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

Before Commissioners:

Ruth Y. Goldway, Chairman;
Mark Acton, Vice Chairman;
Dan G. Blair;
Tony L. Hammond; and
Nanci E. Langley

Market Dominant Product Prices
First-Class and Standard Mail
Discover Financial Services

Docket No. MC2011-19

Market Dominant Product Prices
Discover Financial Services (MC2011-19)
Negotiated Service Agreement

Docket No. R2011-3

NOTICE AND ORDER CONCERNING ADDITION OF DISCOVER FINANCIAL SERVICES NEGOTIATED SERVICE AGREEMENT TO THE MARKET DOMINANT PRODUCT LIST

(Issued January 19, 2011)

I. INTRODUCTION

On January 14, 2011, the Postal Service filed a request pursuant to 39 U.S.C. 3622 and 3642, as well as 39 CFR 3010 and 3020, *et seq.*, to add a Discover Financial Services (DFS) negotiated service agreement to the market dominant product list.[1]

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[1] Notice of the United States Postal Service of Filing Contract and Supporting Data and Request to Add Discover Financial Services Negotiated Service Agreement to the Market-Dominant Product List, January 14, 2011 (Request).

Request. In support of its Request, the Postal Service filed six attachments as follows:

- Attachment A—a copy of Governors' Resolution No. 11-2, authorizing a negotiated service agreement with DFS;
- Attachment B—a copy of the contract;
- Attachment C—proposed descriptive language changes to the Mail Classification Schedule;
- Attachment D—a proposed data collection plan;
- Attachment E—a Statement of Supporting Justification as required by 39 CFR 3020.32, which the Postal Service also is using to satisfy the requirements of 39 CFR 3010.42(b)-(e); and
- Attachment F—a financial model, which the Postal Service believes demonstrates that the agreement will improve its net financial position by an additional $2 million to $15 million in contribution.

In its Request, the Postal Service identifies Greg Dawson, Manager, Pricing Strategy as the official able to provide responses to queries from the Commission. In his Statement of Supporting Justification, Mr. Dawson reviews the factors and objectives of section 3622(c) and concludes, *inter alia*, that the agreement will provide an incentive for profitable mail; will enhance the financial position of the Postal Service; will increase mail volume; will not imperil the ability of First-Class Mail or Standard Mail to cover its attributable costs; and promotes the use of intelligent mail. *Id.,* Attachment E at 1-3.

The Postal Service believes that the DFS negotiated service agreement conforms to the policies of the Postal Accountability and Enhancement Act, and meets the statutory standards supporting the desirability of this special classification under 39 U.S.C. 3622(c)(10). In particular, the Postal Service believes the agreement has the potential to enhance significantly the Postal Service's financial position, and it will not cause unreasonable harm to the marketplace. *Id.* at 2.

Related contract. The Postal Service indicates that the agreement is designed to maintain the total contribution the Postal Service receives from DFS First-Class Mail and Standard Mail and to provide an incentive for net contribution beyond that. *Id.* The Postal Service describes the agreement and its five main components: a revenue threshold, a revenue threshold adjustment, a postage commitment, rebates on First-Class Mail, and rebates on Standard Mail.

Specifically, the revenue threshold is based on the amount of DFS' total postage paid for First-Class Mail automation presort letters, Standard Mail automation presort letters, and Standard Mail carrier route letters. The baseline for the revenue threshold is DFS' total postage for these categories over the period from February 2010 through January 2011. For the first year of the agreement, the threshold is calculated as an amount 10 percent above the baseline; for the second year, 15 percent above the baseline; and, for the final year, 20 percent above the baseline. If DFS meets or exceeds the threshold in a contract year, it will earn rebates on its qualifying First-Class Mail and Standard Mail postage. The revenue threshold will be adjusted upward by 65 cents for every dollar decline in DFS' First-Class Mail postage. Under this adjustment, to qualify for rebates, DFS must send an extra $1.65 worth of Standard Mail to offset each dollar decline in postage from First-Class Mail. *Id.* at 3.

