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

Notice of Price Adjustment	Docket No. R2009-2

COMMENTS OF THE
NEWSPAPER ASSOCIATION OF AMERICA
ON NOTICE OF MARKET-DOMINANT PRICE ADJUSTMENT
(March 2, 2009)

At a time when the Postal Service is reporting record volume losses in Standard and other classes of mail and desperately seeking more revenue, it has announced rate changes in Standard High Density and Saturation flats mail that present a serious risk of driving *out* of the mailstream and into private delivery the $800 million in annual Standard Mail the Postal Service currently receives from newspaper Total Market Coverage ("TMC") programs -- revenues that until now have been growing steadily for years.

The Newspaper Association of America ("NAA")[1] has long been concerned that the Postal Service, over the years, has often manipulated costing and rates to favor saturation mailers over their competitors -- at the expense of other mailers, including First Class mailers. The current rate proposals are a manifestation of this long-standing concern. This is because the Postal Service's new rates systematically discriminate against the High Density rates used

[1] The Newspaper Association of America ("NAA") represents the interests of more than 2,000 newspapers in the United States and Canada. NAA members account for nearly 90 percent of the daily newspaper circulation in the United States and a wide range of non-daily U.S. newspapers.

primarily by newspaper TMC programs, and in favor of saturation mailers, both in absolute terms and in comparative terms. The absolute size of the High Density flats rate increases – in some cases more than double the applicable rate of inflation – are in themselves very damaging to TMC mailers. But even more troubling is the obvious preference given Saturation rate mailers with which newspaper companies compete for the distribution of advertising. In particular, the Postal Service is:

- Raising the High Density pound charge by up to 11 percent at the DDU entry level commonly used by newspaper TMC programs, while making no change in the pound charge for Saturation mail;
- Introducing a so-called Saturation mail "incentive" of 4.0 cents per piece for ostensibly "new" volume, which amounts to a 28 percent rate discount for such pieces; and
- Increasing the High Density flats per-piece rate by more than 5.3 percent (0.9 cents), while increasing the Saturation flats per-piece rate by barely 1.4 percent (only 0.2 cents), thereby expanding the difference between those two worksharing rate categories by 36 percent.

Taken as a whole, these disproportionate increases for High Density mail over Saturation mail would place High Density mailers, such as newspaper Total Market Coverage programs, at a substantial competitive disadvantage to saturation mailers. The significantly higher rates for High Density mail will give saturation mailers an opportunity to entice advertisers to shift their preprint inserts out of newspaper TMC mailings into their own saturation mailings, with no revenue gain for the Postal Service. It is not surprising that these one-sided rate changes came at the request of a lobbying campaign by saturation mailers, which expressly sought to "widen the differential between the rates paid by full saturation mailers and high density mailers" in order to gain a competitive advantage over newspapers in the advertising market.[2]

NAA submits that this will hurt the Postal Service in at least two ways. One is that simply shifting advertising preprints from newspaper TMC mailings to saturation mailings may cause the Postal Service to lose revenue as advertising migrates from the higher priced High Density piece to the lower priced Saturation mail piece. The second is that newspaper TMC programs, facing much higher postal rates than their competitors, will have strong incentives to leave the postal system altogether and shift into private delivery.

Because the changes identified above violate the Postal Accountability and Enhancements Act on their face, the Postal Regulatory Commission should clearly rule that the rates violate the law. In so doing, the Commission would promote rate predictability and restore competitive equity, consistent with the statutory requirement of a just, reasonable, and nondiscriminatory rate schedule. In addition, the Commission would serve the interests of the nation's postal system by preventing the Postal Service from shooting itself in the foot through rates that create substantial incentives for more than one-third of the Postal Service's High Density/Saturation flats – *i.e.*, newspaper TMC program mailings – to move out of the Postal Service to private delivery.

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[2] *See* Exhibit 1 hereto.

I. BACKGROUND

A. Newspaper Total Market Coverage Programs Compete Directly With Saturation Mailers In The Market For Distributing Advertising

As this Commission knows, newspapers in the United States use Standard Mail to distribute advertising to residents (who do not subscribe to the newspaper) as part of the their Total Market Coverage ("TMC") programs. These programs meet the needs of third-party advertisers for "total market" or saturation distribution to all of the residents in a given area. Newspaper TMC programs compete directly with saturation mailers, such as Valassis's Red Plum and members of the Saturation Mailers Coalition, to serve the advertising needs of the same local retailers, restaurants, and other merchants, usually in the form of preprinted inserts. For example, a typical fast-food coupon flyer looks identical whether it is delivered as a newspaper and TMC insert, or as an insert in a saturation mailing.

