

ORDER NO. 1450

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

Before Commissioners:

George Omas, Chairman;
Dawn A. Tisdale, Vice Chairman;
Ruth Y. Goldway; and
Tony Hammond

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

Docket No. MC2004-3

ORDER DENYING
PETITION OF J.P. MORGAN CHASE & CO.
TO REOPEN THE RECORD

(Issued January 6, 2006)

TABLE OF CONTENTS

	<i>Page</i>
I. INTRODUCTION AND SUMMARY	1
II. PROCEDURAL HISTORY	4
III. A CHANGED MAILING ENVIRONMENT WEIGHS ON A MEANINGFUL EVALUATION	9
IV. EVALUATION OF EVIDENCE IN LIGHT MOST FAVORABLE TO PROPOSERS	14
V. CHASE AND POSTAL SERVICE ARGUMENTS TO REOPEN THE RECORD.....	20
VI. SOLICITATION OF COMMENTS	39

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

Before Commissioners:

George Omas, Chairman;
Dawn A. Tisdale, Vice Chairman;
Ruth Y. Goldway; and
Tony Hammond

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

Docket No. MC2004-3

ORDER DENYING
PETITION OF J.P. MORGAN CHASE & CO.
TO REOPEN THE RECORD

(Issued January 6, 2006)

I. INTRODUCTION AND SUMMARY

On September 14, 2005, J.P. Morgan Chase & Co. filed Petition of J.P. Morgan Chase & Co. to Reopen Record (Petition).¹ The Petition asks the Commission to reconsider the procedural framework established in PRC Order No. 1443, issued on August 23, 2005, to the extent that it disallows the filing of any supplemental testimony in this case by the proponents of the Bank One Negotiated Service Agreement.

¹ Bank One Corporation, the original party in this case, merged with J.P. Morgan Chase & Co. on July 1, 2004. In this Order, the Commission refers to this post-merger business entity as Chase. The pre-merger business entity Bank One Corporation is referred to as pre-merger-Bank One, and the pre-merger business entity J.P. Morgan Chase & Co. is referred to as pre-merger-Chase. The product lines derived from Bank One Corporation and J.P. Morgan Chase & Co. which are a subject of this Order are referred to as heritage-Bank One and heritage-Chase, respectively. Chase pleadings were filed under the Bank One Corporation (Bank One) name up until September 14, 2005, after which pleadings were filed under the J.P. Morgan Chase name.

Specifically, Chase proposes to supplement the record with historical First-Class Mail volumes by month disaggregated by solicitation letters, solicitation flats, and operational mail through October 2004 for heritage-Chase and heritage-Bank One.² The Postal Service proposes to sponsor as testimony the material contained in the Declaration of Michael K. Plunkett,³ and is prepared to sponsor testimony in support of the proposed Chase volume data.⁴

The Commission has considered the request to reopen the record from different perspectives. It has considered reopening the record given the context of the current mailing environment in which Bank One no longer exists as a business entity. It has considered the proposed evidence itself examining it in a light most favorable to the proponents. It has considered what are essentially due process arguments presented by Chase in its Petition, and by the Postal Service in support of the Petition. Finally, it has evaluated how best to continue the dialogue on how to foster and improve the Negotiated Service Agreement program. From each perspective, the Commission concludes that reopening the record is without merit. Therefore, the Petition of J.P. Morgan Chase & Co. to Reopen Record, filed on September 14, 2005, is denied.

This does not leave Chase and the Postal Service without a remedy. The Negotiated Service Agreement is currently in place, and apparently Chase is profiting from it. The Commission has established rules for seeking modifications to existing Negotiated Service Agreements. See 39 C.F.R. § 3001.198. These rules establish an accelerated procedure to address technical defects, unforeseen circumstances or intervening events. It may well be that an unforeseen circumstance totally unrelated to the impending merger has caused the volume surge reported in the Petition. The Commission then can consider the operating parameters of the agreement under the

² Comments of J.P. Morgan Chase & Co. in Response to Notice of Inquiry No. 1 (Chase Response to NOI No.1), October 14, 2005, at 6.

³ See Revised Declaration of Michael K. Plunkett May 18, 2005.

⁴ United States Postal Service Responses to Notice of Inquiry No. 1 Regarding Status of Settlement (Postal Service Response to NOI No. 1), October 14, 2005, at 9.

actual mailing environment, rather than basing its decision on information about conditions that may no longer apply.

Another option is for Chase to continue mailing under the current agreement until the stop-loss cap value is exhausted. Under this approach, Chase will obtain a direct economic benefit of up to \$11.5 million in postage discounts. At any time Chase and the Postal Service can, if they choose, negotiate a new agreement reflecting the current mailing environment.

II. PROCEDURAL HISTORY

On June 21, 2004, the United States Postal Service filed a formal request with the Postal Rate Commission pursuant to Chapter 36 of the Postal Reorganization Act, 39 U.S.C. § 3601 *et seq.*, seeking a recommended decision approving a mail classification and related rates and fees predicated on a Negotiated Service Agreement with Bank One Corporation.⁵ The Postal Service contended that the proffered Negotiated Service Agreement is functionally equivalent to the Capital One Financial Services, Inc. Negotiated Service Agreement recommended by the Commission⁶ and approved for implementation by the Governors.⁷ Because of this nexus, the Request relied substantially on record evidence entered in Docket No. MC2002-2 (the baseline Capital One docket).

Ten days after filing the Request, Bank One Corporation merged with J.P. Morgan Chase & Co.⁸ The merged Bank One Corporation and J.P. Morgan Chase & Co. corporate entities have adopted the J.P. Morgan Chase & Co. (Chase) name.

⁵ 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).

⁶ Opinion and Recommended Decision, Docket No. MC2002-2, May 15, 2003 (Capital One Opinion).

⁷ 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.

⁸ The Federal Reserve Board approved the merger on June 14, 2004, and the merger was consummated on July 1, 2004.

On September 15, 2004, the Postal Service, Bank One, and OCA asked the Commission to consider a Stipulation and Agreement as the basis of its recommended decision.⁹ Valpak filed comments in opposition to this request.¹⁰

Through successful negotiations, Valpak's concerns were resolved and 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. They asked the Commission to now consider the Modified Stipulation and Agreement as the basis of its recommended decision.¹¹ The salient feature of the Modified Stipulation and Agreement in regard to this Order is a request to not impose a stop-loss cap, or any other constraint different from the constraints set forth in the DMCS language attached to the Modified Stipulation and Agreement.¹²

⁹ 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; Stipulation and Agreement, September 15, 2004. 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. National Newspaper Association, Newspaper Association of America, and David B. Popkin did not sign nor did they oppose the Stipulation and Agreement.

¹⁰ Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Comments on Commission Consideration of Proposed Settlement, September 27, 2004.

¹¹ 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; Modified Stipulation and Agreement, October 5, 2004. 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.

¹² The Modified Stipulation and Agreement contains other significant features such as a "trigger" mechanism tailored to limit the risks associated with uncertainties in forwarding rates, return rates, and ACS success rates, modifications to the originally filed data collection plan, and provisions that effectively conclude active litigation in this case.

On December 17, 2004, the Commission recommended that the Postal Service proceed with a Negotiated Service Agreement with Bank One Corporation.¹³ The Commission found that the agreement suggested by the parties was in most respects consistent with postal policy; however, it determined that it was necessary to add a “stop-loss cap” to the agreement to provide a reasonable measure of protection for mailers not party to the agreement. The Governors accepted the Commission’s recommendation and the agreement became effective April 1, 2005.¹⁴ At the same time, the Governors’ Decision announced the Postal Service would seek reconsideration of the Commission finding that a stop-loss cap was necessary. If the Commission again recommends the application of a stop-loss cap based on the record already compiled, the Governors request clarification and further explanation of the Commission’s Decision in regard to the potential for uncapped Negotiated Service Agreements styled on the Bank One agreement. They also request further Commission explanations on two related topics: the applicable evidentiary standard that must be met to substantiate a volume-based discount provision without the application of a stop-loss cap, and the role of settlement in uncontested cases.

