

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

COMPLAINT OF CAPITAL ONE  
SERVICES, INC.

Docket No. C2008-3

**OPPOSITION OF CAPITAL ONE SERVICES, INC.  
TO MOTION TO DISMISS OF THE UNITED STATES POSTAL SERVICE**

(July 28, 2008)

**INTRODUCTION**

Capital One opposes the Postal Service's Motion to Dismiss filed July 21, 2008. The Postal Service first applies the wrong legal standard, misconstrues Capital One's discrimination claim, and spends several pages discussing "functional equivalence" precedents of questionable relevance. It then alleges that Capital One has not negotiated long enough and should continue to negotiate with the Postal Service indefinitely, even though, based on facts *admitted in the Postal Service's Answer*, such negotiations would be futile and could not resolve Capital One's claims of discrimination and other violations of law. The Motion also fails to substantively address the other five claims raised in the Complaint. As a result, only the discrimination count is properly challenged by the Postal Service's Motion to Dismiss.<sup>1</sup>

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<sup>1</sup> Less than a month ago, the Postal Service argued forcefully that the Complaint of Capital One Services, Inc. (the "Complaint") raised no less than six "mixed issues of fact and law," many of which

The Commission should deny the Motion for the following reasons:

First, under generally accepted standards, the Commission should treat allegations in the Complaint as true when deciding whether those allegations “raise an issue concerning whether or not rates and services contravene the policies of the Act.”<sup>2</sup> As a policy matter, the Commission should also consider that, in enacting the Postal Accountability and Enhancement Act of 2006, 39 U.S.C. 101 *et seq.* (PAEA), Congress dispensed with traditional rate case procedures and intended for complaints to become one of the primary tools for mailers to challenge unlawful rates and a key mechanism to enable the Commission to ensure transparency. Dismissing a substantial complaint at the earliest stage—and thereby depriving the mailer of its opportunity to prove its case—would frustrate Congress' intent in establishing the PAEA regulatory structure.

Second, the Postal Service's claim that Capital One has prematurely filed its Complaint misstates the facts. As detailed in Section II below, Capital One has already engaged in 18 months of futile NSA negotiations. More importantly, further negotiations would accomplish nothing because the Postal Service has stated repeatedly and unequivocally that any NSA with Capital One must use mailer-specific baselines and discount schedules—a position that forms the basis for Capital One's allegations of discrimination and other violations of law. Without legal resolution of those issues, there is nothing to negotiate.

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required full discovery. See Answer of United States Postal Service in Opposition to Motion of Capital One Services, Inc. for an Order Bifurcating Proceeding and for an Expedited Schedule, at 3-4. Now, however, it asks the Commission to dismiss the Complaint immediately. In the earlier pleading, the Postal Service stated that, "Approximately one and one half years passed before Capital One filed its complaint," and faulted Capital One for "[t]his delay." *Id.* at 7. Now, it argues that Capital One has filed its complaint too early.

<sup>2</sup> 39 C.F.R. § 3001.82.

Third, the Postal Service fails to comprehend that Capital One's claims of discrimination and other violations of law are much broader than the procedural standard of "functional equivalence" applied to determine whether an NSA qualifies for streamlined processing. The Postal Service's laundry list of issues "yet to be negotiated" are relevant only to volume incentive NSAs. The Bank of America NSA is a **cost-savings** NSA with per-piece discounts based on the Postal Service's avoided costs, and baselines unrelated to any attribute of the mailer. Just as the Postal Service cannot demand that each mailer negotiate a different worksharing discount, it cannot demand here that Capital One "negotiate" key components of a mail processing agreement when those components do not vary from mailer to mailer.

Lastly, contrary to the suggestions made by the Postal Service, Capital One did not file this Complaint "to secure [a] better bargaining position[]" see Motion at 8, but rather because it "truly believe[s]," that "the Postal Service is charging rates which do not conform to the policies set out in the Act"—the substantive predicate for a complaint under 39 C.F.R. § 3001.82. Simply put, the Postal Service cannot—without unduly discriminating against users of the mail or otherwise violating the law—negotiate what it claims is a "baseline" NSA, the first of "hundreds of NSAs," and then make it impossible for any other mailer to qualify. The Complaint is ripe, more than adequate under any reasonable legal standard, and the Commission must act to remedy ongoing violations of law. Accordingly, the Motion should be denied.

