

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
TIME WARNER INC.

Burzio & McLaughlin
Canal Square, Suite 540
1054 31st Street, N. W.
Washington, D. C. 20007-4403
Telephone: (202) 965-4555
Fax: (202) 965-4432
burziomclaughlin@covad.net

John M. Burzio
Timothy L. Keegan

COUNSEL FOR
TIME WARNER INC.

December 6, 2005

TABLE OF CONTENTS

	Page
1. The key evidentiary issue respecting volume-based and savings-based NSAs is the same--whether the agreement poses an unreasonable risk of harm to the Postal Service and/or its customers.....	3
2. NSAs that are available on equal terms to mailers able to meet the eligibility conditions, that do not unfairly harm competitors or reduce competition, and that generate additional net revenues for the Postal Service are not inequitable or unduly discriminatory	4
3. Rate and fee changes that achieve mutual gains in efficiency for the Postal Service and mailers--whether in the form of volume-based NSAs, savings-based NSAs, or generally applicable rates and classifications--enhance competition and contribute to a fairer competitive market.....	6

INITIAL BRIEF OF
TIME WARNER INC.

Time Warner Inc. (Time Warner), which owns a 50 percent share in Bookspan, hereby respectfully submits its initial brief in support of the negotiated service agreement (NSA) jointly sponsored by the Postal Service and Bookspan in this docket. The initial briefs of the Postal Service and Bookspan will fully review the extraordinarily complete and persuasive evidentiary record compiled in this proceeding that demonstrates the soundness of the rationale of the NSA, the clarity and completeness of the supporting data, and the thoroughness of the provisions that have been incorporated to eliminate any significant risk to the Postal Service. This brief addresses a more general issue that is before the Commission in this proceeding for the first time: whether volume-based NSAs are fundamentally different from, or require a substantially different analysis or evidentiary standard from, savings-based NSAs.

This is the first proceeding in which the Commission has been asked to approve a proposed NSA consisting of "volume-based discount agreements that do not rely on a cost-savings element."¹ In response to an earlier request from the Governors for an advisory opinion on "the applicable evidentiary standard that must be met to substantiate a volume-based discount provision," the Commission recently declared that "a proposal for a savings-based agreement . . . is fundamentally different from a proposal for a 'pure' volume-based agreement." Order No. 1443 at 2, 11. It held that a volume-based could not appropriately be considered under the rubric of being a "functional equivalent" of a savings-based

¹ Docket No. MC2004-3, Order No. 1443: Order Establishing Procedural Framework for Reconsideration (issued August 23, 2005) at 11-12.

NSA but rather "would have to be considered as a new baseline agreement." *Id.* at 12. It observed that such a proposal would raise an issue of first impression "whether the risks inherent in a pure-volume based discount can be ameliorated satisfactorily through mechanisms other than a stop-loss cap." *Id.*

In Time Warner's view, there is no essential difference between the two types of proposals. Both are appropriately subject to the same test: whether they pose "an unreasonably significant risk" of "harm to the Postal Service and/or its customers." *Id.* at 13. The mechanisms necessary to remove or mitigate any such risk may differ for the two types of agreement, but the evidentiary standard is fundamentally the same.

Time Warner is a longstanding proponent of the legality and appropriateness of NSAs--both savings-based and volume-based--that meet the criteria of the Postal Reorganization Act, that generate a benefit--i.e., an increase in net revenues--for the Postal Service, that do not harm other customers, that are offered on a nondiscriminatory basis to other mailers able to satisfy the conditions of the agreement, and that are implemented pursuant to a favorable recommended decision by the Commission.

A wealth of contextual evidence and authority supports the view that volume-based discounts do not present essentially different issues from those raised by other types of customized rate or service agreements. Properly structured agreements of both types are consistent with the practices of ratemaking agencies other than the Commission that are subject to statutory prohibitions against "undue and unreasonable discrimination" equivalent to § 403(c) of the Postal Reorganization Act,² with judicial precedents,³ and with the practices of foreign

² See *Change of Policy, Railroad Contract Rates (General Policy Statement)*, 361 ICC. 205 (April 4, 1979); and *In The Matter Of AT&T Communications; Revisions To Tariff*, FCC. No. 12, 4 FCC. Rec. 4932 (April 18, 1989).

³ See *Sea-Land Service, Inc. v. Interstate Commerce Commission*, 738, F.2d 1311, 1317 (D.C. Cir. 1984); and *UPS Worldwide Forwarding Inc. v. USPS*, 66 F.3d 621, 634 (3rd Cir. 1995).

postal administrations that have a reserved or monopoly market and are subject to public service and nondiscrimination obligations.⁴

1. The key evidentiary issue respecting volume-based and savings-based NSAs is the same--whether the agreement poses an unreasonable risk of harm to the Postal Service and/or its customers

The Commission "considers the analysis of risk as an important consideration in recommending Negotiated Service Agreements." Order No. 1443 at 14. It interprets the Act as requiring that it determine whether a proposed NSA would create "an unreasonably significant risk . . . that could cause harm to the Postal Service and/or its customers," and, if so, to "condition its recommendation on the addition of an applicable risk control device." Id. at 13. It cautions that "[t]his consideration is magnified where monopoly products are involved." Id at 14.

