

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

Rules Applicable to Baseline And Functionally
Equivalent Negotiated Service Agreements

Docket No. RM2003-5

**REPLY COMMENTS OF THE
NEWSPAPER ASSOCIATION OF AMERICA
October 14, 2003**

The Newspaper Association of America (“NAA”) hereby respectfully submits reply comments in this proceeding.

As the Commission is aware, NAA is on record as opposing negotiated service agreements (“NSAs”) as contrary to the Postal Reorganization Act and unwise as a matter of postal policy. NAA continues to believe that NSAs are ill-advised, pose a substantial risk to the great majority of mailers, and will serve merely to insulate certain favored mailers from the rules and rates applicable to everyone else.

The comments filed to date have largely confirmed NAA’s concerns. Large mailers eager to enter into NSAs advocate setting the evidentiary bar so low as to be almost meaningless. Legitimate concerns that the Postal Service might actively pick and choose among competing mailers and confer material advantages on some, but not others, receive short shrift from mailers intent on their own deals. Indeed, the record offers numerous reasons why niche classifications are much preferable to NSAs.

On the important matter of functionally-equivalent NSAs, the Commission commendably seeks to live to the law and facilitate the access of similarly situated mailers to similar arrangements. Unfortunately, its procedural rules alone are insufficient to

accomplish this important objective. This is because, once it has approved a baseline NSA, the Commission has no power to force the Postal Service to agree to offer a comparable arrangement for a similarly-situated mailer. At best, it can only expedite a functionally-equivalent case if one were ever filed. While the proposed rules for functionally-equivalent cases are well-intentioned, the lack of a means of compelling the Postal Service to enter into a functionally-equivalent NSA is a powerful reason why NSAs should be discouraged, and niche classifications favored.

In these reply comments, NAA will address the following:

- The need for rigorous requirements for “baseline” NSAs, including a consideration of competitive implications;
- Certain aspects of the proposed rules; and
- The need for, but lack of, an effective means of ensuring that other mailers may access the functionally-equivalent rates and terms to which by law they are entitled.

I. “BASELINE” NSAs *SHOULD* HAVE RIGOROUS REQUIREMENTS

It is important to remember what these proposed rules are about. The Postal Service is, under current law, an establishment in the Executive Branch of the U.S. government charged with operating as a public service.¹ It has vast size (\$65 billion in annual revenues), a legal monopoly over the great majority of its volume, and an unparalleled hardcopy distribution network ranging from processing facilities to mailboxes.

Although the Postal Service is subject to common carrier obligations, in an NSA the Postal Service opts to discriminate – by definition – in favor of a single mailer under unique terms and conditions. As the Postal Service does not have shareholders to pressure

¹ 39 U.S.C. §101.

management to negotiate favorable deals, mailers legitimately may fear that the Postal Service will agree to a poor deal. And private entities legitimately may have concern that the Postal Service's very act of singling out certain mailers for preferential treatment could interfere with competitive markets and have significant externalities.

Under the Postal Reorganization Act, this Commission provides the only independent check on the Postal Service's discretion to enter into NSAs, and the only process of public review and participation. It is important that, in shaping its rules, the Commission continue to bear in mind that a special deal for a single mailer is a special privilege that should not be lightly obtained.²

NAA understands that the proposed rules are intended to outline the conditions that the Commission believes may be suitable to NSAs. Despite NAA's misgivings about NSAs *per se*,³ the proposed rules are commendable in many respects. In particular, NAA:

- supports the proposal to make the NSA mailer and the USPS co-proponents of the request. That is appropriate and appeared to work well in the Capital One proceeding.
- supports the Commission's position that volume should not be prerequisite to an NSA; and
- supports the proposed requirement that the NSA improve the Postal Service's financial condition.

² The Major Mailers Association implies that mailers could use NSAs to immunize themselves from the effects of omnibus rate changes. MMA Comments at 2 & n.7. The Commission should not approve deals that would allow individual mailers to avoid rate changes that affect all mailers, which would be a step towards abandoning universal service.

³ Notwithstanding the implementation of the Capital One NSA, it bears mentioning that no court has upheld the legality of domestic NSAs.

The following reply comments address particular issues that emerged in the opening comments.