Both newspaper TMC programs and their saturation mailer competitors use the Postal Service to serve this local advertising market demand. Newspapers "saturate" the area desired by the advertiser through a combination of in-copy delivery to their subscribers, and distribution to nonsubscribers through the Postal Service. Saturation mailers distribute the same preprinted inserts via the mail only.

Newspaper TMC programs use both High Density and Saturation rates to meet the demands by advertisers, depending on the route, and sometimes use both rate categories within an existing SCF.[3] According to the most recent data available, NAA estimates that its member newspapers spent nearly $800 million in Standard Mail postage in 2006. This sum accounts for more than one-third of the entire Postal Service revenues for the Standard High Density/Saturation Flats product in FY 2008.[4] NAA data indicate that the majority of newspaper TMC mailings pay High Density rates, and typically pay the higher pound-rated levels. Saturation mailers, of course, typically use only Saturation mail rates.[5]

B. By Raising Rates For High Density Flats Substantially Above Inflation While Holding Flat Or Reducing Saturation Mail Rates, The Postal Service Is Taking Sides In The Advertising Market And Will Likely Lose Substantial Volume As A Result

With head-to-head competitors using two different, but related, rate categories within the same postal product, those rates – and the differences between them -- are competitively quite sensitive. The following table presents the changes in the most competitively important rates used by newspaper TMC programs and saturation mailers. The disparate treatment, both in absolute terms and in comparative percentage terms, is apparent:

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[3] Only two months ago, the Postal Service acknowledged that the Standard Mail High Density and Saturation Flats and Parcels product allows advertisers "to reach geographically concentrated customers with advertising messages." *United States Postal Service FY 2008 Annual Compliance Report*, at 26 (filed Dec. 29, 2008).

[4] The USPS reported total revenues for the Standard High Density/Saturation product of $2.158 billion. *See* FY08PublicCRA.xls, Docket No. ACR2008, Library Reference USPS-FY08-1.

[5] NAA is not privy to saturation mailers' mailing statements, but believes that currently the average Saturation mailer piece pays the piece rate, not the pound rate. Exhibit 1 hereto indicates that saturation mailers sought a low pound charge as an incentive to increase the weight of their pieces.

	Saturation Flats			High Density Flats		
Below breakpoint	Current	R2009	Change	Current	R2009	Change
SCF	0.149	0.151	*1.3%*	0.168	0.177	*5.4%*
DDU	0.140	0.142	*1.4%*	0.159	0.168	*5.7%*
Above breakpoint						
Per Pound charge						
SCF	0.401	0.401	*0.0%*	0.401	0.441	*10.0%*
DDU	0.356	0.356	*0.0%*	0.356	0.396	*11.2%*
Per Piece charge	0.066	0.068	*3.03%*	0.085	0.086	*1.18%*

Two of these rate relationships are particularly important in the day to day competition between newspapers and Saturation mailers.

One is the difference between the High Density and Saturation piece rates for "below breakpoint" (under 3.3 ounces) pieces. The Postal Service is increasing that difference by *36.8 percent*, from 1.9 cents to 2.6 cents. It does so by increasing the per piece rate for High Density flats by 0.9 cents (a 5.7 percent increase, much higher than inflation), but for Saturation flats by only 0.2 cents (a 1.4 percent increase).

The second is the pound charge for heavy "above-breakpoint" pieces – those that weigh more than 3.3 ounces. Most newspaper TMC program mailings pay these rates. The Postal Service would increase the High Density pound charge by 11.2 percent at the DDU entry level – the most common entry point. In contrast, the Postal Service is making *no change at all* in the pound charge for Saturation flats.

When applied to pieces, these pound charges lead to dramatically different price changes (the pound charge has far more influence on the price than the piece charge):

	High Density	Saturation
4 ounce piece (DDU)	6.3 percent	1.3 percent
4 ounce piece (SCF)	6.0 percent	1.2 percent
8 ounce piece (DDU)	7.9 percent	0.8 percent
8 ounce piece (SCF)	6.2 percent	0.7 percent

The largest increases hit the particular categories most used by newspaper TMC programs – the DDU entry rates, and the heavier weight pieces.

A third rate change (not shown in the above table) that favors saturation mailers is what the Postal Service characterizes as a “volume incentive rate credit” for so-called “new” saturation volume. For commercial flats, this is a “credit” of 4.0 cents, which is a 28 percent discount off of the new normal per piece rate.

The discriminatory treatment of High Density flats rates and the favorable treatment accorded Saturation rates is no accident. Saturation mailers lobbied the Postal Service for competitively favorable rates, as the Postal Service has admitted.[6] Attached hereto, as Exhibit 1, is the text of an email sent by the director of the Saturation Mailers Coalition, and obtained by NAA, boasting that SMC’s lobbying efforts received “the most favorable rates possible.” SMC

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[6] *See, e.g., The PostCom Bulletin*, Issue 09-09 at 7 (reporting on presentation by a Postal Service representative at a recent MTAC meeting).

thanked its members who lobbied the Postal Service “to retain and grow saturation mail volumes” and praised them for making “a tremendous impression on the Postal Service.”

