

NNA-T-1

Before the
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

EXPERIMENTAL CHANGES TO IMPLEMENT
CAPITAL ONE NSA

DIRECT TESTIMONY
OF JEFF M. DAVID
ON BEHALF OF THE
NATIONAL NEWSPAPER ASSOCIATION

TABLE OF CONTENTS

Page

I. PURPOSE OF TESTIMONY.....3

II. VOLUME-BASED RATES IN THE POSTAL SYSTEM
WILL DISADVANTAGE SMALL AND LOCALLY-BASED
BUSINESSES.....5

III. COMMUNITY NEWSPAPERS SPECIFICALLY
WILL FACE HARMS IF THIS PRECEDENT IS
EXTENDED FURTHER INTO THE DIRECT
MAIL MARKETPLACE.....8

IV. EVERY MAILER WILL BE AFFECTED IF CONTRIBUTION
TO INSTITUTIONAL COSTS IS UNNECESSARILY
BARGAINED AWAY.....11

V. CONCLUSION.....14

Testimony of Jeff M. David
On Behalf of the
National Newspaper Association

1 My name is Jeff David. I am owner and publisher of the *Livingston Parish (LA)*
2 *News*.

3

4 The *Livingston Parish News* is a 12,000 paid circulation twice weekly newspaper
5 published in Livingston Parish, Louisiana, directly east of Baton Rouge. I also
6 publish a 12,000 circulation shopper, the *Livingston Parish Dispatch*. The
7 *Livingston Parish News* is delivered through Periodicals mail. The *Livingston Parish*
8 *Dispatch* is delivered through Standard mail.

9

10 I am a native of Baton Rouge and a graduate of Louisiana State University and
11 LSU Law School. Between undergraduate school and law school I served in the
12 U.S. Army (1969-71). I practiced law in Baton Rouge for three years, then
13 assumed management of *The News* in July 1977 when my father, then the owner
14 and publisher, died of a sudden heart attack. I am the seventh owner-publisher of
15 *The News*, which celebrated its 104th anniversary in July 2002.

16

17 From 1984-1997 my wife, the former Nancy Estill from Shreveport, and I owned
18 and operated radio stations WBIU 1210 (AM) and 96.1 The River (FM), both of
19 which were marketed throughout the Baton Rouge metropolitan area. The stations
20 were sold in July 1997.

21

22 I am a former president of the Louisiana Press Association (1987-88), and have
23 served as Chairman of LPA's Government Relations Committee since 1997. I have
24 served as a member of the Board of Directors of the National Newspaper
25 Association since 1996, and as Chairman of NNA's Government Relations

1 Committee from 1997 to 2000. During the last three years, I have been NNA
2 Treasurer, Vice-President, and now President.

3
4 I. The Purpose of My Testimony

5
6 The purpose of my testimony today is to address the precedent set by the terms
7 of this particular Negotiated Service Agreement with Capital One Services, Inc.,
8 and describe the impact upon community newspapers that I expect if volume-
9 based rates are introduced into the postal system. I believe some of my concerns
10 can be extended beyond the newspaper business to many locally-owned and
11 operated businesses.

12
13 The proposal of the Postal Service has a work-sharing discount element in it. But
14 it also presents the equivalent of a volume-based discount by rewarding Capital
15 One with incremental discounts after its annual mail volume exceeds 1.225 billion
16 pieces. While the net contribution from Capital One's future mail volumes may
17 increase, it does not equal the contribution that would be made if those volumes
18 paid the full first-class per piece rates that would be due for the same volumes
19 mailed in the absence of this agreement. Therefore, a component of the proposal
20 involves a volume-based rate.

21
22 NNA supports work-sharing arrangements and while we do not object to the
23 aspects of this case that would exchange a discount for Capital One's additional
24 pre-mailing list hygiene, we do believe this arrangement is better handled in a
25 niche classification case where the benefits could extend immediately to other
26 mailers.

