

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

VALASSIS NSA) Docket No. MC2012-14
)
VALASSIS NSA) Docket No. R2012-8

**VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
RESPONSE TO NOTICE OF INQUIRY NO. 1
(June 29, 2012)**

Valpak Direct Market Systems, Inc. and Valpak Dealers' Association, Inc. (hereinafter "Valpak") hereby respond to Notice of Inquiry ("NOI") No. 1. On April 30, 2012, the Postal Service filed its request in this case. Initial Comments were filed by May 23, 2012 and Reply Comments by June 1, 2012. Two weeks after all deadlines for comments had expired, on June 15, 2012, the Commission issued its first Notice of Inquiry, NOI No. 1, offering "an opportunity to provide additional material on relevant issues." NOI No. 1, p. 2. (Order No. 1371 extended the deadline for response to NOI No. 1 to June 29, 2012.) After an introductory comment, Valpak responds to question nos. 1, 7, and 8.

I. The Commission Has Concluded that the Postal Service Has Not Met Its Burden of Proof.

NOI No. 1 was designed to "afford all interested persons an opportunity to provide **additional material** on relevant issues ... to **more fully support** their respective positions with quantitative information and affidavits of responsible officials." NOI No. 1, p. 2 (emphasis added). However, the Commission explained its specific purpose for issuing NOI No. 1 as follows:

Based on its review of the record, **the Commission concludes** that neither the **claims of the Postal Service** nor those

who opposed the Valassis NSA **have yet been fully developed**.
[*Id.* (emphasis added).]

Thus, after all initial and reply comments, as well as all filings that the Postal Service chose to make, have been submitted and reviewed, the Commission has “conclud[ed] that ... the claims of the Postal Service ... have [not] yet been fully developed.” This conclusion is highly significant and indicates that, in the absence of new and compelling information, the NSA should be rejected.

By statute, when the Postal Service requests the Commission to add a new product to one of the product lists, it must “file with the Postal Regulatory Commission and publish in the Federal Register a notice setting out the **basis for its determination** that the product **satisfies the criteria** under subsection (b)...” 39 U.S.C. § 3642(d)(1) (emphasis added). In this docket, the Postal Service set forth what it hoped would be viewed as compliance with 39 C.F.R. section 3020.32(i) in Attachment E to its request.¹ That filing, when judged against the applicable statutory criteria, has been found wanting by the Commission. Moreover, the Postal Service’s responses to three Chairman’s Information Requests did not cure the inadequacy. Obviously, comments and reply comments by mailing interests did not help lay the necessary predicate for the Postal Service, as almost all such comments were highly critical of the Valassis NSA and urged its rejection. At the end of the day in this administrative proceeding, the Commission concluded that the Postal Service did not prove its case.

¹ 39 C.F.R. section 3020.32(i) requires the Postal Service to “[i]nclude such information and data, and such statements of reasons and bases, as are necessary and appropriate to **fully inform the Commission** of the nature, scope, significance, and impact of the proposed modification.” (emphasis added.) The Commission has concluded that the Postal Service has not met this standard.

As an informal rulemaking under the Administrative Procedure Act (“APA”), the Commission’s procedures and decision in this case must comply with 5 U.S.C. section 553. As such, the Commission’s decision must be designed to withstand the scrutiny of judicial review under Chapter 7 of Title 5, particularly that the decision is not “arbitrary, capricious, and abuse of discretion, or otherwise not in accordance with law.” 5 U.S.C. § 706(2)(A). Although the rule that an agency decision can be set aside if it is “unsupported by substantial evidence” does not expressly apply to informal rulemakings (5 U.S.C. § 706(2)(E)) such as the Valassis NSA, the U.S. Court of Appeals for the D.C. Circuit has determined that the substantial evidence requirement is indistinguishable in operation from the arbitrary and capricious test. “We have held that in the context of the APA, the substantial evidence test (which is applied only to formal adjudication and formal rulemaking, see 5 U.S.C. § 706(2)(E)) and the arbitrary and capricious test (which governs review of all proceedings, see 5 U.S.C. § 706(2)(A)) ‘are one and the same’ insofar as the requisite degree of evidentiary support is concerned.” Consumer Union of the U.S. v. FTC, 801 F.2d 417, 422 (D.C. Cir. 1986). Now the Commission has concluded that after the close of the Commission’s scheduled period for notice and comment, the Postal Service has neither submitted substantial evidence which would allow its approval, nor met its burden of proof.²

