

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

**Rate and Service Changes To Implement  
Baseline Negotiated Service Agreement With  
Bookspan**

**Docket No. MC2005-3**

**INITIAL BRIEF  
OF THE  
NEWSPAPER ASSOCIATION OF AMERICA  
AND THE  
NATIONAL NEWSPAPER ASSOCIATION**

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December 6, 2005

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The Newspaper Association of America (“NAA”) and the National Newspaper Association (“NNA”) hereby respectfully submit their initial brief in opposition to the proposed negotiated service agreement between the United States Postal Service and Bookspan. Unlike all other NSAs previously approved by the Commission, the rate discount in this NSA is not justified by any cost savings. Its purported justification is a “multiplier effect,” an ill-defined basis for discriminating in favor of Bookspan.

In short, the proposed NSA would unlawfully discriminate in favor of a single mailer by conferring a volume discount for a monopoly service without any cost savings or persuasive showing of any other sound rationale. As such, it would violate Section 403(c) of the Postal Reorganization Act and cannot be recommended favorably consistent with the Act and longstanding Commission precedent. Furthermore, even if the “multiplier effect” were legally sufficient, the proponents of the NSA have failed to carry their burden of proof in this case.

NAA is a non-profit organization representing more than 2,000 newspapers in

the United States and Canada. Most NAA members are daily newspapers, accounting for nearly 90 percent of the daily circulation in the United States. NAA's membership also includes many nondaily newspapers published in the United States. A majority of NAA members have circulations of less than 25,000. Most of these smaller newspapers serve less-densely populated rural and suburban communities in our nation. NAA members have a strong interest that the federal government, in the form of the Postal Service, preserve its mission of providing universal service at equitable, non-discriminatory rates.

The National Newspaper Association is a 2,500 member organization of community newspapers. Established in 1885, for its entire history NNA has represented newspapers that primarily rely upon the mail for distribution to readers. NNA's member newspapers are heavy users of periodicals mail, and also of Standard mail for distribution of advertising material to subscribers and non-subscribers. NNA has in the past supported Negotiated Service Agreements that contain a work-sharing or cost-saving component but has consistently opposed volume discounts as unfair pricing that favors large mailers and distorts competitive marketplaces. NNA is a limited participant in this docket.

## **I. STATEMENT OF THE CASE**

In May 2005, after some four years of discussions, the Postal Service signed a proposed negotiated services agreement with Bookspan, one of its very largest

customers.<sup>1</sup> The proposed NSA would allow Bookspan alone to receive discounted Standard Regular rates<sup>2</sup> in the form of a block discount structure. It would also foreclose other mailers, including rival booksellers, from the discounts completely unless they operate pursuant to a similar business model. No other mailer has been identified in this docket as potentially eligible for similar treatment.

Before proceeding further, it is important to note what this case is *not* about. First, contrary to the views of some, this case does not involve a “pure” volume discount.<sup>3</sup> Nor has any competing bookseller challenged this NSA on grounds of competitive impact.<sup>4</sup> Finally, unlike in past NSAs presented to this Commission, the Postal Service is not asserting that the volume discounts are justified on the basis of cost savings or cost differences in Bookspan’s mail. Indeed, the Postal Service’s

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<sup>1</sup> Tr. 3/398 (Epp). Mr. Posch testified that Bookspan is the Postal Service’s 21<sup>st</sup> largest customer. Tr. 3/452.

<sup>2</sup> As NAA has previously commented, the DMCS amendments proposed by the Postal Service in this case allow for discounts only on Standard Regular letters. *Comments of the Newspaper Association of America On Notice of Inquiry No. 1* (Nov. 14, 2005). The Postal Service offered no substantive response. Bookspan’s reply comments ignored the only discounts provision in the DMCS proposal and, in effect, would impose an unprecedented burden on all potential intervenors to review the detailed testimony and exhibits in the formal filings to ascertain the true nature of a request, rather than simply the legally-binding DMCS language. Accordingly, the Commission, if it were to approve this NSA, could lawfully recommend discounts only on Standard Regular letters. Bookspan’s Standard ECR letters may be “eligible” for any other provision of the NSA, but not for the discounts unless they pay Standard Regular rates.

<sup>3</sup> The Postal Service’s policy witness expressly disavowed that this case presents a “pure” volume discount. Tr. 2/321-322 & 331 (Plunkett).