A. NSAs Should Be Signed And Public

While the proposed rule properly would require that the terms of the contract be made public, NAA respectfully disagrees with the proposal to allow the NSA proponents to file an unsigned copy of the contract.

PostCom contends that the contract should be signed in order to deter the mailer from renegeing as the case proceeds. PostCom Comments at 4. That concern is a reasonable one, although it would not prevent the Postal Service from agreeing to a contract that gives a mailer a right to terminate during the hearing stage.

However, NAA offers a different, perhaps simpler, reason for requiring that the filed copy be signed. Such a requirement would provide assurance that the version of the contract being filed is, in fact, the correct one, not an earlier draft that is attached inadvertently. Double-checking for the presence of two actual signatures would ensure that the version of the contract being filed is correct, and would avoid any waste of time or discovery.

Some commenters oppose allowing important details of the arrangement to be made public, citing the proprietary nature of that information. The Commission should not forget that an NSA participant is seeking an exclusive privilege from our nation's government.⁴ The notion that this demands secrecy smacks of the worst kind of backroom deals. This is compounded by the fact that the Postal Service does not have shareholders

⁴ *E.g.*, OCA Comments at 10 (“NSAs are extraordinary arrangements requiring extraordinary justification”).

or other residual claimants to pressure management to negotiate in the best interests of the USPS. Furthermore, such details are helpful, if not essential, in enabling other mailers to determine if they are functionally-equivalent or if the NSA is harmful. The Commission is correct in proposing that NSAs be made public.

B. Mailer-Specific Data Are Important

Many comments addressed the proposed rule regarding customer-specific data regarding costs and volumes. Most of the comments paid lip service to the concept that mailer-specific data is desirable, but expressed a belief that actually obtaining such data generally would be too difficult.

As for the costs, NAA agrees that the relevant costs are those that the Postal Service incurs in handling the mail that is the subject of the putative baseline NSA. The USPS contends, in essence, that such mailer-specific costs are unknowable, but that average costs should usually suffice. USPS Comments at 13.

The Postal Service made a similar argument in the *Capital One* case. NAA continues to be unconvinced by the Postal Service's position. Private regulated carriers engage in such cost analysis routinely when engaged in negotiations with customers. See Docket No. MC2002-2, Tr. 6/1010 (Kent); Tr. 8/2662-63 (Panzar) (noting that the marketing department sometimes is at odds with the accounting department). While this may not be a simple process, one would be forgiven for assuming that the Postal Service's well-known desire to act "more like a business" would lead it to want to approach NSAs in the same manner as other regulated entities. But such seems not to be the case. However, since the Postal Service has no residual claimants to absorb losses from unwise deals and pressure management to avoid similar mistakes in the future, it is more

important, not less, that the Postal Service understand the costs of what it is committing to do.

NAA opposes on principle NSAs based on volumes or that contemplate volume discounts. There is no reason for limiting potentially cost-effective arrangements to only larger mailers. Small and regional mailers can engage in all worksharing activities that a large or national mailer can, and volume discounts are inherently exclusionary in favor of large mailers. National Newspaper Association Comments at 7. Accordingly, a high standard is appropriate for mailer-specific volumes. The Commission should ensure that in any NSA containing volume discounts or similar volume-based incentives, the mailer should provide all relevant data. MMA argues that for some mailers, the likelihood of material changes in volumes as a result of price changes is “remote.” MMA Comments at n.8.⁵ Rather than justifying less scrutiny, as MMA urges, this suggests that the Commission should pay particularly close scrutiny to NSAs involving rate discounts.

Furthermore, the Commission should adopt a presumption that if a baseline NSA is premised on worksharing, a niche classification open to all who are able to engage in that worksharing activity is preferable. One way this might be achieved is having the pertinent cost segment identified, and any putative savings measured, with a view towards making a more generally available offering of the component activity. See, e.g., NNA Comments at 4-6. And, as Val Pak notes, these cost savings should be determined on a unit, not gross, basis, in order to ensure that smaller, but functionally-equivalent mailers, have an opportunity to enter into a similar arrangement. VP Comments at 6.

⁵ Contrary to DMA *et al.* (Comments at 6), volume data (including elasticities) is also necessary in cases not involving volume discounts, if only to assess the likely financial effect on the Postal Service.