27
28 My main purpose here, however, is to point out the long-range problems I would
29 expect to see from volume-based discounts. My concern is not limited to the
30 Negotiated Service Agreement presented here. It extends to the many similar

1 agreements that inevitably will face the Postal Service, the Commission and
2 American businesses if the precedent is established.

3 My concerns are as follows:

4

5 1. If the Capital One NSA is approved, it will open the door for numerous
6 petitions for volume-based rates, which will create a major competitive advantage
7 for large, nationally-oriented businesses in our economy.

8

9 2. Volume-based rates in markets involving newspapers will have a negative
10 impact upon community newspapers, contravening 150 years of public policy.

11

12 3. Volume-based NSA's will inevitably leave money on the table that would
13 benefit the Postal Service and, thus, all mailers.

14

15 II. Volume-based rates in the postal system will disadvantage small and locally-
16 based businesses.

17

18 Any resident of a small town—and particularly of a town that became a growing
19 suburb like Livingston Parish—who has watched the arrival of Wal-Mart knows
20 what it means when massive economies of scale enter a marketplace. When this
21 megabusiness enters a community, seismic shifts begin to occur.

22

23 As Wal-Mart comes in, consumers gain a sprawling one-stop shopping store.

24 What they lose is a business that:

25

26 Keeps its money primarily in a local bank

27 Contributes to local community events

28 Advertises in the local newspaper

29 Handles special orders and provides hands-on customer service

30 And invests in the development of the community.

1 When Walmartization begins, downtowns shrivel. The pleasant strolls through a
2 bustling downtown turn into traffic jams in a suburban parking lot, and the
3 downtown gradually is boarded up.

4
5 Wal-Mart can purchase merchandise on a grand scale. It can order supplies,
6 control inventories, handle bookkeeping and negotiate for capital on a scale that
7 no local business can hope to achieve. Local businesses that hope to survive are
8 up against a daunting foe. Many do survive in spite of the odds, but communities
9 have lost something in the battle, nonetheless. I've read that Wal-Mart opens a
10 new megastore every other day, and that by 2004, it hopes to open one a day.
11 The pace of change in local commerce continues rapidly.

12
13 The analogy is apt. The Postal Service, with a volume of nearly 140 million
14 possible daily deliveries, its private express protections and its government
15 ownership, can carry chosen partners through the mailstream by offering a
16 tremendous economy of scale and scope. Here, its chosen partner is Capital
17 One.

18
19 The consequences of even this limited NSA may be imposed upon businesses in
20 my town, most of which are not yet aware of their peril. It is easy to see how.

21
22 For example, if my local bank wants to promote its credit card service with a
23 letter to the 33,000 households in Livingston Parish, it will pay between 27.5 and
24 30.9 cents at the presort first-class automation rates. As I understand the NSA
25 proposal, if Capital One wishes to promote its own credit card service to these
26 33,000 homes, it may be able to mail a similar size and shape letter for as much
27 as 6 cents less. If both my local bank and Capital One dropped an identical
28 33,000 piece mailing for the same credit card services on the same day and
29 Capital One is enjoying its maximum volume discount, Capital One begins the
30 race for customers \$1,320 to \$1,980 ahead of my bank in just postage savings. It
31 is easy to see why the local bank comes out the loser. And why a company

1 which has no real interest in Livingston Parish community life, culture or
2 business, can push my local bank out of a competitive position.

3
4 Being on this end of the economies of scale battle is a familiar experience for
5 small business owners. A local newspaper like mine experiences the
6 disadvantages of volumes of scale and scope all the time.

7
8 For instance, in my printing operation, I am a reasonably large consumer of ink.
9 In printing two newspapers and the work of various commercial customers, I
10 purchase as much as 25,000 gallons of ink annually. Yet, when my operation is
11 compared to that of a group-owned newspaper in my state—such as the
12 Shreveport Times, owned by the Gannett Company— I am a small ink customer.
13 Ink is priced by volume. Gannett's ink prices are proprietary. But from
14 conversations within the industry, I believe I pay 20 to 40 percent more for ink
15 than such large purchasers. If I compared my costs to those of a major national
16 printer, such as Quad Graphics, the differential would be even greater.

