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

RATE AND SERVICE CHANGES TO IMPLEMENT FUNCTIONALLY EQUIVALENT NEGOTIATED SERVICE AGREEMENT WITH THE BRADFORD GROUP

DOCKET NO. MC2007-4

REPLY BRIEF OF THE BRADFORD GROUP

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INTRODUCTION

The Bradford Group hereby files its Reply Brief in this proceeding. The brief responds to the arguments presented in the Initial Brief of the Office of the Consumer Advocate ("*OCA Initial Brief*"), the only party to oppose the NSA in this proceeding.

ARGUMENT

I. The Bradford NSA Fully Satisfies the Applicable Standards of Review

The Office of the Consumer Advocate essentially argues that the Bradford NSA does not improve the net financial position of the Postal Service, and thus fails to meet the applicable statutory standard of the PAEA. *OCA Initial Brief* at 2 (citing *Opinion and Recommended Decision*, *Bank of America*, PRC Op. MC2007-1). This argument is wholly unfounded. Contrary to the OCA's contentions, the NSA fully satisfies the statutory standard established in the PAEA. The record evidence clearly establishes that this NSA is overwhelmingly likely to improve the net financial position of the Postal Service by providing a contribution to the Postal Service's institutional costs, and thus the NSA proponents have met any reasonable application of the standard.

A. The PRA Did Not Demand Absolute Certainty With Respect to NSAs; Nor Does the PAEA

The Postal Reauthorization Act of 1970 ("PRA") did not demand absolute certainty with respect whether an NSA would adequately cover its attributable costs and contribute to institutional costs. Rather in the Bookspan NSA proceeding, which was decided under the PRA standard, the Commission sought "reasonable assurance that the Postal Service will not lose money on the NSA."[1]

PAEA has clearly not established any tighter standard of certainty with respect to whether an NSA "improve[s] the net financial position of the Postal Service". 39 U.S.C. § 3622(c)(10)(A). Nor has it established more rigid requirements with respect to the Postal Service's analytical frame work. As the Commission observed in its Order No. 43 upon issuing regulations establishing a system of ratemaking (PRC Docket No. RM2007-1), "[t]he statute seeks to provide the Postal Service with greater pricing flexibility for negotiated service agreements coupled with enhanced transparency and accountability. Requiring a specific formula or model for evaluating agreements is contrary to that intent." Order No. 43 at ¶ 2194.

B. The Postal Service's Financial Model Is A Reliable Analysis of the Expected Contribution to Institutional Costs

The OCA completely sidesteps the evidence the Postal Service presents to support its contention that the NSA will cover its attributable costs and will make a reasonable contribution to institutional costs of the Postal Service, in the approximate amount of $5.4 million over the three-year term of the agreement. This evidence has been described in both the Postal Service's and Bradford's Initial Briefs, and will not be repeated here.

Bradford makes rational and efficient marketing decisions that ultimately determine its mail volume in the normal course of operations. It is the best source of information regarding how those decisions are made, and as such, its well-qualified

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[1] *Rate and Services Changes to Implement Baseline Negotiated Services Agreement with Bookspan, Opinion and Recommended Decision,*, PRC Docket No. MC2005-3 (hereinafter, *Bookspan Op.*) ¶ 4089 (citing "PRC Op. MC2002-2 ¶ 8013").

personnel are the source of the best possible forecasts. No party has challenged the integrity of the forecasts.

For its part, the Postal Service has performed the level of due diligence that the Commission has indicated is appropriate to the industry and this customer. *Bookspan Op.* ¶ 4086. Like Bookspan, the Bradford Group is privately held and operating in a small industry, so the data available to the Postal Service was limited. Yet aside from the volume trend analysis, Witness Parr examined the collectibles market environment, and described circumstances in that market indicating that future growth in mail volume is expected to be limited. USPS-T-1 at 8-12.

The Postal Service can not "control for the effects of non-price exogenous factors" (*OCA Initial Brief* at 4), but relies on reasonable economic assumptions regarding the customer's elasticity of demand, under factual circumstances where there are alternatives to the mail. In contrast, the OCA has not even qualitatively estimated the likelihood that volumes would be increased as a result of non-price exogenous factors, and implies that traditional economic assumptions and contractual safeguards cannot be used to meet the standards established by the PAEA.

Implicitly recognizing that there is no such thing as perfect knowledge, the Postal Service set the bar for obtaining the NSA discounts high enough to virtually eliminate any risk that it would be offering discounts on mail that would have been mailed "anyhow" at the prevailing rates, a bar that adjusts in succeeding years and is subject to a floor. The Postal Service also established reasonable contractual safeguards that allow it to continuously monitor the deal and walk away from it at any time if, despite best efforts, the deal proves fruitless or harmful. Yet the results – indeed a limitation – of the

Postal Service's sensitivity analysis presume that any adverse economic circumstances are allowed to continue for a full year. (The OCA's unsupported conclusions suffer the same limitation.)

