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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

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

RESPONSE OF THE UNITED STATES POSTAL SERVICE
TO NOTICE OF INQUIRY NO. 1
(JUNE 29, 2012)

Notice of Inquiry (NOI) No. 1 was issued on June 15, 2012. The request sought answers no later than June 22, 2012. On June 19, 2012, the Newspaper Association of America filed a motion to extend the time for responses to NOI No. 1 from June 22nd to June 29th. The Motion was granted. Attached are the Postal Service's responses to questions 1-5, 6b, and 11-12.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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RESPONSE OF THE UNITED STATES POSTAL SERVICE
TO NOTICE OF INQUIRY NO. 1

1. 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:

Under the Postal Accountability and Enhancement Act (PAEA), "unreasonable harm to the marketplace" stands as an important guideline for evaluating NSAs as special mail classifications. Section 3622(c)(10)(B) expresses this standard as a factor that must be taken into account when the Commission establishes a modern system of rate and classification regulation, and the Commission has codified the criterion as a requirement for changing prices of Market Dominant products through NSAs. 39 C.F.R. § 3010.40(b). Under this standard, NSAs should not cause unreasonable harm to the "marketplace." Neither the statute, nor the Commission's rules, however, provide specific guidance defining marketplace in the context of evaluating a specific NSA.

In an expansive sense, marketplace might be taken to encompass a broad economic environment in which mail competes generally among all forms of communication. Alternatively, marketplace might be restricted to the spectrum of options for hard-copy delivery, including delivery by newspapers and other private delivery companies. The market can be further refined by content to focus on a particular type of communication, such as advertising material generally or, more specifically, delivery of stand-alone advertising circulars. Viewed from these general perspectives, the broader the characterization of the market, the easier it will be to assess the economic effects of an NSA in a narrow segment of the market as not causing “harm” in a relative sense. The problem is that “harm” is not defined in the statute or rules, either.

At the other extreme, it might be acceptable to define the marketplace as narrowly as possible. In the context presented by the Valassis NSA, it could be defined as encompassing only customers and competitors for a very small part of the market for delivery of advertising circulars of a particular type, namely, advertisements from national retailer of durable or semi-durable goods delivered on week-ends in markets where Valassis chooses to establish its mailing programs for this type of content. Under the terms of the Valassis NSA, significant restrictions are placed on the types of advertising eligible for the reduced rates. The relevant marketplace could be viewed as encompassing only businesses that cause Friday or Saturday delivery of advertising circulars, from durable and semi-durable retailers with a presence in 30 or more states. In this context, only a very small number of national retailers actually will be eligible to participate in Valassis’ new shared programs. The creation of these new shared mail programs is also limited to those areas where Valassis already maintains a shared mail program. Valassis currently serves approximately 105 markets. It does not serve “C” and “D” counties. Those counties are served by other shared program mailers such as Mail South. Therefore, this new package will not compete in the smaller markets, which is where the majority of the National Newspaper Association’s businesses are located. Viewed from this narrow perspective, assessment of harm could be analytically simpler, although evaluation of harm would still be problematic, as long as there is no authoritative interpretation of what harm really means.

The Postal Service believes that a moderate approach would be more in tune with the meaning of marketplace in the statute and the Commission's rules. In this regard, realistically, the relevant marketplace for evaluating Valassis NSA should still be a fairly narrow subset of the overall distribution of advertising circulars. Viewed in the context of the critical comments filed by newspapers in this proceeding, furthermore, the overall distribution of advertising circulars is itself a subset of the broader range of business enjoyed by newspapers and other private delivery firms. In this regard, the Postal Service has cautioned the Commission that the newspapers representations of "harm" to their advertising delivery business, meaning (unrealistically) total diversion of their advertising revenues, is substantially exaggerated. The total spent on newspaper advertising in 2011 was $23.9 billion.[1] The 2007 Economic Census for the Advertising Material Distribution Services Industry (NAICS 54187) has indicated receipts of $4.1 billion from delivery by private alternate delivery firms.[2] The Postal Service estimates that, of the sum of these amounts, $28 billion, 40% ($11.2 billion) reasonably characterizes the overall distribution of advertising circulars market.[3]

As noted, furthermore, the Postal Service views the revenues possible from the Valassis NSA as a very narrow subset of this estimated $11.2 billion dollar market.

