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UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

Before Commissioners: Robert G. Taub, Acting Chairman;
Mark Acton, Vice Chairman;
Ruth Y. Goldway;
Tony Hammond; and
Nanci E. Langley

Market Dominant Product Prices
First-Class Mail & Standard Mail
Discover Financial Services
Docket No. MC2015-3

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

COMMISSION INFORMATION REQUEST NO. 1

(Issued December 12, 2014)

To clarify the basis of the Postal Service's request to add a Discover Financial Services (Discover) negotiated service agreement (Agreement) to the market dominant product list,[1] the Postal Service is asked to provide written responses to the following questions. Answers should be provided no later than December 19, 2014.

1. In its review of the Postal Service's Request, if the Commission cannot find that the Agreement "improve[s] the net financial position of the Postal Service through . . . increasing the overall contribution to the institutional costs of the Postal Service," the Commission may also approve the Agreement if it

[1] Notice of the United States Postal Service of Filing Request to Add Discover Financial Services Negotiated Service Agreement to the Market-Dominant Product List, October 27, 2014 (Request).

"improve[s] the net financial position of the Postal Service **through reducing Postal Service costs**." 39 U.S.C. § 3622(c)(10)(A)(i) (emphasis added). Please describe how the Agreement may reduce costs to the Postal Service. If it is anticipated the Agreement will have no effect on costs to the Postal Service, please confirm.

2. In its review of the Postal Service's Request, if the Commission cannot find that the Agreement "improve[s] 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," under section 3622(c)(10)(A)(i), *see also* C.F.R. § 3010.42(f), the Commission may also approve the Agreement on an alternative ground if it "enhance[s] the performance of mail preparation, processing, transportation, **or other functions**" under section 3622(c)(10)(A)(ii) (emphasis added); *see also* 39 C.F.R. § 3010.42(g). In its response to Chairman's Information Request No. 1,[2] question 4, the Postal Service states that it "does not anticipate further performance enhancements relating to mail preparation, processing, transportation as virtually all of Discover's mail is full-service Intelligent Mail barcoded ("IMb")." Please describe the Postal Service's view of what "other functions" are enhanced through the proposed Agreement. If the Agreement will have no effect on "other functions" of the Postal Service, please confirm.

3. The Postal Service states that "this NSA will drive accelerated growth in DFS Eligible Mail and has the potential to impact the trajectory of First Class Mail and Standard Mail among other financial services industry mailers." Request at 5. Yet, the Postal Service also states that it "expects that the contribution from mailers not party to the NSA will not change as a result of this Agreement; thus,

[2] Responses of the United States Postal Service to Chairman's Information Request No. 1, questions 1-12, November 13, 2014 (CHIR Response).

no analysis was provided." CHIR Response at 17. Please reconcile these statements. If the Postal Service does expect the Agreement to induce other financial service mailers to increase volume, please provide the basis for this expectation.

4. The Postal Service states that the Commission should:

> Wait for real evidence of the merits of the deal in the event rebates are provided[.] If that evidence does prove that this NSA failed to provide any financial benefits, the Postal [S]ervice would have no incentive to continue it, and, under the terms of the contract, it could terminate.

Response of the United States Postal Service to Comments of the Public Representative, November 21, 2014, at 6 (Response to PR). Please confirm that the Postal Service intends to terminate this Agreement before or during contract year 2 if the Agreement fails to reduce Postal Service costs or increase the overall contribution to the institutional costs of the Postal Service (using the accepted methodology). If not confirmed, please explain.

5. Please refer to CHIR Response, question 2.4 at 5. Please provide a detailed, step-by-step explanation of the Postal Service's "net value method" and "quantitative analytical methodology."

   Please explain how the Postal Service's "net value method" and "quantitative analytical methodology" are an improvement over the accepted methodology.

6. Please describe the financial risks to the Postal Service if the volume projections provided by Discover and used in the Postal Service's workpapers supporting the Request are either substantially higher or lower than originally projected.

7. Other than the volume projections provided by Discover, please provide and describe the evidence the Postal Service relies upon to state that the Postal Service's revenue attributable to Discover will decline absent the Agreement.

8. In its response to the Public Representative's comments, the Postal Service states that it would prefer the Public Representative's second option (*i.e.,* conditionally approve the Agreement and order the Postal Service to petition for a rulemaking) to the Public Representative's first option. Response to PR at 6. Please provide a proposed duration for the Agreement under any conditional approval and a proposed timeline for the rulemaking docket the Postal Service would file.

9. As a result of this Agreement, does the Postal Service foresee Discover mail volume migrating from a mail category with a relatively low cost coverage to a mail category with a relatively higher cost coverage (*e.g.,* "Letters" to "High Density & Saturation Letters")? Please explain.

10. As a result of this Agreement, does the Postal Service foresee Discover increasing its "prospecting" volume?[3] To the best of the Postal Service's knowledge and belief, does Discover send mail to its current customers at a higher frequency than it mails to its prospective customers? Please explain.

