

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

RATE AND SERVICE CHANGES TO IMPLEMENT )  
BASELINE NEGOTIATED SERVICE AGREEMENT ) Docket No. MC2007-1  
WITH BANK OF AMERICA CORPORATION )

REPLY BRIEF

OF

VALPAK DIRECT MARKETING SYSTEMS, INC. AND  
VALPAK DEALERS' ASSOCIATION, INC.

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The Initial Brief of Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc., referred to collectively as "Valpak," addressed many of the issues raised in the initial briefs of Bank of America Corporation ("BAC") and the Postal Service. Those arguments need not be repeated here, as nothing in the initial briefs of either BAC or the Postal Service overcome the infirmities in the proposed NSA, as pointed out in Valpak's Initial Brief. In this Reply Brief, therefore, Valpak only addresses one item that was not covered in its Initial Brief, and which is discussed in the initial briefs of both BAC and the Postal Service: Undeliverable as Addressed ("UAA") mail, in both First-Class Mail and Standard Mail.

**1. UAA First-Class Mail**

The Postal Service Initial Brief states that:

The per-piece **rate incentives** set forth in ... the agreement will lead to cost savings **by incenting BAC** to undertake activities that will reduce **its** return

and forwarding rates for letter-rated First-Class mailpieces. [USPS Initial Brief, p. 17 (emphasis added).]

BAC's Initial Brief likewise states that “[t]he NSA also would offer **BAC financial incentives** for reducing the return rates of its qualifying First-Class Mail.” BAC Initial Brief, p. 15 (emphasis added).

As both the Postal Service and BAC initial briefs point out, a Negotiated Service Agreement (“NSA”) necessarily focuses myopically, one mailer at a time (BAC in this instance), on helping solve — to a small incremental extent — the system-wide problem of (1) UAA First-Class Mail that cannot be forwarded and, under existing postal regulations, is entitled to free return service, and (2) UAA Standard Mail, most of which must be shredded and disposed of by the Postal Service. The initial briefs of the Postal Service and BAC also stress the important role that financial incentives can play in helping reduce the volume of UAA mail by encouraging bulk mailers to put more effort into cleaning up their mailing lists.

This is not the first time that the issue of UAA mail has arisen in the context of an NSA. The first NSA,<sup>1</sup> with Capital One Services, Inc. (“Capital One”), highlighted the distorted pricing structure that existed between physical returns and electronic (Address Correction Service (“ACS”)) returns. The Postal Service then was charging a significant price for its least expensive service (*i.e.*, ACS), while not charging at all for its most expensive service (*i.e.*, physical return). The incentives those signals gave to mailers could not have been

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<sup>1</sup> Docket No. MC2002-2.

much more distorted and counterproductive. Over four years ago, Commissioner Goldway questioned witness John C. Panzar about these contradictory pricing incentives.<sup>2</sup>

COMMISSIONER GOLDWAY: Now, [on] the issue of the address correction service, and what seems to be at least **counterintuitive** marketing incentives or cost incentives for making people pay for the cheap service and get the expensive service for free.... Do you think that that portion of the NSA is something that we should look at more carefully; that we seem to have **contradictory** market incentive, pricing incentives on that aspect of the NSA?

[WITNESS PANZAR]: Well, I think the **improper** — the **unfortunate** pricing structure has to do with **the bundling nature of the first-class tariffs**....

At the next rate hearing or classification hearing or whatever the appropriate venue would be it might be time to address the **distorted** pricing structures that's built into return policies. [Docket No. MC2002-2, Tr. 8/1785, l. 10 – 1786, l. 20 (emphasis added).]

The best that could be done within the context of the Capital One NSA was to reduce the price of electronic ACS for one company — Capital One — to the same level as physical return of the mail piece; *i.e.*, free. Although some significant improvements in the system-wide pricing of address correction services were effected in Docket No. R2006-1, the basic problem remains.

The discrepancy between the price charged for electronic ACS and physical return of First-Class Mail was reduced by lowering the price for electronic ACS in Docket No. R2006-1. In addition, a new automated address correction option for letters that works in conjunction with the Postal Automated Redirection System (“PARS”) has been implemented.<sup>3</sup>

Nevertheless, the Postal Service continues to provide bulk (and single-piece) First-Class Mail

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<sup>2</sup> See Docket No. MC2002-1, Tr. 8/1785-87 for the complete discussion of that issue between Commissioner Goldway and witness Panzar.

