank One docket when the case was not filed as a "pure" volume discount case. See Order No. 1444. The Commission's Notice of Inquiry seeks dialogue from the Postal Service, Bank One/Chase, intervenors and non-intervenors on these concerns, among other issues. Before the Postal Service specifically responds to the NOI, it will address a more fundamental question:

Is a dialogue about "pure" volume discounts necessary in the Bank One reconsideration phase of the case, whether or not the record is reopened?

The Postal Service readily concurs that the issue of "pure" volume discounts has not yet been presented or litigated in the Bank One case, and that by expanding the inquiry to consider this issue, due process and procedural concerns may be implicated. As we understand the term "pure" volume discount, such a case exists where there are no cost savings and the financial impact of the NSA is based upon increase contribution from additional mail

volumes generated by volume discounts. An example of a pure volume discount case would be the Bookspan NSA which is presently before the Commission in Docket No. MC2005-3.

The Bank One NSA is fundamentally different than the Bookspan NSA and “pure” volume discount cases. The Bank One NSA has two components that impact the finances of the Postal Service: volume discounts and an address correction element designed to generate a substantial pool of cost savings.

The Postal Service submits that the Commission should focus only on the narrow issues implicated in the Bank One case. In their Decision,¹ the Governors framed the issues submitted for reconsideration. Specifically, the Governors stated that:

[W]e respectfully request that the Commission meet several narrow objectives. First, we ask the Commission to reconsider, clarify, and elaborate upon a) the evidentiary requirements necessary to support volume discounts in the Bank One case, and b) whether the Commission’s policy for recommending NSAs will be based on the need to eliminate risk entirely, or on some other standard. In light of the reconsideration of these issues, we then request the Commission to reevaluate the record evidence and determine whether the \$11.5 million cap should be imposed or otherwise modified. We also request the Commission to clarify whether, as a policy matter, it disfavors settlements in functionally equivalent NSAs. If so, we ask the Commission to reconsider such a policy. [Footnote omitted.]

Govenors’ Decision at 9.

Limiting the reconsideration to these issues, as opposed to broadening the scope to encompass “pure” volume discounts, avoids possible due process entanglements. These issues are not new, and they have been actively litigated

¹ Decision of the Governors of the United States Postal Service on the Opinion and Recommended Decision of the Postal Rate Commission Approving Negotiated Service Agreement with Bank One Corporation, Docket No. MC2004-3, February 16, 2005 (Governors’ Decision).

in this docket. In the initial notice of this proceeding, the Commission stated that the Postal Service sought approval of an NSA that, among other terms, would entitle Bank One to volume discounts without a cost-savings cap on the available discounts.² (“The agreement does not establish a limit on the maximum cumulative discount available to Bank One.”) Valpak and the Office of Consumer Advocate both raised the issues of the uncertainties associated with the volume discounts and whether the agreement should be capped.³ Ultimately, the Presiding Officer decided that the issue of the cap fell within the ambit of issues that the Commission has stated will always be under consideration in any request predicated on a Negotiated Service Agreement, rule 196(a)(6).⁴ This was also one of the issues addressed in the settlement agreement.⁵ The Postal Service’s desire to pursue settlement was also part of the original notice of this docket.⁶

The Commission’s concerns about “pure” volume discounts appear to be based, in part, on the Governors’ request for Commission guidance on how to develop a record that supports volume discount proposals, particularly in light of the Commission’s broad statements that would seem to bar approval of volume discounts unless risk has been eliminated.⁷ It may also be based upon the Governors’ request that the Commission elaborate on the statements in the Concurring Opinion that the addition of the cap should not be construed as a

² 69 Fed. Reg. 39520, 39521 (June 30, 2004).

³ Presiding Officer’s Ruling on Motion for Limitation of Issues. POR MC2004-3/ 2 (August 13, 2004) at 3-4.

⁴ *Id.* at 6.

⁵ Modified Stipulation and Agreement ¶¶ 7-10.

⁶ 69 Fed. Reg. at 39520.

