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October 23, 2007

The Honorable Wendy A. Hocking
Secretary, Board of Governors
United States Postal Service
475 L'Enfant Plaza, S.W., Room 10300
Washington DC 20260

Re: PRC Docket No. MC2007-1, *Rate and Service Changes to Implement Baseline Negotiated Service Agreement With Bank of America Corporation*

Dear Ms. Hocking:

Bank of America Corp. ("BAC") respectfully submits this letter as its Comments to the Governors of the Postal Service concerning the October 3 Opinion and Recommended Decision of the Postal Regulatory Commission in this docket.

INTRODUCTION AND SUMMARY

After eight months of litigation, the Commission has recommended, virtually without modification, the NSA proposed in February by BAC and the Postal Service. The Governors should implement without change what the Commission has approved.

The contribution losses projected in the Commission's financial analysis are exaggerated worst-case scenarios based on unrealistic assumptions. A more realistic assessment of the same data used by the Commission demonstrates that the NSA will leave the Postal Service's *financially measurable* contribution from BAC's mail essentially unchanged or slightly improved. With or without the NSA, the Postal Service will earn about \$500 million in contribution from BAC's mail each year during the next three years.

Moreover—and much more important—the Commission's financial analysis gives no weight whatsoever to the single most significant and far-reaching benefit of the NSA for both the Postal Service and the entire mailing community: enabling the full deployment of the Intelligent Mail Barcode ("IMB") and Seamless Acceptance. As Postmaster General Potter stated earlier this year, the IMB, "one of the biggest programs" that the Postal Service has "in the pipeline," "will revolutionize the transparency of the mail and the efficiency of the mail. . . . It will bring

us transparency, quality, efficiency, service measurement, and accountability. And it will be an important part of realizing our vision of end-to-end transparency of mail as it moves through every part of the mail value chain—from creation, to printing, to addressing, to logistics, and processing and delivery.”¹

In testimony before the Senate this August, Mr. Potter elaborated on the potential of the IMB for the Postal Service and its customers:

Our innovative Intelligent Mail system uses barcodes that uniquely identify each piece of mail for purposes of sorting, identifying special services, performing diagnostics as we identify system “pinch points,” and providing status data to mailers. From the perspective of a passive service measurement system, the Intelligent Mail barcode will permit us to identify when mail enters our system, track the mail as it moves through the network, and tell when it has been delivered. As we expand Intelligent Mail to different types of mail, it can be used to accommodate service measurement needs. We anticipate full implementation of the Intelligent Mail barcode for most commercial mail in 2009. The Intelligent Mail barcode contributes to enhancing the value of the mail for our customers, contributing to their business growth and success, ultimately helping the Postal Service to achieve its critical goal of revenue growth.²

But the potential benefits of IMB and Seamless Acceptance are still largely aspirations, not reality. Full implementation of these technologies—as opposed to small-scale pilot tests of stripped-down IMBs with most of their innovative data fields inactivated—will require extensive further R&D, systems engineering, trial-and-error testing and redesign, and large-scale vendor training. This work will be costly and time-consuming, and will require the cooperation of numerous third-party suppliers and mail houses.

BAC, one of the Postal Service’s largest and most technologically sophisticated customers, possesses the expertise and purchasing power needed to serve as a technology driver and large-scale test bed for this remaining work. By enlisting BAC as an active partner of the Postal Service in overcoming the remaining barriers, the NSA will provide enormous long-term additional benefits to the Postal Service—and its other customers. When a mailer is willing and able to serve in this role in exchange for reasonable financial compensation, it is entirely rational for the Postal Service to enter into such an arrangement. This is precisely what the Postal Service has done here.

¹ Remarks of Postmaster General/CEO John E. Potter at National Postal Forum (Mar. 26, 2007) (www.usps.com/communications/newsroom/speeches/speeches.htm).

² Statement of Postmaster General/CEO John E. Potter before the Subcom. on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate (August 2, 2007).

Congress has expressly authorized the Postal Service to enter into NSAs that “enhance the performance of mail preparation, processing, transportation, or other functions” (39 U.S.C. § 3622(c)(10)(ii)), even when the enhancements do not measurably improve the “net financial position” of the Postal Service through “reducing Postal Service costs or increasing the overall contribution to . . . institutional costs” (*id.*, § 3622(c)(10)(i)). And the Commission itself has acknowledged that a reduction in contribution of even \$45 million “may not be unreasonable when considering the unquantified potential of this Agreement.” PRC Opinion ¶ 4056. Given the record evidence that the short-term financial consequences of this NSA will not be a \$45 million loss, but essentially break even, the case for implementation of the NSA is overwhelming.