That mailers seek better rates from the Postal Service is a common phenomenon. But what is unusual in this case is the Postal Service’s willingness to acquiesce to the SMC’s demand for favorable rate treatment so that its members can compete better with other mailers – *i.e.,* newspapers. *See* Exhibit 1 (“One of the requests made by SMC's leadership during the presentation to the Postal Service was for the Postal Service to widen the differential between the rates paid by full saturation mailers and high density mailers . . . [the new High Density pound charges] should help SMC members compete with TMCs to attract heavier weight inserts and circulars at and above the break point”).

The Postal Service’s decision to take the side of one set of mailers against another set of mailers in the downstream competitive advertising market is profoundly troubling on many levels. For one thing, by separating one competitor from another, the Postal Service is fashioning a scenario that will encourage third-party advertising inserts to shift from one mailer to another, with the latter paying lower rates. This is transferred (and less profitable) mail, not organic growth.

For another, the Postal Service’s decision to tilt the playing field in favor of saturation mailers, and against newspapers, could easily worsen the Postal Service’s finances.

Here's how. It has been widely reported that newspapers face serious economic challenges. Some newspapers have filed for bankruptcy; one large daily newspaper, the *Rocky Mountain News*, published its last edition on February 27, and other newspapers are up for sale.[7] While most newspapers will weather this recession and emerge as strong and viable businesses, one thing is absolutely clear -- all newspapers are under extreme economic pressure to reduce their costs. In looking to reduce their operating costs, newspapers are seriously evaluating private delivery for the distribution of their TMC programs.[8] Some newspapers are already testing private delivery in some cities with excellent results.[9] This review of private delivery has accelerated in the short time since the new rates were announced.

Newspaper TMC programs will have little interest in doing business with a Postal Service that increasingly drives up its postage rates while discriminating in favor of their competitors. If newspaper TMC programs leave the mail, the Postal Service stands to lose a great portion of the $800 million those programs currently pay in postage.

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7 That newspapers are in severe financial difficulties today is no secret. In recent months, the owners of *The Chicago Tribune* and *The Los Angeles Times*, *The Philadelphia Inquirer*, the Journal Register Co., and the Minneapolis *Star-Tribune* have filed for bankruptcy. The Seattle *Post-Intelligencer* may soon become an online only publication. The *San Francisco Chronicle* is in dire straits.

8 It goes almost without saying that newspapers have vast experience in delivery services through their circulation departments.

9 This may help explain why the RPW Report for the first quarter of FY2009 shows a volume decrease of 6 percent in the High Density and Saturation Flats and Parcels product, but a larger weight decrease of 14.1 percent. Newspaper TMC mailings, whether at High Density or Saturation rates, typically weigh above 3.3 ounces. The volume loss appears to be disproportionately in heavy pieces.

C. The Commission Has Authority To Rule The Discriminatory Rate Changes For High Density Flats Unlawful During This Review

NAA recognizes that rate changes of unequal magnitude are not unlawful *per se* under the PAEA. But the competitive consequences of unequal rate changes are relevant to the justness and reasonableness of the rate schedule, and to whether the changes unreasonably discriminate in favor of one group of mailers over another.

Moreover, although the PAEA grants the Postal Service substantial ratemaking flexibility, that discretion is simultaneously constrained by the statute itself. Even at this review stage, while the Commission's primary focus is on compliance with the classwide price caps, it has ample jurisdiction to rule on issues that "clearly contradict other objectives, factors, and policies of the PAEA." *Order No. 66* at 19, Docket No. R2008-1 (Mar. 17, 2008).

These comments address the following issues, each of which the Commission may resolve during this review proceeding:

- The increase in the High Density pound charge by up to 11 percent, compared to no change for the pound charge at the Saturation rate category, which violates the Section 3622 requirement for a just and reasonable rate schedule and the prohibition of undue discrimination in Section 403(c);

- The so-called saturation mail "incentive" of 4.0 cents per piece for ostensibly "new" volume, which as filed violates several provisions of the PAEA, most importantly Section 3622(c)(10) (which governs special classifications) and Section 3622(e) (which governs excessive discounts); and

- The increase in the High Density flats per-piece rate by more than 5.3 percent (0.9 cents), while the Saturation flats per-piece rate rises by barely 1.4 percent (only 0.2 cents), thus expanding the difference between those two worksharing rate categories by 36 percent, which appears to violate the Section 3622(e) limitation on worksharing passthroughs that exceed avoided costs.

