

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Postal Regulatory Commission
Submitted 2/11/2011 4:22:28 PM
Filing ID: 71926
Accepted 2/11/2011

DISCOVER NSA

Docket No. MC2011-19

DISCOVER NSA

Docket No. R2011-3

**RESPONSE OF THE UNITED STATES POSTAL SERVICE TO COMMENTS OF THE
PUBLIC REPRESENTATIVE**
(February 11, 2011)

On February 7, 2011, the Public Representative (PR) filed comments in this docket in response to Postal Regulatory Commission (“Commission”) Order No. 654. The Postal Service hereby submits its response to certain issues raised by the PR in those comments.¹

At various points in his comments, the PR asserts that the stated purpose of this NSA is to slow or stop the movement of advertising mail from First-Class Mail to Standard Mail. This is a mistaken inference on the part of the PR. DFS sends virtually no First-Class Mail advertising to begin with (as the PR notes on page 10 of his comments); that ship has long since sailed². Instead, the purpose of this agreement is to maintain and increase the value of DFS’ total business with the Postal Service, even as the nature of that business is changing. The structure is explicitly designed to offset losses in **statement** mail volume with additional advertising mail. Thus, by substituting

¹ In this pleading, the Postal Service has not attempted to respond to all of the PR’s comments. Rather, we have focused on his characterizations of the purpose and effect of the NSA with Discover Financial Services (DFS), as it embodies the agreement between the parties arrived at through negotiations. As noted below, the Postal Service believes that the PR’s mechanistic approach to this and similar agreements is impractical and unnecessary.

² Even the first NSA with DFS, which was intentionally designed to shift Standard Mail advertising into First-Class Mail, could not stop the loss of First-Class Mail volume.

increases in one activity for decreases in another, the Postal Service is attempting to maintain the total contribution it earns from DFS.

It is because the mail the Postal Service seeks to grow is less remunerative than the mail that it is replacing that there is an adjustment factor built into the agreement. As the PR notes, the value of that factor, 1.65, is not the exact ratio at which DFS' Standard Mail postage produces contribution equivalent to its First-Class Mail; instead, the factor guarantees that, for DFS to qualify for rebates, it has to create more contribution to the Postal Service from Standard Mail than it destroys from lost First-Class Mail³. This particular value was not chosen by the Postal Service in a vacuum, as implied by the PR (p. 7), but was determined, along with the thresholds and discounts in the agreement, in the negotiation process, with a view (from each party's perspective) towards ensuring that the entire contract, rather than any particular element, was optimized for DFS' business. There is a range of values for the threshold beyond some minimum (in the case of DFS, 1.4) that would ensure that the value of additional Standard Mail would at least offset the loss of First-Class Mail, as there are ranges for the value of each of the relevant elements that make sure that contribution from DFS will grow. Discussions with another mailer beginning from the same point likely would have led to a different combination of values for those elements, reflecting that other mailer's evaluation of the relative importance of each factor (or, perhaps, to no agreement at all, if no combination of values that satisfied the mailer resulted in contribution growth for the Postal Service). The Commission has recognized in previous NSA dockets that agreements do not have to provide identical incentives to be considered functionally equivalent; if these values were to be fixed for all similar

³ Note that, in the formula presented on page 6 of the PR's comments, the expression "+\$0.229" should be excluded when calculating the amount of Standard Mail revenue necessary to produce the equivalent amount of contribution as a dollar of First-Class Mail revenue.

agreements, as the PR desires, and apparently assumes will happen (p. 15), it could reduce the value of those agreements to the Postal Service or even cause it to lose contribution.

The PR notes that the nature of this incentive is somewhat different than in past NSAs (and other incentive programs), and that analyzing it is not “straightforward” (p. 9)

⁴. As has been discussed at length in other proceedings (principally RM2010-9), applying system-wide elasticities to estimate the behavior of any particular mailer is problematic. It is especially difficult in cases, like this one, where the change in behavior of the mailer that the NSA seeks to influence is the result of a complex interplay of factors. For the same reasons that discussions with similar mailers may result in agreements with different values for the parameters embedded in a particular structure—namely that different factors have more relative importance to different customers, and that customers make decisions based on their evaluation of their particular circumstances (which is informed by those relative value judgments)—trying to evaluate each customer using identical models is likely to give misleading results. The Postal Service has evaluated this agreement based on its best judgment of DFS’ future behavior, given current trends, understanding of DFS’ business, and expectations of market and economic conditions, and will evaluate actual results based on these same factors. The Postal Service will perform the same kind of analysis with regard to other mailers who would like to enter into a similar agreement; the fact that no

⁴ In this context, note that the table on page 16 of the PR’s comments, while it may serve to illustrate his argument, cannot be taken to provide coherent estimates of the value of the agreement. In calculating the contribution, the PR assumes one value for incremental volume, which he uses to calculate incremental discount, then uses this discount to calculate a second—and different—incremental volume estimate. Presumably, there is some incremental volume estimate that satisfies his purpose, but the PR hasn’t found it here.

mechanical model can be substituted for this analysis is not a reason either to doubt the judgment of the Postal Service or to reject this agreement.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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February 11, 2011