COMMENTS

The actual holding of the Commission’s October 3 Opinion and Recommended Decision is quite narrow. On page 56 of its 56-page opinion, the Commission holds that “the record supports the proposed classification changes and the related discounts . . . and that these changes are consistent with the policies of the Postal Reorganization Act.” PRC Opinion ¶ 4067; *accord*, PRC Recommended Decision ¶ 1. In support of this holding, the Commission finds that the NSA satisfies the ratemaking standards of *both* the Postal Reorganization Act of 1970 *and* the Postal Accountability and Enhancement Act of 2006 (“PAEA”)—the latter of which directs the Commission to implement “a system of modern rate regulation that recognizes the desirability of special classifications that improve either the net financial position *or operations* of the Postal Service,” which “has been given broad rate and classification authority to act within that system.” PRC Opinion ¶ 1001 (emphasis added) (paraphrasing 39 U.S.C. § 3626(c)(10)); *see generally* PRC Opinion ¶¶ 4052-4062.

The financial analysis appearing in dictum earlier in the Commission’s opinion, however, has drawn considerably more attention than the Commission’s actual holding. In its analysis, the Commission has rejected the system-average read/accept data that the Postal Service used to set the mail processing performance discount thresholds of the NSA—i.e., the same data that the Commission and the Postal Service have used to set worksharing discounts in every omnibus rate case from R2000-1 through R2006-1—in favor of more recent data produced by the Postal Service midway through this case. According to the latter data, the Commission contends, the Service’s existing mail processing equipment already achieves read/accept rates for the kind of mail subject to the NSA that exceed the levels needed to qualify for the discounts offered by the Postal Service. The Commission projects that the NSA therefore would reduce the Postal Service’s \$500 million annual contribution to institutional costs from BAC mail by approximately 1.5 to 3 percent, or about \$8 to \$15 million per year. The Commission therefore invites the Governors to reject the NSA, despite its approval by both the Postal Service’s professional staff and the Commission itself. PRC Opinion, *passim*.

BAC, like the Commission, is concerned about the NSA process. Negotiation and defense of an NSA is costly for a mailer, and mailers are likely to shy away from entering into NSA negotiations unless the internal operational data that the Postal Service asks its NSA

partners to rely on in setting NSA terms are in fact reliable. Mailers are also likely to avoid entering into negotiations if the Governors withdraw their support for an NSA, at the very end of the regulatory process, because of second thoughts about an agreement that the Postal Service induced its mailer partner to enter into in good faith. BAC therefore agrees with the Commission that the future of the NSA program requires the Postal Service to “ensure effective communication between those developing and approving Negotiated Service Agreements and the operational organizations that have the technical knowledge to assure successful agreements.” PRC Op. ¶ 1011.

The immediate question before the Governors, however, is narrower: whether to implement the NSA. The answer to this question is yes. The most current and reliable evidence in the record indicates that the NSA is likely to provide enormous net benefits to the Postal Service. The Commission’s loss projections of \$25 to \$45 million result from a misapplication of the 2006-2007 data. Moreover, the Commission’s financial analysis gives no weight to the critical role that the NSA commits BAC to perform in driving the remaining software development, systems engineering and testing needed for full deployment of IMB and related technological initiatives. Accelerating the deployment of these technologies will provide enormous benefits to the Postal Service and its customers. Hence, implementation of the NSA is clearly warranted under the Postal Reorganization Act and the PAEA.

I. THE COMMISSION’S FINANCIAL PROJECTIONS REST ON UNREALISTIC ASSUMPTIONS ABOUT THE CURRENT READABILITY OF BAC MAIL.

In its financial analysis, the Commission has rejected the 1999 system average data used by the Postal Service to estimate read/accept rates (i.e., the same data relied on by the Commission to set worksharing discounts in R2000-1 through R2006-1) in favor of system average data from Postal Service end-of-run reports generated in 2006 and 2007 and produced by the Postal Service in discovery during this case as Library Reference USPS-LR-4. Using these more recent data, the Commission has calculated that BAC’s weighted average read/accept rates are 98.7 and 98.8 percent for First-Class Mail and Standard Mail, respectively, rather than the values of 96.8 and 96.9 percent calculated by the Postal Service from the earlier data. PRC Opinion ¶ 4025; *cf. id.*, ¶ 3012(1) and (5). The Commission projects that BAC’s mail could qualify for enough discounts under NSA to reduce the Postal Service’s net contribution by as much as \$45 million over the three-term of the NSA. *Id.* ¶¶ 4021-4032.

