

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Market Dominant Product Prices)	Docket No. MC2015-3
First-Class Mail & Standard Mail)	
Discover Financial Services)	
)	
Market Dominant Product Prices)	Docket No. R2015-2
Discover Financial Services (MC2015-3))	
Negotiated Service Agreement)	

**VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
COMMENTS ON DISCOVER FINANCIAL
SERVICES NEGOTIATED SERVICE AGREEMENT
(November 17, 2014)**

On October 27, 2014, the Postal Service filed a Notice of Filing Request to Add Discover Financial Service Negotiated Service Agreement to the Market-Dominant Product List ("Discover NSA"). The Commission issued Order No. 2231 on October 29, 2014, opening the docket and inviting comments on the proposed contract. Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (hereinafter "Valpak") hereby file their Comments regarding the Discover NSA.

COMMENTS

I. The Proposed Discover NSA Clearly Fails to Meet the PAEA Statutory Requirements.

The Postal Accountability and Enhancement Act ("PAEA") requires that negotiated service agreements ("NSAs"), that is "agreements between the Postal Service and postal users," must, *inter alia*, either:

- (i) improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or

(ii) enhance the performance of mail preparation, processing, transportation, or other functions.... [39 U.S.C. § 3622(c)(10)(A).]

The Postal Service specifically denies that the NSA qualifies under the second criterion. *See* USPS Response to ChIR No. 1, question 4.

As to the first criterion, disregarding Commission rules, the Postal Service relies only on its own “innovative quantitative analytical methodology.” USPS Response to ChIR No. 1, question 2(4). The Postal Service’s claim that the Discover NSA will result in nearly \$1 billion in total revenue, providing \$91.4 million in a net contribution over the three-year term, is fanciful. *See* Notice, p. 15. The Postal Service provides the projected net effect of the NSA using the required Commission methodology (buried in a spreadsheet) for the **first year only: a loss of \$6.18 million**. *See* Notice, Attachment F, tab “5_Commission’s Methodology.” *See also* USPS Response to ChIR No. 1, question 3.a. The Postal Service provides **no estimate of the net results for the second and third years using approved methodology**, and it does not explain this omission in its response to ChIR No. 1, question 3. Clearly, the proposed Discover NSA fails the first statutory criterion using the Commission’s accepted methodology.

The Postal Service goes to great lengths to explain why the Commission’s methodology is wrong, and why it believes the Postal Service’s to be right. It flouts the Commission rules, having learned over the years that the Commission rarely enforces its own rules. The Postal Service methodology relies heavily on volume projections of a private party who stands to benefit financially. No profit-seeking business would make decisions in this way.

In this docket, the Postal Service is defending its speculation about unprecedentedly high elasticities for a single large mailer that range from (i) -6 to -10 for First-Class Mail, and

(ii) -9 to -16 for Standard Mail. *See* USPS Response to ChIR No. 1, question 9(a). However, as recently as May of this year, the Postal Service excoriated mailers for failing to accept Postal Service evidence of the low elasticity of demand, well below -1.0:

Most disturbingly, they [petitioners] also ignore the fact that the Commission, in the exigent case, specifically considered the same materials they cite again here, and found those materials provided **no suitable basis to support their claims that the demand for mail is more elastic than the Postal Service has estimated.** [Docket No. RM2014-5, Answer of the United States Postal Service In Opposition to Petition to Initiate a Proceeding Regarding Postal Demand Analysis (May 9, 2014) (unnumbered) p. 2 (emphasis added).]

A huge gap exists between the Postal Service's assertions concerning Discover's elasticity of demand and the models of witness Thress that underlie the Postal Service's elasticity estimates. If the Postal Service's arguments here are to be given any credence whatsoever, then Witness Thress may need to wholly revise his models to incorporate those considerations and factors cited by the Postal Service and Discover witness Talwar.

Not having objective, independently verifiable data to support the Postal Service's assertions, the Commission must conclude that the proposed Discover NSA will result in a net financial loss to the Postal Service, and must deny the NSA. The only question is whether the regulator Commission will again disregard PAEA and defer to the (supposedly) regulated Postal Service.

II. Commission Approval of the Discover NSA Would Constitute Avoidance of Its Statutory Duties.

In the Commission's FY 2013 ACD, it determined that the prior Discover NSA resulted in a net loss to the Postal Service over the first two years of that agreement, losing

\$4.3 million in year one, and \$6.9 million in year two.¹ *See* FY 2013 ACD, pp. 62, 68.

Nevertheless, the Commission did not require any remedial action, but instead only ordered the Postal Service to provide “a detailed analysis of the lessons learned from the DFS NSA,” as if this somehow would offset the financial losses and rectify the noncompliance with section 3622(c)(10).² *Id.*

Of course, the Postal Service insisted that the prior NSA resulted in a net benefit of \$70.9 million, because it did not lose \$61 million it otherwise would have lost based on Discover’s claims, and enjoyed a \$10 million increase in contribution. Truly this is rank speculation, at best. What is certain is that the Postal Service **paid Discover \$33.4 million in rebates** during that three-year agreement. *See* USPS Response to ChIR No. 1, question 2(1).

The Postal Service now asks the Commission to allow it to lose more money to a favored customer. The Commission may be inclined to believe that if it rejects a Postal Service proposal, it will be viewed in Congress as constraining the “pricing flexibility” of the Postal Service, which would usurp the Postal Service’s role. However, it is the Postal Service that is usurping the Commission’s role. The Commission was created for a time such as this, to block illegal proposals and to prevent the Postal Service from abusing its monopoly.³

¹ Indeed, the Commission approved the first Discover NSA, knowing full well that it would not meet the statutory requirement, weakly rationalizing the decision as follows: “allowing this negotiated service agreement to proceed will allow management to enhance its knowledge of potential tools to slow the overall declining trend for First-Class Mail volume.” Order No. 694, p. 15.

² Clearly, there is no acceptable remedy to an unlawful NSA once the Commission approves it, as demonstrated by the Commission’s last two ACDs.

³ Not satisfied with a passive Commission, the Postal Service is seeking legislation that would render the Commission utterly powerless. Pending bill S. 1486 proposes

Respectfully submitted,

William J. Olson
Jeremiah L. Morgan
John S. Miles
WILLIAM J. OLSON, P.C.
370 Maple Avenue West, Suite 4
Vienna, Virginia 22180-5615
(703) 356-5070

Counsel for:
Valpak Direct Marketing Systems, Inc. and
Valpak Dealers' Association, Inc.

to remove enough of the Commission's authority that it would leave a shell agency with little more to do than review (but not stop) the occasional closure of a post office and hear (but not remedy) an occasional complaint.