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

REPORT ON UNIVERSAL POSTAL SERVICE AND THE POSTAL MONOPOLY : Docket No. PI2008-3

COMMENTS OF VALASSIS DIRECT MAIL, INC.
IN RESPONSE TO COMMISSION ORDER NO. 71

(June 30, 2008)

Pursuant to Commission Order No. 71, issued April 18, 2008, Valassis Direct Mail, Inc. (formerly known as ADVO, Inc.), a wholly owned subsidiary of Valassis Communications, Inc., hereby submits its comments concerning the Postal Service's Universal Service Obligation (USO).

Valassis's Interest in The USO

Universal service and the USO are important to Valassis because of the nature of its mailing business. The core of its business is "shared mail," whereby the company commits to a regularly-scheduled saturation mailing frequency (usually weekly) in a geographically-defined market, and then solicits and commingles advertisements from numerous businesses, each of which can select the specific zones within the market that best meet their business needs. Saturation mail programs, because of their broad reach, cater to businesses that offer products and services of general interest to broad segments of the public, such as grocers, drug stores, automotive services, restaurant and fast food businesses, retailers, consumer products manufacturers, and local service businesses. Universal service enables these programs to serve wide geographic and demographic areas of the nation, including not only prime metropolitan zones but also inner city urban and rural markets that might not otherwise be reachable under another service model.

Service and affordability are critical factors in the choice of distribution media both for Valassis and its customers. Almost all of its customers operate in highly-competitive markets, many on low margins. The larger customers have numerous alternatives to get their advertising messages to consumers, not just among print media but also broadcast and the internet; they can and do shift their advertising dollars among media to achieve the greatest sales return. The smaller customers – small businesses and entrepreneurs that often compete with much larger enterprises – have limited advertising resources and fewer effective alternatives, but for many of them, affordable mail advertising is a critical factor in their ability to survive and thrive. As a consequence, all of these customers for varying reasons are highly sensitive to advertising costs and postal rates.

Valassis's mail business, in turn, is price- and service-sensitive. It competes not only with other print-distribution alternatives such as newspapers and private delivery companies, but also indirectly with other advertising media. On the other hand, Valassis is also a participant in some of these alternatives. In some markets and for some advertising products, it uses newspaper subscriber distribution as well as the internet to reach consumers. In addition, in several major metropolitan markets, Valassis uses private delivery for its shared mail products in lieu of postal delivery.

Valassis currently, and Advo before it, have relied predominantly on saturation mail distribution through the Postal Service because the combination of price and service has been affordable and effective both to it and its customers, a balance that we hope can be sustained indefinitely into the future. But as with any business in the advertising marketplace, the bottom line on choice among distribution media is the bottom line. If postal service or rates deteriorate to a point that threatens the company's ability to compete, it will have no choice but to shift to alternatives.

<u>Overview: Financial Viability, Affordability, and the USO</u>

Section 702 of the Postal Accountability and Enhancement Act (the PAEA) requires the Postal Regulatory Commission to submit a report to the President and Congress on ''universal postal service and the postal monopoly in the United States … including the monopoly on the delivery of mail and on access to mailboxes.'' In its notice requesting comments, the Commission has identified what it believes are the components of the USO and, quite understandably, has requested parties to address these as discrete "topics."

Although the Universal Service Obligation has never been spelled out in law or regulations, the objectives of the USO, broadly stated, are to maintain a universally-available and affordable postal network that serves the needs of the nation – senders and recipients, businesses and citizens alike. The question, however, is not just what mailers and recipients want. Consideration of the USO and the postal monopoly must necessarily start and end with a more fundamental proposition: any USO standard that might be adopted will be meaningless unless the Postal Service is financially able to provide that service at affordable rates.

At the current time, most mailers would generally agree that the Postal Service is providing effective universal service at reasonably affordable rates. The concern is with the future. The substantial inroads of electronic alternatives, particularly the internet and e-mail, have been well documented. Postal volumes have been declining for several years, not just for First Class mail but more recently Standard Mail and other classes. At the moment, these volume losses are being exacerbated by the current economic downturn, but even when the economy recovers, it is far from certain that postal volumes will rebound to their former or even current levels. Much of what has been lost may be irretrievable, with the possibility of further losses if conversion to electronic alternatives becomes more widespread.

If these volume trends continue, the Postal Service will be hard pressed to maintain universal service as we know it today. On the cost side, to its credit, the USPS has done a remarkable job recently of controlling and cutting costs through improved efficiency and productivity, largely through the letter automation program which will soon be extended to flats. Once those programs are in place, however, and the "low hanging fruit" of cost efficiencies have been harvested, it may become increasingly difficult to achieve further productivity gains in the face of declining volumes. Moreover, unlike private companies, the Postal Service's ability to achieve other efficiencies, such as network realignment and contracting-out, are constrained by numerous laws and political interference as described in the Federal Trade Commission's December 2007 Report.[1] Even in the area of labor costs that are set through collective bargaining and arbitration (and that still account for about 80 percent of total costs), the Postal Service is at a disadvantage *vis a vis* private companies because postal employee benefits are largely set by federal law and are not subject to bargaining.