17
18 It's a burden the small business in America has to bear today. It is borne in
19 countless ways in purchases of products and services, from office supplies to
20 insurance to pension benefits. It is a reality of our economic system.

21
22 However, when the seller is a government-owned corporation with a protected
23 monopoly, the smaller purchaser is up against more than simple economies of
24 scale. It is up against an economy created through means other than the private
25 capital that fuels a private business, with all of the attendant risks to shareholders
26 and financiers. A small business, in my view, has a right to object to a misuse of
27 the public trust.

28
29 First, I believe this seller, the Postal Service of today, still relies heavily upon an
30 infrastructure originally created with tax dollars. Second, it is not required to
31 participate in the commercial marketplace on the same terms as any other

1 business. And, finally, because it is the sole source provider, the businesses
2 injured by these volume discounts do not even have the advantage of shopping
3 around to find a less costly provider.

4
5 Let me offer an example of how the sole source problem affects a purchaser.

6
7 I purchase approximately 350 tons of newsprint per year. Compared to a large
8 corporation like Gannett, my purchases are probably less than one percent of its
9 annual purchases. In the newsprint marketplace, discounting is widely practiced.
10 When supplies are limited, my newsprint prices may be as much as 15 to 20
11 percent higher than a nearby competitor with volume purchasing available.

12
13 But the newsprint market is highly competitive. When the market is not tight, I
14 can shop on the spot market and purchase a few tons at a time from the
15 remainder stocks left unclaimed by the big guys. Then, my prices are much more
16 competitive, and possibly even a little lower, because of my flexibility.

17
18 What would it be like if the Postal Service were the only producer of newsprint,
19 as it is a sole deliverer of letters? It would control an essential product for my
20 business, create a favorable rate for my competitors and economically and/or
21 legally restrain me from helping myself out of the bind by shopping elsewhere.

22
23 The Postal Service understandably wishes to follow the patterns of other large
24 businesses by providing volume discounts. But I believe it cannot be permitted to
25 follow the private sector lead in this situation. Extending volume discounts to
26 large mailers would be, in my view, an unfair way to use the monopoly.

27
28 III. Community newspapers specifically will face harms if this precedent is
29 extended further into the direct mail marketplace.

1 My newspaper will be affected by volume discounts that place large national
2 businesses in a preferred competitive position to the local businesses of
3 Livingston Parish. The local businesses are my readers and advertisers. If they
4 are harmed, my newspaper is harmed.

5 Another effect looms in the future, if this precedent is set. It will be the one
6 created by large direct mail firms entering my local advertising marketplace with
7 volume-based rates. If the Commission approves this NSA, it is not hard to
8 imagine that direct mail businesses will be in line for their turn at major discounts.

9

10 The disagreements between the newspaper industry and the Postal Service
11 about the development of the direct mail industry are long standing. They are not
12 always ones that have included NNA, as many of our members are active users
13 of Standard mail. As my biography indicates, I publish a thriving shopper that
14 uses Standard mail. NNA has long urged newspapers to use direct mail and take
15 advantage of the many opportunities it offers.

16

17 But we can do so only if we operate on a reasonably level playing field.

18

19 Just as my business in general is at an economic disadvantage against larger
20 businesses, my newspaper is at a specific disadvantage against large direct mail
21 companies for two reasons.

22

23 One, at least 40 percent of my costs are directly attributable to producing a news
24 and information product for my community. Reporters, photographers and editors
25 are expensive. News-gathering is a complex and costly operation. Competitors
26 interested in distributing only advertising avoid these costs.

27

28 Two, my newspaper is like most NNA members in that our direct mail package is
29 sent only to nonsubscribers. Advertisers reach most homes through the
30 newspaper—a periodicals-rates product. They do not wish to duplicate their ads
31 for our readers by including their ads in a shopper delivered to every household.

