

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

CONSIDERATION OF WORKSHARE DISCOUNT
METHODOLOGIES

Docket No. RM2009-3

**COMMENTS OF THE
NEWSPAPER ASSOCIATION OF AMERICA
ON ORDER ON FURTHER PROCEDURAL STEPS
(September 11, 2009)**

The Newspaper Association of America (“NAA”) submits these comments on the Commission’s Order No. 243, and in response to the discussion at the August 11, 2009, “public forum” and Notice of Inquiry No. 1 in this proceeding.

I. INTRODUCTION

NAA represents the interests of nearly 2,000 newspapers in the United States and Canada. Its 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. NAA member newspapers operate Total Market Coverage (“TMC”) programs that use both High Density and Saturation flats mail rates. Those newspaper TMC programs account for a substantial portion of the High Density and Saturation flats mail volume delivered by the Postal Service, with annual postage nearing \$1 billion.

These comments address several questions identified in Order No. 243 regarding Standard Mail. First, High Density and Saturation flats mail are components of the same postal product, as each provides a means by which the

Postal Service can meet the demand by advertisers for geographic targeting. Second, the difference between High Density and Saturation flats rates is a worksharing discount fully subject to Section 3622(e) of the Act. Third, these comments suggest that these issues could be made less contentious, and competitive equity enhanced, by replacing the current two-tier rate design with a sliding-scale discount structure for High Density and Saturation flats.

II. HIGH DENSITY AND SATURATION FLATS THAT SERVE THE MARKET FOR GEOGRAPHICALLY TARGETED ADVERTISING ARE PROPERLY CLASSIFIED TOGETHER

The Postal Service currently classifies High Density and Saturation flats within the same “product.” This classification is correct, because High Density and Saturation flats serve the same advertiser demand, are components of the same market, and are highly substitutable.

Both High Density and Saturation flats mail meet demand by advertisers for geographic distribution.¹ The clearest evidence that both categories are part of the same product serving the same market that is that newspaper TMC programs use High Density and Saturation interchangeably, sometimes using both rates for a single TMC mailing going to different routes from a single delivery office. Indeed, newspaper TMC programs are substantial mailers in that product, accounting for a substantial share – approximately one third according to NAA data -- of the Postal Service’s revenues for the High Density and Saturation flats product.

¹ In contrast, Carrier Route flats typically consist of more targeted advertising pieces, such as catalog or other list mailings, and serve a much different type of advertiser demand.

That High Density and Saturation flats are two components of one product is best understood by recognizing that the real demand that drives volume in that grouping is the demand by advertisers for distribution throughout a geographic area. Their demand is for geographic distribution, not for “mail” delivery *per se* (and this demand also fuels private delivery services). The Postal Service acknowledged this in its 2008 Annual Compliance Review, stating that the Standard 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).

Newspapers meet this demand for advertising distribution through a combination of inserts in subscriber copies of the newspaper and TMC distribution to nonsubscribers. To deliver advertising preprints to residents who do not subscribe to the newspaper, a newspaper’s TMC program may use the mail.² So-called “saturation mailers” – such as Valassis or Harte-Hanks -- meet this demand via the mail, although NAA understands that some saturation mailers also have private delivery operations. A shared mail package – whether mailed by a newspaper TMC program at High Density or Saturation rates, or by a saturation mailer – contains a set of advertising preprints promoting third-party advertisers.³

² Some newspaper TMC programs have shifted to private delivery, finding the current postal rate structure unbeneficial for their High Density rated flats mailings.

³ Unlike a catalog or other customer list mailing, a mailer using High Density or Saturation flats rates typically is not mailing advertising for its own product except incidentally.

Whether a newspaper TMC program uses High Density or Saturation flats rates on a particular route is affected significantly by its subscriber penetration level on that route. Where a newspaper's subscriber penetration exceeds 25 percent of a route and the newspaper delivers the advertising to subscribers as a newspaper insert, the TMC mailing to addresses that do not subscribe to the newspaper most likely would qualify for the High Density rate. Valassis/SMC acknowledges that High Density mail includes "newspapers that use it in conjunction with newspaper distribution to reach all households." *Valassis and SMC Comments* at 12 (May 26, 2009).⁴ On routes on which a newspaper has relatively low subscriber penetration, the TMC mailings may meet the eligibility threshold for Saturation rates.