On March 7, 2005, the Postal Service filed a motion resubmitting the case to the Commission for reconsideration, suggesting procedures to guide the reconsideration, and requesting that it be allowed to file a memorandum in support of reconsideration further elaborating on areas of concern to the Governors.¹⁵ On May 16, 2005, the Postal Service filed its memorandum accompanied by a technical appendix and the sworn supporting statements of Michael K. Plunkett, John P. Matthews, and Samuel C. Hadaway, Ph.D.¹⁶

¹³ Opinion and Recommended Decision Approving Negotiated Service Agreement, Docket No. MC2004-3, December 17, 2004 (Decision).

¹⁴ 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).

¹⁵ United States Postal Service Motion for Leave to File Memorandum on Reconsideration and for Proposed Procedures, March 7, 2005.

¹⁶ United States Postal Service Memorandum on Reconsideration, May 16, 2005 (Memorandum). The Memorandum and one of the statements were revised on May 18, 2005.

After review of the Memorandum and supporting materials, the Commission issued Order No. 1443 to establish the procedural framework for resolving all issues.¹⁷ In that Order, the Commission discussed the evidentiary treatment of the Postal Service's Memorandum and associated materials. The Commission found the material to be general in nature and more directed at the broader advisory issues posed by the Governors of uncapped volume-based discounts than at the issues arising from the limited factual record of the Bank One case. The material also has the characteristics of testimony that would have to be entered in the record if it were to be considered. Order No. 1443 also discusses potential due process concerns in light of restrictions imposed on participants signing the Modified Stipulation and Agreement, and on potential intervenors that might not be aware of the broader issues posed by the Governors for reconsideration. To address these issues (and others) the Commission bifurcated consideration of the issues directly related to reconsideration from theoretical issues that are advisory in nature. The reconsideration of the Bank One Opinion is to focus on the decision to recommend a stop-loss cap and will be based on the existing record. The broader issues will be considered in a separate rulemaking proceeding.

On September 14, 2005, Chase filed its Petition to reconsider Order No. 1443 to the extent that it disallows the filing of any supplemental testimony by the Negotiated Service Agreement proponents.

On September 27, 2005, the Commission issued a Notice of Inquiry to solicit information necessary to consider the Petition.¹⁸ A *Federal Register* notice also was issued allowing persons who had not intervened in Docket No. MC2004-3 to comment on issues that might affect their interests.¹⁹

¹⁷ Order Establishing Procedural Framework for Reconsideration, August 23, 2005 (PRC Order No. 1443).

¹⁸ Notice of Inquiry No. 1 Regarding Status of Settlement Agreement, September 27, 2005 (NOI No. 1).

¹⁹ 70 Fed. Reg. 57630 (2005). Notice to Participants and Other Interested Persons of Petition to Reopen Record, September 27, 2005.

Comments in response to NOI No. 1 were received from Association for Postal Commerce, Direct Marketing Association, Inc., J.P. Morgan Chase & Co., Office of the Consumer Advocate, United States Postal Service, and Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc.²⁰ Reply comments were received from American Bankers Association, Discover Financial Services LLC, J.P. Morgan Chase & Co., National Postal Policy Council, Newspaper Association of America, and the United States Postal Service.²¹

American Bankers Association, National Postal Policy Council, and the Postal Service also filed pleadings supporting the Petition to reopen the record.²²

²⁰ Response of Association for Postal Commerce to Notice of Inquiry No. 1 Regarding Status of Settlement Agreement, October 14, 2005; Office of the Consumer Advocate Response to Notice of Inquiry No. 1, October 14, 2005; Comments of J.P. Morgan Chase & Co. in Response to Notice of Inquiry No. 1, October 14, 2005; United States Postal Service Responses to Notice of Inquiry No. 1 Regarding Status of Settlement, October 14, 2005; Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Comments in Response to Notice of Inquiry No. 1 Regarding Status of Settlement Agreement, October 14, 2005; Comments of the Direct Marketing Association, Inc., in Response to Notice of Inquiry No. 1, October 17, 2005.

²¹ Reply Comments of American Bankers Association in Response to Notice of Inquiry No. 1, October 24, 2005; Reply Comments Of Discover Financial Services LLC (DFS) in Response to Notice of Inquiry No. 1 Regarding Status of Settlement Agreement, October 24, 2005; Reply Comments of J.P. Morgan Chase & Co. in Response to Notice of Inquiry No. 1, October 24, 2005; Reply Comments of National Postal Policy Council, October 26, 2005; Reply Comments of the Newspaper Association of America, October 20, 2005; United States Postal Service Reply to Comments on Notice of Inquiry No. 1, October 24, 2005. National Postal Policy Council also filed Motion of National Postal Policy Council for Leave to File Comments Two Days Out of Time, October 26, 2005. This motion is granted.

²² Reply of American Bankers Association to Petition of J.P. Morgan Chase & Co. to Reopen Record, October 14, 2005; Reply of National Postal Policy Council to Petition of J.P. Morgan Chase & Co. to Reopen Record, October 26, 2005; United States Postal Service Memorandum in Support of Reopening the Record, October 31, 2005.

III. A CHANGED MAILING ENVIRONMENT WEIGHS ON A MEANINGFUL EVALUATION

Approximately 12 months have elapsed since the Commission issued its Opinion and Recommended Decision Approving Negotiated Service Agreement (Decision) with Bank One. Nine months have elapsed since the Negotiated Service Agreement became operational. The effects of the passage of time challenge the basic premises upon which the Commission founded its Decision. Reopening the record to entertain limited evidence that pertains to conditions that may no longer exist necessarily would have to ignore the realities of the current mailing environment.

Bank One Corporation and J.P. Morgan Chase and Co. merged on July 1, 2004. Bank One Corporation no longer exists as a distinct entity. Chase has announced that the pre-merger-Bank One and the pre-merger-Chase consumer and commercial banking businesses, which include their credit card businesses, will operate under the Chase brand after completion of the merger.²³ Every indication is that the heritage-Bank One credit card portfolio has converted to the Chase brand.

A basic premise of both the Postal Service Request and the Commission Decision is that the heritage-Bank One credit card portfolio will be held separate from the heritage-Chase credit card portfolio until operation of the mergers and acquisitions provisions of the contract. At the time the decision was issued, the Postal Service had not been formally notified of the merger nor had a date for integration of the portfolios been established under the terms of the contract. The Commission recognized the merger and future integration as a complicating factor potentially leading to more uncertainty, but believed it reasonable to rely on the more certain Bank One data to analyze the financial aspects of the agreement.

Holding the credit card portfolios separate is consistent with the Postal Service assertion that the discount element of the agreement will be used "to encourage

²³ J.P. Morgan Chase Press Release dated June 8, 2004.

increased First-Class Mail volume” from Bank One.²⁴ Post-merger-Chase must retain the ability to distinguish heritage-Bank One portfolio mail from post-merger-Chase portfolio mail, while simultaneously recognizing the express intent for both credit card portfolios to share the Chase brand. This is necessary to assure that the Negotiated Service Agreement acts as an incentive to encourage increased First-Class Mail volume from the Bank One product, and not as an incentive to shift mail volume from the pre-merger Chase product that would have been mailed anyway in order to receive mailing discounts.