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1 *See* "Accounting For Laws That Apply Differently To The United States Postal Service And Its Private Competitors," Report of the Federal Trade Commission submitted to the Congress, the President, and the Postal Regulatory Commission, December 2007 (hereinafter "the FTC Report").

The far-overriding contributor to USPS financial viability, of course, is not cost cutting but postage revenues from mailers. Yet in the face of declining volumes, there is only so much that can be collected from remaining mailers through rate increases. The PAEA limits the class-wide level of rate increases through the CPI-U rate-cap mechanism of section 3622(d)(1). But even in the event of “extraordinary circumstances” that might justify an above-cap exigency rate increase pursuant to subsection 3622(d)(1)(E), the level of increases will effectively be capped by the marketplace. A service that charged ten dollars to deliver a letter or advertisement to any address would not truly be “universal” because it would be unaffordable for the vast majority of citizens and businesses. In the end, universal service is meaningless unless it is also affordable.

We would emphasize that the financial challenges described above are not intended as a prediction of doom but are merely illustrative of what might lie ahead -- a possibility albeit a very real one. We all hope that the Postal Service will find ways to cope that do not undermine universal service and affordability of the mail. It is because we do not know with any assurance what the future may hold that the Commission, in considering the various USO issues, must assess each of the sub-issues not just separately but in conjunction with one another, and with a careful eye on their implications on the Postal Service’s financial viability – the essential determinant of its ability to provide universal service, however defined.

This is also why we believe the Commission, in defining the USO, should give the Postal Service a degree of latitude. Hardwiring the USO as a legal obligation may hamper needed flexibility down the road.

1. **<u>Ubiquity Of Delivery To All Addresses</u>**

The core element of universal service is ubiquity of coverage – mail delivery to every deliverable address in the nation, residential and commercial alike. This is the element that most “binds the nation together,” giving everyone the ability to send mail to and receive mail from anyone in the country. Some might contend that in this electronic era, where most people now have alternatives such as the internet for transmitting messages and documents and conducting commercial transactions, universal delivery is somehow less important than in the bygone days when mail was the primary means of communication. However, for the foreseeable future, there will be a segment of the populace that, whether by circumstance or choice, does not have convenient access to these alternatives. For them, universal mail delivery remains as important as ever.

Ubiquitous service does entail costs and a form of cross-subsidy within the postal system, skewed by geography and demographics. Service to remote areas incurs a higher unit cost than in more densely populated areas, and service to low-volume zones generates less total revenue per delivery to cover attributable and institutional costs. No one, however, will argue that the Postal Service should discontinue delivery to addresses whose mail volumes do not cover costs.

This brings us to another element of the postal system and universal service that is not addressed in the Commission’s notice: the current model of this universal coverage is a sender-paid system. Delivery is provided free-of-charge to recipients. Any sender, whether an individual or a business, can reach any address in the nation by paying the appropriate postage. This is a core value of the postal system that makes it attractive to mail users. Any diminution in that reach, such as through “do not mail” initiatives, would undermine the universal coverage and value of the mail to senders. More importantly to the nation as a whole, it would further reduce USPS volumes and revenues at a time when it is already under siege, thereby threatening its ability to maintain the affordability and universality of service that we now have.

Ubiquitous coverage, however, does not mean that every single address should receive the same type of delivery. Decades ago, the Postal Service provided most residential deliveries to the doorstep, either into a mailbox or door slot. Now, it uses a variety of other delivery methods, including curbline and cluster box deliveries – alternatives that are designed to cut delivery costs while still providing reasonable access. In considering the USO, the Commission should not delve into this subject of delivery methods. It is a matter that should be left to the discretion of the Postal Service in managing its operations.

2. <u>Frequency of Service</u>.

Valassis believes that six-day-a-week delivery is an important feature of the nation's postal system that adds value to the mail for both senders and recipients. At present, it is a *de facto* element of the USO, a standard that virtually everyone would prefer to retain. For saturation mailers like Valassis, six-day delivery lessens the likelihood of "late delivery" of time-sensitive advertising material, a critical choice-of-media determinant to their customers whose offers are tied to weekly sales promotions. Any cutback in this standard that threatens timely delivery would make mail distribution less attractive to advertisers than competitive alternatives such as newspaper or private delivery that can guarantee delivery on a given day, and would have a negative effect on volumes, offsetting the cost savings of the reduced delivery frequency.

On the other hand, we recognize that over the longer run, there is nothing immutable about six-day delivery. At one time (within the lifetimes of many current postal observers), the Postal Service provided deliveries twice a day, and in some cases even more frequently. That, however, was in the days of the old Post Office Department predating the Postal Reorganization Act (PRA) when the Post Office was subsidized by the government. With the advent of the PRA that required a self-sustaining postal system under a “breakeven” requirement, such multiple daily deliveries became unaffordable.

