

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

RATE AND SERVICE CHANGES TO IMPLEMENT
BASELINE NEGOTIATED SERVICE AGREEMENT
WITH BANK OF AMERICA CORPORATION

Docket No. MC2007-1

**RESPONSE OF UNITED STATES POSTAL SERVICE TO
NOTICE OF INQUIRY NO. 1
(April 17, 2007)**

On April 3, 2007, the Postal Regulatory Commission (Commission) filed Notice of Inquiry No.1 (NOI). The Commission notes that the Bank of America Corporation (BAC) Negotiated Service Agreement (NSA) offers incentives to BAC in the form of discounts for improvements in read/accept rates for letter-shaped mailpieces entered at First-Class Mail and Standard Mail rates. The baseline from which improvements are to be measured is the current read/accept rates for BAC's mail. The Commission notes that these rates are unknown by the Postal Service and by Bank of America. Since the current rates were not measured specifically for BAC's mail, the Postal Service and BAC selected a proxy baseline from which to measure improvements in read/accept rates for BAC mailpieces. The baseline was calculated by weighting the Postal Service's system-wide average read rates for mail categories by the volume of BAC mail for each category to obtain read/accept rates for BAC mailpieces.

The Commission suggests that BAC's mail preparation requirements and use of Six Sigma quality techniques could result in BAC read/accept rates better than those of other mailers and higher than the Postal Service's system-wide averages, providing BAC with discounts with no change in its current practices. The Commission also notes that BAC's read/accept rates could be less than the system average, possibly providing insufficient incentive to BAC to improve its read/accept rates under the NSA. The NOI also notes that the three-year duration of the NSA provides an opportunity to gather data on read/accept rates for BAC mail during the first year of the NSA, and to incorporate this information into the system-wide averages so the baseline for the second and third years of the NSA would reflect BAC-specific data. The NOI concludes:

Interested participants are invited to comment on the methods of establishing baselines in longer term (three years in this instance) pay-for-performance agreements where actual mailer information is unavailable. Specific comments are encouraged which discuss the need to incorporate adjustment mechanisms, and the benefits or detriments of incorporating the approach outlined in the example above compared with an approach that solely utilizes system-wide averages.

The Postal Service respectfully submits the following comments in response to the NOI. In summary, the Postal Service believes the baselines used in the NSA are appropriate and are supported by record evidence in Docket No. MC2007-1, and that the Commission's suggested approach, or any approach that would modify system-wide baselines from data collected during the running of the NSA, should not be adopted.

Regarding the acceptability of the current baselines, the incentives anticipated for improvements in the read/accept rates must cover more than the expenses to BAC in achieving improvements in such rates. The NSA requires BAC to commit to activities not associated directly with read/accept rates, without providing incentives specifically for those activities. See Response to Interrogatory APWU/USPS-T1-3. Adjusting the baselines would influence the amount of incentives not only for improvement in read/accept rates, but also for those activities unrelated to read/accept rates.

The use of a systemwide average baseline helps mitigate risk to BAC from uncertainty on how much improvement it can expect in read/accept rates from its investment in equipment and procedures to improve such rates. Adjusting the baseline in the second and subsequent years of the NSA introduces greater uncertainty and risk concerning BAC's return on its investment to improve read/accept rates, because it introduces yet another element that affects the amount of incentive to be paid to BAC. Good business practice suggests that the incentive level should be raised to compensate BAC for the increased level of risk, reducing the value of the NSA to the Postal Service. Furthermore, foisting significant, nonconsensual changes to a key element of the negotiations, in this case, the baselines used to determine the discounts, would unnecessarily intrude in the negotiation process and deprive the parties of the ability to use their bargaining strength and leverage to arrive at a mutually agreeable outcome.

The Postal Service has indicated in the testimony of Ali Ayub (USPS-T-1) and in its response to VP/USPS-T1-17(a) that there is no reason to believe that

BAC read/accept rates deviate significantly from the overall average read rate, either above or below.

Acceptance by the Commission of the overall system average in recommending billions of dollars of rates in its recent Opinion and Recommended Decision in Docket No. R2006-1, a much larger case than Docket No. MC2007-1, is similar to the approach taken in this much smaller case. If the Commission wishes to move away from use of systemwide averages, it should consider such option in a larger proceeding where its use impacts many billions of dollars, rather than have the “tail wag the dog” by suggesting a move away from system-wide averages in a case of much smaller dollar impact. Also, the base rates from which discounts to BAC would be calculated will reflect the use of system-wide averages, while the discounts themselves will reflect an alternative approach to the use of system-wide averages, an apparent contradiction.

Moreover, the data used in this Docket to determine the cost-savings from the Bank of America NSA have been used to determine the worksharing discounts that are currently provided to large mailers. Through these discounts, billions of dollars are paid to mailers for undertaking certain worksharing activities. In comparison, the discounts that would be provided to BAC under this NSA are small and would likely have a minimal impact on the rates of other mailers. Therefore, the risk to the other mailers that BAC’s mail characteristics exhibit lower costs than other mailers will have almost no impact on the rates paid by other mailers.

The current pricing structure for letter-rated First Class-Mail and Standard Mail worksharing discounts is based on the average read/accept rate for all mailers of given presort levels and usage of particular automated letter sorting equipment. Today, each individual mailer will receive the same price discount under the structure for regular worksharing discounts even though its customer-specific read/accept rate is likely to be above or below the average. One consequence of this averaging is that it necessarily favors individual mailers that have read/accept rates that are below average, while it does not provide additional rewards to mailers that have read/accept rates that are above the average. Each individual mailer receives the same discount regardless of the amount of cost-savings it generates for the Postal Service. Given these factors, the BAC NSA, which ties price discounts to improvements over the average baseline for all mailers, is no less reasonable than the current pricing structure, particularly given that similarly situated mailers, whether above or below the average cost profile, can receive the benefits of functionally equivalent NSAs.

For the foregoing reasons, the system-wide baseline approach is the most appropriate method by which to establish the baselines for this particular NSA. Witness Ayub's testimony and interrogatory responses offer substantial support for this system-wide baseline approach.

The Commission's proposed alternative approaches to developing baselines, or similar approaches premised on adjusting the baseline during the running of this NSA, are not appropriate in these particular circumstances. As discussed above, these approaches would not address the situation that

incentives to improve read/accept rates also are intended to support other actions the NSA requires of BAC, and to help compensate BAC for the risk that it will not obtain the improvements in read/accept rates it anticipates for the expenses it will incur.

Additionally, the Commission's suggested alternative, and similar alternates, will discourage NSAs by substantially increasing their cost. The alternative of requiring parties to a performance-based NSA, such as the one at issue here, to use customer-specific data to determine the baseline values from which discounts would be calculated would likely deter customers from pursuing NSAs with the Postal Service due to the substantial time or cost of collecting and analyzing such data. The cost of such investments and the delay incurred in collecting data would serve as a strong disincentive for customers contemplating an NSA with the Postal Service.

Collecting data during the running of the NSA that influences the level of incentives provided under the NSA might invite manipulation of mailing practices by BAC to influence data in a direction favorable to it. At the very least, it increases the complexity, and the cost, of such data collection.

For the foregoing reasons, the Postal Service believes the baselines contained in the NSA are appropriate to it and are the best available under the circumstances, and that approaches that would adjust the baselines for customer specific information during the running of the NSA are problematical and inappropriate and should not be adopted.

UNITED STATES POSTAL SERVICE

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