The Postal Service's preference for average costs and inability to measure accurately relevant mailer-specific costs and volumes counsels against single-mailer deals. Niche classifications alleviate this problem by broadening the universe of potential mailers to include more members of the appropriate cost grouping. As a general proposition, this provides greater justification for using averaged costs and volumes.

C. The Financial Consequences Of An NSA Should Be Considered Over The Life Of The Deal

The proposed rules improve upon the Capital One NSA in several important respects. These include, for example, requiring consideration of the financial consequences of the deal throughout its entire duration, not just one year. It is surely not too much of an imposition for the Postal Service, when embarking upon a baseline multiyear contract, to know what the financial outcome is expected to be⁶ and that it be positive.⁷

The Postal Service does not dispute this basic principle. Rather, it protests that such an estimate would be too difficult and necessarily less reliable in the second and third years. USPS Comments at 9-10. Difficulty is no excuse; if anything, it is a reason not to proceed with an NSA. If the Postal Service truly cannot arrive at a reasonably realistic assessment, taking into account all pertinent considerations, whether a particular deal would raise or lower contribution, it should not enter the agreement.

⁶ Presumably it does no less when entering into a contract with its vendors; why should a mailer contract be any less.

⁷ OCA Comments at 16 (urging amendment of proposed § 193(e)(9) to require financial effect of NSA to be "significant and positive"); *accord* DMA *et al.* at 6. While this is surely true for a baseline NSA, competitive concerns may require a less compelling showing for functionally-equivalent NSAs.

The Commission should remember that in *Capital One*, the Postal Service initially offered estimates of cost savings that, during the hearings, were found to have not taken into consideration the effect of a potentially significant future change (the introduction of PARS) in the way undeliverable as addressed mail is handled. This cast doubt on the accuracy of estimates upon which the Postal Service had relied until that point. The individualized facts upon which the costing and pricing of company-specific contracts and service arrangements demand a better analysis over the life of the NSA contract.

If NSA rules are to be adopted, the Postal Service should be required to provide a financial analysis over the lifetime of a baseline NSA.⁸ The Postal Service should verify that it will be better off – with increased unit contribution -- as a result of the NSA.

D. The Commission Correctly Proposes To Require Consideration Of The Effect On Competitors

NAA also strongly supports proposed rule §193(f), requiring the Postal Service to address in its direct case the impact of the NSA more broadly than merely the NSA mailer itself. The Postal Service should recognize that its actions have ramifications (economic externalities) throughout the mailing industry and the economy broadly. Moreover, as an establishment of the federal government, the Postal Service has no proper or legitimate interest in favoring some mailers over their competitors. Congress recognized the importance of this concern in Sections 3622(b)(1), (4), and (5) of the Postal Reorganization Act. This concern also has support in economic theory, as illustrated by the testimony of Professor Panzar and Dr. Eakin in Docket No. MC2002-2.

⁸ As noted *infra*, any subsequent functionally-equivalent mailer should be entitled to rely upon the same cost estimates as used in the baseline case, particularly if average costs are used.

At least two aspects of this inquiry should be required. One would address the net effects on the Postal Service. A complete analysis would not stop merely at a consideration of the NSA mailer's costs, rates, and volumes. It should consider whether the "gains" to the USPS from the contracting mailer's performance are offset by corresponding "losses" to the USPS from other mailers. As Professor Panzar testified during the *Capital One* hearing, the selective offering of a discount to a large mailer "allows final consumers' purchases and associated mail volumes to shift from mailers purchasing according to the standard tariff toward mailers availing themselves of the discounts incorporated in the optional tariff offering." Docket No. MC2002-2, Tr. 8/1582; Tr. 10/2139 (Eakin) (noting that competitors of the NSA recipient are worse off). Where an NSA would merely have the result of shifting mail volumes to an NSA mailer from a disfavored, non-NSA mailer but have little to no effect on total volumes (much less on contribution), this is a relevant fact that should be known from the outset. This analysis requires consideration of the effects of rivals of the NSA mailers, and is an analysis that the Postal Service should engage in for its own reasons even if not required by the Commission's rules.⁹

The second aspect would address competition among the competing firms themselves. An NSA that has the effect of placing a competitor of the NSA mailer at a competitive disadvantage¹⁰ may well not be in the public interest. Evidently misunderstanding this point, several parties recite the standard formulation that the government should be "protecting competition, not competitors." First Data Comments at

⁹ The Postal Service appears to acknowledge the relevance of this consideration. See USPS Comments at 18.