One consequence of this interchangeability is that if a newspaper's subscription penetration declines to a certain point on a particular route, its TMC program's mailings to nonsubscriber households may shift from High Density to Saturation rates as more pieces to that route are delivered by the Postal Service and fewer as newspaper inserts. Pieces that previously were being mailed to homes on that route convert from High Density to Saturation rates simply by virtue of the change in newspaper subscribership. While the Postal Service's volume increases, there is no change in the advertiser's demand for geographic distribution.

⁴ See also *Valassis Communications Inc. Form 10-Q* (August 7, 2009) (stating: "Our RedPlum™ portfolio of products and services delivers value on a weekly basis to more than 1000 million shoppers across a multi-media platform, in the mailbox, in the newspaper, on the doorstep, in store and online. We provide . . . our clients with blended media solutions, including shared mail and newspaper delivery").

The reverse can occur as well. As newspaper subscriptions rise along a route, mailings may convert from Saturation to the higher priced High Density rate level. In this situation, although the Postal Service might lose some volume, that loss would be offset insofar as all of the pieces remaining in the mailing would pay the higher High Density rate.

Another, independent, factor that can affect the eligibility of newspaper TMC mailings for High Density or Saturation rates is the Postal Service's route realignment process. As the Postal Service realigns (or "reduces") routes, it can change the size of a route. By lengthening or realigning routes, it can convert previously High Density routes to Saturation or *vice versa* without any change in the number of pieces being mailed to the affected addresses. The pace of these changes may increase as the Postal Service continues to focus on consolidating routes. As current routes get longer (due to route changes resulting from the implementation of Flats Sequencing System or other factors), that factor alone may cause a particular TMC program's portfolio of routes to vary in the number which pay High Density and Saturation rates.

NAA believes that a substantial portion, perhaps even the majority, of the current High Density flats volume consists of mailings by newspaper TMC programs as part of their responsiveness to advertisers' demand for geographic distribution. However, High Density flats mail appears to include another, different, type of advertising. Valassis/SMC observe that High Density mail consists "not just newspapers that use it in conjunction with newspaper distribution to reach all households, but also other mailers that want to target a

higher-value demographically-selective audience of as few as 25-percent of households. “ *Valassis/SMC* at 12. Those “other mailers” are likely catalog or other customer-list mailers that more typically mail at Carrier Route rates. Such “other” mailings serve a qualitatively different type of demand. As the Postal Service has acknowledged, although historically part of the Enhanced Carrier Route product, “the Carrier Route product is more akin to the Letters, Flats and Parcels/NFM products in that advertising mail pieces are generally demographically, rather than geographically, targeted. *U.S. Postal Service 2008 Annual Compliance Review* at 27.

Is the presence of some demographically-targeted mail within the High Density rate category a problem? Not really. Any postal classifications inevitably have some imprecision around the margins, as mailer behaviors seldom fit neatly within the broad conceptual categories used to classify the billions of mail pieces the Postal Service delivers annually. It is worth noting in this context that the minimum threshold for High Density rate eligibility – 125 pieces per route – was not driven historically by market analysis, but was simply a data point in the cost analysis submitted by the Postal Service in Docket No. R90-1 to justify establishing the discount.⁵ The Commission used it in that case as the basis for recommending establishment of a walk-sequencing discount at the 125-piece level, and the piece minimum for the rate category has never been reexamined.

At some point, the Postal Service may wish to consider whether it would be appropriate to group commercial Standard mail into geographically and

⁵ At that time, all commercial advertising mail was grouped together into one subclass; qualitative demand differences between direct response and geographic distribution advertising was not to affect the mail classification schedule until after the 1995 Reclassification case.

demographically targeted products. Until that occurs, however, the imprecision inherent in current product groupings should not serve as a justification for further discriminating against High Density mail.