The Postal Service explained to the Commission that the Negotiated Service Agreement contract contains an expanded mergers and acquisitions provision partly in anticipation of the Bank One Corporation and J.P. Morgan Chase and Co. merger.²⁵ The expanded provision treats a merger or acquisition of a smaller entity differently than a merger or acquisition of a larger entity. A merger or acquisition with a smaller entity would result in adjustment of the volume thresholds as of the date of the merger or acquisition. The Postal Service explains that mergers or acquisitions of larger entities likely require longer lead times, thus the more appropriate basis for computing adjusted thresholds is the period before integration rather than the period before merger. The presentation of this philosophy reinforced the Commission’s premise that the heritage credit card portfolios would be held separate until a formal integration under the terms of the contract occurred.

The concerns in regard to holding the heritage-Bank One portfolio separate are significantly reduced, if not eliminated, once the heritage-Bank One and the heritage-Chase credit card portfolios are integrated under the terms of the contract. However, at this time, the Postal Service asserts that “Bank One has neither integrated the mail for the two companies nor has it provided notice of the date of integration.”²⁶

The merger of Bank One Corporation and J.P. Morgan Chase and Co. was agreed to before this Request was filed with the Commission, and was consummated on July 1,

²⁴ Request at 4.

²⁵ Tr. 2/141-43.

²⁶ Postal Service Response to NOI No. 1 at 11.

2004, one-and-one-half years ago. The Negotiated Service Agreement contract requires Bank One to provide notice and certain information to the Postal Service in regard to this merger. “Service of all notices under this Agreement shall be in writing and sent by either U.S. Certified Mail, return receipt requested, postage paid, addressed to the Party to be served notice, or by nationally recognized overnight mail service, at the following addresses.” Request, Attachment F at 14-15. The Postal Service asserts that “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.” Postal Service Response to NOI No. 1 at 11.

The protective mechanisms, including the volume adjustment mechanisms, are central to protecting both the interests of the Postal Service and mailers not party to the agreement, and are basic premises upon which the Commission founded its Decision. Failure to apply these mechanisms has the potential of allowing serious revenue protection issues to develop. Given the current mailing environment, where an actual merger has occurred without integration of the mails, and the necessity to hold separate the heritage-Bank One credit card portfolio, it is imperative that the Postal Service has the information necessary to allow operation of the protective mechanisms and assure itself that the contract is being appropriately employed. Adhering to the “letter” of the notice provision requirements of the contract can only facilitate this end.

An important protective mechanism, the “Annual Threshold Adjustment,” relies on information presented in the Bank One Corporation annual report. The Postal Service included this provision to preserve the incentives to increase First-Class Mail marketing volumes. Tr. 2/191. Bank One Corporation no longer exists as a business entity, and thus, no longer produces an annual report.²⁷ The interpretation of this important contract

²⁷ Although significant within itself, this provision raises many other issues as to the interpretation of the contract in relation to the pre-merger Bank One entity, and the post-merger Chase entity. The Commission is uncertain whether the current interpretations are consistent with the premises that the Commission accepted when considering the initial request for the Bank One Negotiated Service Agreement.

provision is now in question. This requirement, which is a basic premise upon which the Commission founded its Decision, may no longer operate as intended.

Chase asserts that “[a]t current and projected volume trends, Chase could exhaust the aggregate volume cap imposed by the Commission as early as May 2006—barely a year into the three-year scheduled life of the NSA.”²⁸ The volume projections presented by Bank One and upon which the Commission founded its Decision indicate that the stop-loss cap limit should not be reached over the duration of the agreement. The volume explosion required to reach the stop-loss cap in this time frame vastly exceeds any year-one volume estimates presented to the Commission. This event, if accurately depicted, represents a significant change from the volume projections presented to the Commission during its consideration of the agreement.

Witness Rappaport projected that in the first year of the Negotiated Service Agreement, Bank One’s First-Class volume would increase as a result of the discount from 571 to 590 million pieces, an increase of 19 million pieces. Tr. 2/117. In order to reach the stop-loss cap in the first year of the Negotiated Service Agreement, First-Class volume would have to increase to more than 805 million pieces.²⁹ Plunkett characterized the 19 million piece increase forecast as “conservative”, Tr. 2/196, but even allowing for that, a 234 million piece volume surge is more than an order of magnitude greater than the Rappaport forecast. The Commission has no information to determine what portion of this surge is due to the merger, other extraneous market factors, or reaction to the

²⁸ Petition at 22-23 (footnote omitted).

²⁹

First 535 million pieces	0 discount		
Next 25	2.5¢/piece	=	\$ 625,000
Next 25	3.0¢/piece	=	\$ 750,000
Next 25	3.5¢/piece	=	\$ 875,000
Next 35	4.0¢/piece	=	\$ 1,400,000
Next 35	4.5¢/piece	=	\$ 1,575,000
Next 125.66	5.0¢/piece	=	\$ 6,283,000
805,660,000 pieces	receives		\$11,508,000 in discounts

discount. However, it is evident that for whatever reasons, Rappaport did not accurately forecast year-one volume.

The Commission recommended approval of a Negotiated Service Agreement with Bank One based on the evidentiary record in a public proceeding and that Negotiated Service Agreement is now in effect. The parties may have failed to explore adequately the short-term ramifications of the pending merger. However, reopening the record for the limited purpose expressed in the Petition can not answer the questions that have arisen through the passage of time, especially where limited knowledge of the actual results of the agreement appear to conflict with the expectations presented to the Commission when it was considering the initial request.

IV. EVALUATION OF EVIDENCE IN LIGHT MOST FAVORABLE TO PROPONENTS

Chase proposes to supplement the record with historical First-Class Mail volumes by month disaggregated by solicitation letters, solicitation flats, and operational mail through October 2004 for the heritage-J.P. Morgan Chase & Co. and Bank One Corporation entities. The Postal Service proposes to sponsor as testimony the material contained in the Declaration of Michael K. Plunkett, and is prepared to sponsor testimony in support of the new Chase volume data.

The Commission will consider the proposed new testimony in a light most favorable to the proponents, both from the perspective of October 2004, the date the record closed, and from the perspective of the current mailing environment. While portions of the testimony potentially could have had merit when the Commission was initially considering the agreement, its merit is considerably diminished in the current mailing environment.

Proposed heritage-Chase testimony. The record as it stands today includes testimony on heritage-Chase historical First-Class Mail volumes disaggregated by solicitation letters, solicitation flats, and operational mail by month from January 2002 through June 2004. Tr. 2/152. Chase is proposing to provide four additional months of historical heritage-Chase data.

The Commission assumes that Chase intends this new information to support the accuracy of the before-rates volume estimates for heritage-Chase previously provided by Bank One. Under some circumstances, the accuracy of the before-rates volume estimates would be an important factor in the Commission's evaluation and ultimate recommendation of a stop-loss cap.³⁰

However, in this case, the Bank One witness repeatedly disavowed his projections of heritage-Chase volumes and the Commission did not rely on heritage-Chase data in

³⁰ Accurate estimates of heritage-Chase volumes, if demonstrated, would weigh on Chase's contention that the Commission did not give adequate weight to the divergent heritage-Chase before- and after-rate projections, and thus did not properly consider the risk that the application of a stop-loss cap could have of inhibiting First-Class Mail volume growth.

analyzing the financial impact of the agreement. Because the volume thresholds that control the financial impact of the Negotiated Service Agreement were expected to be adjusted based on actual volumes once integration took place, the Commission did not rest its decision on heritage-Chase volume projections. The Commission did recognize the merger as an important additional factor increasing the uncertainty surrounding the agreement. An additional four months of historical heritage-Chase data might have been interesting and might have reduced some uncertainty surrounding the agreement. However, it would not have affected the financial analysis of the agreement, or the Commission's final recommendation.