<sup>4</sup> Nonetheless, the Postal Service increasingly tends to approach its showings of competitive impact in a cursory way. An agency of the federal government granted a unique and valuable monopoly in order to fund a vital universal service obligation should be careful not to disrupt competitive markets through its own conduct or take the side of one private firm over a competing firm in the marketplace.

direct case assumes (contrary to evidence) that Bookspan's letters impose average costs. Nor do the proponents identify any incremental cost savings that would accrue to the Postal Service under the NSA. On the contrary, the Postal Service expressly disclaims any cost savings from the NSA.<sup>5</sup>

Instead, the Postal Service contends that the arrangement will result in a net financial benefit of approximately \$7.7 million (based on R2005-1 rates) solely due to incrementally increased volume (less discounts) and a conversion of Bookspan flats solicitations to letters (which pay a higher unit contribution). Response to POIR 3, Q. 3, Attachment 1, Page 9 (Yorgey); see also Tr. 2/100-110 (Yorgey). The vast majority (\$5,073,578 or 65.8%) of the estimated net financial benefit would come from the voluntary conversion by Bookspan of solicitation flats to letters, but no provision in the terms of the NSA requires it to do so. Presumably this conversion would occur because Bookspan currently believes that its letter solicitations produce better results. Tr. 3/394 (Epp).

The only rationale proffered on the record for giving Bookspan a unique discount is that Bookspan's business model generates a so-called "multiplier effect." The idea is that once a recipient of a Bookspan solicitation joins a book club, repeated mailings from both Bookspan and the new club member (books, invoices, declining of club choices) will occur. The theory of the NSA is that the discount given to Bookspan will encourage Bookspan to mail more solicitations, which in turn will enlist more club

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<sup>5</sup> USPS-T-1 at 4 (Plunkett). In comparison, in the *Capital One* NSA the volume discounts induced the mailer to forego its right to physical returns of undeliverable as addressed mail.

members who then will be involved in many mail transactions on a continuing basis. The only record evidence that quantifies the financial value of the multiplier effect addresses only the first step in this process of increased mail business, concluding that the Postal Service will realize approximately \$2.7 million from additional solicitations that Bookspan will send.<sup>6</sup>

Despite the lack of precedent for a government monopoly granting a discriminatory rate on this basis, the Postal Service chose not to quantify any further financial results of the multiplier effect – that is, the “multiplied” mailings to and from a bookclub member. Consequently, the financial showing on which it rests its case claims no benefit from the multiplier effect.

Of course, almost *any* mailer could claim, with some reason, that it might mail larger volumes if it were to receive a discount. And some of those mailers reasonably could maintain that some of their additional mail could in turn generate still more volume from other mailers. In an attempt to comply with the requirement that NSAs must be offered to similarly situated mailers, the Postal Service initially proposed the following language for the Domestic Mail Classification Schedule<sup>7</sup>:

Fun[c]tionally equivalent NSAs, involving declining block rates for Standard Mail letter solicitations for book or analogous club memberships, may be entered into with other customers

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<sup>6</sup> As summarized in Section III, *infra*, the proponents have not carried their burden of proof as to this calculation.

<sup>7</sup> Somewhat surprisingly, the Postal Service did not propose to require a similarly situated mailer to operate pursuant to the Federal Trade Commission’s Negative Option Rule or continuity shipping, which might have provided a basis for a niche classification.

demonstrating a similar or greater multiplier effect, as specified by the Postal Service, and implemented pursuant to proceedings under Chapter 36 of Title 39, of the United States Code.

After the hearing, the Commission issued a Notice of Inquiry proposing alternative language for this section. *Notice of Inquiry No. 1 In Regard To Domestic Mail Classification Schedule and Data Collection Plan Language* at 7 (Nov. 3, 2005). The *NOI* proposed to delete the “as specified by the Postal Service” clause and add the following:

For a mailer to have a similar or greater multiplier effect, at least six times per year, that mailer must send a continuing series of marketing mail, send products to a list of people who have agreed to purchase some stipulated minimum number of items on a more or less regular basis and use at least one other subclass for merchandise fulfillment.

In either case, however, the Postal Service concedes that the universe of similarly-situated mailers is extremely small. The classification appears so narrowly drawn as to be available in practice only to Bookspan.

