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

NOTICE OF PRICE ADJUSTMENT : Docket No. R2009-2

COMMENTS OF VALASSIS DIRECT MAIL, INC. AND THE SATURATION MAILERS COALITION

(March 2, 2009)

Valassis Direct Mail, Inc., a wholly owned subsidiary of Valassis Communications, Inc., and the Saturation Mailers Coalition hereby submit their comments concerning the Postal Service's Notice of Price Adjustment, filed on February 10, 2009. Our comments address two matters: the Postal Service's proposed Standard saturation volume incentive program; and the proper treatment of the rate differential between Standard Saturation and High Density mail.

I. THE POSTAL SERVICE'S PROPOSED SATURATION VOLUME INCENTIVE PROGRAM IS A STEP IN THE RIGHT DIRECTION

The Postal Service's initiative to implement a "saturation mail volume incentive program" as a means to encourage growth of volumes is an important and needed change in its perspective toward a more market-oriented approach to pricing under the new law. Although we have reservations that the program, as proposed, may be too limited to generate substantial growth in the current economic conditions, it is nevertheless an initiative well worth undertaking given the unprecedented financial challenges that both the Postal Service and mailers are facing. Mail volumes, which had been flattening and tapering over the last five or more years, have recently entered steep declines across almost all product lines, in significant part due to the economic turmoil and uncertainty that is affecting all sectors of the American economy (although much of these declines may represent permanent losses in market share). The Postal Service must implement new and innovative strategies to curb volume and revenue losses and retain existing volumes, and to incentivize growth of new, profitable mail volumes.

This proposal, although less than ideal, steps in the right direction. Among the Postal Service's product lines, Standard A Saturation mail is one of the few that offers the opportunity for near-term volume growth though expansion of mailings within existing markets. However, such market expansions, whether by increased mailing frequency or by expanded coverage, entail significant risks for mailers even in favorable economic times. Absent a temporary rate incentive that encourages such initiatives, saturation mailers are unlikely to be willing to undertake those risks.

Saturation "program mail" is particularly well-suited for an incentivized growth initiative. Most saturation mail volume is entered by "program mailers" – including shopper publications, shared mailers, coupon envelope mailers, and similar mailing programs – who mail to discrete geographic zones within an identifiable market on a regular and predictable published schedule, ranging from monthly to weekly frequency. The nature of these programs and the advertising marketplace they serve places a high premium on consistency and predictability of their scheduled offerings. Once an expansion initiative is undertaken, whether of frequency or market coverage, the mailer has a strong incentive to maintain the expansion for the long term, at the risk of losing credibility among advertisers if it later retrenches.

In addition, saturation program mailers tend to have relatively long and stable mailing profiles and frequencies within their markets, making ascertainment of market geography and baseline volumes more reliable, and affording greater prospect that volume- or frequency-expansion initiatives will become permanent. These traits will also simplify and facilitate the Postal Service's administration and monitoring of the initiative.

For these reasons, a rate incentive for expansion of this type of mail offers the real prospect that the new mail will remain in the system after the rate incentive expires, from then on paying full postal rates and contribution indefinitely into the future. From the Postal Service's perspective, this is the greatest benefit of this rate-incentive initiative: the potential to generate new incremental mail volumes and revenues that will become permanent.

However, the success of this incentive program is not assured. As currently structured, the discount will apply only to volume growth that occurs during the one-year period from May 11, 2009 through May 10, 2010. For a mailer to take full advantage of the discount, it would have to initiate market expansions in May of this year. But the reality of market expansion initiatives is that they require substantial lead times to launch, and in most cases the timing of a launch is driven by market characteristics and advertising customer contracts and needs, not by the implementation dates of postal rates. Consequently, a mailer that is considering whether to expand in September of this year would be far less likely to be induced by a discount that will expire in only six months. A preferable alternative would be incentive discounts that remain in place for one or two years from the date of a mailer's expansion effort in a given market. Such an incentive program could be just as easily tracked and monitored as the Postal Service's far more limited proposal, but would mesh far better with marketplace realities and provide a stronger incentive to generate meaningful long-term volume growth.