[1] Pew Research Center's for Excellence in Journalism – The State of the News Media 2012, publically available online at http://stateofthemedia.org/.

[2] Industry Snapshot from 2007 Economic Census, publically available at http://www.census.gov/econ/census/snapshots/index.html.

[3] An estimate of 40% is used as a reasonable approximation of advertising circular market based on the estimates of the percent Sunday advertising contained in the Pew Center's State of the News Media 2012 and a review of the AdAge Top 100 Advertisers spend by media. Advertising spend and receipts are both viewed as the dollars spent to distribute the advertising circular piece.

Based on the limitations contained in the agreement, the Postal Service estimates that only 8 to10 national advertisers, among an estimated average of 32 advertisers in the packages distributed by newspapers on the weekend, would be eligible for the rates established by the agreement. Using this estimate would narrow the $11.2 billion market to approximately $2.8 billion. Furthermore, a Postal Service review of mid-week Total Market Coverage (TMC) programs indicates that advertisements in those programs are typically local and mostly grocery stores. Given the limitations in the NSA, it would be reasonable to exclude these from the relevant marketplace. In this regard, we note that the NSA was structured to exclude the regional, local and non-retailers, as a safeguard to prevent migration of volumes from existing Valassis programs to the lower rates established under the NSA.

The $2.8 billion, therefore, could be used to represent the affected market. The NSA agreement, however, enforces additional limits. Notwithstanding Valassis' business plans, the Postal Service believes that, of the potential approximately105 markets eligible to be considered under the agreement, only about 10 to 15 represent likely sub-markets during the 3 year agreement. These likely target markets' represent approximately 17% of the households in the United States, reducing the relevant market overall to $476 million. As provided in the initial NSA filing, the Postal Services expects to achieve new gross postage revenue of up to $51.8 million by year 3 of the agreement.

These estimates will provide needed perspective in evaluating the newspapers' claims of harm. The Commission, however, should not accept the definition of "harm to the marketplace" as simplistically representing diversion of revenues from newspaper delivery to competitors, including the Postal Service through Valassis. Nor should the Commission assume at the urging of the newspapers that any effect on the decline of the newspaper industry generally is incorporated in the statutory definition of harm to the marketplace. Viewed objectively, the principal consequence of establishing reasonable and more competitive rates for mail from advertisers who currently do not use mail should not per se amount to impermissible harm. To the contrary, from an economic perspective, injection of vigorous, fair competition should benefit most markets. In this regard we note that, analysis of rates under the guidelines of the PRA typically emphasized that the relevant consideration should be the effect on competition, rather that effects on individual competitors. The Postal Service believes that this same perspective should be applied in assessing harm to the marketplace under the PAEA.

Regarding the newspapers objections that the Valassis NSA would do serious damage to the newspaper industry, and to the public's interest in print media as a robust source of information and communication, it should be emphasized that the Valassis NSA already embodies a policy choice that significantly restricts the range of advertisements that would be eligible for the reduced rates. Fundamentally, these restrictions stand as an important safeguard to ensure that the volumes generated by more favorable prices are new volumes arising from heretofore untapped sources consisting of advertisers who currently underutilize mail as a distribution channel. Beyond that consideration, the restrictions reflect a shared intent by the Postal Service and Valassis to moderate the threat of diversion by other types of non-durable or semi-durable retail advertisers, which comprise important sources of business for the newspapers and other channels of advertising.