Proposed heritage-Bank One testimony. The record as it stands today includes testimony on heritage-Bank One historical First-Class Mail volumes disaggregated by solicitation letters, solicitation flats, and operational mail by accounting period from December 4, 1999 through September 30, 2003 and by month from October 2003 through November 2003. Tr. 2/127. Chase is proposing to provide 11 additional months of historical heritage-Bank One data.

In contrast to the proposed heritage-Chase data, an additional 11 months of historical heritage-Bank One data potentially could have been highly probative in support of heritage-Bank One's before-rates volume forecasts. Considered in isolation, this new information could lend credibility to pre-merger-Bank One's ability to forecast its volumes accurately, assuming that no other exogenous factors significantly affected the projections. Chase could argue that this ability to provide accurate forecasts diminishes a significant Commission justification for recommending a stop-loss cap.

However, the changed circumstances since October 2004 presented by the current mailing environment complicate the consideration of the new information in isolation. A key factor in the decision to impose a stop-loss cap was concern about the reliability of the forecasts of First-Class Mail volume growth. Bank One's before- and after-rates volume forecasts indicated that new volumes would not trigger the stop-loss cap in three years. But Chase now asserts that it may trigger the stop-loss cap by May 2006, that is, within 13 months. Petition at 6. For this to occur, there must be a

significant discrepancy between Bank One's after-rates volume forecast and the actual mail volumes. Thus, providing additional heritage-Bank One data to support volume estimates that are now known to be of questionable reliability has little practical value.

The Commission can not ignore the actual unreliability of Bank One's forecasts and attempt to evaluate them anew using additional before-the-fact information. The Commission relied on both the before-rate and after-rate volume projections provided by Bank One. It now appears that the year one after-rate projection was low. But the evidence Chase offers will not clarify whether the discrepancy reflects a misestimation of Bank One price elasticity, a misunderstanding of how the merger would impact mailing patterns, or some other exogenous factor that would have caused a similar spike in before-rate volume.

Proposed Michael K. Plunkett testimony. The Commission encourages the Postal Service's Negotiated Service Agreement partners to participate and fully support requests before the Commission. The partners add context to the request which allows the Commission to make more informed decisions. The actual and projected volume information presented by Bank One is an appropriate starting point in the Commission's analysis. However, it is well recognized that potential Negotiated Service Agreement partners will face a strong temptation to provide estimates that tend to support generous agreements. See MC2002-2 Tr. 8/1651, PRC Op. MC2002-2, ¶ 5094. Therefore, the Commission's focus quickly shifts to the methodologies employed by the Postal Service to assure itself that the information provided by its partner is sufficiently reliable to support an agreement.

Mr. Plunkett's declaration discusses how the Postal Service negotiated declining block rate discounts and thresholds, evaluated Bank One's before- and after-rates volume forecasts, included contract terms to minimize the risks of declining block rates, and evaluated the risks and rewards associated with the Bank One Negotiated Service Agreement.

The Commission previously commented favorably on Mr. Plunkett's declaration.

Mr. Plunkett's declaration is notable. It indicates real progress in the Postal Service's procedures to ascertain the mailing characteristics of its Negotiated Service Agreement partners. There appears to be a significant improvement over the level of analysis presented in the Capital One docket, the case considering the first proposed Negotiated Service Agreement. In the Capital One case, Mr. Plunkett was asked if the Postal Service independently estimated Capital One's volume estimates. He began his response by stating: 'The Postal Service did not develop a parallel estimate of Capital One's mail volume using distinct data sources or methodologies.' Docket No. MC2002-2, Tr. 4/762, 765-6. This introductory statement cemented the Commission's belief that more needed to be done.

PRC Order No. 1443 (August 23, 2005) at 7.

Presentation of an analysis based on Mr. Plunkett's review procedures outlined in his declaration potentially could improve the confidence level of partner supplied estimates, and could facilitate the Commission's future consideration of Negotiated Service Agreements.

Ibid.

The steps outlined in Mr. Plunkett's declaration form an important part of the analysis that the Postal Service must undertake to assure itself of the benefits of entering into an agreement. The Commission can have more confidence in partner-supplied information when the Postal Service demonstrates due diligence in evaluating that information. Due diligence can be demonstrated by having a plan to evaluate the parameters of a Negotiated Service Agreement, by the execution of that plan (specifically the thoroughness of the evaluation), and by whether or not the evaluation supports the conclusion that the Postal Service should proceed with the agreement.³¹ Mr. Plunkett's declaration is the first step in demonstrating due diligence by presenting a plan that appears sufficient for evaluating the Bank One Negotiated Service Agreement.

The Commission noted the general nature of Mr. Plunkett's declaration in Order No. 1443. "Mr. Plunkett's declaration does not provide the Commission with any means of evaluating this thoroughness in the case of Bank One." *Ibid.* (footnote omitted).

³¹ The plan should be tailored to the specifics of the proposed agreement.

Furthermore, in describing what analysis the Postal Service had undertaken to estimate the reasonableness of the mailer-supplied forecasts in the Bank One case, witness Plunkett asserts that the Postal Service did not develop a parallel estimate of Bank One's mail volume using distinct data sources or methodologies. Tr. 2/424. Thus, the Commission has little information to evaluate the Postal Service's execution of its plan, including the thoroughness of the evaluation. The declaration does not reveal any quantitative analysis that might indicate whether or not the evaluation supports the conclusion that the Postal Service should proceed with the agreement. In this respect, Mr. Plunkett's declaration falls short of demonstrating due diligence.

If the declaration was presented prior to October 2004, while the record was open, it could have provided a starting point for evaluating the steps that the Postal Service had taken to analyze the agreement. Participants or the Commission could have posed questions to learn whether adequate supporting quantitative analysis demonstrated due diligence. Today, additional information would have to be developed on the record before Mr. Plunkett's declaration could be of significant value.³²

The mailing environment surrounding the Negotiated Service Agreement has changed since October 2004. The effects of the merger, including the rebranding to the Chase name, changes of the post-merger-Chase management and marketing philosophy, the requirement to hold the heritage-Bank One portfolio separate, and the operations of the threshold volume adjustment mechanisms in the contract are now all relevant if the record were to be reopened. There is no indication that the verification of the volume estimates described in Mr. Plunkett's declaration considers the effect of the merger or the rebranding to the Chase name. The Commission assumes that Mr. Plunkett's declaration is being offered as independent analysis to support the volume estimates provided by Bank One. As with the proposed Chase testimony in regard to before-rates volumes, Mr. Plunkett's declaration could support the volume estimates

³² There has been no showing to demonstrate that Mr. Plunkett could not have provided the substance of his declaration and related testimony while the record was open.

presented on the record, but these estimates may no longer have relevance to the current mailing environment.

The original volumes estimates were that the stop-loss cap limit would not be reached during the three years of the agreement. Chase now asserts that the stop-loss cap limit may be reached by May 2006. The limited information proposed by Chase and the Postal Service does not shed light on what is occurring. A Commission decision based only on the record supplemented by addition of the proposed limited information would have to ignore significant changes in the current mailing environment that challenge the premises upon which the Commission originally based its decision. Reopening the record to consider only information intended to support projections known to be inaccurate will not help the Commission to fulfill its statutory responsibility to make informed recommendations.

V. CHASE AND POSTAL SERVICE ARGUMENTS TO REOPEN THE RECORD

Chase presents several arguments in support of reopening the record. Many arguments imply a denial of due process. The Postal Service, in support of the Chase Petition, presents an additional argument in regard to what the Postal Service could have provided to support the agreement while the record was open. Discussion of the Chase and Postal Service arguments appear below.