The assumptions underlying these pessimistic conclusions are highly implausible. In fact, the record indicates that the NSA will leave the Postal Service’s contribution from BAC mail roughly unchanged (at about \$500 million per year) or increase the contribution by a few million dollars annually.

First, the 2006-2007 end-of-run reports, like the earlier data previously relied on by the Postal Service and the Commission, reflect the performance of barcoded mail whose barcodes

consist almost entirely of POSTNETs and other pre-IMB barcode technology.³ The current read/accept performance of IMBs, however, appears to be about 1.7 percentage points *below* the current read/accept performance of the more established barcode designs. For example, the weighted average scan rate of IMBs in pilot tests of Seamless Acceptance conducted from November 2006 through March 2007 was only 97.14 percent—was barely higher than the baseline scan rates of 96.8 and 96.9 percent incorporated in the NSA. PRC Opinion ¶¶ 3022-3023. The average performance rates of the IMB barcodes in the pilot tests were also approximately 1.5 to 2.0 percentage points below the Confirm scan rates of 99.0 percent and 98.6 percent achieved with traditional barcodes on move validation letter mailings in January and February 2007. PRC Opinion ¶¶ 3024. The slightly poorer baseline performance of the IMB barcodes is hardly surprising: new technology generally starts low on the learning curve. Hence, there is no reason to assume that, without the NSA, the IMB would quickly achieve read/accept rates comparable to those of the existing barcode designs. Indeed, the benefits of accelerating the progress of the IMB up the learning curve provide one of the strongest reasons for approving the NSA.

Second, even the relatively poor results of the IMB pilot tests is likely to overstate the baseline performance of IMBs in an actual production environment. Tr. 205 (Ayub). The pilot test results were based on an unrepresentative *subsample* of the mailpieces, produced by *excluding* mailings with a MERLIN success rate below 95 percent. This selection process obviously skewed the results upward, because barcode readability is one of the grounds for rejection of mailpieces by MERLIN, and MERLIN pass rates correlate strongly with successful scan rates. *Id.* at 142 (citing <http://ribbs.usps.gov/files/mtac/merlinbc.doc>); Tr. 155 (USPS *Seamless Acceptance Pilot* (Feb. 20, 2007), p. 8). Moreover, high profile pilot studies of this kind are often viewed by the participants as an opportunity to showcase both the new technology and the skill of the study participants at mastering it. For this reason, participants in studies of this kind often devote more resources to maintenance, alignment, cleaning and calibration than might be expected with a technology used in the ordinary production environment. Tr. 141-42 (Ayub answer to OCA/USPS-T1-35).

Third, even if (contrary to fact) the 2006-2007 end-of-run report data could be accepted as a reliable proxy of the system-average read/accept rate of IMBs today, system average data clearly overstate the read/accept rates of mail entered where BAC enters its mail. The system-average values drawn by the Commission from the end-of-run reports represent an average of the performance of mail entered at multiple points in the Postal Service network. Averages of this kind, however, overstate the read/accept rates of mail that is entered deep into the network, and therefore has not been processed upstream in the system on the Postal Service's automated equipment. Mail entered deep into the network has significantly lower read/accept rates than

³ The pieces generated by the IMB pilot tests represented only a tiny fraction of the total volume of First-Class Mail covered by the 2006-2007 end-of-run reports. *See* Tr. 151 (USPS presentation on Seamless Acceptance Pilot (Feb. 20, 2007)); Tr. 189 (USPS presentation on Seamless Acceptance).

mail that was previously processed upstream by the Postal Service. Because BAC's mail mix is predominantly 3-digit and 5-digit, BAC's automation mail is likely to bypass upstream operations and receive its first scan in a downstream mail processing operation. As a result, BAC's mail is more likely to experience lower-than-average accept rates than mail processed in the same operation that has been previously processed and accepted in an upstream operation, since the mail mix in downstream operations would presumably exclude pieces that were already processed and rejected upstream. Tr. 403 (Raney answer to APWU-ST3-5). Properly weighted for this fact, BAC's current read rates—even if based solely on the same 2006-2007 data relied on by the Commission—would be approximately 97.9 percent, not 98.7 or 98.8 percent. Correcting the Commission's analysis for this *one error alone* reduces the projected loss in contribution over the three-year life of the NSA from \$25-45 million to approximately \$6 million.⁴ Compared with the \$1.5 billion in total contribution that the Postal Service is likely to earn from BAC mail over the three-year term of the NSA, a \$6 million decline in contribution is essentially break-even, and certainly well below the threshold of materiality.