III. THE RATE DIFFERENCE BETWEEN HIGH-DENSITY AND SATURATION FLATS IS A WORKSHARING DISCOUNT FULLY SUBJECT TO SECTION 3622(e)

The Commission observes that the “observed cost difference” between High Density and Saturation flats “could be characterized as gains in efficiency brought about by worksharing activity, *i.e.*, the Postal Service’s cost per piece of sorting mail to walk-sequence order declines as density increases.” *Order No. 243* at 8. The Commission is correct that the difference between High Density and Saturation flats is a walk-sequencing worksharing discount. That discount is subject to the restrictions of Section 3622(e) of the Act.

A. The Discount Was Created As A Walk-Sequencing Discount

The historic fact of the matter is that the High Density (then called “125-piece”) and Saturation rates were established as walk-sequencing worksharing discounts.⁶ At that time, the then-Postal Rate Commission stated that “walk sequencing is the critical distinguishing feature of the Service’s proposal” for a Saturation discount factor. *Opinion and Recommended Decision*, Docket No. R90-1, at V-209 (stating the discount rate “is based on the savings associated with walk sequencing”).

⁶ These discounts were added to a rate schedule that at that time already contained separate rates for 5-digit and carrier-route presorted mail mail.

In Docket No. R90-1, the Postal Service presented cost testimony that measured cost savings from presorting into walk-sequence at only the 125 piece and 100 percent saturation levels. The testimony concluded that a letter carrier could case flats in the then-prevalent horizontal flats case at a higher speed when the flats covered every address at the route compared to a mailing consisting of only 125 pieces -- suggesting, as the Commission notes (*Order No. 243* at 8, n.6) declining marginal cost of casing sequenced mail over that range. The Commission relied on that testimony in recommending a “two-tier walk-sequencing discount.” *R90-1 Op.* at V-219, ¶5917 (see also *id.* at V-205, ¶5889 referring to a “two-tier walk-sequencing rate category”).

Thus, it is a matter of historical fact that the cost savings between High Density and Saturation mailings were, from the outset in Docket No. R90-1, based on a perceived declining marginal cost of casing a walk-sequenced 100 percent saturation flats mailing compared to a walk-sequenced mailing consisting of 125 flats. Neither the Postal Service nor the Commission has ever contended that “density” without presorting by the mailer into walk-sequence deserves a special rate.

B. Arguments That The Saturation Discount Is Not A Worksharing Discount Subject To Section 3622(e) Are Without Merit

The Postal Service, joined by saturation mailers, argue that “density” – not walk-sequencing -- is the key difference between High Density and Saturation rates. They further argue that “density” is not worksharing, and that the difference between the High Density and Saturation rate tiers should not be

considered a worksharing discount subject to Section 3622(e).⁷ The practical consequence of that position is that there would be essentially no statutory limitation to the difference between those two rate tiers, and the Postal Service could price these two clearly interrelated products as arbitrarily as it wishes. Those parties are mistaken, as discussed below.

1. It is walk-sequencing, not density, that produces cost-savings

The assertion that the difference between the High Density and Saturation rate tiers is due to “density” is mistaken on its face. Only cost savings associated with walk-sequencing justify the rate differential. In contrast, density alone contributes no cost savings.

To illustrate, if additional pieces were added to a High Density mailing, but those additional pieces are not walk-sequence, no cost savings would be created. Indeed, as the Commission correctly observed in Order No. 243, a Saturation mailing presented without walk-sequencing would not be eligible for either the Saturation or High Density rates, or even the Carrier Route rate. Nor is there any reason to expect that a non-sequenced saturation mailing would engender cost savings if sorted by letter carriers compared to a non-sequenced High Density mailing. Put simply, the Commission has never reviewed, considered, or approved a discount for “density” *per se*, and there is no evidence that density without sequencing accounts for any cost savings. Nor does anything in the Act or in economic theory require cost savings associated with

⁷ Presumably this argument would apply equally to the High Density discount rate compared to the Carrier Route rate, although the Postal Service does not say so explicitly.

worksharing necessarily to be constant across all volume levels to which the discount applies.