## LEGAL STANDARD

Under widely accepted standards, motions to dismiss are rarely granted, and even then, only in situations where the complaint suffers from some obvious and fundamental defect. Tribunals understandably hesitate to dismiss a claim before the claimant has even had a chance to prove his case. The Federal Rules of Civil Procedure set the standard for evaluating the legal sufficiency of a complaint as “notice pleading”: a “short and plain statement of the claim showing that the pleader is entitled to relief.”<sup>3</sup> In considering a motion to dismiss, the tribunal must assume “that all the allegations in the complaint are true.”<sup>4</sup>

While the Federal Rules do not apply directly to Commission proceedings, they provide a useful frame of reference, and existing Commission regulations and prior statements echo that general approach. So, for example, the existing complaint rules specify that the Commission “*shall* entertain” complaints that “clearly raise an issue concerning whether or not rates and services contravene the policies of the Act.”<sup>5</sup> Moreover, the Commission has found that it should be “hesitant to foreclose complaints.”<sup>6</sup>

As the Commission has recognized, the structure of the PAEA heightens the need for full and fair complaint procedures: parties must have “the opportunity to utilize the Commission’s complaint procedures *whenever compliance with the statutory*

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<sup>3</sup> Fed. R. Civ. P. 8(a)(2).

<sup>4</sup> *Bell Atlantic Corp. v. Twombly*, 127 S.Ct. 1955, 550 U.S. \_\_\_ (No. 05-1126) 2007; *see also Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974) (“The issue is not whether a plaintiff will ultimately prevail, but whether the claimant is entitled to offer evidence to support the claims.”).

<sup>5</sup> 39 C.F.R. § 3001.82 (emphasis added).

<sup>6</sup> Postal Regulatory Commission, Docket No. RM2007-1, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products (October 29, 2007) at ¶ 2096.

*requirements becomes an issue.*<sup>7</sup> In the absence of traditional rate case procedures, complaints become one of the few remaining avenues for the mailing public to challenge discrimination or other unlawful acts by the Postal Service and for the Commission to ensure transparency. To grant the Postal Service’s Motion in this case, the Commission would need to find that Capital One’s 22-page Complaint and eight-page Declaration fail to state a claim upon which relief could conceivably be granted. Such a ruling would foreshadow an extremely limited interpretation of the new role of the complaint process under the PAEA, contrary to Congressional intent and the structure of the new law.<sup>8</sup>

## **ARGUMENT**

### **I. Capital One has adequately pleaded a claim for discrimination under 39 U.S.C. § 403(c).**

The Postal Service begins with an odd—and mistaken—formulation of Capital One’s discrimination claims, and then uses that twisted formulation to jump into an extensive discussion of Commission precedent involving the term “functional equivalence,” precedent that has little or no bearing on Capital One’s statutory claims of discrimination.

The Postal Service’s argument makes two fatal mistakes: first, the Postal Service confuses discrimination with the procedural concept of functional equivalence;

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<sup>7</sup> RM2007-1 at ¶ 4029 (responding to public comments expressing concern about lack of public participation in mail classification changes) (emphasis added); *see also id.* at ¶ 2193 (“The Commission recognizes that the 45-day review period does not lend itself to in-depth analysis; however, the complaint process will allow for further review where necessary”).

<sup>8</sup> The Postal Service implies that the Complaint should be dismissed for a purported failure to “establish” discrimination, as if a complaint must definitively prove discrimination rather than simply allege facts that, if taken as true, would support such a claim. *See* Motion at 1-2.

second, it applies the wrong conceptual framework, treating the Bank of America NSA—a cost-savings NSA—like an NSA involving volume-incentive discounts.