Moreover, this projection is clearly conservative. *First*, as noted above, baseline read/accept rates on IMBs are likely to be a percent point or more *below* the read/accept rates on the older barcodes that dominate the volume in the 2006-2007 end-of-run reports.

⁴ The 97.9 percent value is the value derived by the Commission for the Outgoing Secondary operation, which generally includes first sorts. PRC-LR-1, "New Average RAs.xls." Because Bank of America's letters generally receive their first sort in downstream operations, the average read/accept rate for the Outgoing Secondary operation is a better proxy for Bank of America's read/accept rates in downstream operations. The \$6 million figure was derived by using this 97.9 percent figure as BAC's before-rates read/accept rate. This translates into discounts to BAC for mail processing improvement equal to 1.1 percent and 1.0 percent, respectively, for First-Class Mail and Standard Mail for currently-achieved read/accept rates, percentages that are much more modest than assumed by the Commission. In addition to reducing the discount for currently-achieved read/accept rates, the changed assumption also increases the opportunity for improvement from current levels. To derive the \$6 million figure, we substituted these lower values for discounts for currently-achieved discounts into PRC-LR-1, "PRC Method.xls" and assumed that BAC's mail processing performance will improve by 0.1% in Year 1, 0.7% in Year 2, and 1.3% in Year 3—the same values proposed by BAC and the USPS.

The Commission declined to make a similar adjustment on the ground that USPS witness Raney "does not have any knowledge of how BAC mail was processed before getting to the Postal Service," and it thus "may or may not actually resemble downstream mail." PRC Opinion ¶ 3025. Nothing in the record, however, indicates that BAC mail is better prepared than the average mail entered at the downstream locations where BAC mail is typically entered. *See* Tr. 479, 486 (BAC does not currently use IMBs, OneCode ACS markings, Seamless Acceptance, FAST or MPTQM for production mailings, and BAC employees do not receive MERLIN training). Moreover, only about 22 percent of mail entered by BAC is processed by a presort bureau before entry into the Postal Service network.

Second, the \$6 million figure, like the Commission's loss projections, ignores the cost savings that are likely to result from BAC's placement of IMBs on *reply* mailpieces enclosed in BAC mailings. PRC Opinion ¶ 4030. The record demonstrates, however, that an improved read/accept rate of only *one-half percent* would save the Postal Service over \$5.4 million over the three-year life of the NSA; a one percent improvement would save the Postal Service approximately \$11.4 million; and a 1.5 percent improvement would save it roughly \$17.1 million. *See* Tr. 468, 479 (BAC discovery responses).

The Commission observes that "reply envelopes are typically of high quality and must go through a screening process before being supplied by the mailer" (PRC Op. ¶ 4030). Preprinted reply envelopes, however, still require a quality control process to ensure that the FIM and Barcode are correct. Even then, flaws and errors still appear in the finished product. More importantly, implementation of the NSA will enable BAC to imprint each mailpiece with a unique identifying code, and to perform custom design work to ensure that the personalized payment coupon, when inserted by the customer, is properly oriented and positioned in the window reply envelope so that the Intelligent Mail Barcode is consistently visible and legible.

Third, the \$6 million loss projection also assumes that no cost savings whatsoever will occur from the reduction of personal knowledge required ("PKR") mail that is likely to result from improvements in BAC's address lists. PRC Opinion ¶ 4031. The Commission's reason was that the "co-proponents were unable to agree on a baseline for personal knowledge required mail and on a method for measuring improvements from a baseline." *Id.* But the parties did agree that PKR imposes substantial costs on the Postal Service. If BAC mail has PKR rates by class equal to system-wide PKR rates by class, then BAC PKR mail imposes costs of over \$2 million annually. If BAC address improvements reduce the PKR rate by 10 percent, the Service will save over \$600,000 over three years. For a reduction of 50 percent, the savings will be over \$3 million. And a 60 percent reduction would produce savings of \$3.7 million. *See* BAC comments on NOI #1 (April 17, 2007) at 15-16. The NSA will enable BAC to take a leading role with the Postal Service and address and software vendors in developing effective systems and processes to reduce PKR mail.

