

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

RULES APPLICABLE TO BASELINE)
AND FUNCTIONALLY EQUIVALENT)
NEGOTIATED SERVICE AGREEMENTS)

Docket No. RM2003-5

VALPAK DIRECT MARKETING SYSTEMS, INC., AND
VALPAK DEALERS' ASSOCIATION, INC.
REPLY COMMENTS ON PROPOSED NSA RULES
PURSUANT TO COMMISSION ORDER NO. 1383
(October 14, 2003)

These reply comments on proposed rules applicable to Commission consideration of Negotiated Service Agreements (“NSAs”) are filed on behalf of Valpak Direct Marketing Systems, Inc., and Valpak Dealers’ Association, Inc. (“Valpak”), and are submitted pursuant to the terms of Order No. 1383 in response to comments filed by mailers and the OCA on September 25, 2003, and by the Postal Service on September 30, 2003.

**1. Contrary to Implications in Some Comments,
the Commission’s Proposed Rule Concerning Mailer-Specific
Cost Information Is Reasonable and Necessary**

At least three commenters have expressed concerns about proposed section 193(e)(5) requiring the use of mailer-specific costs in NSA filings by the Postal Service.¹ This rule requires the Postal Service to:

¹ PostCom Comments on Notice and Order Establishing Rulemaking Docket for Consideration of Proposed Rules Applicable to Baseline and Functionally Equivalent Negotiated Service Agreements [NSA Rulemaking] (“PostCom comments”), at 5-6; Initial Comments of Major Mailers Association (“MMA comments”), at 5; Comments of Capital One Services, Inc. (“Cap One comments”), at 4-5.

(5) include an analysis, which sets forth the actual and estimated **mailer-specific costs, volumes, and revenues of the Postal Service** for each year which result from the implementation of the Negotiated Service Agreement... [Emphasis added.]²

PostCom has suggested that the rule be clarified to state that references to “mailer-specific costs” are limited to the Postal Service’s costs, and do not pertain to any costs incurred by the mailer, urging the proposed rule be revised to read:

Include an analysis which sets forth, **to the extent practical**, estimated **mailer-specific costs to the Postal Service** and the estimated volumes and revenues which will result from implementation of the Negotiated Service Agreement. [PostCom comments, at 7 (emphasis added).]

Any interpretation that the proposed requirement applies to costs of the mailer, as opposed to costs of the Postal Service, would appear to be rather stretched. The proposed requirement is already clear, seeking the “mailer-specific costs ... of the Postal Service.” Further, data on mailers’ costs have never been a pertinent factor in any rate or classification proceeding before the Commission. Nevertheless, Valpak would have no objection to word edits of this sort.

On the other hand, Valpak would object to the inclusion of the phrase “to the extent practical” as it could, in practice, vitiate the rule. The Commission needs to base its recommended **mailer-specific rate reductions on mailer-specific Postal Service cost savings**. Inclusion of the vague concept of “practical” could operate as a permanent waiver of the

² This rule must be read in conjunction with section 193(e)(4) which requires mailer-specific information based on rates in effect without the NSA (“include an analysis, which sets forth the estimated mailer-specific costs, volumes, and revenues of the Postal Service for each year that the Negotiated Service Agreement is to be in effect assuming the then effective postal rates and fees absent the implementation of the Negotiated Service Agreement...”).

requirement for customer-specific costs, a result expressly sought by certain commenters.

Some mailers may believe that it is **impractical** to require the Postal Service to meet virtually any burden to obtain a desired change in rates, but that subjective notion is not relevant under the Postal Reorganization Act. The issue is reliability, not practicality. If the Postal Service provides **unreliable** cost estimates on the record for a postal product, the Commission cannot recommend rates for that product. Likewise, if the Postal Service provides no reliable mailer-specific cost estimates for an NSA, the Commission cannot recommend mailer-specific rates for that NSA. If a cost estimate is unreliable, no basis exists for using it for rate setting, even if some would believe it would be “too much work” or “too expensive” or “too time consuming,” and therefore “not practical” to improve it and develop a better estimate.³