2. To assist the Commission in determining the Valassis NSA's financial impact on the Postal Service as required by 39 U.S.C. 3622(c)(10)(A)(i):
   a. Please provide a quantitative analysis of the expected loss in contribution primarily attributable to the Valassis NSA (in pieces and postage pounds), including lost revenues from mailers that are not a party to the agreement. Please include all supporting workpapers.
   b. For each contract year that the Valassis NSA is scheduled to be in effect, please provide estimates of Total Mail Coverage (TMC) volumes (in pieces and postage pounds) currently delivered by the Postal Service that are likely to be diverted to private (nonpostal) carriers primarily as a result of the Valassis NSA. Explain the basis for your estimates.

RESPONSE:

a. Estimating what fraction of the volume mailed in a new or modified product is actually new to the Postal Service, and what fraction would have been mailed "anyhow" is difficult to assess, even after the fact. To conduct a "quantitative analysis" on this question before the new or modified product is available would be both more difficult and less accurate. However, one can qualitatively assess the NSA's financial impact on the Postal Service from the spreadsheet VDM_NSA_Financial_ModelFinal.xls submitted as Attachment F to the initial filing of the NSA. The spreadsheet applies the terms of the NSA to two volume projections provided by Valassis – a low estimate and a high estimate that is 5 times the low estimate. At the extreme, if every piece of shared mail under the NSA would have been mailed anyhow, the financial impact on the Postal Service would be the amount of the rebate – no new volume, no new costs, but less revenue, which flows down to reduce contribution by the same amount.

In FY 2011, contribution from the Standard Mail High Density and Saturation Flats and Parcels product was $998 million. The rebate on the first year's "low estimate" volume would be $617 thousand, which is a negligible fraction of the product's total contribution.   Of course, the first year rebate is higher for the "high estimate" volume and both grow in the second and third years. If NSA volume does turn out to be primarily old volume at lower prices, the Postal Service can protect itself by terminating the NSA.

In a very important respect, however, in assessing the financial consequences of the Valassis NSA, the newspapers claims of diversion must be evaluated realistically. Diversion of newspapers' volumes is, in substantial part, the result of factors other than postal rates. Business from the newspapers may continue to decline, and newspapers will continue to face economic challenges, but we disagree that these phenomena will be primarily the result of the Valassis NSA. The undisputed fact is that TMC volume is already diverting to private delivery.   According to Postal Service estimates based on data using the newspaper Industry classification code, Saturation & High Density Flats revenue declined by 4.3% from FY 2010 to 2011, and, through May of FY 2012, is declining by 4.6%. Associated volume declined by 4.4% from FY 2010 to FY 2011, and, through May FY 2012, is declining by 7.6%.   The newspaper industry's postal volume and postage data, indicates the 2011 Saturation & High Density Flats volume was 1.6 billion pieces. If volume declines at a 4% rate per year, the Postal Service will lose an additional 187 million pieces from the newspaper industry, notwithstanding the NSA. As detailed in previous responses, furthermore, the Postal Service believes that any impact on the TMC programs by the NSA could be minimal to none.

Viewed more broadly, the Postal Service itself is subject to the economic effects of the digital age. The decline in advertising revenue for newspapers is a combination of declining circulation, declining readership, and digital alternatives. The continued circulation decline and consumer readership patterns are also driving advertising dollars away from newspapers in dramatic fashion. In fact, these developments likely present a greater threat to maintaining newspaper advertising revenues than the Valassis NSA. The State of the News Media 2012 reported that, in 2011, newspaper industry advertising revenue was at $23.9 billion, a decrease of 7.3% from 2010, and less than half its peak of $48.7 billion in 2000.[4] In addition, Magna Global US Media is forecasting continued newspaper advertising decline through 2016 to $15.6 billion.[5] Circulation and readership trends will only increase the need for alternate means of distribution, which could continue to benefit private delivery companies. The Postal Service is not a cause of any of the factors impacting the newspaper industry, but, based on existing distribution networks, is in a position to offer an additional channel for advertisers to reach their audience in consistent format in all markets.