**II. THE PROPOSED NSA WOULD VIOLATE SECTION 403(c) OF THE ACT AND COMMISSION PRECEDENT BY CONFERRING A VOLUME DISCOUNT WITHOUT OFFSETTING COST SAVINGS OR OTHER RATIONAL BASIS**

Section 403(c) of the Act provides:

In providing services and in establishing classifications, rates, and fees under this title, the Postal Service shall not, except as specifically authorized in this title, make any undue or unreasonable discrimination among users of the mails, nor shall it grant any undue or unreasonable preferences to any such user.

This statutory prohibition applies directly to the proposed volume discount for Bookspan. The Commission has held repeatedly that Section 403(c) prohibits volume discounts that have no cost justification. Accordingly, the proposed Bookspan NSA would violate this provision.

**A. The Commission Has Consistently Held That Volume Discounts That Are Not Cost-Justified Violate Section 403(c)**

The Commission first addressed a proposed non-cost-based volume discount more than 17 years ago in Docket No. R87-1, in which the Postal Service had proposed “market based” volume discounts in Express Mail. The Commission rejected the proposal, holding that the “proposed discounts were unsupported by any measurable cost difference between low-volume and high-volume mailings or other empirical justification.” *Rate and Fee Changes*, Docket No. R87-1, Opinion and Recommended Decision, at 747, ¶ 6020 (Mar. 4, 1988). The Commission rejected an identical proposal in Docket No. R90-1 for the same reason. *Rate and Fee Changes*, Docket No. R90-1, Opinion and Recommended Decision, V-387, ¶ 6533 (Jan. 4, 1991). The Commission has continued to adhere to this construction of the statute ever since.

In a formal report to Congress in February 2002, this Commission described its interpretation of Section 403(c) in the context of negotiated service agreements:

Negotiated rates—unaccompanied by a change in service conditions that provides cost justification—are a problematical approach to introducing additional flexibility into Postal Service business practices.

*Report to the Congress: Authority of the United States Postal Service To Introduce New Products and Services and To Enter Into Rate and Service Agreements With Individual Customers Or Groups Of Customers*, Postal Rate Commission (Feb. 11, 2002). That report emphasized the necessity under the statute for discriminatory rates negotiated with a single mailer to have a cost justification.

Shortly thereafter, the Commission applied its interpretation of the statute in the *Capital One* NSA proceeding. In that case, the Commission reaffirmed its construction, stressing that a discriminatory rate will be unlawful in the absence of a “reasonable justification” or “rational, ascertainable basis.” *Experimental Rate and Service Changes to Implement Negotiated Service Agreement with Capital One*, Docket No. MC2002-2, Opinion and Recommended Decision at ¶ 3030 & 3026 (May 15, 2003). In *Capital One*, the Commission concluded that the NSA offered “significant cost-saving opportunities.” *Id.*, ¶ 3030. It held that the volume discounts were justified by Capital One’s agreement “to take measures that will avoid the potential costs of physical return” of undeliverable as addressed mail. *Id.* at ¶ 3031.<sup>8</sup> In doing so, the Commission equated “reasonable” with “cost,” contrasting the *Capital One* NSA with proposed discounts that, as in this case, are “unsupported by any measurable cost difference.” *Id.*

The Commission’s historic reliance on cost differences as a basis for rate discrimination is a sound and prudent practice for a federal government monopoly

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<sup>8</sup> In the *Capital One* NSA and the three subsequent NSAs based on *Capital One*, PRC has found “significant cost-saving opportunities.”

service affecting every American on a daily basis. Basing rate differences for monopoly services on proven cost differences is a recognized principle of regulatory rate making, and provides a reasonably solid and quantifiable basis for setting a rate difference. The rate difference is based upon the cost difference.<sup>9</sup> In contrast, the Postal Service's definitional gymnastics around what would be required of a functionally-equivalent NSA are a direct result of its abandonment of cost as a justification for discounts.

As a policy matter, requiring volume discounts to have a cost justification also provides an objective basis for determining which mailers may be eligible for the rate and which mailers are not. This can be particularly useful in the context of NSAs, in which the Commission often must review projections of the future mailing and business practices of an unregulated firm – a topic in which the Commission does not necessarily have the same level of information and experience as it does with respect to the Postal Service. The Commission should adhere to its long-standing application of the law and reject the Postal Service's purported new justification.