Based on the comments criticizing the requirement for mailer-specific information, it appears necessary to revisit the issue as to why the Commission needs mailer-specific cost data rather than nationwide cost averages. NSAs can be expected to involve circumstances that are highly unusual, perhaps even unique, and the Cap One NSA provides a good illustration. There, it was stated that Cap One originated about 1.5 billion pieces of First-Class Mail annually, of which about 9.7 percent of its solicitation mail (0.77 billion pieces) consisted of physically-returned pieces that were Undeliverable as Addressed (“UAA”) and could not be forwarded. In other words, Cap One received about 74 million pieces of returned mail each year. On average, that represents **237,000 pieces per day** (on a Monday-Saturday basis), or

³ Similarly, when a forecast lacks content, it is not reasonable to rely on it for mail classification and rate setting purposes as though it did, just because it is not practical to improve it.

284,000 pieces per day (on a Monday-Friday basis). If each piece averaged 0.9 ounces, each working day Cap One received about 13,300-16,000 pounds of returned mail, which is a fairly sizeable truckload. All of this mail was processed through the area distribution center (“ADC”) at Richmond, Virginia directly to Cap One. To maintain that the nationwide average cost of handling returned UAA mail is a good proxy for the specific cost of handling Cap One’s mail is equivalent to maintaining that:

- the unit cost of processing pieces of UAA mail through ADCs to sectional center facilities (“SCFs”) and destination delivery units (“DDUs”) is the same as the unit cost of processing a sizeable truckload of such mail through an ADC direct to the recipient — *i.e.*, the Postal Service enjoys no economies of scale when handling large quantities of UAA mail and it costs nothing to carry it further downstream;
- the cost of handling mail with a dedicated sorting bin on the first incoming sort is the same as the cost of handling mail that requires two (or more) incoming sorts; and
- the unit cost of getting a truckload of UAA to a single recipient is the same as when individual pieces of UAA mail are delivered.

Of course, if the Postal Service can demonstrate persuasively that the use of a nationwide cost is a reasonable and reliable proxy for mailer-specific costs in a particular NSA, it could seek a waiver of the requirement for mailer-specific costs in its proposal on that basis. PostCom points out that “[t]he Commission itself has used proxies for actual cost in countless of its decisions over the years....” (PostCom comments, at 6.) What PostCom fails to note is that the Commission has endeavored to use only **good** proxies. The idea of using a nationwide proxy **without persuasive evidence that it is a good proxy** is unreasonable on its face. When the Postal Service seeks to use an average nationwide cost as a proxy for mailer-specific costs

in the context of an NSA, it should be required to meet the burden of justifying a waiver. If a waiver could not be justified based on the demonstrated reasonableness of the proxy, and the Postal Service were unwilling to present record evidence of a special cost study, the Commission would have good reason to reject the financial predicate of the proposed NSA, and therefore to reject the NSA.

The Postal Service's comments on mailer-specific costs discuss the perceived difficulty and expense of tracing the costs of a specific mailer's mail through the entire postal system.⁴ Such comments are largely a red herring. The Postal Service generally agrees that an effort should be made, and it is impossible to believe that such an effort cannot be successful in improving on the use of nationwide costs in all, or almost all, cases. For instance, as the preceding discussion illustrates, one could use national average costs for processing Cap One's UAA mail from delivery units around the country back to the ADC, while conducting a special cost study at the sole ADC which receives such a uniquely large volume of returns for a single mailer. In the Cap One case, however, the Postal Service neglected the obvious and provided no discussion as to whether the cost (and projected savings from the NSA) might be less than the national average. Unless the Commission is willing to delegate its statutory responsibilities to the Postal Service, as some commenters appear to want, its rules must require that the Postal Service provide the record data it needs to make an informed and reasonable recommendation.

The Commission's proposed requirements for mailer-specific information for future consideration of NSAs are both reasonable and necessary.

⁴ Initial Comments of the United States Postal Service, at 13.