⁷ See, e.g., Governors’ Decision at 13, 14-15.

precedent for all NSAs, or even all NSAs that are functionally equivalent to the Capital One NSA.⁸

An expansive inquiry into “pure” volume discounts is not needed to address fully the Governors’ concerns. The Governors’ objective that reconsideration result in Commission guidance on volume discounts will be achieved if the Commission 1) re-evaluates the decision to impose a cap, 2) explains the evidentiary standard it applied to the Bank One record evidence, 3) explains the assessment of risk it applied to the Bank One NSA and, 4) if the Commission should decide that a cap on discounts must remain, explains the adequacies and/or deficiencies of the evidence on the record of Bank One and identifies the type of evidence needed to support the volume discounts. This guidance will be valuable, if tailored to the facts in this case, and need not be sweeping enough to cover factual situations not presented herein. It is foreseeable that standards of evidence and risk that the Commission applies to volume discounts will not be static but will mature as experience with NSAs grows. What should be made clear, however, are the standards applied in a given case. As we understand the Governors’ Decision, the lack of clarity in the Bank One Opinion and Concurring Opinion, as well as their disagreement with the result, prompted the Governors to send the case back for reconsideration.

While tackling the issue of “pure” volume discounts in the Bank One docket would be outside the scope of the Governors’ immediate concerns, there are other avenues that might be better suited to provide guidance on this issue. One opportunity would be in the Bookspan case, which is the first docket to

⁸ Governors’ Decision at 9.

consider a “pure” volume discount NSA. Another might be a broader forum such as a rulemaking or conference.

Before turning to our responses to the NOI, the Postal Service would like to provide the following comments on the status of its Memorandum on Reconsideration and the attached declarations as they relate to the Bank One case. The Memorandum’s primary focus was to support the Governors’ request for reconsideration of the Commission’s apparent standard that risk must be eliminated before uncapped volume discounts can be approved in the Bank One case. The Postal Service proposed an alternate standard, and supported it with two general declarations on risk assessment in both the business and regulatory realm.⁹ The Postal Service also provided a detailed declaration of Michael K. Plunkett to explain how the Postal Service evaluated Bank One’s volumes before negotiations, assessed the attendant risks, and took steps to mitigate those risks.

In response to the Memorandum, the Commission issued Order No. 1443 in which it clarified that the Commission does not expect that NSAs will be risk-free, but that it will still address unreasonably significant risks by conditioning its recommendations with an appropriate risk control device. Order No. 1443 at 13. The Commission also decided that the proposed standard should be used as the basis for the proposed rulemaking. *Id.* at 5. In light of that order, as well as the comments herein, the Postal Service will not seek to sponsor as testimony the material in the Matthews and Hadaway Declarations. This is also appropriate because these declarations do not rely on the specific facts of the Bank One

⁹ See United States Postal Service Memorandum On Reconsideration, at 2; Declaration of John P. Matthews; and Declaration of Samuel C. Hadaway, PhD.

NSA. The Postal Service would be willing to sponsor this material, either in the narrower Bank One reconsideration, or in some broader discussion that occurs outside the context of the Bank One case, if requested by the Commission.

By contrast, the Plunkett Declaration consists of a comprehensive explanation of the Postal Service's evaluation of the Bank One volume trends, its assessment of the reliability of the company forecasts, and its analysis of how the risks inherent in those forecasts have been mitigated. The Postal Service supports Chase's petition to reopen the record to include Plunkett's Declaration (as well as the additional volume information) and will file comments accordingly on October 31.

If and when the Commission pursues a broader discussion on pure volume discounts in a more appropriate setting, the Postal Service would not object to the use of proposed standard, as discussed in Order No. 1443. .

The Postal Service provides the following responses to the NOI:

RESPONSE OF THE UNITED STATES POSTAL SERVICE TO
NOTICE OF INQUIRY NO. 1, QUESTION 1

1. Chase proposes to sponsor new Chase, heritage-Chase, and heritage-Bank One volume estimates to be entered into the record. Please fully describe the proposed new volume data to be provided, including applicable time frames, and levels of disaggregation. Does Chase contemplate sponsoring additional testimony, for example testimony to explain the volume data? Because this information will be used to supplement the co-proponents' direct case, rule 192(b) requires the Postal Service to affirm that it has reviewed such testimony (and supplemental volume data) and that such testimony may be relied upon in presentation of the Postal Service's direct case. What is the status of the Postal Service's review?

Response:

The Postal Service has reviewed the volume estimates as they have become available, but it has not finalized its review. In compliance with Rule 192 (b), the Postal Service will present testimony of a witness who will affirm that Chase's additional testimony has been reviewed and explain how it may be relied upon in presentation of the Postal Service's direct case.