¹⁰ See Discover Comments at 3 ("NSAs can have a serious impact on the competitive marketplace").

2; MMA Comments at 3; Postal Service Comments at 18 n. 5. Those commenters overlook that the Postal Service's *very* act of singling out one mailer for a unique privilege can itself harm *competition* by tilting the competitive playing field.¹¹ This is certainly the case for any mail service affected by the postal monopoly and likely so, to some degree, for all postal services. This competitive disruption from being "left out" is not cured by merely the possibility of a functionally-equivalent NSA in the future; only the actual participation in a similar arrangement can level the playing field. The proper inquiry is broader.¹²

The Postal Service should have sufficient understanding of the markets which it serves to grasp the consequences of the deal. If it does not, perhaps it would be wisest not to consider an NSA in that market at all. For its part, the baseline NSA mailer surely has information about its competitive position in its markets and the likely consequences on rivals. Also, the NSA mailer would be in a position to address whether or not it intends to reflect any savings flowing to it from the NSA in its own prices to its customers.

The effects on competition and competitors can be greatly mitigated if all those in a market have access to the same rates and service configurations. As NNA suggests, the Postal Service should bear a heavy burden to explain why the NSA arrangement is offered exclusively to one mailer. NNA Comments at 5. Expanding eligibility to a wider number of mailers through a niche classification would both reduce the possible competitive harm

¹¹ This tilt can be presumed to be material based on the fact that, if the arrangement did not have a material effect on its business, the NSA mailer would be unlikely to have sufficient interest in the arrangement to proceed.

¹² Thus, PostCom errs in asserting that the only inquiry is merely whether or not the favored mailer is, in a narrow sense, cross-subsidized. PostCom Comments at 3.

and increase the net benefits to the Postal Service. It is the exclusionary nature of NSAs that is problematic.

E. Length of Proceedings

As several commenters noted, the *Capital One* case was the first NSA case and the Commission took a reasonable amount of time to consider carefully a variety of novel issues. This was proper, and the Commission should ensure that it has sufficient time to consider the issues raised by a baseline NSA.

The amount of time needed to hear a future NSA will depend on a number of factors. These include the complexity of the proposal, the degree by which the direct cases of the USPS and the co-proponent address all relevant issues, and the depth of cost and competitive analyses involved.¹³ Even if the Commission decides to adopt a rule stating its general predisposition to decide cases within a certain period of time, it should expressly reserve the right to take longer time if necessary for a full and fair consideration.

These factors do not mean that all cases must have the same duration as *Capital One*. However, with the limited experience of only one NSA case having been filed to date, the Commission should not hamstring itself in the event more time truly is needed.

If time is of genuine concern, well-crafted niche classifications that, by definition, do not exclude certain “rival” mailers can also receive expedited approval. Several commenters complained that the *Capital One* case took more time, but involved a smaller amount of estimated net revenues to the USPS, than the recent *Experimental Parcel*

¹³ NAA shares the OCA’s uncertainty about the purpose and effect of proposed rule § 193(a)(4). See OCA Comments at 12. The Commission should clarify whether a waiver at the outset of the case will preclude an intervenor from challenging an NSA on the subject

Return Service case. Perhaps a major reason for this disparity is the fact that the latter, by being more inclusive of the affected mailing community, was less controversial.

II. THE PROPOSED RULES FOR “FUNCTIONALLY-EQUIVALENT” NSAs, WHILE WELL-INTENTIONED, FAIL TO ENSURE THAT FUNCTIONALLY-EQUIVALENT MAILERS WILL OBTAIN AN NSA

By definition, an NSA is discriminatory. Whether or not an NSA violates Section 403(c) of the Postal Reorganization Act,¹⁴ NSAs indisputably discriminate in favor of the mailer that enters the agreement and against all others, as they are unable to avail themselves of the same mailing rights and benefits.