2. The Existence of Mailers Who Are Similarly Situated to One With an NSA Is Highly Relevant to the Existence of Unreasonable or Undue Discrimination

PostCom's comments seek to minimize any concerns by the Commission about undue discrimination and fairness:

With or without procedural rules, mailers who are similarly situated to an NSA participant **can apply** for their own "functionally equivalent" NSA based on the similarity of their mailing practices to those of the NSA participant; there are **several channels of recourse** if, in fact, the Postal Service seeks to violate the statutory prohibitions against unreasonable or undue discrimination. See 39 USC §403(c). [PostCom comments, at 3 (emphasis added).]

The above comment brushes by the difficult problem of ensuring that NSAs are available to all similarly situated mailers, rather than being offered to only a few favored mailers. It cannot be assumed that all similarly situated mailers will be provided follow-on NSAs simply because their situations are "functionally equivalent."

Of course, no matter how well-conceived the Commission rules may be, they will have only an indirect effect on the Postal Service's critical decisions as to which NSAs to pursue and to propose. The Postal Service has virtually complete discretion as to which mailers will be the beneficiaries of proposed NSAs. It remains to be seen how the Postal Service will exercise that discretion. Having a comprehensive set of rules in place to govern Commission consideration of NSAs is probably the best that can be done at this time. However, to the extent that Commission rules can reduce or avoid altogether discrimination in treatment of mailers, they should seek to do so. Criteria should be developed to determine "functional equivalence," or all such decisions will be made on an ad hoc basis. Those mailers who

perceive themselves to be similarly situated, but for whatever reason are denied that status, likely will feel that they are victims of unreasonable or undue discrimination. The Postal Service would benefit from express criteria in this area, as would mailers, and the Commission.

PostCom's reassuring statements about the "several channels of recourse" available to mailers who are not offered functionally-equivalent NSAs are not persuasive. (PostCom comments, at 3.) The only legal options that would appear to exist are: (i) the filing of a complaint with the Commission, which probably cannot compel the Postal Service to offer an NSA unless it defers to the Commission's opinion, or (ii) the filing of a complaint in federal district court, which the Postal Service would certainly seek to have the court dismiss as intruding on their managerial discretion. It is unclear how appellate review of the action of the Governors could be obtained more than 10 days after the Governors issue their order implementing the baseline NSA. In the final analysis, there may be no "channels of recourse" whatsoever if the Postal Service takes the position that it has unreviewable discretion to determine what NSAs are functionally equivalent.

When there are a number of mailers who might reasonably consider themselves similarly situated to one that has received a baseline NSA, at some point both the Postal Service and the Commission will need to consider the following question: Under what circumstances should a plethora of functionally equivalent NSAs be regarded as superior to a single niche classification?⁵ The Commission's proposed rule requires that the Postal Service

⁵ With niche classifications, the thorny issue of determining whether a mailer is similarly situated or functionally equivalent does not arise.

justify the use of an NSA, as opposed to a niche classification. Section 195(a)(1). This is an excellent provision, which certainly should be in the final rules.

PostCom's minimization of the problem of discrimination ignores the fact that, unlike niche classifications, NSAs are inherently exclusionary and discriminatory. A mailer who is the recipient of an approved NSA can be presumed to be receiving a benefit from the Postal Service, *i.e.*, a lower rate from which other mailers are excluded, even though some of them indeed may be similarly situated. The Commission must make decisions under the law as it exists, not as some would wish it to be, and the law requires the Commission to consider whether all rates which it approves are consistent with "the establishment and maintenance of a fair and equitable schedule." 39 U.S.C. §3622(b)(1).

The comments of the National Newspaper Association ("NNA") are instructive on this important principle, and its proposed addendum to section 190(b) adding the provision that the Commission will not recommend NSAs "if a general or niche classification change will achieve substantially similar effects upon the Postal Service's Revenues or Costs..." should be adopted.⁶

⁶ Comments of the National Newspaper Association on Proposed Negotiated Service Agreement Rules, at 4-6. Also, the Office of the Consumer Advocate is on record as preferring niche classifications to NSAs. Office of the Consumer Advocate Comments, at 2.