(a) Confusing discrimination with “functional equivalence”

Discrimination under Section 403(c) is a much broader concept than the procedural rules that defined “functionally equivalent” NSAs. The Commission took care to explain this distinction in Order 1391,<sup>9</sup> which first established Section 3001.196, the “functional equivalence” rule:

The purpose of Section 3001.196 is to provide an opportunity to expedite the review of a request for a functionally equivalent [NSA] by allowing the proponents of the agreement to rely on relevant record testimony from a previous docket . . . avoiding the need to relitigate issues that were recently litigated and resolved in a previous docket.<sup>10</sup>

The Commission went on to expressly reference issues of “discrimination” and “competition” and treat them as distinct from the procedural concept of functional equivalence.<sup>11</sup>

At pages 2-3 of the Motion, the Postal Service seems to argue that an “identical” NSA is not a “functionally equivalent” NSA, but this entire discussion misses the point.<sup>12</sup>

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<sup>9</sup> Docket No. RM2003-5, Order Establishing Rules Applicable to Requests for Baseline and Functionally Equivalent Negotiated Service Agreements (February 11, 2004).

<sup>10</sup> *Id.* at 48. The PAEA and related regulations changed the procedures for NSA approvals from prior review to after-the-fact compliance reporting. The Commission declined to incorporate Section 3001.196 in the new procedural rules, stating that “NAA also suggests that procedures similar to the existing rules regarding functionally equivalent negotiated service agreements be carried forward into the rules. The intent of the rules regarding functionally equivalent negotiated service agreements was to streamline the litigation process. Given the 45-day review contemplated in subpart D, retaining these rules seems unnecessary.” RM2007-1 at ¶ 2198.

<sup>11</sup> *See generally, id.* at 53. The Postal Service itself seems to recognize this at various points in the Motion, though it does not seem to appreciate the significance. *See* Motion at 2, note 2 (“Section 403(c) of Title 39 makes no mention of functional equivalence.”); *see also id.* at 4, note 7 (observing that the term “has no statutory foundation”).

<sup>12</sup> Relying upon false logic, the Postal Service argues that because an NSA does not need to be “identical” in order to be functionally equivalent to a baseline NSA, Capital One’s proffered NSA must not be functionally equivalent to the Bank of America NSA. This is the same as saying that because the set of functionally equivalent NSAs can include NSAs that are not “identical,” it necessarily follows that an

Functional equivalence aside, the real question is, “Has unreasonable discrimination been alleged?” The fundamental question raised by the Complaint is whether the Postal Service can offer an apple to one mailer and an onion to the next: Can it offer Bank of America an NSA that uses dated, industry average baselines to calculate financial incentives in exchange for Bank of America’s implementation of a panoply of mail processing services and then turn around and tell Capital One that it will only offer it a true pay-for-performance NSA using mailer-specific baselines? The Postal Service admits these facts in its answer, and those admissions, coupled with the detailed facts alleged by Capital One, more than suffice to state a claim for discrimination under Section 403(c).

(b) Confusing a “cost savings” NSA with “volume incentive” NSAs

The Bank of America NSA is a “cost-savings” NSA, not a volume incentive NSA, but this distinction seems lost on the Postal Service in the context of this Motion. As the Postal Service itself recognized in its Request for a Recommended Decision, MC2007-1 (February 7, 2007), the Bank of America NSA is intended to “provide incentives that will encourage an individual mailer to engage in voluntary changes in mail preparation that will reduce the costs to the Postal Service of handling the mailer’s mail.” Request at 4. In contrast, a key component of all previous NSAs was volume discounts to encourage the mailer to increase its mail volume over what would have been sent without the discounts. By necessity, to ensure that the Postal Service paid discounts only for

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“identical” NSA cannot fall within the functionally equivalent set. This makes no logical sense. “Functionally equivalent” NSAs can include both identical and non-identical NSAs, and, the Commission does not need to define the entire universe of *non-identical* NSAs that might be considered “functionally equivalent” to determine, that an *identical* NSA, such as the one at issue here, is “functionally equivalent.”

incentivized mail and did not lose contribution, each volume-incentive NSA had to be tailored to reflect each individual mailer's volume history and contribution.