New standard applied to Bank One without notice. Chase alleges that the Commission has changed the standard used to evaluate the Bank One Negotiated Service Agreement from what was used to evaluate the Capital One Negotiated Service Agreement without providing Chase with advance notice of the change in standard. This allegation, if accurate, could indicate a serious lapse in due process.

The theme of this allegation carries through much of Chase's Petition. Chase argues that the record should be reopened to allow Chase to address this new standard. Chase recognizes, and the Commission agrees, that its argument presents a different question than the question of reconsidering which standard is in fact the appropriate standard. Petition at 18. Chase asserts that "[d]ue process entitles the NSA proponents to notice of the Commission's current standards for approval of uncapped discounts, and an opportunity to submit evidence responsive to the standards, before the Commission can lawfully decide whether the evidence submitted by the NSA proponents has satisfied the standards." Petition at 5 (emphasis omitted, footnote omitted).

Chase characterizes the alleged change in standard as follows:

Abandoning its previous willingness to balance the potential downside of uncapped discounts against the potential downside of a cap, the Commission held that the evidence of the massive potential losses to the USPS from a cost-savings cap on Bank One's discounts was irrelevant as a matter of law.

Id. at 15-16 (footnote omitted).

The differences began with the basic conceptual framework: rather than balancing the financial risk of uncapped discounts against the financial risk of a cap, the Commission held that the latter was irrelevant, and that the risks of uncapped discounts should be assessed in isolation. This one-sided definition of relevant risk led in turn to a disproportionate concern with the accuracy of the Before Rates projections.

Id. at 3.

The decisional standards applied by the Commission flow from the statutory requirements of the Act. The statutory requirements of the Act must be interpreted and applied to the specific facts developed on the record for the particular request in question. The Commission follows the precedent of previous decisions whenever and wherever appropriate.

There are instances where precedent may not be followed, for example, when the facts presented on the record are in key respects different from the facts of the precedent setting case, or when the Commission becomes aware that the established precedent in fact does not comport with the requirements of the Act. Neither circumstance exists here. The facts developed on the Bank One record, although different from the facts developed on the Capital One record, follow a sufficiently similar pattern so that the Commission determined that the Capital One precedent should be followed. The Commission was not persuaded that the standard applied in Capital One was either the incorrect standard, or that it did not fit the factual situation presented in this case. Thus, the issue is whether or not the Commission changed its standard of review.

Chase asserts that the Commission, in Capital One, balanced the financial risk of uncapped discounts against the financial risk of a cap. It alleges that the Commission did not apply this balancing standard to Bank One. The financial risk of a stop-loss cap is the risk that a stop-loss cap will at some point choke off the Postal Service's opportunity to earn additional contribution through increased mail volume caused by the discount incentive. This also will place a limit on the dollar value of discounts that Bank One is eligible to earn. The primary financial risk of uncapped discounts is the risk that the Postal Service will lose contribution through providing a discount on mailpieces that a

Negotiated Service Agreement partner would have mailed anyway, absent a discount.³³ In Capital One, this risk was associated with the questionable reliability of before-rates volume forecasts.

Both risks are discussed in the Capital One decision. A comprehensive discussion of declining block tariffs, including the effects of stop-loss caps, appears on pages 57 through 111 of the Capital One Decision. The Commission's understanding of the issues is derived mainly from the written and oral testimonies of Presiding Officer witness John C. Panzar (JCP-T-1) and Postal Service witness B. Kelly Eakin (USPS-RT-2). The Postal Service has incorporated the testimonies of witnesses Panzar and Eakin into the Bank One record. Thus, the discussion appearing on pages 57 through 111 of the Capital One Decision also applies to Bank One.

Although the Commission was aware of both risks, it did not conclude that they were of equal importance, or attempt to quantify and then balance one against the other. In Capital One, "the Commission's focus in this case is on assuring that the NSA will not make mailers other than Capital One worse off." PRC Op. MC2002-2, ¶ 8006. This emphasis was clearly and repeatedly stated.

The Commission finds that the estimates of 'before rates' volumes for Capital One are so unreliable that without a stop-loss provision there is no reasonable assurance that the Postal Service will not lose money on this NSA. If that were the result, other mailers would be harmed by the unreasonable preference being given to Capital One. Additionally, such a result would conflict with the Commission's long-term practice of assuring that classification changes recommended in the interim between omnibus rate cases are, at worst, revenue neutral. See § 3621 (the break even requirement).

Id., ¶ 8013.

The decisional issue before the Commission is whether it can reasonably conclude that volume discounts paid to 'free riders' (mail that would have been sent even absent the NSA) over the course of the NSA will not exceed the savings generated by the electronic address correction features of the

³³ This argument is not considering the loss of contribution caused by discount thresholds intentionally set below before-rates volume forecasts.

agreement. Under the circumstances set out above, the Commission can not reasonably make that conclusion unless a stop-loss provision is added. To the contrary, the Commission finds that absent such a provision there is a serious risk that discounts given to ‘free riders’ will exceed savings to the Postal Service, and that other mailers will be worse off because of the NSA.

Id., ¶ 8016.

The Commission recognized that theoretically, there was the potential risk of losing volume that might have been attracted if the stop-loss cap did not cut off discounts. But, the Commission could not quantify either risk, and thus could not compare the financial risk of uncapped discounts (the risk that the Postal Service will lose contribution through providing a discount on mailpieces that a mailer would have mailed anyway, absent a discount) against the financial risk of a cap (the risk that a stop-loss cap will at some point choke off the Postal Service’s opportunity to earn additional contribution through increased mail volume because of the discount incentive). The decision to recommend a stop-loss cap predominately was to protect against losses associated with unreliable volume estimates.

The balancing test described by Chase might be appropriate for a private entrepreneur. The Commission did not have the necessary information to apply this test in Capital One. However, the Commission has not concluded and is not convinced that the balancing test described by Chase is an appropriate standard for reviewing a government monopoly’s Negotiated Service Agreements. The policy considerations attendant to such a conclusion have never been argued before this Commission. Each of the risks would have to be quantified in order to be balanced in the Capital One case, not an easy task. The risks were not quantified on the record, although there is qualitative discussion. The Commission was unable to rely on the Capital One volume estimates, or place realistic bounds on these estimates. Capital One’s customer-specific price elasticity was not established on the record. Without this necessary information, the Commission could not quantify the opposing risks or perform the balancing test described by Chase.

Nonetheless, in Capital One, the risk that the stop-loss cap would choke off the Postal Service's opportunity to earn additional contribution through increased mail volume was considered to be small. Capital One's best estimate of its volumes during the test year, and presumptively continuing through the three-year Negotiated Service Agreement, was below the volume thresholds necessary to earn any discounts under the terms of the agreement.

In Bank One, the Commission recognized the risk that a stop-loss cap could deny the Postal Service the opportunity to earn additional contribution through increased mail volume. This helped persuade the Commission to adjust the stop-loss cap formula to provide Bank One with the opportunity to earn discounts in excess of what would have been permitted by applying the Capital One formula.

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.

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.

PRC Op. MC2004-3, ¶¶ 6088-89.

The Commission further recognized that a stop-loss cap could deny the Postal Service the opportunity to earn additional contribution through increased mail volume.

Assuming the accuracy of the volume estimates provided by Bank One's witnesses, Bank One could earn \$11.1 million in discounts and not be limited by the stop-loss cap.

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. 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. 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.'

Id., ¶ 6090 (footnote omitted).

In Bank One as in Capital One, the Commission did not attempt to quantify and then balance the risk of loss related to the reliability of before-rates volume forecasts assuming uncapped discounts, against the risk that a stop-loss cap will deny the Postal Service the opportunity to earn additional contribution through increased mail volume. The same standard was applied in Bank One as was applied in Capital One.