Furthermore, in the Bookspan NSA proceeding, the Commission applied the subclass elasticity as the default elasticity, and utilized the Panzar test to assess the range of circumstances under which the Postal Service may lose money. Here, Witness Parr performed a comparable Panzar analysis, which indicated that the Bradford NSA satisfies the parameters of the analysis. USPS-T-1 at App. D and USPS-LR-L-1.

Thus, the Panzar test should adequately satisfy the Commission that at any possible level of mail volume that is eligible for discounts, the Postal Service will not lose Standard Mail contribution in any year of this agreement, and therefore "there is reasonable assurance that the Postal Service will not lose money on the NSA." *Bookspan Op.* ¶ 4089 (citing PRC Op. MC2002-2 ¶ 8013). Adding to the Panzar analysis the positive benefits from Bradford's multiplier effect, and the contractual termination provisions, particularly the provision enabling the Postal Service to cancel the agreement without cause on 30-days notice, and weighing "the totality of the circumstances," the Commission should be reasonably satisfied that the financial risks that are inherent in any NSA are minimal, and acceptable in this case.

The OCA points to *Bank of America* as an example of an NSA that, upon review, the Commission determined was not likely to improve the net financial position of the Postal Service, and essentially argues that there is no case-saving performance-enhancing function to the Bradford NSA. *OCA Initial Brief* at 2-3. But the argument is a red herring: *The Bradford Group* case is not analogous to *Bank of America.* In *Bank of*

America, the bank had committed to implementing several advanced mailing practices, and was provided discounts for performance improvements relative to six negotiated baselines. Two of these baselines, First Class Mail and Standard Mail read/accept rates, governed the vast majority of potential cost savings to the Postal Service and discounts paid to Bank of America. In that case, the Postal Service utilized 1999 data for the read/accept rates, but the Commission found that read/accept rates had improved to such an extent that Bank of America would not have to make any improvements in barcode readability to receive the available mail processing performance discounts, and that the Postal Service would lose between $25 and $45.8 million from the Agreement. By contrast, in this case, the underlying data upon which the Postal Service's financial model is based have not even been challenged.[2]

C. A Customer-Specific Elasticity Model Cannot Be Constructed That Would Be More Reliable Than the Customer's Own Before- and After-Rates Volume Forecasts

The Postal Service's model does not, because it cannot, fully anticipate and explain the many factors that influence the Bradford Group's product marketing and mailing decisions that determine the company's NSA eligible mail volumes. Any model that the Postal Service might attempt would be artificial, and overwhelmingly unlikely to be more accurate than the Bradford's own forecasts. The OCA implicitly acknowledges this point, having declined to put forward its own financial model.

Instead, the OCA manipulated the Postal Service's sensitivity analysis to attempt to illustrate various scenarios of "financial risk". The OCA's position is based on pure

2 The *Initial Brief of the American Catalog Mailers Association* indicates that by using LR-22 to develop unit cost contribution estimates, the Postal Service may have *overstated* its total unit costs, but suggests that this would have the effect of "decreasing", that is, understating contribution and depressing NSA discounts. Thus, ACMA's argument implies that the Postal Service could offer *greater* discounts without compromising its financial position.

speculation: the OCA offers no assessment of the market environment that disputes the assessment presented by the Postal Service, and no expert testifies to the likelihood (or not) of realizing any the scenarios of “financial risk” the OCA lays out. In other words, the OCA does not weigh the likelihood that other factors might lead to “anyhow” volumes. (Nor does the OCA evaluate how well this risk is managed by contract.) The OCA does say that “the introduction of non-price exogenous factors into the Postal Service’s financial model causes the financial risks to the Postal Service to explode.” But there, the OCA confuses its own (flawed) valuation of a potential outcome with the *likelihood* that a particular outcome will actually occur. In any event, Postal Service Witness Parr – the only witness to address the OCA’s position – simply rejected the OCA’s so-called “model” as “conceptually flawed” (as the OCA itself points out, *OCA Initial Brief* at 9). In other words, the argument is wholly unsupported.

CONCLUSION

The OCA wishes to substitute its own business judgment for that of the Postal Service's, and would apparently reject an arrangement that poses any level of risk whatsoever. If the Commission allows the OCA to do so, there will be no NSAs, and that is certainly not the result Congress intended.

For the reasons provided above, the Commission should recommend the adoption of the proposed NSA and implementing DMCS rate schedules.

Respectfully submitted,

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