² See, e.g., Valpak Initial Comments, pp. 6-11, Valpak Reply Comments, pp. 5-7, and NAA Initial Comments, pp. 11, *et seq.*, for an explanation of the inadequacies of the Postal Service’s Request.

Although the Commission's Notice of Inquiry also notes that "the claims ... those who opposed the Valassis NSA have [not] yet been fully developed" (p. 2), the opponents do not have the burden of proof. Of course it is the Postal Service, as the proponent of the Valassis agreement, that has the burden of proof with respect to its proposal's compliance with applicable statutory criteria and policies. In this docket, opponents of this ill-conceived NSA have been numerous, respected companies, who are well informed, vigorous in their presentation, and detailed in their comments, and who believe that this NSA is extremely ill-advised and even illegal and should be rejected — but opponents have no burden to prove anything.

At this late date in these proceedings, the Valassis NSA is not in compliance with the policies of Title 39 for the purposes of section 3622(c)(10) and, after giving "due regard" to the requirements of 39 U.S.C. section 3642(b)(3), the Commission should reject the Valassis NSA.

II. Question No. 1

Question:

Pursuant to 39 U.S.C. 3622(c)(10)(B), the Commission must determine if the Valassis NSA would "cause unreasonable harm to the marketplace." Please identify the relevant marketplace concerning the Valassis NSA. Include a statement of supporting justification.

Response:

The relevant marketplace concerning the Valassis NSA consists of all firms capable of distributing free-standing hard-copy advertising matter. Thus, the relevant marketplace includes newspapers, their TMC programs (however distributed), and independent distribution

companies. All such firms are referred to by the Postal Service under the rubric “distribution alternatives.”

The free-standing hard-copy advertisements targeted by the NSA — *e.g.*, advertisements for durable and semi-durable goods by large “national” retailers — currently are almost always distributed **jointly** (*i.e.*, in conjunction with advertisements for other products by other merchants). The cost to distribute two or more free-standing advertising pieces is largely a fixed, joint cost that is common to all included pieces, regardless of the nature of products being advertised, regardless of whether the advertisers are local, regional, or national firms, and regardless of whether the distributor is the Postal Service or a private sector alternative.³ Because the cost of distributing any “bundle” of advertisements is largely fixed, the loss of revenue from losing even a single advertisement may cause harm to the distributor. Thus, to assess whether the Valassis NSA might cause unreasonable harm, definition of the relevant marketplace must include all distributors who might lose business on account of, and be affected by, implementation of the NSA. In some cases, loss of a single advertisement could make the distributor’s cost exceed the revenues generated. Any narrower definition of the relevant marketplace runs a high risk of overlooking significant harm which the NSA might cause.

In theory, **individual** pieces of free-standing hard-copy advertising matter — whether restricted to durable and semi-durable goods, or a broader array of products — could be

³ Regardless of the distributor, total weight of the advertising package may cause some variation in the cost of distribution, but such variation is relatively minor. For Saturation Mail, the Postal Service similarly has relatively low attributable costs, and high fixed (common) costs.

distributed either through the mail or by alternate delivery. In point of fact, however, this rarely occurs. In economic terms, the distribution of free-standing hard-copy advertising matter is subject to such large economies of scope and scale that distribution of individual pieces, either by the Postal Service or by alternate delivery, is economically prohibitive. Such advertising matter generally is distributed jointly along with other advertising matter and, not infrequently, along with a newspaper.