In contrast, the Postal Service's benefits in the Bank of America NSA rest only on the per-piece cost savings to the Postal Service, not on any attribute of the mailer. The per-piece savings to the Postal Service, as in worksharing, do not vary based on each individual mailer's volume and mail profile. The amount of per piece savings rests only on the Postal Service costs established in the latest rate case or approved Annual Compliance Report. Thus, the Postal Service's position that "all NSAs, including functionally equivalent agreements, are tailored to each NSA partner's unique situation," Motion at 3, makes sense only for volume-incentive NSAs, not for cost-savings NSA.<sup>13</sup>

An analogy to worksharing discounts clarifies this distinction. Certain mail processing practices by mailers (such as presorting or prebarcoding) can result in the Postal Service avoiding costs it would otherwise have incurred. Under 39 U.S.C. § 3622(e), the Postal Service can pass through to the mailer a portion of the avoided costs, but no more than 100%, unless certain conditions are met. When specific discount rates are proposed for worksharing activities, the Postal Service's avoided costs do not vary by mailer. More importantly, if two mailers perform the same worksharing activities, the Postal Service cannot pass through 100% of the avoided costs to the first mailer (*e.g.*, a five-cent discount) but only 20% of the avoided costs to the second mailer (*e.g.*, a one-cent discount). Presumably, Section 403(c)'s prohibition of discrimination would prevent such unfairness.

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<sup>13</sup>. The cost-savings elements of previous NSAs were not subject to "negotiation". See, *e.g.*, Docket No. MC2004-4 (Discover NSA), Docket No. MC2005-2 (HSBC NSA); *cf.* Motion at 2.

The Postal Service's insistence in this case that different baselines and different discount schedules apply to Capital One raises the same question of discrimination. The Complaint sets forth the Postal Service's oft-stated position in the Bank of America NSA that Bank of America would receive a certain amount of discounts (unrelated to its actual read/accept rate) for Bank of America's adoption of a "panoply of modern mail processing services."<sup>14</sup> The Complaint then juxtaposes the Postal Service's subsequent refusal to provide the same amount of discounts (*i.e.*, the same discount schedule and baselines) for Capital One's adoption of the same "panoply of modern mail processing services." Thus, the Complaint has made a *prima facie* showing of discrimination.

**II. The 18-month history of negotiations and the Postal Service's unequivocal position demonstrate that Capital One has exhausted all reasonable, good faith efforts to negotiate.**

The Postal Service's repeated protestations to the effect that the parties have "never engaged in, much less exhausted, reasonable efforts to negotiate," Motion at 4, ignore the nature and history of 18 months of NSA discussions between the parties. Further negotiations at this point would not be productive given the Postal Service's position that the discount schedules and baselines must be negotiated and differ fundamentally from those offered to Bank of America, the very position Capital One claims to be discriminatory.

As alleged in the Complaint, Capital One began asking for an NSA similar to the one offered to Bank of America shortly after that NSA became public in early 2007, and has been repeatedly rebuffed: Over the course of a year and a half, the Postal Service

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<sup>14</sup> As the Commission found, the Bank of America NSA was not a "pay-for-performance" agreement, and it was likely that Bank of America would not need to do anything to improve its read/accept rates in order to obtain all the available discounts. See Postal Regulatory Commission, Docket No. MC2007-1, Opinion and Recommended Decision (October 3, 2007) at 1-2.

would offer a volume-incentive NSA and a pay-for-performance NSA. Importantly, the Postal Service never offered to Capital One the kind of NSA given to Bank of America. In fact, the Postal Service explicitly refused to offer such an NSA.

In addition to numerous informal conversations (described generally in the Complaint at paragraphs 29-42), Capital One had the following face-to-face meetings and formal communications with the Postal Service, with discussions that included aspects of an NSA similar to the Bank of America NSA:

- February 27, 2007: Face-to-face meeting (discussion of the Bank of America NSA and whether Capital One could do something similar).
- June 5, 2007: Face-to-face meeting (discussion of Capital One's specific interest in a non-volume-based, cost-savings NSA).
- October 4, 2007: Face-to-face meeting (discussion of an NSA structure that included cost savings and UAA elements).
- November 29, 2007: Face-to-face meeting (discussion of an NSA structure, as well as Capital One's mail processing practices such as IMB, ACS, and Seamless Acceptance).
- January 31, 2008: Informal meeting between Niki Howard of Capital One and Jessica Lowrance (Ms. Howard was told by Ms. Lowrance that Capital One would not be able to use the industry-average rates offered to Bank of America).
- March 6, 2008: Face-to-face meeting (discussion of ACS, IMB, Address Hygiene, Seamless Acceptance).
- April 2, 2008: Telephone conversation between Ms. Lowrance and Ms. Howard (Ms. Lowrance stated that the Postal Service "was not supporting any NSAs like the Bank of America filing" and were only interested in doing volume-based deals).
- April 17, 2008: Telephone conversation between Ben Lamm of Capital One and Stephen Kearney (Mr. Kearney reaffirmed that Capital One could not use the industry average baselines for its NSA).
- May 15, 2008: Letter from David Hummelberg of Capital One to Mr. Kearney (letter explained the competitive disadvantage created by the Bank of America NSA and offering to sign a substantively identical agreement).