1 Our shopper, then, has less than total saturation. We cannot enjoy the saturation
2 discounts as a rule, and our direct mail competitors can. If a competitor enjoyed a
3 work-sharing saturation discount AND a volume-based discount, my small
4 newspaper would truly be operating under a great handicap.

5
6 Community newspaper publishers face daunting circumstances today. The
7 family-owned paper is not as common as in 1977 when I entered the business.
8 Yet many of us have survived. We believe our function in the democracy and in
9 our local communities is vital, and we struggle against the odds to succeed.

10
11 Because of my role as NNA's Government Relations Chairman, I've spent some
12 time with the history of newspaper postal rates. As recently as 1986, I
13 understand, the Commission revisited reasons for a within county mail class. The
14 now 150 year old public policy struck by Congress to encourage local
15 newspapers when it created the local newspaper mailing rate was created
16 specifically to help local papers fend off the impact of larger scale, inexpensive
17 publications from major cities. The notion of encouraging local papers was
18 redebated by Congress and examined by several major commissions over the
19 years, as I understand it, and the conclusion was always the same. Local news is
20 important. Local newspapers are still the predominant channel for local news.
21 Even the all pervasive Internet has not displaced newspapers in their traditional
22 function of delivering news, even if the great fragmentation of the advertising that
23 pays for the news has made it more difficult to perform the mission. My paper is
24 still the major source of information for local politics, organizations, schools and
25 government in Livingston Parish.

26
27 I have traveled to other nations in my NNA work. It is striking that the United
28 States enjoys such a widely-diverse local press when most developed nations
29 have mostly national newspapers, with only a few locally-owned papers. I believe
30 postal policy is one major cause for our history of strong local newspapers.

1 The purpose of this policy is not to favor any particular business, but to favor
2 local information and news. Congress has reinforced and readopted the policy so
3 many times in the past 150 years that it is unimaginable to me that it would want
4 to undermine it now by permitting large national direct mail companies to enjoy
5 favorable rates through volume discounts. Such discounts would take a playing
6 field that already operates somewhat to the disadvantage of the local press and
7 tilt it dramatically against us.

8
9 I hope the Commission declines to permit volume-based rates. But if it decides to
10 permit Capital One's specific NSA to go forward, I urge the Commission in the
11 strongest terms to make it clear that the Postal Service may not enter into
12 agreements with national mailers that place local businesses at a direct
13 competitive disadvantage for no reason other than the volumes of their mail.

14
15 IV. Every mailer will be affected if contribution to institutional costs is
16 unnecessarily bargained away.

17
18 As a small mailer, I can attest that the impact of seven rate increases since 1991
19 has made every mailer apprehensive about policies that gamble with the Postal
20 Service's bottom line. As the president of NNA, I can further assure the
21 Commission that the frequent rate increases have been a factor in the severe
22 financial stress that in 2001 forced a major downsizing of the organization.

23
24 NNA has supported many initiatives to reduce the costs of postal operation. We
25 were pleased to learn in 2001 that within county mail fully covered its own costs
26 and even made a contribution to USPS overhead slightly in excess of its legal
27 requirement. We realize that the fixed costs of the postal system are massive,
28 and that when USPS cannot fully cover the costs, financial losses create more
29 frequent increases. Losses may also be created when the Postal Service leaves
30 money on the table in its contractual arrangements, as I believe it does here.

1 One major reservation about this NSA, and future negotiations with private
2 businesses is how the Postal Service will know whether it is leaving money on
3 the table that might have aided the system overall.

4
5 What I mean is that a company may be well aware that it is about to engage in
6 new and expansive commercial activities that would cause its mail volume to
7 grow. Or it may not even be fully aware of possible mail growth, but have merely
8 a sense that it may become a more active mailer. Yet, it may not choose to
9 share everything it senses or knows with the Postal Service. Why would it? The
10 nature of negotiation is to reveal enough and hold back enough to gain an
11 advantage.