In approving the Capital One NSA, this Commission reviewed the substantial law regarding single-customer arrangements in regulated carrier industries. *Opinion & Recommended Decision*, Docket No. MC2002-2 at 138-40). The Commission also recognized the utility of the functionally-equivalent test in identifying similarly situated mailers.

The Commission’s discussion, and its recognition of the desirability of rules for functionally-equivalent NSAs,¹⁵ is soundly based on legal precedent. The USPS is a common carrier provider of postal services. *UPS Worldwide Forwarding, Inc. v. United*

(...Continued)
matter of the waiver later during the hearing.

¹⁴ The legal test for discrimination is whether such discrimination is undue or unreasonable. PostCom errs insofar as its comments may be read as suggesting that the discrimination test should be the only consideration an NSA must hurdle. PostCom Comments at 3.

¹⁵ NAA opposes the Postal Service’s suggestion to rename functionally-equivalent NSAs “derivative” NSAs. Changing the name could inadvertently cloud the legal analysis by obscuring the fact that the second mailer is in a functionally-equivalent posture.

States Postal Service, 66 F.3d 621, 637 (3rd Cir. 1995); *Sea-Land Service Inc. v. Interstate Commerce Commission*, 738 F.2d 1311, 1317 (D.C. Cir. 1984). In *Sea-Land Service Inc.*, the U.S. Court of Appeals unequivocally held that even where common carriers are permitted to offer individual contract rates, they may do so consistently with the principle of nondiscrimination only if carriers “make [the contract rates] available to *any* shipper willing and able to meet the contract’s terms.”¹⁶ Courts and federal agencies have analogized this principle to multiple common carrier contexts, including mail carriage.

In the *Capital One* Recommended Decision, the Commission quoted favorably from its own Report to Congress in February 2002, concluding that an NSA is legally permissible under the Postal Reorganization Act provided that:

The negotiated rate-and-service package is made available on the same terms to other potential users willing to meet the same conditions of service.

Opinion and Recommended Decision, Docket No. MC2002-2 at 50, quoting Report To Congress at 1 (February 2002). Unfortunately, however, this proviso has yet to be realized.

In the five months since the Commission approved the *Capital One* NSA, no “functionally-equivalent” NSAs have been approved. Nor have any been announced. Even if one *were* announced today, it could not take effect until after completion of a case of unknown duration, favorable decisions by this Commission and the Governors, and some period of preparation. Put simply, the *Capital One* arrangement is “not available” today to any other mailer.

¹⁶ *Sea-Land Service Inc. v. Interstate Commerce Commission*, at 1317 (emphasis added). See also *MCI Telecommunications Corp. v. FCC*, 917 F.2d at 34 and 7 CFR § 69.727(a)(2)(i) (allowing certain local telephone carriers to enter into contracts if “services are made generally available to all similarly situated customers”)

This fact alone undermines footnote 7 to the Capital One NSA, upon which some parties rely (see USPS Comments at 24). That footnote, in its entirety, reads as follows:

Comparable NSAs, involving adoption of electronic Address Correction Service in lieu of physical returns for First-Class Mail that qualifies for Standard Mail rates and declining block rates for First-Class Mail, *may be entered into* with other customers, *as specified by the Postal Service*, and implemented pursuant to proceedings under Chapter 36 of Title 39, of the United States Code.

(Emphasis supplied.) That footnote says absolutely nothing beyond the bare minimum required by law. Of course the Postal Service “may” enter into comparable agreements. Then again, it may not.

The problem is that the footnote leaves it entirely to the discretion of the Postal Service whether any mailer is functionally-equivalent,¹⁷ and whether to enter into an agreement with that mailer, not to mention a subsequent proceeding before this Commission. To say that another mailer perhaps could mail at the same contracted rates, but only after negotiating a separate deal and a proceeding before this Commission, is not what is meant by “available to others” under any standard interpretation.¹⁸ The only truly adequate solution is for the “functionally-equivalent” mailer to be entitled as a matter of right to the same terms and privileges as the baseline mailer immediately, without being subject

¹⁷ By this, NAA does not mean to refer to the comparatively minor, but important, administrative determination of whether Mailer “A” meets the eligibility criteria for Mail Classification “B”. At issue is whether such eligibility criteria will exist at all.