Fourth, the \$6 million figure adheres to the conservative assumption of BAC and the USPS that the proposed discounts stimulate no increase in mail volume at all. If the bank's First-Class Mail and Standard Mail have class-average elasticities, however, the discounts will elicit enough additional volume to generate approximately \$5.6 million in additional contribution to the Postal Service's institutional costs over three years.⁵

⁵ The \$26 million in discounts projected by the Commission for First-Class Mail equate to a reduction of 1.89% in the average price per piece paid by BAC for First-Class Mail. The \$28 million in discounts projected by the Commission for Standard Mail equate to a reduction of 2.17% in the average price per piece paid by BAC for Standard. Multiplying these price changes by the own-price elasticities submitted by the Postal Service and accepted by the Commission in Docket No. R2006-1 presorted First-Class Mail (-0.13) and for Standard Regular (footnote continued on next page)

II. THE NSA WILL ENABLE THE POSTAL SERVICE TO ACHIEVE MAJOR IMPROVEMENTS IN MAIL PROCESSING AND OTHER FUNCTIONS BY ACCELERATING THE DEPLOYMENT OF THE INTELLIGENT MAIL BARCODE AND SEAMLESS ACCEPTANCE.

The most significant benefit of the NSA, however, involves not gains in cash flows or contribution from BAC mail over the three-year term of the NSA, but the potentially massive, if longer-run, benefits from harnessing BAC as the driver of improvements in the technology needed for full-scale implementation of the Intelligent Mail Barcode (“IMB”) and Seamless Acceptance for mailers generally.

The IMB and related innovations have the potential to cause the most far-reaching transformation of mail service in decades. As PMG Potter has stated, the IMB is “one of the biggest programs” that the Postal Service has “in the pipeline.”⁶ “This barcode will revolutionize the transparency of the mail and the efficiency of the mail. It’s real ‘Star Wars’ stuff—and it’s here today. It will bring us transparency, quality, efficiency, service measurement, and accountability. And it will be an important part of realizing our vision of end-to-end transparency of mail as it moves through every part of the mail value chain—from creation, to printing, to addressing, to logistics, and processing and delivery.”⁷ Senior Postal Service officials have testified that they expect the IMB to contribute to “enhancing the value of the mail for our customers, contributing to their business growth and success, ultimately helping the Postal Service to achieve its critical goal of revenue growth.”⁸

(footnote continued from previous page)

Mail (-0.296) (*see* PRC R2006-1 Op. & Rec. Decis. (Feb. 26, 2007) at 8 and App. 1, Table I-3) implies a volume increase of 0.245% for the former and 0.64% for the latter. Multiplying these volume increases by the projected contribution from BAC’s mail in the two categories yields a projected increase in contribution of approximately \$2.2 million from First-Class Mail and approximately \$3.4 million from Standard Mail, or a total increase in contribution of about \$5.6 million over the three year life of the NSA.

⁶ Remarks of Postmaster General/CEO John E. Potter at National Postal Forum (Mar. 26, 2007) (www.usps.com/communications/newsroom/speeches/speeches.htm).

⁷ *Id.*

⁸ Statement of Postmaster General/CEO John E. Potter before the Subcom. on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate (August 2, 2007); *accord*, Statement of William P. Galligan, Senior Vice President, Operations, before the Subcommittee On Federal Workforce, Postal Service, and the District Of Columbia, Committee on Oversight and Government Reform, U.S. House Of Representatives (July 26, 2007).

The benefits to the Postal Service from achieving full-scale deployment of IMB in 2009, as the Postal Service currently hopes to do, clearly should exceed by several orders of magnitude the effects of the NSA on the Postal Service's contribution from BAC mail. But enormous development and systems integration hurdles must be surmounted before full-scale rollout of the IMB can occur. Software and hardware must be developed and tested, and a large array of complex and interrelated systems and software must be integrated. Much of this work must be done by third parties. Much of it still remains undone. And mistakes and wrong turns will abound: the scaling up of technology as innovative as the IMB from small-scale beta tests to large-scale industry-wide usage is almost never trouble-free. As PMG Potter testified before a Senate oversight committee earlier this year concerning the implementation of IMBs, "My expectation is once that comes to pass, there are going to be a lot of problems because I'm sure that there are deficiencies in our system."⁹

What BAC brings to the table is the experience, sophistication and leverage of a large customer that can drive the necessary technological changes and serve as a very large test bed for the systems and processes necessary to identify and then correct deficiencies. First, consider some of the important contributions that BAC has *already* made to prepare for implementation of this NSA:

- To date, BAC has induced more than 20 BAC vendors, at 47 physical locations in the United States, to become IMB approved and certified, and then prepared for the Postal Service's *PostalOne!* requirements.
- BAC discovered a gap in the software needed to generate Mail.dat "piece detail record" for Seamless Acceptance, documented a work-around, and convinced software providers to give high enough priority to this issue to implement a solution in their software releases.
- BAC identified and help develop a solution to a glitch in the Mail.dat spoilage reporting algorithm.
- BAC developed solutions to previously unsolved technical obstacles to the application of Mail.dat to commingled mail.
- BAC induced major industry vendors to invest the resources necessary to cooperate with the Postal Service, in advance of a USPS interface, to master the processes necessary to use Seamless Acceptance and IMB systems. These steps have dramatically moved each vendor up the learning curve for interfacing with the USPS for all mailer clients, not just BAC.

⁹ Testimony of the Honorable John E. Potter before the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security (Aug. 2, 2007).

- At the request of the USPS, BAC joined the relevant MTAC workgroups to develop and solidify the rules requiring retention of the mailer identity in the IMBs of mail handled by presort suppliers. After a review of several technical proposals, the seven MLOCR manufacturers agreed to a single specification and format for all vendors—again at the insistence of BAC. The presort bureaus will facilitate mail owner identification, as BAC insisted, for mailers who want this functionality.
- BAC worked with 13 outside letter shops and the Bank of America in-house facilities at a total of 47 physical locations to get them ready to produce the IMB, pay for postage electronically through PostalOne!, and participate in Seamless Acceptance, thus reducing the USPS costs by substantial amounts.
- BAC wrote IMB creation rules and usage guidelines, customized for their initial application with BAC but useable by all.
- BAC worked with and finalized Select (a web-based program developed by GrayHair Software that enables mail manufacturers to obtain customized mailer IMBs from GHS and apply those IMBs to the outbound mail). Eight of the 20 major vendors are already participating.
- BAC has completed a majority of the test scripts (i.e., information security tests required by every financial institution for any barcodes that might reveal customer identifying information) for the IMBs with seven of BAC's major vendors. The functions covered by the test scripts have included: (1) Running Select to append the IMB's to the mail file; (2) printing address block with IMB in window; (3) producing high quality, accurate Mail.dat files; (4) connection with and data transfer to PostalOne!; (5) connection and data transfer with Seamless Acceptance; connection to and retrieval of data from Confirm; and (7) proper coding for OneCode ACS data.

Many of the most important, time-consuming and costly tasks still remain ahead. Without an approved NSA, BAC's role in this work will stop. These tasks include:

- Completing and documenting supplier compliance and implementation of eDoc, PostalOne!, Seamless Acceptance.
- Creating and beta testing the ACS electronic interface for file exchange.
- Creating and beta testing a new CAPS application.
- Pressure testing Confirm and PostalOne! and moving Seamless Acceptance into a production-scale environment.

- Creating and beta testing software systems needed by USPS, mailers and third-party vendors to enable each of these participants to interface as needed for Seamless Acceptance and Intelligent Mail Barcodes to function fully.
- Compelling a significant portion of the presort industry to get up to speed with Mail.dat, PostalOne!, Seamless and the overall mail quality requirements of NSA-quality mail.

BAC's participation in the NSA will also help realize the potential of IMB for improved service measurement. Under the NSA, BAC will provide approximately three billion pieces of mail with IMBs for Service Standards and Service Performance Measurement activities for both First Class and Standard Mail. This volume should increase the statistical robustness and reduce the standard errors of USPS service performance measures generated from IMB scan data.

The Commission endorses in principle the general concept of an NSA that recruits a large and sophisticated mailer to serve as a technology driver and test bed for projects of this kind:

The Commission endorses the concept of the overall Agreement. It finds merit in the Postal Service seeking out a very large volume mailer to facilitate introduction of a panoply of modern mail processing systems. This approach may present advantages over a piecemeal approach of soliciting individual mailers to run pilot tests on individual features in that it could provide valuable information on a modern integrated system. If the Agreement is appropriately monitored and the Postal Service expends the effort to further the development of these new systems through this Agreement, all mailers may benefit in the long term by having a modern mail processing system in place for their use with many typical start-up problems reduced or resolved

PRC Opinion ¶ 4002. The Commission declined to give any weight to such benefits in this case, however, on the grounds that (1) the benefits are unquantified (PRC Opinion ¶ 4029); and (2) with or without the NSA, the IMB will be required for some automation mailings by 2009 (*id.* ¶ 4045). These grounds are unfounded.