II. THE INCREASE IN THE POUND RATE FOR ABOVE-BREAKPOINT HIGH DENSITY MAIL IS UNREASONABLY DISCRIMINATORY AND IS UNJUST AND UNREASONABLE

The four cent increase in the pound charge for above-breakpoint High Density Mail is substantial. For the commonly-used DDU-entry rate, the 4 cent increase raises the pound charge from the current $0.356 to $0.396, an 11 percent jump. This translates to a 7.9 percent increase for an 8 ounce High Density flat. In contrast, there is no change in the Saturation pound charge. Thus, a 4.0 cent per pound rate differential would exist at each entry level.

The Postal Service's *Notice* offers no explanation for the substantial magnitude – well over the rate of inflation, and more than *twice* the inflation rate at important weight levels -- of the increase imposed on High Density mailings. Indeed, *it does not even acknowledge* that it is raising the rates for heavy High Density mail. This silence certainly cannot be squared with its obligation to describe the rate changes. This disparate treatment is also legally flawed.

First, the Postal Service's increase in the High Density pound charge, while the Saturation pound charge is unchanged, abandons a longstanding rate design principle by charging different pound rates for High Density and Saturation mail. Until now, High Density and Saturation mailings have always paid equal pound charges for above-breakpoint mailings, with the rates differing only by the piece charge. Since the effect and purpose of abandoning this longstanding principle is a discriminatory rate change against one set of mailers for the competitive benefit of another set of mailers, the Commission must determine whether the new rates are consistent with Section 403(c)'s prohibition of unreasonably discriminatory or preferential rates and the requirement of a just and reasonable rate schedule.

Second, the rate increase for heavy High Density mailings in fact *conflicts* with the Postal Service's stated objective of reducing the effect of weight on price. The *Notice* (at 15) states that the Postal Service's "key strategy" in Standard mail is "to adjust the role weight has in pricing" because the current rate table "makes it difficult for some customers to increase the weight of their mail pieces."[10] The *Notice* goes on to assert that "the Postal Service has either reduced the pound rate, or limited its increase, for Standard Mail Flats products categories." *Id*.[11] But that is not true at all for High Density rates. High Density mailers looking at rate increases of twice the inflation rate, while other mail within the same product receives little or no increase, rightly wonder why their rate increase was not also "limited." Raising rates for High Density mail without explanation – and without even the pretense of an attempt at any cost justification -- all the while claiming to be reducing rates, is arbitrary and unreasonably discriminatory.

Finally, the Postal Service's proposal flies in the face of what it told this Commission little more than two months ago: "High Density and Saturation Flats

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10 Perhaps "some customers" is merely a reference to saturation mailers. But newspapers also face difficulties in increasing the weight of their mail pieces.

11 The Postal Service's sole "example" is a table (at 16) showing that an 8 oz. 5-digit/DMBC-entered catalog will experience an increase of only 0.4 percent under the new rates. (That example appears to be a 5-digit automation flat entered at the DBMC, a rate cell for which the pound charge actually declines). The Postal Service's table provides no example of High Density rates.

and Parcels serve an advertising market in which business customers have many alternative options to convey their message or distribute samples. The Postal Service has long recognized this fact when pricing this product." *United States Postal Service FY 2008 Annual Compliance Report* at 25 (Dec. 29, 2008). Despite those worries, the Postal Service essentially disregards those alternative options altogether by announcing High Density rate increases that greatly exceed inflation.

Although the Postal Service talks about "increasing" volumes, it must first retain the volume it now has before there can be growth. The new rates give newspaper TMC mailing programs strong reasons to consider "alternative options" to the mailstream for their existing volume. NAA has learned that private delivery firms are aggressively taking advantage of the opportunity the new rates present for them.

For these reasons, the Postal Service's decision to set a different pound charge for High Density mail than for Saturation, and to increase the former by more than twice the rate of inflation while holding the latter unchanged, is discriminatory on its face and extends an undue preference to Saturation rate mailers. The Commission should reject this disparate treatment of High Density mailers on the grounds that it violates the Section 3622(b)(8) requirement of a just and reasonable rate structure and is unreasonably discriminatory in violation of Section 403(c).[12]

[12] The Commission has held that the "same considerations" inherent in Section 403(c) are covered by its Rule 3010.13. *Order No. 43, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products*, Docket No. RM2007-1 at 35 (Oct. 29, 2007).