RESPONSE OF THE UNITED STATES POSTAL SERVICE TO
NOTICE OF INQUIRY NO. 1, QUESTION 3

3. Chase has indicated that it desires to reopen the record to incorporate various materials that are under the control of the Postal Service. Chase first refers only to the Plunkett declaration, and then it refers to the supplemental material submitted by the Postal Service on May 16, 2005. Does the Postal Service intend to sponsor any of this material as testimony? Does the Postal Service intend on sponsoring any further testimony; for example, an analysis of the new Chase volume data?

Response:

The Postal Service intends to sponsor as testimony the material contained in the Declaration of Michael K. Plunkett. At this time, it does not believe it would be necessary to incorporate as testimony the material contained in the declarations of John P. Matthews and Samuel C. Hadaway. Should the Commission request that such material be provided, the Postal Service would be prepared to submit the material as testimony. The Postal Service is prepared to sponsor testimony in support of the new Chase volume data.

RESPONSE OF THE UNITED STATES POSTAL SERVICE TO
NOTICE OF INQUIRY NO. 1, QUESTION 4

4. Chase is proposing to provide new volume data. At the same time the Commission is being asked to reevaluate the necessity of a stop-loss cap. To reevaluate the necessity for a stop-loss cap in light of new volume data, it is necessary to have current information on any adjustments to the volume thresholds that have been made or that are planned, but yet to be implemented. For this question, "Chase" refers to Chase, heritage-Bank One, and heritage-Chase.

- a. Please provide a copy of all documentation specifying the estimated volume allocation by quarter, as referenced in the Negotiated Service Agreement contract paragraph III.E, provided to the Postal Service by Chase. At what levels by quarter (provide applicable dates) has the Postal Service set volume thresholds in response to this information?
- b. Has the Postal Service made, or does it possess information indicating that it will need to make, an annual threshold adjustment as referenced in the Negotiated Service Agreement contract paragraph III.F. If applicable, please provide the proposed or adjusted threshold levels, the proposed or actual implementation dates, and all supporting volume figures and calculations used to determine the proposed or adjusted threshold levels.
- c. Has Chase notified the Postal Service of a merger, acquisition, or purchase of portfolio triggering the requirements of Negotiated Service Agreement contract paragraph IV.A? If applicable, please provide all Chase notices demonstrating compliance with the requirements of Negotiated Service Agreement contract paragraph IV.A.2. If applicable, please provide the proposed or adjusted threshold levels, the proposed or actual implementation dates, and all supporting volume figures and calculations used to determine the proposed or adjusted threshold levels.
- d. Has Chase notified the Postal Service of a merger or acquisition triggering the requirements of Negotiated Service Agreement contract paragraph IV.B? If applicable, please provide all Chase notices demonstrating compliance with the requirements of Negotiated Service Agreement contract paragraph IV.B.1. If applicable, please provide the proposed or adjusted threshold levels, the proposed or actual implementation dates, the proposed or actual integration dates, and all supporting volume figures and calculations used to determine the proposed or adjusted threshold levels.

RESPONSE OF THE UNITED STATES POSTAL SERVICE TO
NOTICE OF INQUIRY NO. 1, QUESTION 4

- e. Has Chase notified the Postal Service of a loss or sale of a portfolio triggering the requirements of Negotiated Service Agreement contract paragraph IV.C? If applicable, please provide all Chase notices demonstrating compliance with the requirements of Negotiated Service Agreement contract paragraph IV.C.2. Please provide the proposed or adjusted threshold levels, the proposed or actual implementation dates, and all supporting volume figures and calculations used to determine the proposed or adjusted threshold levels, if applicable.

Response:

- a. Bank One/Chase did not specify or request a volume allocation pursuant to Paragraph III E. of the NSA. Therefore, the quarterly threshold allocation is 25% of the annual threshold.
- b. The DMCS provisions pertinent to the volume discounts were implemented on April 1, 2005. Since the Postal Service has only six months of volumes, an assessment of whether the threshold should be adjusted based upon the annual volume of mail pursuant to paragraph III.F of the NSA would be premature. The DMCS provisions pertinent to ACS were implemented on March 1, 2005.
- c. No.
- d. Yes. Bank One provided the information about the Bank One merger with Chase, as required in Paragraph IV B, through Bank One's response to Interrogatory OCA/USPS T1-13. Tr. 2/142-143. Bank One has neither integrated the mail for the two companies nor has it provided notice of the date of integration.