¹⁸ MMA asserts “the ability of similarly situated mailers to obtain NSAs under the less stringent rules governing functionally equivalent NSAs should vitiate any concerns about undue discrimination.” MMA Comments at 4. The key word is “ability” – the current process does not clearly make other mailers “able” to get a functionally-equivalent NSA.

to the discretion of the Postal Service and a subsequent hearing before this Commission.¹⁹

As this discussion indicates, NAA strongly supports the policy objective of allowing what the *Notice* refers to as similarly-situated or “functionally equivalent” mailers – particularly those that compete with the mailer of the “baseline” NSA – to obtain essentially the same deal as a “baseline” NSA. NAA understands that the proposed rules for functionally equivalent NSAs are intended to facilitate this result. NAA appreciates the Commission’s effort. The problem is, however, that the Commission’s procedural rules alone cannot achieve this result.

Absent a generally available offering such as a niche classification, there is no effective recourse under current law for a mailer with which the Postal Service – for *whatever* reason, or no reason – chooses not to agree to a functionally-equivalent NSA. A mailer in that predicament has two choices. One, the mailer could file a complaint with this Commission pursuant to Section 3662 of the Act. Even assuming, however, that the mailer ultimately were to prevail before this Commission, the only available remedy would be a Recommended Decision forwarded to the Governors pursuant to Section 3625. Having been presented with no NSA for that mailer by postal management, there is little reason to expect that the Governors would exercise any option but rejection.

The second option would be, presumably, to file a lawsuit in federal district court seeking a writ of mandamus or other relief. This is not a promising option. Such writs are

¹⁹ If the deal is truly a good one for the USPS, there is no apparent reason why it would not want to increase the benefits by having it more widely available. If the USPS opposes “broadening” the NSA to other mailer for fear of losses, then perhaps the baseline NSA is not well conceived.

seldom granted, securing one can take considerable time, and success is not assured. In short, a mailer denied access to a functionally-equivalent NSA has no effective, timely means of redress.

Accordingly, the Commission's strongest power is at the outset – by refusing to approve proposals that are not generally available. The Commission's proposed rules do require the Postal Service to justify why the particular arrangement being proposed is filed as an NSA and not as a niche classification. The Commission should apply this rule rigorously. *Accord NNA Comments at 5.*

This having been said, as long as functionally-equivalent NSAs must as a practical matter follow the current flawed process, the Commission can facilitate matters by crafting procedural rules that expedite consideration of functionally-equivalent NSAs. See *Discover Comments at 3.* In particular, the Commission should provide that:

- The functionally-equivalent NSA can be justified on the basis of the same cost evidence as the baseline NSA, measured on a unit (not gross) basis;
- The functionally-equivalent mailer need not have comparable volumes to the baseline mailer;
- The functionally-equivalent NSA is processed on a rapid procedural schedule. In instances where the second mailer competes with the baseline mailer, time is money and these delays can have serious consequences in the market;
- Adopting a presumption that the functionally-equivalent NSA will not harm the mailer having the baseline NSA, but rather will correct the injury by leveling the playing field.

The proposed rules appear to understand the need for the functionally-equivalent mailer to obtain relief rapidly. The proposed rules properly take a broad view of “functionally equivalent” by not defining “similarly situated” in terms of mail volume.

However, the rules could usefully clarify this point by expressly providing that a particular volume level is not necessary to be “similarly situated” or “functionally equivalent.”

Also, the rules could usefully be clarified as to what record the Commission will have at the preliminary hearing stage when it decides whether expedited hearings are appropriate. Will discovery be allowed to determine the validity of the contention that the second mailer is, in fact, in a functionally equivalent position? If not, the Commission should set forth the basis on which that determination is capable of being challenged.

In sum, NAA supports the goal of making any baseline NSA arrangements available to functionally-equivalent mailers. While NAA has deep concerns that the Commission’s proposed rules will not be enough, it nonetheless favors making an approved arrangement as generally available as possible.

III. Conclusion

For the foregoing reasons, the Newspaper Association of America respectfully urges the Commission to amend its rules of practice in a manner consistent with these comments.

Respectfully submitted,

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