Another impediment to success is the current economic recession. Many retailers and other advertisers are experiencing the worst financial storm in decades, forcing them to cut costs in all phases of their businesses, including advertising. Saturation program mailers, in turn, are facing difficult times as their advertisers retrench, and are being forced to consider cutbacks in their mailing programs – a particularly difficult decision because the credibility of their programs is tied to maintaining a regular and predictable mailing schedule. Consequently, the normal mailer risks associated with market expansions are now greatly magnified and might overwhelm the potential benefit offered by the Postal Service's volume incentive proposal.

This also allays any concern that the proposed discounts might be rewarding mailers who would have otherwise increased their volumes even at full rates, the so-called "anyhow" volume argument. In today's marketplace, "anyhow" volume has been displaced by "where'd it go" volume. Moreover, any new mail that may be generated by this proposal, even if some of it might have been mailed otherwise, will still provide a positive contribution and the likelihood of new permanent volume that will remain long after the discounts have expired. The far graver risk at this critical time would be to forego the opportunity for desperately-needed new mail volume generation.

II. THE RATE DIFFERENTIAL BETWEEN SATURATION AND HIGH DENSITY MAIL IS NOT A FUNCTION OF "WORKSHARING" DIFFERENCES BUT MAILING DENSITY

In our initial comments in Docket ACR2008, we explained that because the differences between Saturation and High Density mail have nothing to do with differences in mailer "worksharing" activities, but are due solely to volume-related differences in mailing density, the rate differential is not a true "worksharing" discount. In its reply comments, the Newspaper Association of America (NAA) contended that the Saturation-High Density rate differential is comparable to other "worksharing" discounts such as dropship discounts, which it claims are also a function of mailing density.

A. The Differences Between High Density And Saturation Are A Function Of Mailing Density, Not Worksharing.

The question that NAA has carefully avoided is whether the rate differential *between* Saturation and High Density should be limited to the cost differential on the ground that it is due to differences in mailer-provided worksharing. For other true worksharing discounts, such as drop shipping or automation, a mailer that wants to qualify for the next level of discount must undertake additional mail preparation. A mailer currently drop shipping to the destination BMC, for example, must undertake additional work (i.e., transportation) if it wants to qualify for the destination SCF discount. That is not the case with the choice between mailing at High Density or Saturation rates. There, the essential "worksharing" element – preparation of the mail pieces in "carrier walk-sequence" order – is identical for both. The only difference in qualification is the number of pieces delivered on a carrier route, which is purely a function of mailing density unrelated to mailer worksharing efforts.

Thus, a High Density mailer that wants to take advantage of the Saturation rate does not have to undertake any additional "worksharing" efforts. It only has to increase the *volume* of its mailings up to the Saturation-level threshold. Saturation mail is, indeed, more efficient and lower cost for the Postal Service to handle than High Density mail. But these cost differences are due to mailing density, not to any element of extra worksharing. [1]

NAA in its reply comments in Docket ACR2008 also claimed that our characterization of the difference as due to "mailing density" was irrelevant on the ground that many other discounts are also related to mailing density:

> "Logically, similar reasoning also could apply to the difference between destination entry at BMCs, SCFs, and DDUs. There too, mailers' choices between these entry points are influenced by the density of their mailings to each entry level. The Valassis/SMC argument would suggest that those discounts also could be redefined as density-related instead of worksharing? [sic]" NAA Reply Comments, ACR2008, at 10, fn 12.

It is NAA that has missed the point. While it is true that mailing density can influence a mailer's *choice* between different dropship rate tiers, *eligibility* for the next higher tier is not based on mailing density, but rather on the mailer undertaking additional work at its own extra cost to transport and enter the mail deeper into the postal system. By contrast, as noted above, a mailer can shift from High Density to Saturation solely by increasing its volume, without any additional element of "worksharing."

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[1] NAA makes too much of the fact that the Postal Rate Commission in some past decisions has characterized High Density and Saturation as "worksharing discounts." In fact, the Commission's terminology has vacillated over time. In Dockets R2001-1 and R2006-1, for example, the Commission referred to these simply as "density tiers," without mentioning worksharing. See, e.g., PRC RD R2001-1 at 97-98, and RD R2006-1 at 267-68. Their true character, of course, should not be determined by labels but by the nature and substance of the differences.