Chase prohibited by regulator from providing information. Chase asserts that "exclusion of the updated Chase volume data would be unjust for an additional reason: Chase could not have submitted those data before the close of the record because hold-separate restrictions on bank operations before regulatory approval of the merger denied access to the data." Petition at 5-6 (footnote omitted). It further explains that "[u]ntil the merger was consummated, Bank One and J.P. Morgan Chase could not lawfully exchange this volume information with each other, and thus could not submit data on actual heritage-Chase volumes to the Commission." *Id.* at 21 (footnote omitted).

Chase proposes to supplement the record with historical First-Class Mail volumes by month disaggregated by solicitation letters, solicitation flats, and operational mail

through October 2004 for the heritage-Chase and heritage-Bank One entities. This represents 11 additional months of historical heritage-Bank One data and four additional months of historical heritage-Chase beyond what appears on the record.

Bank One, as a proponent of the agreement, was in control of and under no regulatory prohibition to provide historic heritage-Bank One volume data while the record was open. To the extent additional data were available, it could have been offered for the record.

Bank One also was in control of most of the monthly historic heritage-Chase First-Class Mail volume data disaggregated by solicitation letters, solicitation flats, and operational mail while the record was open. It provided this information on the record for the time periods of January 2002 through June 2004. Tr. 2/152. It is not clear why the four additional months of data should have been treated differently. There was no legal impediment to providing such data.

In response to NOI No. 1, Question 2, Chase provides a relevant timeline of events.

(4) While regulatory approval was pending, the flow of information between Bank One and Chase was limited for antitrust related reasons. This impediment was removed upon consummation of the merger, although specific volume information was not fully available, as a practical matter, immediately following the merger.

(2) The Federal Reserve Board approved the merger on June 14, 2004.

(3) The merger was consummated on July 1, 2004.

(8) The record in the proceeding closed on October 21, 2004. On December 17, 2004, the Commission issued its Opinion and Recommended Decision, which first set forth several key decisional standards relating to the cost-savings cap.

Chase Response to NOI No. 1 at 7-8.

This timeline demonstrates that the regulatory prohibition as referenced by Chase was removed on July 1, 2004, upon consummation of the merger. Therefore, Bank One

had a window from July 1, 2004 through October 21, 2004 upon which to provide the additional historical heritage-Chase volume data, subject to its availability.

The Chase arguments in regard to regulatory prohibitions do not withstand scrutiny.

Chase unaware of Mr. Plunkett's declaration. Chase argues that “[e]xcluding Mr. Plunkett’s testimony would be unjust to Chase on a second and independent ground: Chase could not have included it in the original record, or demanded that the USPS include it in the record, because Chase was unaware of its existence until after the Governors acted on the December 2004 Recommended Decision, and the Postal Service disclosed to Chase the contents of Mr. Plunkett’s declaration.”³⁴ Petition at 20 (emphasis omitted).

The Postal Service and Bank One are recognized as co-proponents of the Negotiated Service Agreement Request. As co-proponents, the Commission expects the Postal Service and Bank One to jointly support the Request.³⁵ One of the co-proponents, the Postal Service, is assumed to be fully aware of the status of Mr. Plunkett’s actions during negotiations and while the record was open. Bank One’s co-proponent, the Postal Service, could have presented if it chose to do so, testimony as to Mr. Plunkett’s actions while the record was open.

Chase asserts that it became aware of the existence of the information contained in the Plunkett declaration after March 17, 2005.³⁶ Chase Response to NOI No. 1 at 8. However, Bank One was aware of the Commission’s interest in “any” independent analysis done by the Postal Service to evaluate the reasonableness of mailer-provided volume forecasts. See Presiding Officer’s Information Request No. 1, Question 7.³⁷

³⁴ The first ground Chase asserts is that Mr. Plunkett’s declaration addresses the Commission’s alleged change of decisional standard.

³⁵ By statute, the Postal Service is the co-proponent responsible for submitting the Request to the Commission.

³⁶ The working assumption of the Commission is that Mr. Plunkett prepared his actual declaration as part of the United States Postal Service Memorandum on Reconsideration originally filed May 16, 2005. Under this assumption, the declaration was prepared well after the record was closed.

³⁷ Presiding Officer’s Information Request No. 1, July 14, 2004 (POIR No. 1).

Bank One also suspected that the Postal Service had undertaken such an analysis, although it might not have known the extent of that analysis.

During NSA negotiations, Bank One assumed that the Postal Service was independently verifying its volume estimates. Bank One did not have actual knowledge that this verification had been performed until approximately March 17, 2005.

Chase Response to NOI No. 1 at 8.

Accepting that Bank One was not aware of the actual declaration, it was aware of the importance of the issue and had reason to believe that the Postal Service was performing such an independent analysis. It could have pursued this issue with its co-proponent (and the Commission) while the record was open. Bank One can not allege that it lacked notice.

Postal Service unaware supportive information was necessary. The Postal Service filed United States Postal Service Memorandum in Support of Reopening the Record, October 31, 2005 (Postal Service Support). The Postal Service argues that “[h]ad the Commission signaled its concern that the record did not sustain the settlement agreement while the record was open, the signatories could have submitted supporting material.” Postal Service Support at 1.

The Commission bases its recommendations on the record developed in each case and the statutory requirements of the Act. It is the proponent’s responsibility to present evidence for the record supporting their request and demonstrating that the request is in accord with the requirements of the Act. This applies whether or not a settlement agreement is offered for consideration to the Commission.

This does not inhibit the Commission from requesting information to better understand the evidence offered or the substance of the request. The responses to Commission information requests may or may not support the proponents’ positions. Although the subjects of these requests frequently indicate areas of Commission interest, it is not the intent of the Commission to signal or prejudge the outcome of the proceeding.

The Postal Service has no grounds to allege that it was unaware of the issues of concern to the Commission, or what supporting material the Commission was seeking in

the Bank One case. The substance of the Bank One case essentially parallels the previously recommended Capital One case. The reliability of volume estimates was a major concern in the Capital One case, as it was in the Bank One case. The limited reliability of volume estimates led to the imposition of a stop-loss cap in the Capital One case, as it did in the Bank One case. By filing the Bank One case predicated on an agreement functionally equivalent to the Capital One agreement, the Postal Service was aware of these similarities.

The Presiding Officer issued a Presiding Officer Information Request asking Postal Service witness Plunkett to provide “any” independent analysis to evaluate the reasonableness of the mailer-provided forecasts.

Please refer to USPS-T-1, pages 11-14 and Docket No. MC2002-2 Tr. 2/334. Witness Plunkett accepts the forecasts of before-rates volume, after-rates volume and estimated return rates provided by Bank One witness Rappaport (BOC-T-1) and characterizes the after-rates volume estimates as conservative. Please provide any independent analysis done by the Postal Service to evaluate the reasonableness of the mailer-provided forecasts of: (a) before-rates volumes, (b) after-rates volumes and (c) estimated return rates.

POIR No. 1 at 3. Witness Plunkett’s complete response follows.

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.

The estimated return-rates are based on data provided by Bank One (see POIR-1). The Postal Service cannot estimate the return rate for an individual mailer, but ad hoc discussions with customers indicates that the Bank One return rate is within the range for similar First-Class marketing mail.

The Postal Service believes that the TYAR rates forecast provided by Bank One may be conservative because as described in Bank One witness Buc's testimony the effect of the price incentives on mailing decisions cause a material shift in marketing mail volume from Standard to First-Class. A sensitivity analysis appears on the following page.