- e. No.

RESPONSE OF THE UNITED STATES POSTAL SERVICE TO
NOTICE OF INQUIRY NO. 1, QUESTION 5

- 5. The Postal Service filed its Memorandum and the attached material with an intent to formulate guidance for Bank One and future Negotiated Service Agreements, i.e., effectively establishing a precedent for review of volume-based Negotiated Service Agreements. The Postal Service has anticipated the need to solicit comments on this material. The Chase position is that the signators of the settlement agreement should be inhibited from commenting on this material if it is accepted into the record.

The participants that have signed the Modified Stipulation and Agreement have agreed: “to the extent that matters presented in the Postal Service/Bank One Request, in any Commission Recommended Decision on that Request, or in any decision of the Governors of the Postal Service in this docket, have not actually been litigated, the resolution of such matters will not be entitled to precedential effect in any other proceeding.” Agreement at para. 14. Because the Commission believes that similarly situated mailers should be allowed an opportunity to participate in Negotiated Service Agreements under similar terms and conditions, whatever recommendations the Commission makes in one case has precedential value in the next case.

- a. How do the participants who signed the settlement agreement view the status of the settlement agreement in light of (1) the Chase petition to reopen the record, (2) the issues outlined above, including the potential for establishing precedent, and (3) paragraphs 9 and 10 of the settlement agreement which specify the record upon which the agreement is based, and the limitations on filing further pleadings or testimony?¹⁰

¹⁰ The undersigned participants agree that the direct testimony and designated written cross-examination of the Postal Service, Bank One, and their witnesses provide substantial evidence supporting and justifying a Recommended Decision recommending the rate and classification changes proposed by the Postal Service and Bank One in this docket, as reflected in the proposed DMCS language and rate schedule attached hereto as Attachments A and B, respectively. On the basis of this record, for this proceeding only, the undersigned participants stipulate and agree that the experimental DMCS and Rate Schedule changes set forth in Attachments A and B to this Stipulation and Agreement comply 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 undersigned parties also agree that the Bank One NSA is functionally equivalent to the NSA in Docket No. MC2002-2 (Capital One NSA). *Id.* at para. 9.

This Stipulation and Agreement is offered in total and final settlement of this proceeding. The undersigned participants agree not to file any further pleadings or testimony with the Commission in this proceeding, except for: (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

RESPONSE OF THE UNITED STATES POSTAL SERVICE TO
NOTICE OF INQUIRY NO. 1, QUESTION 5

- b. How should the Commission balance any due process rights available to the settlement participants to subject new testimony to adversarial testing, and the commitments made by the settlement participants in the settlement agreement?

Response

An overriding concern as expressed in both the NOI and Order No. 1443, is what type of participation by the signatories would be consistent with the settlement, should the record be reopened.¹¹ In this regard, from a practical perspective, the Postal Service believes that there may be factual issues that could benefit from further elucidation in discovery if the record were reopened. Sound policy might favor the signatories' participation in that effort. Consequently, the Postal Service will not object to participation by signatories in discovery on issues raised by additional testimony.

- a. The status of the settlement agreement, as an obstacle to participation beyond discovery, presents a legitimate, albeit highly-complex, issue. It would, however, be premature to attempt to address all ramifications of that issue at this time. The answers will be determined in part by whether the Commission decides to expand this proceeding into a review of "pure" volume discounts, an issue not contemplated or addressed by the Modified Stipulation and Agreement, and whether the Commission reopens the record. If reopened, the additional evidence that

opposition to this Stipulation and Agreement; or (c) pleadings, testimony or comments in support of this Stipulation and Agreement. *Id.* at para. 10.

¹¹ NOI at 4; Order No. 1443 at 13.

is ultimately included in the record could conceivably impact status of the settlement or raise questions about particular types of participation.

Therefore, any determination of the status of the settlement agreement should be tabled until after the relevant facts have been developed, should the record be reopened.