It appears self-evident that there is nothing in the nature of an undertaking to tender specified increased volumes that makes its fulfillment more risky than the fulfillment of an undertaking to engage in some cost-saving activity, or less susceptible to accurate prediction of the benefits it is likely to generate, or less amenable to conditions that would eliminate or ameliorate any significant risk of loss to the Postal Service or harm to other postal customers. The specific proposal under review in this proceeding amply illustrates the adaptability of volume-based agreements to a variety of effective "risk control devices."

In evaluating the adequacy of these protections, one must begin with the observation that Bookspan's promotional mail looks far less like a "monopoly product" than the First Class mail that has been the subject of previous NSA proceedings.⁵ Bookspan has a myriad of competing distribution channels to choose

⁴ See, e.g., *Fourteen-Nation Survey of Postal Ratemaking*, International Postal Affairs Division, USPS, March 1989.

⁵ We assume that when the Commission observed that considerations of risk are "magnified where monopoly products are involved," its intended reference was less to the Postal Service's technical legal monopoly than to the extent of its de facto monopoly or genuine market dominance.

from. Among other things, the existence of these competitors provides the Postal Service with valuable information about the magnitude of the incentive required to make particular volume commitments economically attractive to Bookspan. Other circumstances particular to Bookspan and/or to the proposed agreement under review, make it appear exceedingly unlikely that this NSA poses an "unreasonably significant" risk of harm to the Postal Service or its customers. Among these are the well documented, indisputably powerful multiplier effect of successful Bookspan solicitations, the conditions of the agreement that provide for annual adjustments to the volume commitments based on actual experience, a penalty provision for failure by Bookspan to meet minimum volume guarantees, a cap on volumes eligible to receive the discounted rate, and escape mechanisms such as the right of either party to cancel the agreement on thirty days notice. Indeed, the Bookspan NSA is proof that volume-based agreements are among the easiest to impose risk-limiting conditions on, particularly the sort of "sliding scale" mechanisms that build into the agreement a set of adjustments suited to a wide variety of potential outcomes or developments.

- 2 NSAs that are available on equal terms to mailers able to meet the eligibility conditions, that do not unfairly harm competitors or reduce competition, and that generate additional net revenues for the Postal Service are not inequitable or unduly discriminatory

An eminent jurist who is also a pioneer in the study of law and economics once observed how an unjustifiably narrow conception of undue discrimination on the part of regulatory agencies had tended to produce rates that are needlessly insensitive to market forces:

Regulatory statutes forbid discrimination in rates and the tendency in the interpretation of these statutes is to equate discrimination with difference in rates and nondiscrimination with rate uniformity. Under this, a non-economic view of discrimination, multipart pricing

has been suspect and average cost-pricing, although less efficient, encouraged.⁶

Since Judge Posner wrote those words, the sophistication of modern rate regulation has steadily advanced, and agency after agency has steadily moved away from "a non-economic view of discrimination." The ICC, the FCC, and FERC have all approved the use of volume-based NSAs by the industries they regulate and have found that such NSAs do not violate their governing statutes' prohibitions against undue discrimination.⁷ In *Sea-Land Service, Inc. v. ICC.*, 738 F. 2d 1311, 1317 (D.C. Cir. 1984), the D.C. Circuit upheld this policy and provided a detailed explanation of its rationale:

The core concern in the nondiscrimination area has been to maintain equality of pricing for shipments subject to substantially similar costs and competitive conditions, while permitting carriers to introduce differential pricing where dissimilarities in those key variables exist. Refined economic analyses have permitted the Interstate Commerce Commission over the years to adopt increasingly sensitive ratemaking methodologies. In recent decades, for example, the Commission has approved noncontract discount rates on guaranteed annual volume shipments in various areas, on grounds of reduced costs and the need to meet intermodal competition. *See, e.g., Coal from Kentucky*, 308 ICC. 99 (1959). Because shippers meeting these volume requirements are not similarly situated with other shippers tendering lower volumes of traffic, no discrimination results from differential pricing in these circumstances.

A logical next step was for the Commission to recognize the economic efficiencies that accrue from private contracting. Although one normally regards contract relationships as highly individualized, contract rates can still be accommodated to the principle of nondiscrimination by requiring a carrier offering such rates to make them available to any shipper willing and able to meet the contract's terms. If those terms result in lower costs or respond to unique competitive conditions, then shippers who agree to enter into the contract are not similarly situated with other shippers who are unwilling or unable to do so. Under these

⁶ R. Posner, *Economic Analysis of Law* (2nd edn. 1972), at 262-63.