Now, under the PAEA which has eliminated the breakeven guarantee in favor of a price-cap regime, the cost of delivery and the affordability of mail distribution are more critical than ever. Yet with the daunting challenges the Postal Service now faces, as described earlier, no one today can say with any certainty where the Postal Service will be financially ten years from now, or even five years. We all hope that it will forever continue to provide the kind of service it does today, at prices that remain affordable. But the possibility remains that the Postal Service may become financially unable to do so, in which case something or somebody will have to give – either mailers in the form of higher rates or lower service which itself may precipitate a death spiral; or postal employees in the form of mitigated wages and benefits or work rules; or Congress by either reducing PAEA-mandated payments for retiree health, or appropriating direct subsidies, and/or eliminating the many legal and political constraints identified in the FTC Report that impair the Postal Service’s ability to compete.

It is for this reason that, in “defining” the USO, the Commission must recognize that the definition depends on the circumstances and the alternatives. Six-day delivery makes a sensible definition today because it is attainable at an affordable cost. But even if the Commission adopts that level as the USO standard, it should do so with the express caveat that any standard may require future modifications.

Separately, in its Discussion Memorandum attached to Order No. 71, the Commission has posed the question whether frequency of delivery should vary by type of mail, such as "providing more frequent delivery for letters than for advertisements." *Id*. at 15. Valassis strongly believes that there should be no distinction by class or type of mail. First, such a dichotomy would be impractical and would undoubtedly lead to higher costs, not lower. The Postal Service would be required to segregate the mail streams, create larger storage areas for the deferred mail, and revamp its mailflow and workhours on alternating days. Moreover, it would result in "lumpy" workloads – light mail volumes on "letter only" delivery days and heavy volumes on the alternate "letter plus advertisements" delivery days, creating a nightmare for carrier-route alignments. Second, it would diminish the value of mail distribution to advertising mailers, leading to loss of volumes. Third, it is unnecessary. Standard Mail is currently subject to a lower service standard (as distinct from a lower USO "frequency of delivery" standard). It is already deferrable at various stages in mail processing and delivery, at the discretion of postal managers – a deferability that gives the Postal Service some flexibility to manage its workload in a cost efficient manner. By contrast, a USO frequency distinction would cause inefficiencies. The Commission should reject any such dichotomy.

3. <u>The Postal Monopoly And The Mailbox Restriction</u>.

The postal monopoly on delivery of "letters" and the restriction on access to the maibox by private delivery companies are inextricably interrelated to the USO. The primary purpose of these two restrictions is to protect postal revenues from diversion so that the Postal Service will be able to provide universal service to the public at affordable rates. Consequently, any consideration of relaxing these restrictions must be done with a keen and cautious eye on the potential impact on the Postal Service's USO.

Some observers question whether the Postal Service really has a monopoly any more, or alternatively, whether it enjoys a "natural monopoly" on the delivery of hard-copy letters that would be unaffected by a lifting of the legal monopoly. As to the former, it is obvious to all that in this electronic age, the Postal Service no longer has a monopoly on communications, like it effectively had in the 19th Century and for much of the 20th. The internet and e-mail have had a profound and likely irreversible effect on postal mail volumes, a deterioration that many believe will only worsen over time. That, however, is all the more reason to maintain the legal monopoly on the delivery of hard-copy letters.

As to the natural monopoly argument, the simple answer is that no one knows for certain what impact the lifting of the monopoly would have on Postal Service volumes and finances, and consequently on its ability to meet the USO. It is unlikely that any private company would try to replicate the Postal Service's national network and universal service. The Postal Service may indeed have a "natural monopoly" on the delivery of a hard-copy letter from Oskaloosa, Iowa to Biloxi, Mississippi. But within larger local markets or even between major metropolitan areas, there may well be entrepreneurs who, given the chance, would jump at the prospect of siphoning some of the cream – particularly business-to-business and business-to-customer/consumer bills and statements and advertising.

Many professional and academic economists, of course, disfavor a monopoly of any kind. Those who advocate mitigating the monopoly on economic grounds presumably do so because they believe competition will force the Postal Service to become more efficient while providing the public (or at least certain segments of the public) with more choices. As a corollary, they presumably believe that lifting of the monopoly would, indeed, encourage entry by private competitors (at least in certain profitable segments of the market).

In any case, no one, not even learned economists, can predict the outcome of lifting the monopoly. Unpredictability is a hallmark of competition. Would the Postal Service become leaner and better (or could it, given the legal and political constraints it currently operates under)? Would it be able to continue providing its current universal service at affordable rates? If not, would the new-entrant private competitors be able (or willing) to fill the gaps for the American public?

Clearly, the full impact of lifting the monopolies should be examined but in a very thorough and careful manner. There should be no rush to judgment. Until we can be reasonably assured that such changes will be, on net, beneficial to the postal industry, they should not be made.

Respectfully submitted,

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