III. THE PROPOSED SATURATION RATE INCENTIVE VIOLATES SECTIONS 3622(c)(10) AND SECTION 403(c)

The Postal Service proposes an incentive for increased Saturation flat volume in the form of a 4 cent "credit," subject to eligibility criteria to be fleshed out by the Postal Service.[13] This equals a 28 percent price reduction on the "new" mail off of the new Saturation flat DDU piece rate, and a reduction of more than 20 percent above the breakpoint. Only mailers that can show that they used Saturation rates in each of the past two years would be eligible.

The volume incentive "credit" is intended to encourage volume growth. But giving a 28 percent discount to a narrowly defined subset of current Saturation mailers but not to the High Density mailers with whom they compete – thereby separating one type of competitor (saturation mailers) from others (newspapers) – is not well designed to achieve that result. Unlike the volume discounts that the Commission has previously approved for credit card solicitations, the "new" mail likely will not consist of the mailer's own solicitations.[14] The advertising in the so-called "new" mail will come from a third-party advertiser, whose advertisements likely will simply be transferred from another mailer's piece (such as a newspaper). Thus, the effect of the new classification is to encourage transfers among competing mailers, in which so-

[13] The Postal Service has published DMM language regarding the credit, but that notice leaves many open questions regarding how volumes deserving of the "credit" will be determined.

[14] For example, the very first negotiated services agreement – for Capital One – gave Capital One a volume discount for certain increases in its own solicitations. It could not have received discounts for mailings solicitations for, say, Discover. Here, neither newspaper TMC or saturation mailers mail their "own" solicitations. Rather, they distribute the advertisements of third parties, such as retailers, restaurants, and home improvement businesses.

called “new” volume will consist of “transferred” volume rather than truly “new” growth.

The Saturation rate credit is unlawful on its face. First, it constitutes a special classification under Section 3622(c)(10), and the Postal Service has failed to make the showing required by statute and by rule 3010.14(b)(7) of the Commission’s rules of practice. Second, it also constitutes an excessive discount in violation of Section 3622(e).[15] Accordingly, it must be rejected.

A. The Saturation Mail Volume Incentive Credit Violates Section 3622(c)(10)

As the Commission’s *Notice* initiating this proceeding points out, the Saturation volume rate incentive is one of several class-specific classification changes announced by the Postal Service. 74 *Fed. Reg*. at 8125. In this one, eligibility for the new credit is limited to a narrowly drawn subset of current saturation mailers, constituting a special or “niche” classification. Section 3622(c)(10) establishes certain conditions that a special classification must meet before it can take effect.[16] That provision of the PAEA, the sole statutory support for special arrangements for market-dominant products, authorizes the Commission to consider as a factor in designing a modern rate system the desirability of:

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[15] The Postal Service’s implementation of the “credit” may also be in violation of the Section 404a(a)(1) prohibition against the adoption of any regulation the effect of which is to preclude competition or establish the terms of competition,” as it does not appear to have made the statutorily-mandated showing. *See* 39 U.S.C. §404a(a)(1).

[16] *See also Order No. 43* at 107 (stating that although the Postal Service has great flexibility to manage products below the level rising to Section 3642, that flexibility must still be exercised so that the products conform to the statutory requirements of the PAEA).

> . . . special classifications for both postal users and the Postal Service in accordance with the policies of this title, including agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers, that (A) either—(i) improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or (ii) enhance the performance of mail preparation, processing, transportation, or other functions; and (B) do not cause unreasonable harm to the marketplace."

Congress enacted Section 3622(c)(10) to ensure that special classifications that favor certain mailers over others are not unduly discriminatory and are consistent with a just and reasonable rate schedule. The Postal Service is obligated to make the showings required by Section 3622(c)(10). It has failed to do so. Accordingly, the Commission should reject the proposed change for that reason alone.

The purpose of the Section 3622(c)(10) conditions is to require the Postal Service to make a careful public analysis before creating a special classification, and submit that to this Commission before the new classification takes effect. This case demonstrates the wisdom of Congress in enacting that requirement. There are many questions that should be addressed before one could reasonably conclude whether the incentive will truly improve the net financial position of the Postal Service. For example, would the rate credit be extended to mail that Saturation mailers were planning to increase their volumes in any event, a practice that the Commission seeks to prevent when the issue arises in negotiated services agreements? If so, the "credit" will simply hurt the Postal Service.

A net financial position analysis would consider whether the "new" mail receiving the discount would simply replace other mail, with any benefits from increased revenue from the new pieces being offset by reduced revenue from previous mail that would simply disappear. At least two scenarios come to mind. The rate incentive may allow Saturation mailers to underprice High Density mailers, resulting in taking advertising out of the High Density piece. If the High Density piece disappears from the postal system, that would constitute a net loss of revenue.[17] The Postal Service apparently has not considered how to prevent Saturation mailers from meeting the eligibility requirement by simply taking business away from a newspaper TMC program, which would cost the Postal Service revenue (even before the credit is applied) by replacing a higher priced High Density piece with a lower priced Saturation piece.