11. In the workbook "DFS Appendix," the Postal Service assumes that the exigent surcharge will be removed during contract year 2.

    a. Please confirm that the Postal Service estimates that, absent the implementation of the Agreement, Discover's volumes will continue to decline during contract year 2 despite a real price decrease of 4.3 percent. If not confirmed, please explain.

    b. Please confirm that if the Agreement is implemented, the Postal Service estimates that the 2.5 percent price decrease will incentivize over 255 million pieces of Standard Mail in contract year 2. If not confirmed, please explain.

c. Please provide additional analysis to support the Postal Service's estimation that a 2.5 percent price decrease will lead to increased volume, while a 4.3 percent price decrease will lead to a decrease in mail volume.

12. In Docket No. R2013-11, the Postal Service used its roll forward model to estimate volume change due to the proposed price increases. The following table details how the Postal Service estimated that the CPI price change of Docket No. R2013-10 would impact Standard Mail (as a class) and Standard Mail Letters volume.

		2014 BR Forecast (Millions)	2014 AR Forecast (Millions)	Change in Volume (Millions)
All Standard Mail		81,856	81,395	-462
Standard Mail Letters		48,432	48,164	-268

In this docket, the Postal Service estimates that providing Discover a 2.5 percent price decrease in contract year 3 will incentivize over 300 million pieces of additional Standard Mail, an increase of 41 percent. In Docket No. R2013-11, the Postal Service estimated that increasing prices for all standard mailers by 1.6 percent would decrease volume by 462 million pieces, a 0.56 percent decrease in volume. Further, the Postal Service estimated that increasing prices for all Standard Mail Letter mailers by 1.6 percent would decrease volume from 48.3 billion pieces to 48.1 billion pieces. Please explain why the Postal Service believes that Discover's response to price changes diverges dramatically from that of other Standard mailers. Please include data gathered during the prior Discover negotiated service agreement that supports this belief.

13. Figure 1 shows Discover's Standard Mail Regular Letter monthly volume for fiscal year FY 2013 and FY 2014. During FY 2013, the previous negotiated

[3] "Prospecting volume" is volume sent to prospective customers, with the expectation that some prospects will become Discover's customers.

service agreement (NSA) was in effect. During FY 2014, the NSA was in effect for the first 6 months. As Figure 1 illustrates, from March through September, the FY 2013 volumes exceed the FY 2014 volumes for all months except June.

Figure 1

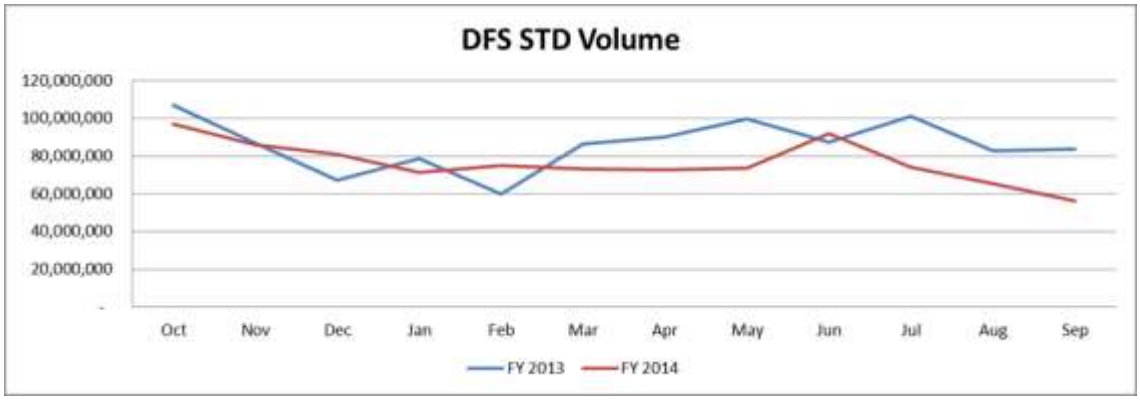

Figure 2 shows the year-to-date (YTD) volume of Discover's Standard Mail Regular Letters for FY 2013 and FY 2014. This reflects the cumulative amount of Discover mail from October through September.

