

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Valassis NSA

Docket No. MC2012-14

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Docket No. R2012-8

Reply Comments of the Public Representative in Response to Order No. 1330
(June 1, 2012)

I. *Introduction*

On April 30, 2012, the Postal Service filed a request to add a Valassis Direct Mail Inc. Negotiated Service Agreement (NSA) to the market dominant product list. Order No. 1360 set a deadline for reply comments of June 1, 2012

II. *Market dominant products are inherently unsuited to price discounting schemes.*

The proposed Valassis NSA is the latest installment in the ongoing tragedy in which the Postal Service offers discriminatory prices to individual businesses for delivery services over which it exercises monopoly power. The comments of Valpak describe the history of market dominant NSAs, which is an unbroken procession of failed price discrimination schemes. Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc., Initial Comments, May 23, 2012, at 13-17.

The Postal Service's elaborate attempts to fence off portions of monopolized markets for mail service for the exclusive benefit of a single business have all lost money for a reason. They are an attempt to repeal an economic "law of gravity." Any product whose price elasticity has an absolute value of less than 1.0 is price inelastic. Market dominant products are, by definition, price inelastic.¹ This means that lowering the price for Saturation mail gives up more in revenue than it gains in volume. The net effect is a reduction in profits. Trying to increase profits by reducing prices for services like Saturation mail that are price inelastic is like trying to stay dry by spitting into the

¹ The Postal Service estimates the price elasticity of the Standard Mail group that is comprised mostly of Saturation mail to be -0.782.

wind. The elaborate discriminatory schemes that the Postal Service devises to keep that economic wind at bay are destined to fail. The result is the history of loss in net contribution from market-dominant NSAs that Valpak describes.

III. *Disruption of the market has already been demonstrated.*

Not only do market dominant NSAs that seek a favorable net revenue effect from reduced prices damage the Postal Service's bottom line, they damage mailers as well. In Order No. 694, the Commission shows an awareness of the economic damage that private businesses can suffer when the Postal Service proposes to practice price discrimination in the market for a particular product over which it exercises monopoly power. In reluctantly approving the Discover NSA, the Commission issued the following warning to the Postal Service.

Thus, upon a showing of market disruption, a mailer competing in the credit card industry may be entitled to a non-functionally equivalent NSA to neutralize the negative effect of DFS's agreement on it. Such a mailer need not be similarly situated and the case would necessarily turn on the facts presented. If presented to the Commission in a complaint proceeding, an alternative remedy could be to terminate the existing NSA. The Commission urges the Postal Service, if approached by downstream or other competitors alleging market disruption, to consider each claim fairly and promptly. Commission Order No. 694 at 22 (Discover NSA)

In the instant proceeding, there is no need to issue a warning to the Postal Service to be sensitive to post-agreement showings of market disruption. Those showings have been made at the outset by both the direct competitors of Valassis and downstream users of High Density and Saturation mail. They have shown that if this NSA is approved, major disruption of the markets for delivering advertising inserts is unavoidable.

IV. *The risk of market disruption from this NSA are unprecedented in scale*

In reading the comments in this docket, what comes through is how much more is at risk this time than was at risk in previous NSAs if the Commission should overlook the NSA's legal flaws and allow it to take effect, or if the Commission should leave it to

others to demonstrate its legal flaws sometime down the road through the filing of a complaint case. Past NSAs involved businesses that don't sell hard-copy advertising as a main product line, and whose use of advertising mail was an optional means of promoting their main line of business (banking services, book selling, etc.) For that reason, allowing previous NSAs to set uneconomic or discriminatory prices for postage would have caused only minor disruptions of the market for the banking services, the books, or the other retail goods being advertised.

The Valassis NSA is a different story. It is the first NSA that is designed to manipulate prices and to alter the balance of market forces among companies whose main product (or one of their main products) is the delivered mailpiece itself. Valassis's main business is providing for the delivery of free-standing advertising inserts (FSIs) by mail. One of the newspaper industry's main products is providing for the delivery of newspaper advertising inserts, often through the mail. The price for delivering advertising inserts is *the price of the core business for these companies*. The price of postage largely determines the total product price for these companies. Getting that price wrong can mean an undeserving company lives and an deserving company dies in the advertising circular delivery market.