% Change in Marketing Letter Volume	Letter Marketing Volume	ACS Savings	Contribution New Mail	Exposure	Incremental Discounts	USPS Value
-20%	23,509,600	\$7,431,765	\$0	\$2,343,234	\$0	\$5,088,531
-10%	26,448,300	\$7,577,732	\$0	\$2,607,717	\$0	\$4,970,015
10%	32,325,700	\$7,869,668	\$0	\$3,136,683	\$0	\$4,732,985
20%	35,264,400	\$8,015,636	\$0	\$3,401,166	\$0	\$4,614,470
30%	38,203,100	\$8,161,604	\$0	\$3,665,649	\$0	\$4,495,955
40%	41,141,800	\$8,307,572	\$0	\$3,930,132	\$0	\$4,377,440
50%	44,080,500	\$8,453,540	\$0	\$4,206,218	\$0	\$4,247,322
75%	51,427,250	\$8,818,459	\$0	\$4,977,626	\$0	\$3,840,833
100%	58,774,000	\$9,183,379	\$0	\$5,749,035	\$0	\$3,434,344
200%	88,161,000	\$10,643,058	\$0	\$9,132,480	\$0	\$1,510,578
300%	117,548,000	\$12,102,736	\$0	\$12,872,535	\$0	-\$769,799

29,387,000 Current Marketing Letter Volume
 Assume TYAR and TYBR are the same
 No other variables change

Tr. 2/424-25.

At this late date, the Postal Service asserts that it actually had done vastly more analysis than it described in its response to the Presiding Officer's request, and that if it had only known what the Commission required, it would have provided it. Participants place themselves at risk of an unfavorable decision when they adopt a litigation strategy of withholding requested information, and offering only what they believe is just enough evidence to support their position.

Functional equivalency as a reason for a stop-loss cap. Chase argues that "the Commission's finding that the uncapped NSA proposal was not functionally equivalent to the Capital One NSA under Rule 196 cannot bar reopening of the record." Petition at 7, 26-32.

Whether or not the Bank One Negotiated Service Agreement is functionally equivalent to the baseline Capital One Negotiated Service Agreement does not have a direct bearing on the Commission's decision of whether or not to reopen the record in this

case.³⁸ Most important, it did not have a direct bearing on the Commission's finding that the Bank One Negotiated Service Agreement as originally presented on the record was not in accord with the requirements of the Act. This finding was based on the uncertainties presented with Bank One's volume estimates, and not on the agreement's functional equivalency status.

The functional equivalency analysis did provide a useful framework for comparison of the Bank One Negotiated Service Agreement with the referenced (Capital One) baseline agreement. There were many parallels between the agreements and many parallels between the Commission's analysis and findings in regard to the agreements. The Capital One agreement, as implemented (with a stop-loss cap) provided adequate protection against misestimation of before-rates volumes. Had the Bank One agreement been accompanied by sufficient protection against misestimation of before-rates volumes, either from reliable evidence, or some other satisfactory means such as an appropriate stop-loss cap, it would have been functionally equivalent to the Capital One agreement. However, the Commission determined that the record did not provide adequate protection against misestimation of before-rates volume. The Commission did recommend that this deficiency could be overcome if Bank One discounts were capped at \$11.508 million. The Governors and Bank One each accepted this limitation, although the Governors have requested the Commission to reconsider that portion of its recommendation. Because the Postal Service filed its request as a functionally equivalent agreement and these parallels, the functional equivalency concept had an influence on the method the Commission chose to remedy the deficiencies of the Request.

The proponents of a Negotiated Service Agreement must develop a record which demonstrates that their Request is in accord with the requirements of the Act. Whether or not the Negotiated Service Agreement is functionally equivalent to another agreement does not change this requirement.

³⁸ There are due process implications to filing a request as a functionally equivalent agreement. Interested persons will base intervention decisions on the Postal Service's representation that a new request is predicated on a functionally equivalent agreement. See PRC Op. MC2004-3, ¶¶ 6001-07. This could influence a decision to reopen the record; however, this issue has not been raised.

The Decision describes the purpose of the functionally equivalent concept.

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.

PRC Op. MC2004-3, ¶ 6001. Whether or not the Negotiated Service Agreement is functionally equivalent to another agreement does not influence the level of record evidence needed to support a Request or the standards used to evaluate the record. However, it does influence procedurally how the record is developed, with the intended purpose of expediting the proceeding.

The standard applicable to evaluating risk. Chase argues that “[r]ather than the standard of proof prescribed under the Administrative Procedure Act, the preponderance of the evidence, the Commission effectively demanded that the NSA proponents prove that the NSA would be profitable beyond a reasonable doubt—or even beyond a hypothetical doubt.” Petition at 3-4 (footnote omitted). “These heightened standards of proof in turn led unsurprisingly to the Commission’s ultimate conclusion, that the risk of uncapped discounts was unacceptable.” *Id.* at 16.

The Commission interprets this argument as asserting that the Commission has heightened its standard of review in the case of Bank One such that the Commission is unwilling to allow the Postal Service to accept any risk associated with an agreement that does not include a stop-loss cap.

In Order No. 1443, at 13-14, the Commission discusses its general views in regard to risk.

Discussion of Risk. The Commission recommended a stop-loss cap to bring the risks associated with potentially inaccurate volume projections to within an acceptable range. If these risks materialize, mailers not party to the agreement could be subject to harm. The Commission cannot eliminate all risks from Negotiated Service Agreements, and the Commission does not expect that Negotiated Service Agreements will be risk-free. However, if an unreasonably significant risk is identified that could cause harm to the Postal Service and/or its customers, the Commission would be remiss if it did not condition its recommendation on the addition of an applicable risk control device.

In the Bank One case, the Commission only took specific action to address one risk — potentially inaccurate volume projections. Many other risks are present within the Bank One agreement, for example: the risks associated with the implementation of PARS; misestimations of forwarding and return rates; changes in Bank One's business plans; mergers, acquisitions and portfolio changes; and myriad exogenous factors related to the nation's economy, among others. In some areas, the Commission commented on the effectiveness of the risk reduction provisions already included in the agreement, but did not find that the agreement warranted change. For example, the effectiveness of the trigger mechanism described in the Modified Stipulation and Agreement was questioned, and the end result of the J.P. Morgan Chase merger is still an unknown even with the included mergers and acquisition clauses.

The Commission considers the analysis of risk as an important consideration in recommending Negotiated Service Agreements. This consideration is magnified where monopoly products are involved. If a specific risk that would jeopardize a favorable recommendation cannot be eliminated, it must at least be quantified and controlled. The stop-loss cap fulfills this role in addressing an identified specific risk.

The Commission's position on risk in regard to Bank One is consistent with its position in regard to Capital One.³⁹

³⁹ The Commission employs the same standard and analysis of risk it used to evaluate Negotiated Service Agreements with Discover and HSBC.

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.

PRC Op. MC2004-3, ¶ 6067. The Commission has applied the same standard to Bank One that it applied to Capital One, and it has not modified or heightened its standard of review.

Chase attempts to buttress its argument in regard to risk by citing the level of risk that the Commission has allowed in regard to an experimental classification.

...MC2004-2 Op. & Rec. Decis. at 13-14 (holding that the ‘reasonably bounded risk of potential revenue leakage estimated by the Service’ from its experimental Priority Mail flat rate box proposal ‘does not significantly detract from the merits of its proposed innovation’ in comparison with the potentially significant gain in contribution offered by the proposal). The Commission tries to distinguish MC2004-2 on the ground that the Priority Mail flat rate box proposal, unlike the Bank One NSA, was reviewed under the Commission’s rules for experimental classification changes. MC2004-3 Op. & Rec. Decis. ¶ 6046. This is a distinction without a difference. The point is that neither proposal implicates more than small fraction of the Postal Service’s total revenues; hence, neither would jeopardize the overall financial integrity of the Postal Service even in a worst-case scenario. Moreover, the notion that approval of the Bank One NSA would lead to a flood of similar proposals ‘ad infinitum prior to determining its success or failure’ (*id.*) is completely at odds with actual experience

Petition at 15, fn. 10.