<sup>3</sup> Docket No. R2006-1, *Op. & Rec. Dec.*, pp. 419-421.

with expensive return (and forwarding) service at no out-of-pocket cost to mailers. In other words, despite witness Panzar's insightful observation, free return of UAA mail that cannot be forwarded continues to be bundled into the rate for First-Class Mail, which is unfortunate.<sup>4</sup> The discussion in the Initial Brief of the Postal Service, as well as that of BAC, does not even hint at the fact that the Postal Service continues to charge a bundled rate that includes free physical return of undeliverable First-Class Mail, nor do either of those two initial briefs mention that this bundled rate constitutes a major impediment to providing **all** bulk First-Class mailers with a cost-based financial incentive to reduce the volume of their UAA mail.

In his testimony, Postal Service witness Ali Ayub (USPS-T-1, App. A) estimates the value that the Postal Service expects to receive from a reduction in BAC's UAA First-Class Mail. Rather than measure the actual reduction in BAC's UAA First-Class Mail, however, and base some portion of the total payment to BAC on measured reductions actually achieved for its UAA First-Class Mail, under this NSA all payments to BAC would be bundled into a single payment for improvements to the read/accept rate over the 1999 system-wide average baseline (which Valpak discussed at length in its Initial Brief). In other words, a portion of the payments proposed for BAC under this NSA has no direct linkage to the performance which has been estimated to underlie some of the value of the NSA for the Postal Service. In this

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<sup>4</sup> "First-Class Mail service includes forwarding or returning the mail piece in the price of postage, so the additional cost of providing address correction service via the electronic option is lower for First-Class Mail pieces than for other classes of mail." Docket No. R2006-1, Direct Testimony of Postal Service witness Drew Mitchum (USPS-T-40), p. 8.

manner, bundled pricing distorts what otherwise is a straightforward pay-for-performance principle.<sup>5</sup>

Instead of addressing the problem of UAA First-Class returns one mailer at a time, as NSAs necessarily must do, Valpak suggests that a more preferable way to address such a system-wide problem is with an across-the-board approach that would be applicable to all mailers. By way of illustration, suppose that the Postal Service were to (1) effect an across-the-board reduction in the rate for **all** bulk First-Class Mail by an amount equivalent to the unit cost of all UAA mail that now is bundled into rates for First-Class Mail, and (2) for bulk First-Class Mail introduce a separate rate for physical return that reflects 100 percent or more of the cost of such returns. Employment of a universal across-the-board pricing policy to help achieve such a desirable result would give every bulk First-Class mailer — both large and small — a strong financial incentive to reduce their volume of UAA mail. Following implementation of any such pricing scheme, every bulk First-Class mailer that has (or readily can achieve) a below-average return rate would be rewarded immediately, while those with higher-than-average return rates would see their mailing costs increase in proportion to the extent to which their return rate exceeds the average. In other words, rewards to mailers for reducing their rate of UAA returns would be based directly on the number of returns each mailer generates (and not on the initial read/accept rate for their mail).

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<sup>5</sup> Problems that arise from bundled pricing for many of the obligations in the proposed NSA were discussed in Valpak's Initial Brief, pp. 20-21, as well as Valpak's Reply Comments to Notice of Inquiry No. 1 (April 24, 2007), pp. 1-2.

The volume of UAA First-Class Mail is said to be around 1 billion pieces each year. Postmaster General John E. Potter has called attention to the seriousness of the UAA mail problem in a 2005 speech at the Postal Forum,<sup>6</sup> and the Postal Service has spent large sums of money on research and development and various investments aimed at ameliorating the UAA problem. The cost that this mail imposes on the Postal Service unfortunately will remain a pervasive problem, at least until the Postal Service implements appropriate financial incentives for all bulk First-Class mailers. The fact that the initial briefs of both the Postal Service and BAC address a major system-wide problem such as UAA mail only in the narrowest terms possible would seem to indicate that NSAs, although they may help surface pricing problems, do not constitute an appropriate vehicle for dealing with them.