B. <u>The ECP Concept And The Worksharing Cost Passthrough Constraint Are Inapplicable To The Saturation/High-Density Differential</u>

Unlike other true worksharing activities and rate tiers, the principles of Efficient Component Pricing (ECP) do not apply to the differences between High Density and Saturation mail. ECP is favored by economists in cases where there is a single mail product but the different mailers of that product can provide different levels worksharing. In such a case, it is more efficient for a mailer to perform the worksharing activity if it can do so at a cost less than the Postal Service's avoided cost. Because the mailer can compare its actual worksharing cost to the actual postal cost for the same activity, it can make an efficient decision, and the combined resource cost (to the nation) of the mailing is reduced. Thus, under the ECP concept, the worksharing discount should be based on 100% of the avoided postal cost: if it based on any greater amount, then inefficient worksharing is encouraged; whereas if it based on any lesser amount, then inefficient postal work is encouraged (since the mailer can do the work at less cost but does not).

Additionally, under ECP, as long as the worksharing discount equals a 100% passthrough of avoided cost, the Postal Service will receive the same unit contribution regardless of whether the mailer workshares or not. Thus, if dropship discounts are set at a 100 percent passthrough, the Postal Service will be indifferent if a mailer decides to drop ship to a destination SCF rather than to a DDU, because the rate differential will equal the cost differential – and the net contribution to institutional costs will be unchanged. That is *not* true, however, if a mailer decides to change from Saturation distribution to High Density. In that case, even though the per-piece contribution would be the same at a 100 percent passthrough of the cost differential, the Postal Service would be worse off, losing total volume and contribution due to the reduced mailing density.

Indeed, the newspaper High Density “total market coverage” (TMC) products cited by NAA have characteristics that – because of their hybrid use of postal and private delivery – make them distinct postal products compared to saturation program mail. Unlike saturation program mailers whose entire distribution is in the mail, newspaper TMCs have only a portion of their distribution (to nonsubscribers) in the mail, with the remainder delivered to subscribers by their own carriers. Because postal rate changes affect a greater proportion of the total distribution costs of saturation program mailers, their mail has a greater postal price sensitivity.

Moreover, because the postal rates for high-density/saturation flats exceed their attributable costs by well over 200 percent, the decision to switch either to or away from private delivery cannot ensure a lower combined resource cost. Private delivery cost may actually exceed postal delivery cost yet still be priced substantially lower than the relevant postal rates, particularly given the postal system’s delivery scale economies. Thus, when a saturation mailer makes the decision to shift its saturation mail program back to a combined private delivery/high-density program, not only will the Postal Service lose contribution, but total resource cost (to the nation) may increase. And, if substantial numbers of saturation mailers make the same decision, the USPS will lose delivery scale economies and costs for all remaining mail volume will increase.

This potential postal volume loss is not an idle concern. The current rate structure, with equal pound rates for Saturation and High Density mail, can create a perverse incentive for a mailer currently at the Saturation level to convert to a TMC program at High Density rates, with no impact on its postal pound rate and a savings on its total distribution cost due to the shift of a portion to newspaper delivery – a conversion that costs the Postal Service not only volumes and revenues but net contribution. A pound rate differential would lessen the conversion incentive and, in the event of conversion, at least allow it to recoup a portion of its lost contribution.

For these reasons, the distinction between High Density and Saturation mail cannot in any meaningful way be considered a "worksharing" difference. It is clearly due to product cost and market/demand differences, and should be priced accordingly. The Postal Service's proposed rates for High Density and Saturation Mail are consistent with the intent of the Postal Accountability and Enhancement Act, especially the sections that emphasize Postal Service pricing flexibility so that it may retain and encourage mail volume and operational flexibility, and thereby ensure adequate and stable revenues to support universal service. The proposed rates will move the Postal Service in that direction.

Respectfully submitted,

/s/________________________

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