**B. The Proponents Disavow Any Cost Justification For The Volume Discount**

There is absolutely no claim in this NSA that the Bookspan volume discount is

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<sup>9</sup> The Commission's approval of surcharges not based on costs in the *Repositionable Notes* proceeding does not represent a departure from this position. That case involved a generally available rate, not a discriminatory discount for a single mailer. That rate is an optional surcharge that First Class and Standard mailers are free to use or not. That case also focused on a different legal issue -- the value of service rate criterion, not Section 403(c).

justified on the basis of costs.<sup>10</sup> Mr. Plunkett concedes that there are no cost savings from any negotiated change in Bookspan's mail practices. USPS-T-1 at 4.

Nor does the Postal Service contend that Bookspan's high-volume mailings are lower cost than other Standard mail. Nor is there even any claim that Bookspan's mail costs less than that of other mailers with comparable mailing profiles. Instead, as noted above, the Postal Service used Standard *average* costs as a proxy for Bookspan's costs, adjusting them merely by Bookspan's mailing profile. USPS-T-2 at Appendix A (Yorgey); Tr. 2/93 & 100-101 (Yorgey).

Perhaps the proponents could have argued that Bookspan's conversion of flats solicitations to letters constitutes a form of cost justification, although they have chosen not to do so despite that shift, which accounts for the great majority of the estimated financial benefit. Thus, the proponents have identified no cost-based reason to single out Bookspan for a volume discount. Accordingly, the proponents cannot satisfy the Commission's longstanding requirement that volume discounts have a demonstrated cost basis. *See Opinion and Recommended Decision*, Docket No. R87-1 at ¶ 6020.

**C. The "Multiplier" Effect Rationale Fails To Justify A Discriminatory Rate Discount In An NSA**

Lacking cost justification for the proposed NSA, the Postal Service is asking the Commission to accept a new basis for a discriminatory volume discount – a claim that

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<sup>10</sup> Mr. Plunkett testified that he wants the Commission to establish a precedent that volume discounts need not be justified on the basis of explicit cost savings. Tr. 2/321.

it will increase postal volumes via a so-called “multiplier effect.” Presumably it is for this reason that the Postal Service describes the “multiplier effect” as a “key condition” and a “defining characteristic” of the agreement. Tr. 2/217, 234, & 259 (Plunkett). It is also proposed as an essential component of a “functionally-equivalent” NSA. See Request, Attachment A, Page 1.

This attempt is unavailing. The asserted “multiplier effect” does not provide a sufficient distinguishing principle to meet the Section 403 requirement of nondiscrimination, and therefore does not provide a legally sufficient rationale for singling out one mailer for special treatment.

**1. A multiplier effect is not a reasoned basis for a non-cost-based discount for a single mailer**

At the simplest level, what has been called in this record a “multiplier effect” is simply the recognition that many promotional mailings, if successful, may generate additional mail in the forms of fulfillment, invoicing, and/or payment. And a volume discount for such mailings, in nearly all cases, would lead to more promotional mailings, which in turn would lead to more fulfillment mailings and invoices. But this is a description of an effect, not a rational defining principle that can justify a discriminatory rate.

The Postal Service clearly realizes that potentially many thousands of Standard Regular and other mailers quite reasonably could argue that their direct response mail generates a “multiplier effect” deserving of a discounted rate. A promotion for a weekly newspaper can generate a subscriber, which in turn can generate many

weekly newspaper mailings, as well as invoices and payments. Promotional inserts in First Class mail billing envelopes also may generate multiple shipments, invoices, and payments. Other mailers of solicitations could easily provide other examples.

So to keep the floodgates shut and defend a unique volume discount only for Bookspan, the Postal Service has tried to limit the universe of “multiplier effects” that might qualify as “functionally-equivalent.” This effort in effect concedes that a “multiplier effect” fails to provide a valid basis for discriminating among mailers. However, the Postal Service’s effort to limit what mailers might be similarly situated is unavailing, as discussed immediately below.