- May 27, 2008: Letter from Mr. Kearney to Mr. Hummelberg (letter stated that “a new Capital One NSA would not be identical to the Bank of America NSA. Certain terms and conditions would necessarily have to be changed, as the situation regarding the factors in the Bank of America agreement is different today.”)
- May 30, 2008: Letter from Mr. Lamm to Mr. Kearney (letter asked Mr. Kearney to specify on a draft what terms and conditions would need to be changed and why, and specifically what changes would need to be made to the discount baselines and discount schedules offered to Bank of America).
- June 4, 2008: Letter from Mr. Kearney (Mr. Kearney declined to indicate the required changes and requested a face-to-face meeting).
- June 9, 2008: Face-to-face meeting (Mr. Kearney stated that changes would have to be made to the discount schedules and baselines and that Capital One would have to use mailer-specific baselines).

Most recently, counsel for the parties have communicated since filing of the Complaint. In attempting to set up another negotiation session, however, counsel for the parties have been unable to identify significant issues to discuss. In response to Capital One’s specific inquiry, the Postal Service indicated that it had not changed its original position that it would not agree to the baselines and discount schedules from the Bank of America NSA. In a later conference call, in response to Capital One’s inquiry as to what would be discussed at a negotiation session, Postal Service counsel could identify only one topic: minor and non-controversial word changes to the contract language (details usually raised and resolved only after a deal is struck). In that conference call, Capital One also explained that there had already been a history of extensive negotiations between Capital One and Postal Service officials Jessica Lowrance and Michael Plunkett.<sup>15</sup> Postal Service counsel seemed unaware of these earlier discussions, including the existence of an operative Non-Disclosure Agreement

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<sup>15</sup> Both of these individuals are currently on leave from the Postal Service. Thus, it is possible that Postal Service counsel have been unable to inform themselves of the history of negotiations, resulting in erroneous statements such as those described in the following footnote.

(NDA), signed by Michael Plunkett on October 23, 2006, a copy of which Capital One provided to Postal Service counsel on July 15, 2008.<sup>16</sup>

In light of this 18-month history of NSA discussions and the Postal Service's repeated and unequivocal position that Capital One's NSA cannot use the schedules and baselines given to Bank of America, there is little to be gained in negotiating further. Indeed, despite good faith efforts of both sides, the parties *cannot* negotiate further without legal resolution of these issues by the Commission. The Motion states that "The Postal Service ... remains prepared to continue NSA negotiations with Capital One .... *Most importantly, specific thresholds and discounts must be negotiated.*" But the point of the Complaint is that because the Bank of America NSA is not a "pay-for-performance" NSA and does not depend upon the individual mailer's actual read/accept rate, the specific thresholds cannot be changed or discounts reduced without discriminating against the mailer or otherwise violating the law.

The Postal Service's purported "willingness to negotiate" is thus a mirage. Accordingly, dismissal of the Complaint on these grounds—*i.e.*, that Capital One must first negotiate with the Postal Service its own "specific thresholds and discounts"—would be akin to a ruling on the legal merits of the discrimination issue and would effectively deprive Capital One of any opportunity to prove its case, instead forcing Capital One to engage in endless negotiations for an Bank of America-style NSA that the Postal Service has already said it will refuse to offer.

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<sup>16</sup> Despite all these concrete steps and discussions, the Motion represents that "The parties had yet to exchange data, discuss specific contract terms, or even clarify whether a Non-Disclosure Agreement between the parties is applicable . . . . [O]ne wonders why [Capital One] did not demand to meet face-to-face and initiate NSA negotiations *well before* the Bank of America NSA was even implemented." Motion at 7 (emphasis in original). In fact, Capital One did all of these things.