Parties suggesting that density is the defining difference between the High Density and Saturation tiers mistakenly confuse an estimated marginal gain in efficiency with a distinct cost-causative factor. Thus, for example, Valassis/SMC are simply wrong in their criticism (Comments at 8-9) of the Commission's discussion of this issue in the 2008 Annual Compliance Report. They fault the Commission for noting in the 2008 ACR that the deeper presortation required for the 5-digit discount rate compared to the 3-digit rate requires a certain density, accusing the Commission of "confus[ing] the volume necessary to meet a discount threshold with the *extra worksharing activity* that the mailer must undertake to save postal costs and *earn* the discount" (emphasis in original).

In fact, it is the Commission that is correct, and Valassis/SMC make the exact error that they accuse the Commission of having made. In arguing that density is the "*sole* distinction" between High Density and Saturation flats rates, they ignore that density alone does not, by itself, earn a mailer a discount. Simply adding enough pieces in a random order to a High Density mailing does not earn a Saturation rate. Instead, a Saturation discount is *earned* by the mailer's extra worksharing activity of *presorting the additional volume into walk-sequence order* and the resulting postal cost savings.⁸

⁸ The Postal Service and saturation mailers also overlook that it is possible, if unusual, for a High Density mailing to contain more pieces on a route than a Saturation-rated mailing. This is because "saturation" is defined as the minimum of 75 percent of total addresses, or 90 percent of residential addresses, on a route. If 90 percent of the residential addresses on a mixed Business and Residential route total less than 125 pieces, the "Saturation" mailing would have *less* density than the High Density mailing, yet receive a bigger discount.

For this reason, the argument by the Postal Service (echoed by Saturation mailers) that because it cannot substitute density by adding pieces to convert a mailing from one tier to the next in a manner akin to walk-sequencing, “density” cannot be considered worksharing, is beside the point. The cost differences between the tiers are not due to volume, but instead to the preparation of the mailing in walk-sequence. Merely adding more pieces achieves no cost savings, and the inability of the Postal Service to convert a mailing to a greater density is immaterial to the worksharing issue.

2. The Saturation discount is subject to Section 3622(e)

Second, the Postal Service and other parties advance a legal argument that the Saturation discount is not a worksharing discount, based solely on “density” not specifically being listed in the definition of “worksharing” in Section 3622(e).⁹ That argument is flawed for several reasons.

For one, their argument presupposes erroneously that Congress needed to list “density” separately. But as discussed above, the cost savings derive not from “density” *per se*, but rather from an increased marginal efficiency resulting from mailer presorting in walk-sequence as volume increases. Reduced to its essence, the argument being made by the Postal Service and its allies consists

⁹ As in footnote 7, this argument presumably also would apply to the High Density rate (compared to the Carrier Route discount), because the Postal Service likewise cannot convert a Carrier-Route mailing into a High Density mailing. However, the Postal Service appears to make this argument selectively. It cannot convert a 3-digit mailing into a 5-digit mailing, or a 5-digit mailing into a Carrier Route mailing, but it does not argue that those are not worksharing discounts.

of identifying a word that is not in Section 3622(e),¹⁰ and inventing for that word a putatively dispositive significance, in order to circumvent the limitations that Congress imposed in Section 3622(e).¹¹ The Commission should reject such wordplay out of hand.

In addition, the Postal Service's argument implicitly requires the Commission to ignore that walk-sequencing is a form of presorting. A mailer that prepares a mailing in walk-sequence is, literally, *presorting* the mail so that the Postal Service need not sort the mail. "Presorting" is indisputably "worksharing" under Section 3622 of the Act. 39 U.S.C. § 3622(e)(1). There is no discount for "density" absent walk-sequencing.

Still another flaw in the Postal Service's legal argument is that Congress squarely delegated the authority to "further define" the workshare discounts to the Commission, not to the Postal Service. 39 U.S.C. § 3622(a)(1). It is not the prerogative of the Postal Service to reinterpret a longstanding discount in order to wriggle out of a ratesetting limitation that Congress deemed important to include in the law. The scope of the delegation to the Commission assuredly includes the power to affirm that, as the Commission's predecessor plainly held nearly twenty years ago, the difference between the High Density and Saturation flats rates is a presort discount.