3. Undue and Unreasonable Discrimination Can Arise from Lengthy Delays in Obtaining Follow-on NSAs That Far Exceed any Recommended Time Limit for Commission Action

The reasons that niche classifications are preferable to NSAs — except for those mailers which pay lower rates under NSAs from which their competitors are excluded — are numerous. In addition to avoiding discrimination in determining which mailers qualify as similarly situated to one that has become the recipient of a baseline NSA, there is a further question of the required “end-to-end” time, over which the Commission has only limited control.

For instance, assume it is agreed that Mailer B, which is seeking a functionally equivalent NSA, is similarly situated to Mailer A, who already is operating under a baseline NSA. How long must Mailer B persevere and continue to mail without a “functionally equivalent” NSA before Mailer B (or other similarly situated mailers) can allege unreasonable or undue discrimination? Six months? One year? Two years? Even longer? Since justice delayed is justice denied, the problem here is not whether the Commission takes 60, 90, or even 120 days to process applications for functionally equivalent NSAs, but how long it takes the Postal Service to negotiate with similarly situated mailers, such as Mailer B, and file for functionally equivalent NSAs.

By way of illustration, the Cap One NSA was recommended by the Commission on May 15, 2003, yet five months later no follow-on NSA request has been even sought for any other mailer. One can envision the elapsed time between (i) application to the Postal Service, (ii) subsequent negotiations with the Postal Service, and finally, (iii) filing of the “functionally

equivalent” NSA, taking many months, even years. The Commission, of course, has no control over this time span. Even complaint dockets initiated by aggrieved mailers which consider themselves similarly situated are unlikely to result in satisfaction.

Although not an adequate solution to the problem, at the very least, when a three-year baseline NSA comes up for renewal, before giving the Commission’s approval, the Commission should require the Postal Service to identify the number of pending applications, as well as the length of time over which they have been pending, from mailers who consider themselves to be similarly situated.

4. The Commission Has a Duty to Assure That NSAs Do No Harm to Other Mailers

The foundational principle which underpins PostCom’s criticisms of the Commission’s proposed rules and recommendations for watered-down standards seems to be “if an NSA does not entail cross-subsidies in the legal sense of that term, there can be no finding of ‘harm’.” (PostCom comments, at 3.) This clearly is untrue, even without considering the issue of fairness, which the Commission is obligated to consider. A badly-designed NSA easily could reduce the contribution to Postal Service overhead, thereby harming other mailers (under a breakeven constraint), without technically entailing any cross-subsidy. Moreover, PostCom’s position deviates from even the Postal Service’s own published guidance as to the criteria it will use for NSAs to be considered. The initial criteria for consideration include the following:

- The negotiations must result in substantial, measurable net benefit to the Postal Service, as well as to the customer; and

- The NSA cannot unduly discriminate against or adversely affect any customers. [*Postal Bulletin* 22109 (8-21-03).]

Some commenters object to proposed section 193(e)(6) and 193(f)(1) and (2) which would require the Postal Service to explain on the record how the NSA might affect parties other than the mailer who is party to the NSA. See, *e.g.*, Cap One comments, at 6-7. It should be noted that the Postal Service's own criteria, cited above, require such considerations. For example, to assure that the NSA results in a measurable **net** benefit to the Postal Service, the possibility of external effects ("unintended consequences" — see Valpak's comments at 8-11) needs to be given at least some consideration. Similarly, the Postal Service can determine that an NSA does not unduly discriminate against or adversely affect any customer only by looking beyond the immediate effect of the NSA on the benefitted party. The proposed rule only requires that the Postal Service share its considerations on such important matters with the Commission.

Conclusion

Valpak recommends that the Commission implement the rules that it has proposed, with the addition of express criteria for functional equivalence and the NNA's proposed language discussed *infra*, at 8. Most criticisms of these proposed rules are not persuasive, based on speculation about an excessive burden on the Postal Service and mailers in order to provide the Commission what it needs in considering the proposals expeditiously and fairly. However, Valpak urges the Commission to revisit the rules after the next few NSAs are litigated to

determine if any recalibration is required. Until then, the Commission's proposed rules should be adopted as providing a workable framework for the litigation of future NSA proposals.

Respectfully submitted,

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