**2. The proposed DMCS language to codify the “multiplier effect” for functionally-equivalent NSAs is arbitrary**

The Postal Service is a common carrier subject to a duty not to engage in unreasonable discrimination. *UPS Worldwide Forwarding, Inc. v. United States Postal Service*, 66 F.3d 621, 637 (3<sup>rd</sup> Cir. 1995). In *Sea-Land Service Inc. v. Interstate Commerce Commission*, 738 F.2d 1311, 1317 (D.C. Cir. 1984), the U.S. Court of Appeals held that common carriers may offer individual contract rates consistently with the principle of nondiscrimination only if they “make [the contract rates] available to *any* shipper willing and able to meet the contract’s terms.”<sup>11</sup>

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<sup>11</sup> 738 F.2d at 1317 (emphasis added). This principle was applied in the postal context in *UPS Worldwide Forwarding, Inc. v. United States Postal Service*, 66 F.3d 621, 635 (3<sup>rd</sup> Cir. 1995) (every international service agreement must be available to similarly situated customers under similar circumstances and conditions).

Under the Commission's approach to NSAs, this principle is embodied in the concept that similarly situated mailers may enter a "functionally-equivalent" arrangement with the Postal Service. The Commission holds this necessary so that NSA discounts are not unreasonably discriminatory in violation of Section 403(c) . *See Postal Rate Commission Report to Congress* (stating required condition that "rate-and-service package is made available on the same terms to other potential users willing to meet the same conditions of service.)

In this case, the Postal Service initially proposed to implement this concept through the DMCS language that would have required mailers seeking a functionally-equivalent NSA to demonstrate "a similar or greater multiplier effect, as specified by the Postal Service." The Postal Service thereafter spent much of the discovery period offering various, and at times inconsistent, understandings of what type of mailer and mailing profiles might qualify as functionally-equivalent. For example, the USPS vacillated on whether a similar situated mailer should operate pursuant to the Federal Trade Commission's Negative Option Rule or similar business model, with its latest statement seeming not to require that grounds.

The Commission's post-hearing alternative DMCS proposal deletes the "as specified by the Postal Service" clause and adds the following itemized list of requirements:

For a mailer to have a similar or greater multiplier effect, at least six times per year, that mailer must send a continuing series of marketing mail, send products to a list of people who have agreed to purchase some stipulated minimum

number of items on a more or less regular basis and use at least one other subclass for merchandise fulfillment.

*Notice of Inquiry No. 1 In Regard To Domestic Mail Classification Schedule and Data Collection Plan Language* at 7 (Nov. 3, 2005). The Postal Service and Bookspan generally support this alternative language. *Response of U.S. Postal Service To Notice of Inquiry No. 1* (Nov. 14, 2005); *Comments of Bookspan on Notice of Inquiry No. 1 in regard to Domestic Mail Classification Language and Data Collection Plan Language* (Nov. 15, 2005).

While the alternative presented in the *NOI* has more specificity, it does not cure the fundamental problem of subjectivity or arbitrariness. Under neither version does the “multiplier effect” provide a principled basis for distinguishing among mailers. The Postal Service’s original proposal would have expressly reserved to itself, through future implementing rules, the power to say what might constitute “a similar or greater multiplier effect.”<sup>12</sup> In proposing to delete this clause, the Commission correctly noted that the Service’s proposal would have made the process “unfairly subjective.” *NOI No. 1* at 10. However, deleting that phrase has little effect. In practice, the Postal Service would always retain great discretion in deciding whether a second mailer

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<sup>12</sup> The *NOI* did not indicate whether the specific criteria set out therein is meant to override the Postal Service’s repeated characterization of functional equivalence as a “qualitative” consideration. Tr. 2/238 (Plunkett). To the extent that this evaluation is “qualitative,” the Postal Service has leeway to discriminate against other mailers.

exhibits a “similar or greater multiplier effect” for purposes of a potential functionally-equivalent NSA.<sup>13</sup>

Drawing lines to limit eligibility for a volume discount for “multiplier effect” purposes is an arbitrary exercise. There is no basis in the record for drawing the eligibility lines at any particular level. Why require a minimum of six annual mailings, rather than eight or ten? In addition, the record contains little in the way of support for a “more or less regular basis” criterion.<sup>14</sup>

The alternative presented in the *NOI* could provide a starting point for consideration of a possible niche classification. Alternatively, during the discovery phase it appeared that the record might support a niche classification premised on a mailer’s compliance with the Federal Trade Commission’s negative option rule, which might be less arbitrary than the currently favored language. However, that is not what the proponents seek.

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<sup>13</sup> It is unclear whether the Postal Service would still insist on writing its own implementing regulations. If so, it could readily adopt new provisions that would ensure that it has ample discretion over with whom to negotiate.