The agreement also contains a postage commitment, equal to the adjusted threshold. If the amount of DFS' total postage from eligible mail in the first year of the contract is less than the adjusted threshold, DFS must pay a penalty in the amount of 10 percent of the difference between DFS' revenue threshold and the actual total postage paid for contract year one. Subsequent year threshold adjustments to the penalty are to be negotiated by the parties within 7 months of the previous contract year. *Id.* at 3-4.

If DFS meets or exceeds the adjusted postage thresholds in any given year of the contract, it will earn rebates on its qualifying First-Class Mail and Standard Mail postage. The rebate for First-Class Mail will be equal to 75 percent of the increase in postage as a result of a subsequent cumulative price increase (relative to First-Class Mail prices in existence at the initiation of the agreement) for all qualifying pieces. For Standard Mail, the rebate will be equal to 37.5 percent of the increase in postage as a result of a subsequent cumulative price increase (relative to Standard Mail prices in existence at the initiation of the agreement) for all qualifying pieces. *Id.* at 4.

The Postal Service also describes several other elements of the agreement: (1) a merger and acquisition clause; (2) a termination clause; and (3) a clause that requires the Postal Service to negotiate with DFS on the terms upon which DFS may participate in other incentive programs so there is no "double-dipping." *Id.* at 3-4.

The Postal Service expects the value of the agreement to still be positive if the penalty provision is triggered, reducing the risk of the agreement.

The Postal Service indicates that the contract will become effective March 1, 2011, and will expire 3 years from the effective date. *Id.* at 1; *see also id.,* Attachments A and B. Either party may terminate the agreement for convenience prior to the last 90 days of each contract year, without penalty, with 90 days' written notice to the other party. Implementation of the agreement is pending regulatory approval.[2]

Similarly situated mailers. With respect to potential similarly situated mailers, the Postal Service states that the design imperative, to generate additional contributions, and the basic structure of the agreement described in the Request, will guide the Postal Service in the negotiation of similar agreements as well as those that are substantially different. *Id.* at 4; *see also id.,* Attachment E at 3. It notes that in assessing the desirability of the agreement, the Postal Service believes that the defining characteristics of DFS are its size, its large but declining billing and statement volumes, its significant volume of advertising mail, and its almost complete reliance on

[2] The Commission will make every possible effort to review the Request and issue its decision by March 1, 2011, consistent with parties' due process rights. The Commission, however, does not read 39 U.S.C. 3642 as mandating regulatory action by a date certain. If the Postal Service (or an interested person) has a different view, the issue may be addressed in comments.

letter-shaped mail. The Postal Service views heavy use of both First-Class Mail and Standard Mail as necessary mailer attributes.

Notice. The Postal Service represents that it will inform customers of the new classification changes and associated price effects through a press release, notification on USPS.com, and publication in the *Federal Register*.

II. NOTICE OF FILING

The Commission establishes Docket Nos. MC2011-19 and R2011-3 for consideration of the Request pertaining to the proposed new product and the related contract, respectively.

Interested persons may submit comments on whether the Postal Service's filing in the captioned dockets are consistent with the policies of 39 U.S.C. 3622 and 3642 as well as 39 CFR parts 3010 and 3020. Comments are due no later than February 7, 2011. The filing can be accessed via the Commission's website (*http://www.prc.gov*).

The Commission appoints Malin Moench to serve as Public Representative in these dockets.

III. ORDERING PARAGRAPHS

It is ordered:

1. The Commission establishes Docket Nos. MC2011-19 and R2011-3 for consideration of the matters raised in each docket.

2. Pursuant to 39 U.S.C. 505, Malin Moench is appointed to serve as officer of the Commission (Public Representative) to represent the interests of the general public in these proceedings.

3. Comments by interested persons in these proceedings are due no later than February 7, 2011.

4. The Secretary shall arrange for publication of this Order in the *Federal Register*.

By the Commission.

Shoshana M. Grove
Secretary