## 2. UAA Standard Mail

The Postal Service states in its Initial Brief that:

[t]he per-piece rate incentives ... will [incent] BAC to undertake activities that will reduce its undeliverable-as-addressed (UAA) rates for letter-rated Standard Mail mailpieces through improvements in address quality. Incremental improvements (*i.e.*, reductions) in the percentage of Standard Mail mailpieces that are UAA will be measured against a baseline of 6.4 percent. [USPS Initial Brief, p. 18, footnote omitted.]

Similarly, BAC states in its Initial Brief:

Because the Bank lacks company-specific data on the UAA rate of its Standard Mail, the Bank and the Postal Service have agreed to use the UAA rate for all subclasses and shapes of Standard Mail, 6.4 percent, as a proxy baseline rate. ... This baseline value is conservatively low. [BAC Initial Brief, p. 17, citations omitted.]

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<sup>6</sup> Keynote address, Postmaster General John E. Potter, National Postal Forum, Nashville, Tenn., March 21, 2005.

The total volume of Standard Mail in FY 2005 was approximately 54 billion pieces. Docket No. R2006-1, Library Reference USPS-LR-L-77, FY 2005 Billing Determinants. Applying the baseline value of 6.4 percent for UAA mail to that total volume indicates an estimated 3.45 billion pieces of UAA Standard Mail in FY 2005. According to BAC's Initial Brief, this estimate should be considered conservatively low.

"The Bank estimates that, with the NSA in place, the Bank would reduce the UAA rate for its Standard Mail by 10 percent." BAC Initial Brief, p. 17, citation omitted. The estimated reduction in the volume of BAC's UAA Standard Mail is 12,600,000 pieces. Direct Testimony of witness Ayub (USPS-T-1, App. A, p. 9). Measured against the total volume of UAA Standard Mail in FY 2005, the estimated reduction in UAA Standard Mail on account of this NSA would be 0.37 percent.

The Postal Service and BAC lack company-specific data on the UAA rate of BAC's Standard Mail. BAC Initial Brief, p. 17. This lack of company-specific data acknowledged by BAC's Initial Brief means that, if BAC's actual UAA rate is either somewhat above or below the baseline, the amount actually earned by BAC, as well as the amount actually saved by the Postal Service, will differ from the original estimates. Lack of mailer-specific data for BAC's UAA Standard Mail could leave the expected outcome unchanged, but the degree of uncertainty about the actual outcome clearly is heightened by a considerable amount.

Since this NSA does not propose to shift any Standard Mail, with its high UAA content, to First-Class (unlike several previous NSAs), the only effect from this provision of the NSA may be some reduction in the volume of UAA Standard Mail generated by BAC. Any reduction, however small, in the total volume of UAA Standard Mail can be said to

represent a movement in the right direction. At the same time, Valpak respectfully suggests that the volume of UAA Standard Mail is substantial and pervasive, largely unaddressed in Docket No. R2006-1, and beyond any meaningful solution via NSAs. Moreover, the value for the Postal Service on account of any estimated reduction in BAC's UAA Standard Mail, like that for reductions in UAA First-Class Mail, is a different matter than the value received on account of improvements in the read/accept rate.

Valpak suggests that in pay-for performance contracts, wherever performance improvements can be supported by mailer-specific data, payments for such improvements should be linked directly to those activities generating the improvements and providing value to the Postal Service. Where performance improvements cannot be supported by any mailer-specific data, estimating efforts which aim at quantifying value to the Postal Service should receive little weight, especially when the activity is ancillary to, and not the major thrust of, the NSA.

## **CONCLUSION**

In the case of UAA First-Class Mail, the NSA process actually seems to be getting in the way of a system-wide fix. Were this NSA process not available, the Postal Service might be more likely to direct its attention to solving the problem for all bulk First-Class Mail. The “counterintuitive” and “contradictory” pricing scheme for postal mail returns now is being used repeatedly by the Postal Service to provide a rationale for NSAs based on a tiny reduction in damage that indirectly results from bundled pricing for UAA First-Class Mail. In this way,

NSAs such as that proposed for BAC actually seem to prop up, if not help perpetuate, the existing bundled pricing scheme for UAA First-Class Mail.

Respectfully submitted,

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