In addition, a saturation mailer could use the rate credit strategically by reducing its volumes on some less profitable routes outside of a region for which it seeks the credit, such as in one SCF, while increasing volumes on the routes subject to the credit in another. In fact, the Postal Service will expressly allow precisely this manipulation of the scheme.[18] The overall result could be no new volume, or even a net volume reduction. In this scenario, the Postal Service would simply have cost itself four cents per piece.

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[17] The analysis is more complicated because the volume of High Density mail leaving the system may be less than the new Saturation volumes. This could turn on individual market conditions specific to each mailer. But the Postal Service's failure to comply with Section 3622(c)(10) means that there is no opportunity to consider such an analysis.

[18] *See* 74 *Fed. Reg*. 8009, 8010 (Feb. 23, 2009) (stating in an example that a "mail could qualify for a credit with an increase in saturation volume within the Miami FL SCF independently of fluctuations in volumes destinating in other areas").

For present purposes, the issue is that these are precisely the types of questions that a properly conducted "net financial effects" analysis should consider. And among the reasons Congress enacted Section 3622(c)(10) was precisely to force the Postal Service to conduct such an analysis. Its failure to do so alone justifies rejection of the Saturation rate credit.

Second, the proposed credit also would violate subpart (B) of Section 3622(c)(10) by causing unreasonable harm to the marketplace in at least two respects. One, it would create an artificial rate incentive that on its face favors saturation mailers over their competitors (newspaper TMC programs) that use High Density mail. These comments have already explained that a 28 percent advantage in postal rates would cause distortions in the marketplace for the distribution of advertising.

Two, the Postal Service's terms for eligibility for the rate "credit" are themselves anticompetitive. This is because the discount is not truly available for new Saturation volumes. Instead, eligibility is limited only to existing saturation mailers that had saturation volumes in the years 2007 and 2008, with at least six such mailings in calendar year 2008. New saturation mailers (that is, those with no history of mailing at saturation rates in the relevant SCF or nationwide in the past two years) are not eligible for the credit. In the words of the Valassis Chairman, CEO, and President, the rate incentive is "really not designed to encourage new competitors to come into a market.[19] This "pulling up the ladder

[19] *Valassis Communications Inc. Q4 2008 Earnings Conference Call Transcript* at 14 (Feb. 17, 2009). He continued: "It's really designed to get existing users such as ourselves to increase circulation."

behind them" both harms market competition by discouraging new entrants and extends an undue preference to existing mailers.[20]

B. The "Saturation Mail Volume Incentive Program" Is An Excessive Worksharing Discount In Violation Of Section 3622(e)

The new "saturation mail volume incentive plan" for Saturation mail is, in effect and in fact, an increase in the Saturation mail *discount* on a selective basis. Only Saturation mail that meets the eligibility criteria specified in the DMM would receive the 4.0 cent rate "credit."

The "credit" has the following effect on rates: "new" flats weighing less than 3.3 ounces entered at a DDU would pay not the new 14.2 cents per piece, but only 10.2 cents after the "credit."[21] That is 6.6 cents *less* than a High Density flat of the same weight, or in percentage terms, a 39 percent price advantage.

Despite its disguise in form, it is an expanded Saturation discount. Accordingly, as an increased Saturation discount, Section 3622(e) applies. The "credit" fails to satisfy the Section 3622(e) requirements.

Postal Service data filed in the 2008 Annual Compliance Review indicate that the costs avoided between a High Density piece and a Saturation piece were

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20 It also appears that the Postal Service reserves the right to pick which applicants may be allowed to claim the credit based on criteria that have yet to be published. This is because the Postal Service states that mailers must "request" participation by letter to their District Manager. It is unclear whether District Managers must allow participation or may refuse, based on criteria not currently known. *See* 74 *Fed. Reg*. at 8010.

21 New above-breakpoint pieces would pay a per-piece charge of only 2.8 cents, far below the 6.8 cent charge for "old" saturation flats. With the credit, "new" Saturation flats entered at the SCF would pay only 11.1 cents, compared to the High Density rate of 17.7 cents.

2.48 cents in FY2008.[22] The 6.6 cent "incentive credit" – which is the difference between what the saturation mailer would pay on the "new" volume and the corresponding High Density piece rate – exceeds the recently reported avoided costs by 4.12 cents, or *266 percent*.

Therefore, the 6.6 cent discount violates Section 3622(e) as excessive unless one of the exceptions in subsection 3622(e)(2) applies. The Postal Service does not try to contend that any such exceptions applies. None does. The discount does not involve new worksharing, a new product, a change to an existing service, or Periodicals or other ECSI mail; it is simply a poorly designed volume discount.