As the comments of the National Association of Newspapers demonstrate, revenue from delivering advertising circulars is a core revenue source for the newspaper industry. A scheme to authorize one participant in this market to charge an uneconomic and anti-competitively low price not available to the other participants has the potential to push the entire newspaper into bankruptcy. The fate of an entire industry is quite literally in the Commission's hands.

V. *Mere approval of this NSA risks major market disruption*

Boiled down to its essence, the Valassis NSA is a scheme to enable a proxy for the Postal Service (Valassis) to charge predatory prices in the market for Sunday advertising inserts for the purpose of prying that market loose from the newspaper industry. A key point made in the comments in this docket is that approving this NSA on a trial basis with the idea that it could be monitored for adverse effects on the newspaper industry would not provide the newspaper industry with meaningful protection. Long-term implementation of this agreement is not required to deal a fatal

blow to the newspaper industry's Sunday insert delivery business. Short term implementation is not required either. The dynamics of the advertising circular delivery business are such that all it would take to deal a fatal blow to the newspaper industry's Sunday insert delivery business is approval of this NSA by the Commission.

The reason for this has been spelled out in the comments of Public Representative, dozens of individual newspaper companies, and those of the NAA. For national-scale durable goods retailers, merely to know that Valassis and no other player has access to postal delivery service at as much as one-third less than the regular price is enough to enable Valassis to credibly promise national durable goods retailers service at prices with which the newspapers could not compete. This, by itself, would force the newspaper industry to alter its price structure to remain in business. For national-scale durable goods retailers to know that at certain weight thresholds Valassis has the ability to add delivery service *at no cost itself or its customers* is more damaging still. This is enough to enable Valassis to credibly promise national durable goods retailers introductory service at no cost for protracted periods of time. The Postal Service's purpose in proposing this eccentric rate structure is to hand Valassis a crowbar with which to pry the advertising of national durable goods retailers loose from the newspaper industry. With it, Valassis can beat any counter offer that newspapers could possibly make, even if newspapers move away from the Postal Service to private delivery of their inserts.

This potentially devastating impact on the market for advertising circular delivery from the mere approval of the NSA would damage not just for the newspaper industry, but the Postal Service itself. This is because it stands to lose more of the highly profitable, regular-rate High Definition and Saturation business of the newspapers than it would gain of the relatively low-profit, high-discount NSA-based Saturation business of Valassis.

VI. *Niche Classification*

The Postal Service has proposed this agreement, in part, because it appears to believe that it needs a business partner to help it recruit specific businesses to use the mail. While the Postal Service has not provided a detailed analysis showing that retailers of durable and semi-durable goods are not currently using the mail, it is arguing

that lower rates would encourage these businesses to increase their usage of the mail. If the Postal Service has identified a segment of the economy that has an elasticity that is greater than the average business, the path toward increased mail usage is not a discriminatory NSA with one mailer that will cause significant market disruptions. The Postal Service could easily design prices targeting these mailers in the form of a niche classification. The Postal Service has not explained why a broader, market based solution would not be effective at this juncture.

VII. *Summary.*

From an economic standpoint, this NSA, as it is currently structured, is a lose-lose proposition for both the newspaper industry and the Postal Service. From a legal standpoint, it violates section 3622(c)(10)(A)(i) [requirement that the NSA increase the Postal Service's net revenues], and section 3622(c)(10)(B) [requirement that the NSA not cause unreasonable harm to the marketplace]. It grants an unreasonable preference to a user of the mail (Valassis) in violation of section 403(c). Finally, it gives the Postal Service an "unfair competitive advantage" over the newspaper industry by setting up the newspaper industry's main competitor (Valassis) as its proxy, and offering it free and heavily discounted prices with which to outbid the newspaper industry for the main client base of the Sunday-delivered insert market (national durable and semi-durable goods retailers).² This is a plain violation of section 404a(a)(1) of the PAEA.

The Commission must reject the Postal Service's request for approval of this NSA on the legal and economic grounds described above.

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² See the detailed description in the mid-week and Sunday components of the advertising insert market in the Public Representative's initial comments.