⁷ See *Change of Policy, Railroad Contract Rates (General Policy Statement)*, 361 ICC. 205 (April 4, 1979); *In The Matter Of AT&T Communications; Revisions To Tariff*, FCC. No. 12, 4 FCC. Rec. 4932 (April 18, 1989); *Explorer Pipeline Company*, 71 FERC ¶ 61,416 (1995)...

circumstances, a carrier may properly charge different rates for contract and noncontract carriage without running afoul of the prohibition on discriminatory pricing. Endorsing the logic of this position, the Interstate Commerce Commission acted to approve contract rates for the first time in 1978. *Change of Policy*, slip op. at 2-3 (Nov. 9, 1978); 361 ICC. at 209-10.

More recently, in the area of international mail, volume-based negotiated service agreements have been upheld against challenge under § 403(c) of the Postal Reorganization Act itself. In *UPS Worldwide Forwarding Inc. v. USPS*, 66 F.3d 621, 634 (3rd Cir. 1995), the court held that purely volume-based discounts are not unduly discriminatory under § 403(c) when made available on equal terms to similarly situated customers.

3. Rate and fee changes that achieve mutual gains in efficiency for the Postal Service and mailers--whether in the form of volume-based NSAs, savings-based NSAs, or generally applicable rates and classifications--enhance competition and contribute to a fairer competitive market

The only party likely to be adversely affected by a properly structured NSA is a competitor of either the Postal Service or the NSA mailer(s), for all competitors are comparatively disadvantaged by anything that benefits their competition.⁸ However, such a shift in comparative positions, standing alone, is no evidence that proposed negotiated rates *unfairly* impact Postal Service competitors or constitute, in any sense, *anticompetitive* conduct.

The modern regulatory era is distinguished by the recognition that the borders between regulated and unregulated economic activity are extremely porous and that the public and other captive customers of regulated monopolies are placed

⁸ Not surprisingly, the only private party that has indicated its opposition to this NSA is in direct competition with the Postal Service for the advertising business of Bookspan and of similarly situated mailers that are the potential beneficiaries of functionally equivalent agreements. See Comments of the Newspaper Association of America on Notice of Inquiry No. 1 (November 14, 2005), at 1 ("As NNA will explain in its initial brief, the NSA proposed in this proceeding is unlawful under the Postal Reorganization Act"). Witness Epp testified that Bookspan uses a variety of media for its promotional campaigns, including print advertising and inserts in newspapers. BOOKSPAN-T-2 at 5-7.

at an unfair disadvantage by ratesetting policies that prevent regulated entities from taking advantage of opportunities to negotiate with its customers to achieve mutual gains in efficiency. Such policies are not necessarily pro-competitive. To the extent that they prohibit undue discrimination or cross-subsidy, such policies are rightly deemed necessary to safeguard fair competition. But, absent these two circumstances, they are the opposite of pro-competitive and serve only to deny "the public the variety of price and quality options that a competitive market would have provided."⁹ In approving individually negotiated contract rates as a general policy, the ICC stated this point with admirable succinctness:

The potential effect of a proposed contract rate on competitive modes will of course be an important factor in the analysis of individual contract rate proposals. However, we again stress that contract ratemaking is a useful tool in helping to meet, as opposed to eliminate, competition.¹⁰

The ICC recognized also that evaluating arguments that competitors might be unfairly impacted by a negotiated rate agreement requires a fact-specific analysis of the evidence presented in support of such claims:

Our analysis of the comments received convinced us that this weighing process [of the potential benefits of contract rates against any possible adverse consequences, including anticompetitive effects] could best be made on a case-by-case basis. Each individual contract rate proposal would be evaluated on its own merits.¹¹

Similarly, although the Postal Reorganization Act requires the Commission to consider impact on competitors of the Postal Service from discriminatory and anticompetitive postal rates and policies, it also requires the Commission to enable the Postal Service to meet private competition on fair terms. The Act gives

⁹ Alfred E. Kahn, "The Theory and Application of Regulation," *55 Antitrust Law Journal* 1 (Spring Meeting Issue, 1986), at 178.

¹⁰ *Change of Policy, Railroad Contract Rates (General Policy Statement)*, 361 ICC. 205 (April 4, 1979).

¹¹ *Id.*

competitors of the Postal Service the right to participate in Commission proceedings--presenting evidence on the issue of whether proposed contract or customized rates unfairly impact upon them and challenging evidence presented by other parties--and the right to appeal Commission findings in federal court. However, no evidence of any likelihood of unreasonable harm to competitors has been presented on the record of this proceeding. In the absence of such evidence, the Commission should regard entirely speculative and theoretical apprehensions of harm with skepticism.

Respectfully submitted,

s/ _____
John M. Burzio
Timothy L. Keegan

COUNSEL FOR
TIME WARNER INC.

Burzio & McLaughlin
Canal Square, Suite 540
1054 31st Street, N. W.
Washington, D. C. 20007-4403
Telephone: (202) 965-4555
Fax: (202) 965-4432
E-mail: burziomclaughlin@covad.net