The Commission has put this argument to rest.

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 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.

PRC Op. MC2004-3, ¶ 6046.

The Commission’s concern in evaluating risk, especially with experimental or Negotiated Service Agreement proposals, focuses on the potential for unfairness, more than on whether or not any single request will significantly jeopardize the Postal Service’s total revenues.⁴⁰ It is unlikely that any single request will have a significant impact on the Postal Service’s approximate \$70 billion in annual revenue. However, the financial impact of any individual agreement that results in financial losses to the Postal Service could be unfair to other mailers. Whether a request proposes a limited duration, limited participation but quantifiable experiment; a fixed duration Negotiated Service Agreement susceptible to repetition; or a permanent classification of indefinite duration may affect the Commission’s views on risk.

The Bank One commissioned study. Chase asserts that it “also commissioned an economic study to show that capping the NSA discounts would choke off the incentives for Chase to increase its First-Class Mail volume, and thus was likely to reduce the net expected contribution to the USPS from the NSA by millions of dollars.” Petition at 2-3.

Assuming that Chase is referring to the testimony of witness Buc, the Commission considered witness Buc’s testimony in establishing the stop-loss cap. See Tr. 2/40-70.

[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

⁴⁰ The potential for replication of Negotiated Service Agreements increases the potential of increased financial risk, which may or may not heighten the fairness concerns of non-participating mailers.

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.

PRC Op. MC2004-3, ¶ 6089.

Witness Buc contends that his study supports the general conclusion that “volume block discounts under the proposed Bank One/Postal Service NSA will create incentives for Bank One to switch a substantial amount of solicitation mail from Standard Mail to First-Class Mail.” Tr. 2/41. Because of this, he asserts that witness Rappaport’s after-rates volume projections are highly credible. *Id.* His study does not employ inputs specific to Bank One, nor does it develop volume estimates for the combination of Bank One’s Standard Mail and First-Class Mail solicitations pieces for any year of the agreement.

Order No. 1443 justifications for reopening record. Chase argues that “[r]eopening the record is required by the standards for reopening spelled out by the Commission itself in Order No. 1443, as well as the basic norms of due process under the Administrative Procedure Act.” *Id.* at 5, 8-21.

The Commission previously discussed general standards for reopening the record when considering the materials associated with the United States Postal Service Memorandum on Reconsideration, filed May 16, 2005, which included Mr. Plunkett’s declaration.

Typically, the Commission will reopen a record in a fully concluded and litigated docket only for the purpose of administrative corrections, or to make non-substantive changes. In extraordinary circumstances, the Commission could reopen a record if there is an acceptable demonstration of why material could not have been initially presented during the course of the proceeding, and why it should be considered late in the proceeding. The Commission also might reopen the record if the material was directly on point and there would be an injustice if the record were not reopened. There has been no showing that this material could not have been entered during the litigation of this docket, and the material has been produced well after the Commission has issued its Opinion. Furthermore, review of the material reveals that it is predominately general in nature, and there is not a showing that any injustice would occur if this material were not admitted into evidence at this point.

Order No. 1443 (August 23, 2005) at 8.

There has not been an acceptable demonstration of why the material could not have been initially presented during the course of the proceeding. The Chase arguments in regard to regulatory prohibitions against disclosure do not withstand scrutiny. Chase further had the option to alert the Commission to regulatory prohibitions while the record was open. Chase first raised this issue in the Chase Petition, long after the record was closed.

The Commission requested the Postal Service to provide any independent support for Bank One's volume estimates during the proceeding. The Postal Service waited until well after the record closed, until its United States Postal Service Memorandum on Reconsideration, filed May 16, 2005, before it indicated that its previous answer to a specific Commission question had been inadequate, and that it had independently analyzed Bank One's volume estimates.

Whether or not Chase was aware of the specific contents of Mr. Plunkett's declaration is not material. The Postal Service and Chase (Bank One) were co-proponents required to present a unified case. One of the co-proponents, the Postal Service, was aware of the status of Mr. Plunkett's analysis. Further, Chase was on notice of the importance of volume estimates and assumed that the Postal Service would be independently analyzing volume information during negotiations.

There has not been a persuasive demonstration of why an injustice will arise if the limited material proffered by Chase is not accepted now, more than a year after the evidentiary record was closed. The Commission is sympathetic to Chase's desire to have prompt consideration of potential adjustments to its Negotiated Service Agreement. However, the Commission finds the obvious inaccuracy of witness Rappaport's year one volume projection makes it fruitless to open the record for the limited purpose of trying to show that his year one (and beyond) estimates should have been found reliable.

The Commission has established rules for the purpose of allowing prompt consideration of changed circumstances or unexpected events. If modification of the

existing Negotiated Service Agreement can be justified, a request under Rule 198 is the most appropriate and effective way to proceed.

Bank One denied opportunity to litigate case. Chase asserts that it is not seeking to modify its NSA. “It seeks a fair hearing on its original proposal in this case. ... Requiring Chase to undergo anew the ‘arcane rigors of the regulatory process,’ merely to get a fair opportunity to be heard on the terms of its original NSA proposal, would be arbitrary and unfair.” Petition at 24 (emphasis omitted).

Bank One has been provided with a fair hearing on the Postal Service and Bank One original proposal. The Commission found that based on the record, the original proposal had a serious deficiency and did not comport with the requirements of the Act. Therefore, the Commission was unable to recommend the original proposal based on the record.

After this finding, the Commission recommended a remedy to make the proposal conform to the requirements of the Act. This was done because the Commission supports the Postal Service’s Negotiated Service Agreement initiatives and believed that the Bank One agreement could potentially benefit the Postal Service. The Governors had the option to disagree with the Commission’s recommendations and not implement the agreement. However, the Governors also saw benefit in the agreement, and implemented the agreement while returning several issues, one of which is the stop-loss cap, to the Commission for reconsideration.

VI. SOLICITATION OF COMMENTS

The Commission will undertake reconsideration of its Bank One opinion, with a focus on its decision to recommend the addition of a stop-loss cap to the Bank One Negotiated Service Agreement. The reconsideration will be based on the existing Bank One record.

PRC Order No. 1443 previously established September 16, 2005 and September 30, 2005 as the deadlines for participants to file comments and reply comments in regard to the Commission's reconsideration of the Bank One opinion. Two days before comments were due, Chase filed its Petition to reopen the record. Presiding Officer's Ruling No. MC2004-3/9 suspended the filing of comments and reply comments to allow participants the opportunity to reply to, and for the Commission to consider, the Petition. As this Order resolves the issues related to the Petition, the Commission must re-establish dates for filing comments and reply comments.

The Commission will entertain comments based on the existing record from interested participants which address issues relevant to the reconsideration. Interested participants should file initial comments by January 25, 2006, and reply comments by February 1, 2006.

It is ordered:

1. Motion of National Postal Policy Council for Leave to File Comments Two Days Out of Time, filed on October 26, 2005, is granted.
2. Petition of J.P. Morgan Chase & Co. to Reopen Record, filed on September 14, 2005, is denied.
3. Comments in regard to the reconsideration of the Docket No. MC2004-3 Opinion and Recommended Decision Approving Negotiated Service Agreement based on

the record developed in that docket shall be filed no later than January 25, 2006.
Reply comments shall be filed no later than February 1, 2006.

By the Commission
(SEAL)

Steven W. Williams
Secretary