¹⁰ One cannot reasonably fault the Congress for having failed to anticipate the current *post-hoc* re-interpretation offered by the Postal Service and mailers that stand to benefit from it.

¹¹ Presumably saturation mailers would favor this outcome, as it would allow the Postal Service to continue to grant them competitively valuable rate preferences over newspapers, perhaps beyond the existing tariffed rate difference and the saturation "volume incentive" discount. The Postal Service, like most regulated entities, presumably wishes to reduce any limitations on its ability to set prices.

3. Section 3622(e) cannot be circumvented simply by making a worksharing activity an eligibility requirement

The Postal Service also advances a more subtle argument based on mailing eligibility criteria that require both High Density and Saturation rate mail to “be presorted by carrier route and sequenced.” It argues that because sequencing is a requirement for the rate, there is no sorting or sequencing for the Postal Service to perform for mail entered at that rate. From this premise, the Postal Service concludes that since walk-sequencing is not “optional” for those rate categories, the difference between the two tiers must be “density” – which as noted above it contends is not worksharing and thus falls outside of Section 3622(e). *Postal Service Comments* at 29 & 32. Applied to this proceeding, the practical consequence would be to allow the Postal Service to price the difference between the clearly interrelated High Density and Saturation flats tiers as arbitrarily as it wishes.

The Postal Service’s argument should be rejected as inconsistent with Section 3622(e) of the Act. Section 3622(e) contains no exception for worksharing activities that are classified as eligibility requirements. The provisions of Section 3622(e) apply to worksharing activities regardless of whether they are optional or required for a particular rate. *Accord Greeting Card Association Comments* at 4. Whether presorting and sequencing are eligibility “requirements” rather than “options” does not change the fact that they are still actions performed by a mailer that the Postal Service otherwise could do (even walk-sequencing of Saturation mail is an “option” despite being an eligibility

requirement, because a mailer could choose to enter an unsequenced mailing at 5-digit rates) and are subject to Section 3622(e).

The Postal Service's position is that calling a worksharing activity an eligibility requirement can trump Section 3622(e) of the statute. Under its theory, if a worksharing activity is mandatory for a particular rates, it becomes "required" and thus can no longer be considered a worksharing discount subject to Section 3622(e). Taken to its logical extreme, the Postal Service's theory would render Section 3622(e) toothless, because the Postal Service could simply insulate any rate it wished from Section 3622(e) review by defining the appropriate worksharing activities as eligibility requirements.

Labeling a mailer worksharing activity as a "requirement" for eligibility for a rate does not convert that activity into some unregulated rate category outside the scope of Section 3622(e). It is the substance, not the label, that matters. And it cannot seriously be contended that Congress intended for carefully considered statutory provisions to be circumvented by creative use of labels and eligibility requirements. Congress made explicitly clear that the power to modify the statutory worksharing factors resides in this Commission, not in the Postal Service.¹²

¹² There may be cases, such as rates that cross class or, in some instances, product lines, in which the applicability of Section 3622(e) may prove not susceptible to a hard and fast rule, but may remain a matter of judgment ultimately for the Commission. However, there appears to be no sound reason for not applying Section 3622(e) within a product.

4. Section 3622(e) was enacted by Congress specifically to curtail pricing “flexibility” that produces discounts in excess of avoided costs

A Commission ruling that Section 3622(e) applies to the High Density and Saturation flats discounts would not conflict with “pricing flexibility” intended by Congress. *See Comments of Mail Order Association of America* at 2. Section 3622(e) is simply a constraint that Congress thought it necessary to impose to prevent discounts that exceed costs avoided, embodying 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. This congressionally-imposed constraint does not significantly affect the Postal Service’s substantial pricing flexibility under the new law compared to the previous law, both in speed and in the lack of any need for the detailed cost justifications, and helps to protect its finances.