<sup>14</sup> Some of these provisions are based on USPS testimony. However, that a witness’s testimony mentions a particular number, without more, does not in and of itself constitute substantial evidence of what is an essentially arbitrary eligibility criterion.

**3. The volume discount is so tailored for Bookspan as to be unreasonably discriminatory**

The proponents' basic position is that "Bookspan's extensive reliance on the mail for almost all aspects of its business and the scope and breadth of its direct and indirect multiplier effects set it apart from other negative option businesses and other mailers in general." OCA/USPS-6(c); OCA/USPS-7 (stating "As to 'direct and indirect multiplier effect, Bookspan appears to stand as unique"). So much so, Bookspan now ranks as the Postal Service's 21<sup>st</sup> largest customer. Tr. 3/452 (Posch). No other bookseller approaches its size, scope, and market position. And the record contains only general references to other types of mailers that may have similar business models.

On cross-examination, Mr. Plunkett conceded that the universe of potential candidates for a "functionally-equivalent" NSA is very small. Tr. 2/336. Indeed, the Postal Service admitted early in the case that "few companies" are likely similarly-situated to Bookspan.

At the same time, the Postal Service has proposed to require that a mailer seeking a functionally-equivalent NSA must have "a similar or greater multiplier effect." This language is preserved in the Commission's suggested alternative. Yet there is little likelihood that any other mailer would have a "similar or greater" multiplier effect, regardless whether that standard is quantitative or qualitative.

If the "similar or greater" multiplier effect standard were quantitative, only a larger mailer could likely qualify. But there is no evidence that any of the twenty

mailers that currently are larger postal customers than Bookspan have a comparable business model or make comparable use of Standard and other classes of mail. And, given that Bookspan's business model makes highly intensive use of the mail for solicitations, fulfillment, billing and payments, the chance that a smaller mailer than Bookspan could qualify for an NSA with a "similar or greater" quantitative multiplier effect is remote, much less have the time or resources to negotiate one.<sup>15</sup>

If the "similar or greater" effect language were qualitative, as the USPS has urged, it would also be problematic. Presumably, other mailers may plead a multiplier effect in petitioning for similar discounts but be found wanting for a lack of quality in their multiples, since no one seems to know what quality is necessary to justify the special rate. The Bookspan "baseline" NSA is unlikely ever to be replicated on a local level for smaller mailers.<sup>16</sup> This single deficiency may be the element that is most unfair about the proposed NSA. Because it can be offered by its very terms only to the very largest mailers, the small and independent bookseller is defined to be ineligible by fiat. The precedent set by this practice bodes ill for all small mailers.

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<sup>15</sup> National mailers have more time to participate in negotiations which "may extend over several months." Tr. 2/237 (Plunkett).

<sup>16</sup> Bookspan is quoted in the trade press as believing that the benefit it derives from the close relationship with the USPS that it developed over this time may be as valuable as the discount itself. Tr. 3/398 (Epp). Many small mailers, including small newspapers, would appreciate developing an improved close working relationship with the Postal Service, although they do not have the time and staff to conduct a four-year negotiation. A mailer should not have to enter an NSA to develop an improved working relationship with the Postal Service. Is it any wonder that this docket has attracted the attention of parties that are neither part of the bookseller industry nor users of Standard letter mail?

The combination of Bookspan's company-dependent mailing practices and the requirement for a "similar or greater" multiplier effect appears to foreclose, as a practical matter, any other mailer from a functionally-equivalent NSA.<sup>17</sup> That the NSA is tailored for Bookspan is unsurprising, as it is the result of a negotiation involving Bookspan. But defining an NSA in such a way that only one company could satisfy its terms does not comply with the Section 403(c) prohibition of undue discrimination.

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In sum, for all the reasons explained above, the NSA should be disapproved because, as a legal matter, it discriminates among mailers and does not meet the requirements of Section 403.

### **III. THE PROPONENTS HAVE FAILED TO MEET THEIR BURDEN OF PROOF**

Even if the proposed NSA's "multiplier effect" were sufficient as a matter of law, the proposal should be disapproved. Proponents of an NSA have the burden of proving that their proposal would satisfy the Commission's standards for approval of NSAs. In this case, the proponents have failed to meet this burden.