**III. Capital One has adequately pleaded numerous harms that flow directly from the Postal Service’s violations of law, and those harms will continue until the Commission rules on claims raised by the Complaint.**

The Postal Service’s final substantive argument—that Capital One has failed to “demonstrate” harm or “irreparable” harm—fails for at least two reasons: first, neither 39 U.S.C. § 403(c) nor 39 U.S.C. § 3622(c)(10) require Capital One to show harm *to itself* to state a valid claim under these statutes and regulations.<sup>17</sup>

Second, in the Complaint and accompanying Declaration, Capital One alleged several different kinds of significant harm, including the following:

Type of Harm <sup>18</sup>	Citations to Complaint or Declaration
Competitive Injury	Complaint ¶¶ 6, 34, 36, 44-46, 55, 62-63, 73 Declaration ¶¶ 20, 23, 31
Corporate Resources Expended <sup>19</sup>	Complaint ¶¶ 71-72
Direct Economic Harm <sup>20</sup>	Complaint ¶¶ 6, 50 Declaration ¶ 31

All of these harms are ongoing and accumulating, and they cannot be remedied unless the Postal Service either changes its position voluntarily or the Commission rules in Capital One’s favor.

<sup>17</sup> Section 403(c) requires no showing of harm, and Section 3622(c)(10) requires a showing of harm *to the marketplace* (broadly), which Capital One alleged at ¶¶ 64-65 of the Complaint.

<sup>18</sup> Again, under widely accepted standards for evaluating a motion to dismiss, all of these allegations of harm must be taken as true. *See supra* at 3-5.

<sup>19</sup> This includes not only internal resources devoted to this issue for over a year, but significant legal fees and costs incurred in petitioning the Commission to require the Postal Service to comply with the law.

<sup>20</sup> Because Capital One is in a position to implement an NSA on the terms offered to Bank of America, Capital One is losing discounts that it could be obtaining now.

**IV. Capital One has adequately pleaded five additional claims and these claims are not seriously disputed in the Postal Service’s Motion.**

The Complaint alleges six, distinct claims:

Claim 1 – The Postal Service Unreasonably or Unduly Discriminated Against Capital One in Violation of 39 U.S.C. §403(c).

Claim 2 – The Postal Service Has Granted an Undue or Unreasonable Preference to Bank of America in Violation of 39 U.S.C. §403(c).

Claim 3 - The Postal Service Has Created a Special Classification that is Not Available on Public and Reasonable Terms to Similarly Situated Mailers in Violation of 39 U.S.C. §3622(c)(10).

Claim 4 - The Postal Service Has Created a Special Classification that Creates an Unreasonable Harm to the Marketplace in Violation of 39 U.S.C. §3622(c)(10).

Claim 5 – The Postal Service Has Also Violated Commission Rule 3010.40 *et seq.*

Claim 6 – Equitable Relief

The Postal Service’s Motion directs substantive arguments to only the first of these six claims, addressing the rest with a series of conclusory statements tied to the mistaken understanding just described. To cite just one example, the Complaint contains detailed allegations in Claims 3 and 4 that that the Postal Service has caused unreasonable harm to the marketplace and failed to make available a mail classification on reasonable terms to similarly situated mailers in violation of 39 U.S.C. § 3622(c)(10)—a new statutory section added by the PAEA that has nothing to do with functional equivalence. In response to these carefully pleaded claims,<sup>21</sup> the Postal Service states—without any further explanation—“Nor has the Postal Service created a special classification not available on public and reasonable terms to similarly situated mailers in violation of 39 U.S.C. § 3622(c)(10).” *Ipsi dixit* (“because I said so”) is no

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<sup>21</sup> See Complaint ¶¶ 56-65.

substitute for reasoned argument. The practical effect of the Postal Service's failure to substantively challenge Claims 2 – 6 is that only Claim 1 (discrimination) is properly before the Commission on the Motion to Dismiss.

### **CONCLUSION**

For all of these reasons, the Postal Service's Motion to Dismiss the Complaint should be denied.

Respectfully submitted,

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July 28, 2008