IV. STANDARD MAIL RATE DESIGN COULD BE IMPROVED SIGNIFICANTLY BY A “SLIDING SCALE” DISCOUNT FOR WALK-SEQUENCING HIGH DENSITY AND SATURATION MAIL

The current rate design could be significantly improved by replacing the current two-tiered High Density (minimum 125-piece) and Saturation (75 percent of routes or 90 percent of residential addresses) rate schedule with a “sliding scale” discount structure. In this design, the amount of the walk-sequencing discount earned by a High Density mailer would increase with the volume per route. This approach would benefit both the Postal Service and mailers.

Under a sliding scale discount structure, the amount of the discount received by a mailer could depend upon the mailing penetration (density) per

route. Using current rates as an example, the current Saturation flats discount is 2.5 cents from the High Density rate. At the DDU entry rates for below-breakpoint pieces, the price per piece for a High Density flats is 16.7 cents, and 14.2 cents for a Saturation flat.

Under a sliding scale, the discount would vary with volume per route (density). There are two alternatives as to how this could be done. One way is to have a sliding scale apply between the 125-piece and 75 percent density levels. Under this approach, the sliding scale would apply to mailings between 125 pieces per route (again, approximately 25 percent) and 75 percent (the current minimum threshold for Saturation rates). Again, a mailing with only 125 pieces per route would earn no discount beyond the standard High Density discount. A mailing at 50 percent penetration (halfway between 125 pieces and 75 percent penetration) would receive half of the Saturation discount, or 1.25 cents per piece, for a rate of 15.45 cents. A mailing would be eligible for the full Saturation discount at 75 percent penetration, as now. This is consistent with the increasing cost efficiency from mailer presortation as volume per route increases.

Alternatively, another way would be to apply the sliding scale on the full range between the 125-piece level (roughly 25 percent of the average route) to 100 percent saturation. At the 125-piece level, no discount would be available beyond the High Density discount (as in today's rate schedule). At a 50 percent density (which is one-third of the difference between 25 percent and 100 percent penetration), a mailer could be eligible for a discount of $\frac{1}{3} * 2.5$ cents, or 0.835 cents, for a rate of 15.865 cents. At 75 percent density, the discount could be $\frac{2}{3}$

* 2.5 cents, or 1.670 cents, for a rate of 15.3 cents. At 100 percent density, the full 2.5 cent discount would be available. This approach is most consistent with the cost study upon which the current discount structure was based.

A sliding scale discount structure along these lines could benefit both mailers and the Postal Service. Mailers, including newspaper TMC programs, would have a greater incentive to mail high volume mail at High Density rates. Under the current rate structure, for example, a newspaper TMC program pays 16.7 cents for each High Density flat regardless of whether the mailing goes to 125 addresses or to 74 percent of the addresses on the route. Only if it reaches 75 percent of the addresses would the price per piece fall to 14.2 cents. This structure – with the noticeably higher price for High Density mail -- creates a disincentive for a High Density mailer to increase volume on a route until the threshold density for Saturation mail is attained.

Under a sliding scale, however, this disincentive would be reduced, and a mailer would have a rate incentive to mail more High Density volume per route. This would provide a clear incentive for a newspaper to continue to use the mail to distribute its Total Market Coverage advertising product to addresses that do not subscribe to the newspaper, instead of shifting to private delivery.

The Postal Service would benefit from the additional volume attracted by the sliding scale (under either version outlined above) to the higher priced High Density rate category. A sliding scale also would help the Postal Service to recognize via rates the differences between demographically targeted and geographically targeted mailings within the High Density category. In addition,

the Postal Service would benefit insofar as the sliding scale could help level the playing field between newspaper TMC companies and Saturation mailers and reduce the perception that the Postal Service is taking sides in that competition. A sliding scale discount would create a more equitable rate schedule on which newspaper TMC programs and saturation mail competitors could base their mailing decisions, and reduce distortions in advertising markets caused by the current discount structure.

V. CONCLUSION

For the foregoing reasons, the Newspaper Association of America respectfully submits (1) that the Commission should adhere to its previous interpretations and confirm that High Density and Saturation flats are part of the same product, (2) that the difference between the High Density and Saturation flats rates is a worksharing discount subject to Section 3622 of the Act, and (3) that a sliding scale discount structure in the High Density and Saturation flats product could materially improve upon the existing rate schedule.

Respectfully submitted,

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