Only last year, the Commission stated that Section 3622(e) embodies a deliberate policy decision by Congress that "places restrictions on the Postal Service's flexibility to set workshare discounts" in favor of big mailers. *Order No. 66*, Docket No. R2008-1 at 32. Now, the Postal Service intends to do exactly what Section 3622(e) intends to prevent through the ruse of giving the discount a new label.

Some may contend, however, that applying Section 3622(e) to the High Density and Saturation discounts in general, and to the saturation mail volume incentive credit in particular, would arbitrarily constrain the Postal Service's pricing flexibility for those products. It suffices to say that the considerable

[22] The Postal Service is due to file, within a few days, updated data in response to Presiding Officer's Inquiry No. 4, Question 7. However, it is highly unlikely that the Postal Service will present data showing avoided costs between High Density and Saturation flats mail of 6.6 cents. Certainly the Postal Service has not asserted that the additional 4.0 cent discount has any cost basis.

pricing flexibility granted to the Postal Service by Congress is not unlimited. Section 3622(e) establishes one important and conscious limitation on postal pricing that Congress, it turns out, correctly feared might be subject to abuse.

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Accordingly, the Commission should disallow the proposed credit for commercial Saturation mail as filed.

IV. THE INCREASE IN THE DISCOUNT BETWEEN STANDARD REGULAR HIGH DENSITY AND SATURATION FLATS VIOLATES THE WORKSHARING DISCOUNT PROVISION OF SECTION 3622(e)

The Postal Service's increase in the difference in the per piece rate (and in the piece charge) between the High Density and Saturation rate categories by 37 percent -- from the current 1.9 cents to 2.6 cents – appears to be an excessive discount that violates the worksharing discount limitation in Section 3622(e). Accordingly, the Commission should reject the increase as unlawful.

This issue arose last year, and the Postal Service has again refused to accept the Commission' resolution of the matter. In its review of the Postal Service's proposed rate adjustments under the PAEA only last year, the Commission clearly treated different presort tiers as worksharing discounts. *See Order No. 66*, Docket No. R2008-1 at 35 (referring to mailings that "lack the density to qualify for deeper presort discounts"). In its Annual Compliance Determination for FY 2007, the Commission treated the difference between High Density and Saturation flats as a presort worksharing discount, as it has consistently done since Docket No. R90-1. *See Annual Compliance Determine:*

U.S. Postal Service Performance Fiscal Year 2007 at Table VII-D-4 and associated text (Mar. 27, 2008).

Nonetheless, in its Annual Compliance Review for 2008, the Postal Service ignored the "established method of estimating cost avoidances between . . . High Density and Saturation for letters, flats, and parcels." *Order No. 169* at 5. In that proceeding, the Commission rightly ordered the Postal Service to file data using the established methodology.[23] In this proceeding, the Postal Service has again failed to file data using the current methodology to show the worksharing costs avoided between High Density and Saturation flats.

Question 7 in the Chairman's Information Request No. 4 asks the Postal Service to provide data regarding the Saturation worksharing discount according to the established methodology. The Postal Service must do so by March 4, two days after these Comments are filed. Assuming that the Postal Service relies upon the same data as it filed in the FY2008 Annual Compliance Review, it would report a cost difference between the High Density and Saturation presort tiers of 2.48 cents.[24] The new 2.6 cent rate disparity exceeds that cost difference by 0.12 cents, and therefore should be rejected as a facial violation of Section 3622(e).

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[23] NAA addressed the Postal Service's arguments on this issue in its Reply Comments in Docket No. ACR2008. Those reply comments, which apply here and are incorporated herein by reference, pointed out that the Postal Service's position is historically inaccurate and legally deficient.

[24] *Responses of the United States Postal Service To Commission Order No. 169 at 17-19 & Items 6 & 9 Spreadsheet.xls* (January 21, 2009).

V. CONCLUSION

For the foregoing reasons, the Newspaper Association of America urges the Commission to reject as unlawful the rate adjustments for Standard High Density and Saturation mail as described herein, and thereby help to preserve Postal Service revenues.

Respectfully submitted,

NEWSPAPER ASSOCIATION OF AMERICA

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Exhibit 1: Text of Saturation Mailers Council Email Report On Rate Changes

SMC reports on postal rate details

I am back from Washington with public and private news about the Postal Service's price adjustments. I am pleased to report that SMC's business volunteers, and advocacy team, received "the most favorable rates possible" (I am quoting someone from behind the scenes) that the Postal Service could propose. The volunteers who communicated with the Postal Service, and met with the Postal Service last year to talk about the growth opportunities for saturation mail, were successful in making the case that the Postal Service should reach out to retain and grow saturation mail volumes. I am attaching to this email materials and graphs prepared by SMC's legal counsel, Tom McLaughlin, that shows the specific change in rates for saturation flats, high density flats, and letters. There is also a "cut and paste" summary of the discussion and proposed rules on the Postal Service's New Incentive Program for New Saturation Mail Volumes.