12
13 If the Postal Service is the delivery service of choice—and for most of the mail in
14 the mailstream now, it is the only service available—USPS would have carried
15 the new mail volumes anyway. Unless it can tune its crystal ball with perfect
16 accuracy, it cannot predict which promised new volumes it would have had
17 anyway, and which truly are the result of an agreement. Nothing the Postal
18 Service or the Commission can do will force these inchoate plans into being or
19 onto a public record before their time, but the Postal Service can certainly, in its
20 eagerness to induce mail volumes, give away money that it would have gotten
21 anyway.

22
23 I look at it the same way I look at negotiations in my own business.

24
25 Let's imagine a grocery store came to me with a request for a discount and a
26 promise of new advertising lineage in the next year.

27
28 I certainly want the new advertising lineage. Perhaps it would help me post
29 another reporter at the State Capital.

1 But before I offer a discount, I must assess whether this advertiser is likely to
2 take its new volumes to another newspaper or a different advertising medium if I
3 do not provide the discount. If I believe I am likely to get the business anyway, I
4 then need to decide whether the advertiser is likely to spend more than its usual
5 one or two percent of its annual retail sales on advertising because of my
6 discounts.

7

8 If I'm likely to get the business anyway, and the discounts aren't going to change
9 my customer's ad budget, I have to conclude that this advertiser's proffered
10 business is driven by its need to generate new or more customers, and that it will
11 use my newspaper at its current rates if I do not provide the discount. Neither of
12 us knows what the other is thinking, or truly planning. But I do know this: if I give
13 away a lower rate to attract advertising that I would have had anyway, I'm giving
14 away money that I would probably otherwise spend on gathering local news and
15 strengthening my newspaper in its offerings to the readership. There will be an
16 impact to my decision, both to my company and the community, whichever way I
17 go.

18

19 The Postal Service can find itself in the same position. I understand it will offer
20 Capital One discounts in declining block rates after it exceeds 1.2 billion pieces
21 and goes as high as 1.6 billion pieces. But what if Capital One would have mailed
22 1.6 billion pieces anyway, at full rates, even if no NSA were in place? The Postal
23 Service cannot know. Even Capital One cannot perfectly foretell its own future.

24

25 When a business is offering discounts to protect itself from losing business to
26 competitors, the rationale for making discount decisions is different from the
27 rationale it would employ if it is simply trying to get a customer to buy more of a
28 product than it otherwise would. The Postal Service in this case does not need to
29 worry about losing Capital One's business to another Postal Service. Here it is
30 only trying to stimulate more activity. And I cannot see how it will ever know with
31 certainty that it is inducing a business to send more mail than it otherwise would

1 not have sent. Customers may say so, but that is a part of striking the bargain, in
2 my view.

3

4 I offer this perspective as a business owner, who practiced the economics of
5 pricing in commerce. If I owned the Postal Service, I would not take this risk. As a
6 mailer and a citizen, I urge the Commission to recommend strongly against it.

7

8 V. Conclusion

9

10 NNA is customarily in accord with much that the Postal Service does to develop
11 its mail services. We have entered into several niche classification cases and
12 participated in settlements that will allow the Postal Service to give back money
13 in exchange for more work by mailers. Nothing in my testimony changes NNA's
14 view that these agreements—which preferably would come in large enough
15 categories that many mailers could benefit—should continue.

16

17 This case is dramatically different. It will send the Postal Service on a new and
18 unwise course, which future decisions will not be able to reverse. Volume
19 discounting by the Postal Service as it is situated today cannot be equitable in
20 the marketplace. It cannot be productive in local economies. It places the future
21 financial position of the Postal Service at risk in ways that no one will ever be
22 able to precisely analyze. It requires both the Commission and the Postal Service
23 to guess at the future of entities they cannot control, and can only predict at great
24 hazard to all of us who use the mail.