#### ***Failure of proof of the multiplier effect***

Although the Postal Service relies on the multiplier effect to justify the unique discount for Bookspan, as noted above it excluded any estimates of the multiplier

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<sup>17</sup> It certainly seems to foreclose other booksellers: "our greatest competition is from retail establishments and on-line sales." Bookspan-T-2 at 2 (Epp). The record indicates that no other bookseller uses the club approach anywhere close to the same extent.

effect from its direct case addressing “financial benefit” USPS-T-2 at 7 (Yorgey).<sup>18</sup> This produces the very curious result that the Postal Service’s testimony presenting the projected “net financial benefit” relies for the majority of its showing upon a factor not deemed “key” or even required – the conversion of flats to letters<sup>19</sup> – while ignoring an “essential” factor – the multiplier.

The Postal Service’s unwillingness to quantify the ephemeral multiplier effect should preclude the Commission from placing any reliance upon this factor to justify the NSA. The Postal Service is entitled to choose not to quantify a value of the multiplier effect as part of its litigation strategy. But in so doing, it has not proven an essential part of its case, without which it must fail. The Commission cannot, consistent with its statutory responsibility to base its recommendation solely on record evidence (39 U.S.C. § 3624(a)), fill the evidentiary void.

***Failure of proof of the \$5 million from conversion***

The Postal Service also cannot rely on the purported \$5 million in additional net contribution stemming from Bookspan’s conversion of flats to letters. The first and most obvious reason is that Bookspan is under no obligation to convert flats to letters under the terms of the NSA. Even if the Commission were to overlook this logical flaw, the proponents have not shown that the \$5 million is a reliable estimate.

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<sup>18</sup> Nor did the Postal Service apparently believe it was necessary or even useful to calculate the multiplier effect even for its internal purposes. Tr. 2/227 (Plunkett).

<sup>19</sup> Tr. 2/333-34 (Plunkett).

One reason for this failure is that there is no evidence of the actual costs of Bookspan's solicitation mail. Although section 193(e)(1)(i) of the Commission's rules<sup>20</sup> requires the Postal Service to present the specific costs of Bookspan's mail, the USPS did not comply.<sup>21</sup> Instead, it has assumed that Bookspan's solicitations impose average costs, adjusted only by Bookspan's mailing profile. The Postal Service then compares the average unit contribution of pre-conversion flat pieces to the average unit contribution of letter pieces.

But what little evidence the record does contain is contrary to the assumption of average costs. This record evidence suggests that the costs of handling Bookspan's flat mail may in fact be less than the average assumed in the USPS's direct case. Such evidence includes Bookspan's mailing profile (reflecting dropshipping and weight),<sup>22</sup> the inability of the parties to identify any promising new worksharing

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<sup>20</sup> 39 C.F.R. § 3001.193(e)(1)(i). The Postal Service has routinely ignored this provision of the Commission's rules, despite the impossibility of making an accurate estimate of the true financial effect of the NSA without knowing the actual costs of the mail. It is unsurprising that the USPS routinely reports "net profits" from NSAs; because the USPS does not know the actual costs of the mail subject to the NSA, it can easily present a "showing" of a net profit by selecting a proxy that leads to the desired result.

<sup>21</sup> In adopting the requirement, the Commission was not persuaded that it was imposing an unfair burden on any proponent. The Commission stated it "expects the Postal Service to know and understand mailer-specific costs where they have a bearing on a request. This is all part of analyzing the financial aspects of any proposed agreement." Order No. 1391 at 34 (Feb. 11, 2004). The Commission further noted that because NSAs provide participating mailers with benefits that are not available to other mailers in general, a "requirement to substantiate a request for a Negotiated Service Agreement is part of the cost of receiving those benefits."

<sup>22</sup> See also Tr. 2/95 (Yorgey): "To the extent that the rates applicable to pieces above and below the breakpoint and for differing levels of dropship activity reflect underlying cost differences, it is reasonable to assume that the fact that Bookspan's mail exhibits lower unit revenues than do the national averages, there are also lower costs that have not been adequately reflected in the unit costs that were used as proxies for Bookspan's unit costs."

initiatives, and Mr. Posch's assertion that Bookspan mailings have a high degree of address hygiene, which is a practice that presumably will continue absent the NSA, and which implies inherently lower cost. Tr. 3/449h-449j (Posch).