Figure 2

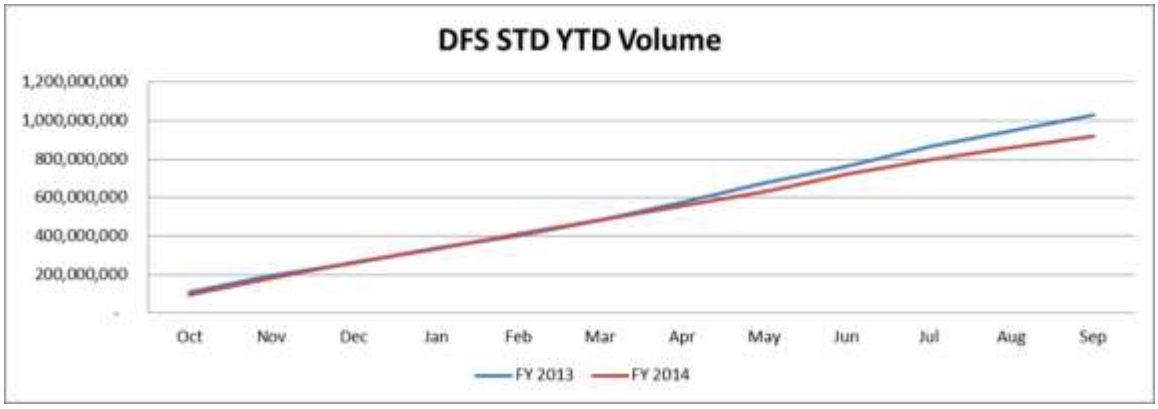

Figure 2 presents the cumulative volume. It appears that in the first 6 months of FY 2013 and FY 2014 it follows the same path. The termination of the NSA at the end of March 2014 appears to cause the slope to decrease, as compared with the FY 2013 slope. The exigency price increase may also have affected the change in slope. The two figures may provide a basis for estimating own-price elasticities for Discover.

a. Please provide an elasticity estimate for Discover First-Class and Standard Mail supported by quantitative analysis and based on historical volume data. Please include a discussion of how the analysis accounts for the effects of other factors like the exigency price increase, volume increases when prices are constant,[4] general economic conditions, and other relevant non-price factors.

b. Please provide an analysis of the net value of the Agreement using the accepted methodology and the elasticities derived in part a. of this question.

14. In CHIR Response, question 3, the Postal Service states that it relies on "marketing intelligence, customer-specific information furnished to us by the customer (as in the case of Discover), and past history (again provided by Discover in relation to their prior NSA)" to determine the net value of the Agreement.

    a. Please explain how the Postal Service evaluates the quality of the data furnished by Discover.

    b. Please provide the customer-specific information provided by Discover.

    c. Please provide any internally-produced reports, analyses, etc. that the Postal Service relied upon in its estimates of before- and after-rates volume.

    d. Please provide any data from any sources not a party to this Agreement that the Postal Service relied upon in its estimates of before- and after-rates volume.

15. In CHIR Response, question 3.c., the Postal Service contends that the subclass elasticity "includes mailers from such diverse industries as cataloguers, retail stores, Direct Mail sales and financial institutions." It asserts that to "use the class elasticity implies that all these industries react to price changes identically."

    a. Please list specific reasons why Discover has a higher price elasticity (in absolute terms) than the mailers within its subclass.

    b. Please provide quantitative evidence that Discover's elasticity deviates significantly from the subclass average.

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[4] *See, e.g.,* Docket ACR2012, Annual Compliance Determination Report, May 7, 2013, at 154-55 (Commission reports Discover increased volume by 236 million pieces prior to the implementation of the NSA).

c. Does the Postal Service believe that other large financial institutions have similar elasticities to that of Discover? Please explain.

d. What group or groups of mailers of Standard Mail have elasticities significantly below the average in absolute terms? Please explain the rationale for your response.

e. Does an NSA, which contains volume and revenue thresholds affecting the eligibility for discounts, cause the contract partner's own-price response to be different from its typical own-price response to general price changes for postal products? Please explain the rationale for the response.

16. The Postal Service states that it "negotiated and evaluated this NSA based on its best business judgment of Discover's future behavior, given current trends, understanding of Discover's business, and expectations of market and economic conditions, and will evaluate actual results based on these same factors." Response to PR at 5.

a. Please provide the analysis of current trends relied upon by the Postal Service.

b. Please describe the aspects of Discover's business the Postal Service considered in evaluating this Agreement and how the Postal Service's understanding of Discover's business factored into the evaluation.

c. Please describe the Postal Service's expectations of market and economic conditions as related to the Agreement.

17. The Postal Service's after-rates forecasts for Discover's volume in year 1, year 2, and year 3 of the previous NSA was off by 7.1 percent, 6.5 percent and -8.0 percent, respectively. In addition, based on the 8 prior NSAs, the Postal

Service's volume projections in years 1, 2, and 3 were off by 7.7 percent, 14.0 percent, and 24.2 percent, respectively.

a. What factors contributed to the inaccuracy of these forecasts?

b. What steps has the Postal Service taken to ensure more accurate forecasts for the Agreement?

18. The Postal Service states that the "NSA is designed to minimize risk in an unstable market environment." Response to PR at 3. It concurs with the Public Representative's suggestion that it is "acting logically by trading risk for certainty." *Id*.

a. Please explain how the minimization of risk may improve the net financial position of the Postal Service.

b. Please quantify any benefit discussed in part a. and provide quantitative evidence supporting this estimate.

By the Commission.

Shoshana M. Grove
Secretary