The Commission's first objection is clearly at odds with the language and policies of PAEA. Some of the most significant benefits of innovative pricing arrangements, particularly those designed to promote systematic operational changes, are inherently difficult to quantify in advance. The PAEA recognizes this fact. 39 U.S.C. § 3622(c)(10) identifies two alternative ways in which an NSA may make the Postal Service better off: by improving its "net financial position" through "reducing Postal Service costs or increasing the overall contribution to . . . institutional costs" (§ 3622(c)(10)(i)) *or* by enhancing "the performance of mail preparation, processing, transportation, or other functions" (§ 3622(c)(10)(ii)). The notion that the benefits of the latter prong of the statute must be disregarded unless quantifiable in terms of the Postal Service's "net financial position" would collapse the two alternative provisions into one. Significantly, even the Commission ultimately acknowledged that even the worst-case reduction

in contribution projected by the Commission, \$45 million, “may not be unreasonable when considering the unquantified potential of this Agreement.” PRC Opinion ¶ 4056.

The Commission’s second objection is also unfounded. As noted above, the full-scale deployment of IMB and Seamless Acceptance are still aspirations, not reality, and will not occur until extensive further R&D, systems engineering and testing are completed.¹⁰ This work cannot be made to happen by administrative fiat. Without the resources, expertise, and buying leverage of BAC that the NSA will enlist on behalf of the Postal Service, the deployment of IMB and Seamless Acceptance to more than a pilot group of mailers, and with more than a token subset of the functionalities of the technology, almost certainly would be delayed significantly.

While the Postal Service can mandate that mailers and third-party vendors use *existing* technology, it cannot command them to innovate. By contrast, a large and sophisticated mailer like BAC possesses not only the ability to drive technological change, but the bargaining clout to induce its vendors to do so as well. The NSA will enable the Postal Service to harness these capabilities for its own benefit, and the long-run benefit of other mailers.

The Governors need not speculate about the likelihood that the deployment of IMB and Seamless Acceptance would remain on track for the 2009 target date if the Postal Service were to attempt the necessary development work without BAC as its partner. Experience with (1) the proposed Electronic Verification System (eVS) for Parcel Select mail and (2) and Move Update illustrates how innovative projects can go awry without the support of a major private sector partner.

The Postal Service first proposed to require the use of eVS on all permit imprint Parcel Select mailings almost two years ago. *See* 70 Fed. Reg. 67399 (Nov. 7, 2005). More than a year ago, the Postal Service published a “final” rule that would have required “all permit imprint Parcel Select mail and all permit imprint mail authorized to be commingled with Parcel Select to be prepared using eVS.” 71 Fed. Reg. 38966 (July 10, 2006). Almost four months ago, however, the Postal Service postponed the required use of eVS indefinitely “because of the large number of format and coding changes required by the R2006-1 omnibus rate case . . . and because of the addition of several new subclasses of mail that will become available under eVS after May 14, 2007.” 72 Fed. Reg. 35177 (June 27, 2007).

The Move Update rules offer another example. The Postal Service first proposed extending the Move Update requirement beyond First-Class Mail, and shortening the minimum frequency of Move Update processing from 180 to 90 days, more than five years ago. *Proposed*

¹⁰ Further, the version of the “IMB” that the Postal Service aspires to implement in 2009 would have little of its intelligence activated. It would use the delivery point barcode as representation of the address; and the Postal Service has not proposed to require use of the multiple other data fields that add intelligence to the barcode. Similarly, the Postal Service has not proposed to require use of Seamless Acceptance by 2009.

Changes to the Move Update and Address Matching Requirements, 67 Fed. Reg. 38041 (May 31, 2002); *id.*, 68 Fed. Reg. 51750 (Aug. 28, 2003). In doing so, the Service noted that expanded Move Update requirements could avoid several billion dollars annually in costs from mail that is undeliverable as addressed. *Id.*, 67 Fed. Reg. at 38041. In response to mailer objections that the expanded requirements were infeasible, however, the Postal Service shelved the proposals for several years. Not until September 2007 did the Postal Service finally extend the Move Update requirements beyond First-Class Mail and double the minimum required frequency. *New Move Update Standards for First-Class Mail and Standard Mail*, 72 Fed. Reg. 5055 (Sept. 28, 2007). Even without any further slippage in the schedule, the required changes will not take effect until November 23, 2008—more than six years after they were first proposed.