Here are highlights of the case as it applies to saturation letters and flats:

The average increase for all postal products was 3.8%. Selected price adjustments for saturation mail are:

Saturation letters at SCF - 1.5%
Saturation flats at SCF - 1.3%
Saturation flats at DDU - 1.4%
No change in the saturation pound rate
No increase in the DAL surcharge. It is still $.017 dollars or 1.7¢.
Favorable increases in drop ship discounts.

NEW SATURATION MAIL VOLUME INCENTIVE PROGRAM

The Postal Service listened to our pitch that saturation mailers could grow new, incremental volume for the Postal Service by expanding geography or frequency. The Postal Service has implemented a limited time "experiment" to develop an incentive program for saturation mailers who increase their saturation Standard mail letters or flats volume. This program is new and an unprecedented. You can expect that everyone in private industry and at the USPS will spend some time figuring it out. I have attached the discussion and regulations that were released on it in a condensed form. (Thanks to Tom McLaughlin for cutting and pasting this down from the lengthy regulations).

Here are the highlights:

To participate a saturation mailer must demonstrate saturation mail volumes in 2007 and 2008 with a minimum of six saturation mailings in the 2008 calendar year.

Mailers wanting to participate must "submit a letter requesting participation to their District Manager, Business Mail Entry between February 11, 2009 and June 11, 2009."

The incentive is paid in the form of a credit to the postage paid "on the incremental saturation mailing volume" over prior volumes computed and credited sometime after May 10, 2010. The per piece credit is as follows:

Standard mail saturation letters: $0.037 per piece
Standard mail saturation flats: $0.04 per piece

The incentive program is annual and will begin on May 11, 2009. Approved participants demonstrating "an increase in saturation mail volume" and otherwise in accordance with the terms of the Postal Service program, will receive a credit to their specified CAPS account after the close of the annual program period.

The program has additional eligibility requirements that include the maintenance of a functioning

Centralized Account Payment Systems (CAPS) account and the ability to submit mailing documentation electronically to the Postal Service using an approved method at the time of application and for the duration of the program.

We recognize that these difficult economic times may make it challenging or impossible for mailers to increase program frequency or circulation, but the Postal Service's efforts to give saturation mailers the lowest possible price increase, combined with this opportunity to get a credit against postage paid for new volumes, shows a tremendous step forward for the Postal Service in listening to the business opportunities presented by saturation mailers.

OTHER RATES

One of the requests made by SMC's leadership during the presentation to the Postal Service was for the Postal Service to widen the differential between the rates paid by full saturation mailers and high density mailers. Several presenters made the point that their saturation programs were hampered in the ability to compete with newspapers TMCs because the TMCs could always offer a better rate than the full saturation mailer. We noted that TMCs often use their blended postal and private carrier rate as a loss leader or offer rates that are below the pound rate postage that saturation mailers must pay to the USPS. Although the Postal Service did not give us the lower pound rate we requested, it did widen the gap between saturation rates and high density (TMC) rates. For high density pieces entered at the DDU, the percentage increase is 5.7% in the piece rate with an 11.2% increase in the pound rate. This differential should help SMC members compete with TMCs to attract heavier weight inserts and circulars at and above the break point.

The full chart of new prices and services runs 41 pages. It is available at usps.com/prices.

FURTHER UPDATES

There was nothing in the filing about changing the requirement to put a city style address on flat mail. We are still working to urge the Postal Service to adopt a form of "simplified but certified" addressing for city routes. When I know something - you will all know something. I hope to have something to report later this year.

Kudos and thank yous for the tireless work of Vince Giuliano and his Government Relations team at Valassis, and the executives at Valassis who make it possible for Vince and his advocacy team to present these issues to the Postal Service and postal regulators on a 24/7 basis. On the "behind the scenes" front, I was told by several people within the Postal Service, and other trade association leaders and mailers who were meeting with the Postal Service last year, that the industry presentation made to Postal Service officials by Pete Gorman, Albert Braunfisch, Harry Buckel, Dick Mandt, John Sabo, Carol Toomey, Steve McKinnon, Dean DeLuca, Bill Cotter, and Chet Cleaver, made a tremendous impression on the Postal Service. As a government regulated enterprise, facing enormous financial challenges and loss of volume, the Postal Service officials of Mailing Services, Marketing, and Pricing were enthused about the business opportunities and spirit of unprecedented industry cooperation they saw at our SMC/USPS presentation.

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