III. Question No. 7

Question:

Please discuss the meaning of a “similarly situated mailer” under 39 U.S.C. 3622(c)(10) as it relates to the Valassis NSA.

Response:

Valpak addressed the issue of “similarly situated mailer” in its Initial Comments, pp. 22-25. Valpak has explained that the Valassis NSA was presented by the Postal Service with the understanding that, there was no similarly situated mailer to Valassis, and the NSA never would be made available “on public and reasonable terms to similarly situated mailers.”

Some commenters have suggested, or at least speculated, that the NSA actually was designed so that it could be used only by Valassis. *See* review of such comments in Valpak Reply Comments, pp. 14-16. If this decision was intentional, this would constitute solid evidence of discrimination by the Postal Service. Indeed, the contract for this NSA contains a number of provisions that appear designed more to preclude other mailers than to further the Postal Service’s goal of increased volume and more contribution to overhead. However, it is

not necessary to demonstrate intentional discrimination for the Postal Service to violate 39 U.S.C. section 403(c).

The fact that no other mailer could be similarly situated to Valassis for such an NSA, as already demonstrated in this docket, puts this proposed NSA into conflict with the statute's anti-discrimination provision. The Postal Service already has defined what it considers to be a similarly situated mailer, and when it established that standard the Postal Service was fully aware that no other mailer could meet it. *See* Response to ChIR No. 2, Question 1. No matter what any commenter may now say, the Postal Service has admitted that this NSA was submitted with the knowledge that it would not be offered to any other mailers as required by 39 U.S.C. section 3622(c)(10).

It is worth asking about one particular provision of the NSA — namely, the degree to which the content requirement contained in the Valassis NSA would apply to a similarly situated applicant. Generally, any mailable matter under 1 pound which is not personalized can be mailed at Standard Mail rates.⁴ The Valassis NSA breaks new ground in that it would impose a strict content requirement on a Standard Mail product⁵ — namely, advertisements restricted to durable and semi-durable goods and only if sent by certain types of mailers. Would the same content requirement be imposed on all other similarly situated mailers? Or could a similarly situated mailer propose a different content requirement — or no content

⁴ *See, e.g.*, Domestic Mail Classification Schedule, Section 310, p. 19. <http://www.prc.gov/PRC-DOCS/library/mcs/DMCS.pdf>, and Domestic Mail Manual section 243.2.1.

⁵ The Notice explains that “the Postal Service requests that it be added to the market-dominant product list within the Mail Classification Schedule....”

requirement at all? These are among the thorny questions raised by this NSA that could be avoided if the NSA is rejected by the Commission.

IV. Question No. 8

Question:

Please discuss whether each of these currently market-dominant subproducts would qualify as a competitive product under 39 U.S.C. 3642(b)(1).

- a. Saturation Flats.*
- b. Saturation Parcels.*
- c. High Density Flats.*
- d. High Density Parcels.*

Response:

All of the subproducts identified in this question are part of Standard Mail, the totality of which are contained within one Market-Dominant Product under 39 U.S.C. section 3621. The Postal Service Notice of Filing (April 30, 2012) which led to commencement of this docket, was filed pursuant to 39 U.S.C. section 3622 — which relates exclusively to Market-Dominant Products. The Notice explains that “the Postal Service requests that it be added to the market-dominant product list within the Mail Classification Schedule....” This is a market-dominant special classification within the meaning of 39 U.S.C. section 3622(c)(10). The Commission’s Order No. 1330 (May 3, 2012) accurately describes the Postal Service request as a proposal to add a NSA “to the market dominant products list.”