BAC is not suggesting that the delays in deployment of these projects were the fault of the Postal Service. But the Postal Service is inherently at a disadvantage in trying to drive technological changes that require substantial commitments of time and money by mailers and third-party vendors without the support of a large and sophisticated mailer that is willing to serve as a technology driver. When a mailer is willing and able to serve in this role in exchange for reasonable financial compensation, it is entirely rational for the Postal Service to enter into such an arrangement. This is precisely what the Postal Service has done here.

III. THE POSTAL SERVICE NEED NOT INCLUDE IDENTICAL DISCOUNT TERMS IN FUNCTIONALLY EQUIVALENT AGREEMENTS WITH OTHER MAILERS THAT OFFER SMALLER BENEFITS TO THE POSTAL SERVICE.

The Commission, in its financial analysis, expresses a further concern that “many mailers similarly situated to Bank of America may qualify for functionally equivalent agreements, and demand equivalent discounts even after these mail practices become mandatory.” PRC Opinion ¶ 1008. This circumstance, the Commission suggests, could multiply the losses that the Commission projects for the NSA. *Id.* at ¶¶ 1008, 4042 n. 39, and 4045. This concern can be readily dispelled.

As noted above, BAC’s commitment under the NSA to serve as a developer and large-scale test bed for IMB and related technology is an important element of the proposed NSA. It is possible that arranging for other mailers to play a similar role may also be beneficial to the Postal Service. If so, functionally equivalent NSAs with discount schedules comparable to the BAC baseline NSA may also serve the interests of the Postal Service.

At some point, however, IMB technology is likely to have matured enough to reduce or eliminate the value of further assistance from other mailers in developing the technology. At that point, nothing in the provisions of Title 39 governing NSAs or undue discrimination would require the Postal Service, like the water-carrying brooms in *The Sorcerer’s Apprentice*, to offer to pay other mailers for further such assistance after it has lost its value. The prohibition against undue discrimination imposed by 39 U.S.C. § 403(c) does not require the Postal Service to offer two mailers identical discount terms when the benefits provided by the two mailers are unequal. Section 403(c) “forbids granting only those preferences to mail users that are ‘undue or

unreasonable.’ It does not preclude conveying a benefit to a mail user for which there is a rational, ascertainable basis.” *Experimental Rate and Service Changes to Implement Negotiated Service Agreement With Capital One*, Docket No. MC2002-1, PRC Op. & Rec. Decis. (May 15, 2003) at ¶ 3026; *see also Sacramento Municipal Utility Dist. v. FERC*, 474 F.3d 797, 803-03 (D.C. Cir. 2007) (ratepayer that facilities needed to exchange capacity with supplier not “similarly situated” for discrimination purposes with ratepayer that can offer such exchange capacity); *Competitive Telecommunications Ass’n v. FCC*, 998 F.2d 1058, 1062-64 (D.C. Cir. 1993) (two telecommunications ratepayers not similarly situated for discrimination purposes where there were qualitative differences between their service packages; “so far as ‘unreasonable discrimination’ is concerned, an apple does not have to be priced the same as an orange”).

The existing NSAs that were functionally equivalent to the Capital One NSA approved in Docket No. MC2002-2—Bank One (MC2004-3), Discover (MC2004-4) and HSBC (MC2005-2) make clear that functionally equivalent NSAs need not have the same terms. All three functionally equivalent NSAs had economic terms—discount thresholds, discount volume tiers, and unit discount values—that differed from those of the Capital One baseline NSA. Yet no one has contended that the Postal Service discriminated unduly against Bank One, Discover or HSBC by failing to offer them discount terms identical to those offered Capital One.

In any event, the issues of what baseline values, discount tiers, and unit discount values would be appropriate in functionally equivalent NSAs with other mailers, as the Postal Service moves up the IMB learning curve, are completely premature here. The proper terms for future NSAs with other mailers are questions of fact that should be addressed in the first instance in negotiations between the Postal Service and those potential NSA partners. Any mailer dissatisfied by the outcome of these negotiations is of course free to seek relief by filing a complaint alleging undue discrimination under 39 U.S.C. § 403(c). The absence of any such complaints to date from banks and other large financial institutions suggests, however, that such disputes are unlikely. Accordingly, the Governors should evaluate the financial impact of the present NSA on its own merits, and refrain from speculating about the appropriate discount terms for future functionally equivalent NSAs with other mailers.

CONCLUSION

For the foregoing reasons, the Governors should implement the NSA on the terms recommended by the Commission.

Respectfully submitted,

/s/

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cc: All parties