If this testimony is accurate, then it is reasonable to expect that Bookspan's costs for flats are likely lower than the subclass-average costs relied upon by the USPS. It follows that the unit contribution of those flats currently is higher than for the average Standard flat. And this would suggest that the financial benefit to the Postal Service of Bookspan converting flats mailings to letters correspondingly could be overstated to an unknown degree.<sup>23</sup> This illustrates the wisdom of the Commission's rule that the Postal Service provide mailer-specific costs, suggests that the Postal Service's failure to comply with rule 193(e)(1)(i) has consequences, and constitutes a fatal failure of proof.

Another flaw in the proponents' estimated \$5 million net contribution from conversion is that it takes credit for a change in Bookspan's mailing mix that might occur in the absence of the NSA due to Bookspan's own business reasons. Bookspan has been shifting its relative mix from flats to letters in recent years without any rate incentive for marketing reasons. USPS-T-2 at 11 (Yorgey). To the extent

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<sup>23</sup> It may also be possible that Bookspan's migrated letters may impose lower unit costs than its flats (thereby increasing the net contribution of letters), but the record is devoid of data that would enable this to be tested.

that any estimated benefit from the NSA would occur by market forces without the NSA, the proponents should not be able to claim it in defense of the NSA.<sup>24</sup>

Yet another defect in the Postal Service's estimated \$5 million in new contribution from conversion is that the Service does not know which pieces will convert. Val-Pak showed during its cross-examination of witness Yorgey that the Postal Service's calculation of the net benefit of conversion is highly sensitive to which of Bookspan's flat mailings in fact convert. The Postal Service's use of average figures in estimating the contribution from converting pieces is misleading insofar as it masks significant differences between the per piece contributions made by different rate categories.<sup>25</sup> The net benefit of conversion heavily depends on the rate category or categories from which the flats convert. If the "wrong" pieces convert, the net benefit could be far less than the USPS estimates.

***Failure of proof of the "new" volume of \$2.6 million***

If one merely subtracts from the Postal Service's financial showing the effects stemming from the conversion of flats to letters, then the benefit to the USPS in the form of incremental institutional cost contribution from "new" volume is barely \$2.6 million, mere pocket change to the USPS. This amount supposedly represents new

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<sup>24</sup> By analogy, in antitrust law parties to a proposed merger are unable to justify their merger by claiming purported efficiencies that would have occurred in any event.

<sup>25</sup> For example, a Val-Pak cross-examination exhibit indicates that the USPS actually may lose \$0.009 on every Standard Regular Auto 3/5 rated flat sent by Bookspan (Bookspan's largest volume), while making 8 cents on each ECR Basic flat (Bookspan's second largest volume). Tr. 2/194.

volume presumably responsive to the discount—but that alone is insufficient to justify granting only one mailer a rate discount, as volume discounts for many other mailers would have a similar effect. There is no evidence that the effect on Bookspan is special in this respect. And if one looks at the estimated “new” volume spurred by the volume discount, this is plainly sensitive to a number of assumptions.

NAA and NNA understand that the Office of the Consumer Advocate intends to address in its brief problems in the Postal Service’s forecast of Bookspan’s volumes relevant to this point, and respectfully refers the Commission to that discussion. Here, NAA and NNA will observe only that it is more difficult for the Postal Service to meet its burden of proof when it asks the Commission to accept that a rate discount will result in particular volume changes from a single mailer. This is because the volume forecast and related necessary economic evidence relate to the expected behavior of an unregulated company. As such, it is inherently more difficult to verify and, as noted above, ventures into matters outside of the Commission’s normal area of expertise.

***Failure to include costs of negotiation and litigation***

Finally, the Postal Service’s financial calculation completely ignores the costs incurred by the Postal Service in negotiating the agreement and litigating this case. Here, the record indicates that negotiations between Bookspan and the Postal Service extended over at least four years. This included many meetings and visits, although none of the costs incurred by the Postal Service in doing so are included in the testimony regarding the financial net benefit. This means, in short, that all other

mailers are taxed with the costs of the Postal Service's negotiating a volume discount available only to Bookspan.

### III. CONCLUSION

For the foregoing reasons, the Newspaper Association of America and the National Newspaper Association respectfully urge the Commission not to recommend approval of the Bookspan negotiated service agreement, at least insofar as it includes the volume discount feature.

Respectfully submitted,

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### CERTIFICATE OF SERVICE

I hereby certify that I have this date served the instant document on all participants requesting such service in this proceeding in accordance with section 12 of the Rules of Practice.

December 6, 2005

William B. Baker  
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