With respect to precedent, the main issue before the Commission on reconsideration is an evidentiary one: whether the record in Bank One supports the requested volume discounts. If it does, then a cap is unnecessary. Similarly situated or functionally equivalent cases will have the same evidentiary issue. Every proponent of a functionally equivalent NSA must prove the financial impact of the NSA on the Postal Service and cannot simply rely on earlier “precedents.” See Rule 196(a)(6). The signatories to the settlement would not be barred from litigating the financial impact of volume discounts in subsequent NSA.

b. If the signatories are permitted to participate in discovery, if the record is reopened, the Commission does need to balance the due process rights of signatories with their obligations under the agreement.

RESPONSE OF THE UNITED STATES POSTAL SERVICE TO
NOTICE OF INQUIRY NO. 1, QUESTION 6

6. The Commission has noted, in PRC Order No. 1443, that adequacy of notice is an extremely important issue especially where a request has been filed under expedited rules for functionally equivalent agreements. The functionally equivalent rules are meant to send a clear signal that no new major issues are present in the request. Reopening the record opens the possibility for consideration of novel issues related to pure volume-based discount Negotiated Service Agreements. Interested persons who have not intervened in this docket potentially may allege that inadequate notice has been provided to alert them to the existence of novel and precedent setting issues. How should the Commission view this potential problem, and what possible steps can the Commission take to alleviate this situation?

Response:

To alleviate the potential due process issues, the Commission should not expand the issues to be considered upon reconsideration to include “pure” volume discounts. Instead, the Postal Service respectfully recommends that Commission narrow its inquiry to the objectives delineated by the Governors:

[W]e respectfully request that the Commission meet several narrow objectives. First, we ask the Commission to reconsider, clarify, and elaborate upon a) the evidentiary requirements necessary to support volume discounts in the Bank One case, and b) whether the Commission’s policy for recommending NSAs will be based on the need to eliminate risk entirely, or on some other standard. In light of the reconsideration of these issues, we then request the Commission to reevaluate the record evidence and determine whether the \$11.5 million cap should be imposed or otherwise modified. We also request the Commission to clarify whether, as a policy matter, it disfavors settlements in functionally equivalent NSAs. If so, we ask the Commission to reconsider such a policy.

Governors Decision at 9.

Reopening the record to consider these issues will not implicate due process since there has been proper notice and these issues have already been actively litigated. See discussion *infra* at 4. The issues, therefore, are not novel.

NOTICE OF INQUIRY NO. 1, QUESTION 7

7. The Bank One Negotiated Service Agreement is based on a declining block rate volume discount element and an address correction cost savings element. The Bank One Negotiated Service Agreement request was filed as an agreement functionally equivalent to the Capital One Negotiated Service Agreement, which also included volume discount and cost savings elements. The Bank One record was developed considering both elements. Reopening the Bank One record potentially will lead to the consideration of issues directly related to Negotiated Service Agreements based solely on pure volume-based discounts. Given this potential, both participants and interested persons who have not intervened in this docket are invited to comment on the use of the Bank One docket to potentially decide issues related to Negotiated Service Agreements based solely on pure volume-based discounts.

Response:

See response to 6.

RESPONSE OF THE UNITED STATES POSTAL SERVICE TO
NOTICE OF INQUIRY NO. 1, QUESTION 8

8. The Commission realizes that until the Postal Service and Chase actually present new data and/or testimony it may not be possible for a participant to evaluate whether it will conduct discovery or file rebuttal testimony. Given this limitation, participants are invited to comment on any plans or considerations for discovery and/or rebuttal testimony.

Response:

We recommend the following if the Commission decides to reopen the record:

- 1) Identify the issues that are to be litigated in this phase of the case
- 2) Issue a procedural schedule that will provide an opportunity for discovery and cross-examination of any testimony filed.

RESPONSE OF THE UNITED STATES POSTAL SERVICE TO
NOTICE OF INQUIRY NO. 1, QUESTION 9

9. The Commission invites comments on possible improvements and/or changes to the procedural framework detailed in PRC Order No. 1443. Comments will be considered that either include the reopening of the record, or base the reconsideration on the existing record.

Many of the issues raised in Order No. 1443 have already been addressed herein or will be addressed when the Postal Service files comments on Chase's petition to reopen the record.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking

Nan K. McKenzie

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-3089; Fax -5402

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.

Nan K. McKenzie

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
October 14, 2005