Accordingly, all proceedings in evaluating the Valassis NSA and all initial comments and reply comments filed herein have focused on the current reality that the Valassis NSA would take certain volume from within Market Dominant Standard Saturation Flats to create a new Market-Dominant Product for this Valassis NSA consisting of a particular type of

Saturation Flats entered by a particular Saturation Flat mailer. Nevertheless, after all comments have been filed, the Commission poses a new question about competitiveness without explaining the context for the question which would appear not to relate to the current Postal Service proposal. Moreover, the question is posed with respect to only 39 U.S.C. section 3642(b)(1), even though section 3642 has other subparts which could be relevant to the question posed. And, the question posed is limited to four saturation and high density subproducts, which aggregate up to one product: High Density/Saturation Flats/Parcels. No question is posed concerning the other five major Standard Mail Products: Flats, Carrier Route, Letters, Not Flat-Machinables and Parcels, and High Density/Saturation Letters. And no question is posed about prior NSAs which were approved as Standard products.

It might be that the Commission has taken note of the Postal Service's repeated protestations about the increasingly intense competition it faces for saturation flats and its loss of saturation mail volume to competitors.⁶ These statements seem inconsistent with the presumed nature of a Market Dominant Product, giving rise to the question as to whether High Density and Saturation Flats and Parcels really are market dominant — defined as products over which the Postal Service exercises considerable “market power.”

This issue has not arisen before in this docket and, in the abstract, all that can be said is that the Postal Service has different levels of “market power” over different products. Indeed, the degree to which the Postal Service can exert market power over any product can differ over time as relative pricing changes, and competition waxes and wanes in response to postal

⁶ See, e.g., Postal Service Notice, p. 3.

pricing. If the Postal Service persistently overprices a product like Saturation Mail for years, inevitably it will signal other firms to enter the market to provide the same service at a lower price. It appears that this is exactly what is happening with High Density/Saturation flats, which for years have had a coverage over 200 percent and which pay a coverage of 213.6 percent in FY 2011.⁷ Even the Postal Service seems to have admitted that its overpricing of saturation flats has harmed its business, when, in response to ChIR No. 3, Q. 6, it stated:

Saturation shared mail has been a reasonably attractive distribution channel for non-durable goods businesses, such as grocery and drug stores, fast food and restaurants, and service businesses. However, for many national durable and semi-durable goods retailers that have a need to reach a general audience on a regular and frequent basis, the **distribution cost at current postal prices is an impediment to their usage of the mail.** [Emphasis added.]

Valassis agrees that the basic problem faced by saturation mailers is that the Postal Service has overpriced these products. Valassis Reply Comments (June 2, 2012), p. 8 (“Already, the level of Saturation postal prices is too high to sustain current volumes.”).

There are always limits to the degree to which the Postal Service can exert market power. By overpricing any product, abusing its market power, and thereby attracting competitors into the field, the Postal Service theoretically could transform any market dominant product into a competitive product. The solution to this problem is not to transfer a product to the competitive side, but to encourage the Postal Service to price its products more realistically and not to abuse its pricing flexibility.

⁷ High Density/Saturation Letters also pay a coverage over 200 percent, and an even higher coverage of 221.1 percent in FY 2011. *See* FY 2011 ACD, p. 120.

In Docket No. ACR2011, Valpak asked the Commission to roll back the most recent price increases for saturation mail, as coverages for those products were abusively high, particularly when other similar Standard products were deeply underwater, but the Commission declined. FY 2011 ACD, p. 120. If the Postal Service does not take action to remedy its own abusive pricing, this issue likely will arise again in the next Annual Compliance Review.⁸

Of course, the proposed NSA must be evaluated on the terms on which it was filed — as a Market Dominant NSA.⁹ Analyzing this NSA from any other standpoint would neither make sense, nor be legally permissible.

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⁸ From a practical standpoint, it is worth noting that if advertising mail generally is deemed competitive, there would be less justification for the Postal Service's mailbox monopoly, which is already under attack. *See* Valpak Reply Comments, pp. 13-14.

⁹ *See, e.g.*, Valpak Initial Comments, pp. 6-26, and Valpak Reply Comments, pp. 1-7, for a discussion of the statutory provisions governing the evaluation of this proposal to create a Market Dominant NSA.