Beyond these considerations, numerous factors contribute to the difficulties in providing quantitative estimates of diversion. These include the following:

- The Postal Service does not have an accurate count of current TMC volumes – we only have data reported by relevant postal

[4] The Pew Research Center's Project for Excellence in Journalism – The State of the News Media – April 11, 2012

[5] Magna Global US Media Forecast – January 2012.

products – high density and saturation. We would need to assume that either all or a percentage of the volume from identified newspapers companies is TMC volume.

- Postal Service data for newspaper companies is based on the industry classification and most likely does not capture all newspaper companies. Our data indicates about $363 million for Saturation & High Density total. The newspapers' self-reported claim is about $500 million.

- The steady decline of Newspaper postage revenue presents further challenges to accurate estimation. As noted above, newspapers use of the Postal Service for TMC distribution has eroded for a number of years and continues during FY 2012. The Postal Service data indicates FY 2012 Newspaper postage revenue is declining by 4.6% and volume by 7.6%.

b. This part of the question asks for estimates of how much TMC volume now delivered by the Postal Service will be diverted to non-postal carriers primarily as a result of the Valassis NSA. As the question is posed, there does not appear to be any significant connection between the two. If non-postal delivery is now available in a particular area and provides a more attractive price/service combination for TMC delivery than the Postal Service, newspapers should be expected to shift TMC volume to non-postal delivery with or without the NSA. If, however, the comparison favors the Postal Service, newspapers should not be expected to choose the inferior price/service combination provided by non-postal delivery services.

In fact, if the Valassis NSA is successful in demonstrating that there is a distinct group of businesses that will advertise in a shared delivery program focusing on the weekend, but not in a mid-week program, the newspapers should be able to compete in that market as well.

Beyond these observations, the Postal Service would need to make many assumptions about what is likely to happen to evaluate quantitatively the newspapers' claims. Is "likely" driven by actual impact or perceived impact of the NSA? If "likely" is actual impact, we would first need to assume that the NSA would indeed drive an advertiser to remove its current advertising piece from a TMC and into the Valassis piece. This analysis would involve the following:

- Identification of the market(s) where the program exists
- Identification of the advertiser(s) that would now pull their piece from a TMC program
- Identification of the TMC program losing the piece
- An assumption that the advertiser(s) one piece is what made the TMC package break even, and that the TMC package would cease to exist, as a consequence.
- An assumption that a viable alternate delivery company would be available in the market.

Making these assumptions, furthermore, would require us to ignore the realties of current advertising circular distribution, including the use of multiple newspapers in a given market and the circumstance that advertisers move in and out of TMC programs for a variety of reasons,

3. In its Notice, the Postal Service states “[s]aturation mailers are increasingly looking to private delivery options, and newspapers are extending their reach through Total Market Coverage and Sunday Select (distribution to nonsubscribers) delivered via nonpostal carriers.” Notice at 3. Please provide any available data on the diversion of advertisement circulars that were historically delivered by the Postal Service that are now delivered by private (nonpostal) carriers.

RESPONSE:

The available data on the diversion of advertisement circulars is a combination from a variety of sources, including but not limited to, a Newspaper Association of America study, internal Postal Service data and a review of alternate delivery company websites.

The NAA study titled, “"How Are USPS Rates Affecting the Preprint Advertising Market?", specifically assessed the impact of postal rates on TMC advertising volumes, as well as the impact of postal rates on newspapers' use of the nation's postal system. The summary provided on the NAA website provides the following statements:

> Recent increases in postal costs and decline in profits have led many newspapers to find alternative delivery methods for TMC products. Newspapers mailed 650 million fewer pieces of TMC mail in 2008 and 2009 combined, which represented a net loss of $120 million in postage revenue for the Postal Service.

and

> This trend is expected to accelerate as the majority of respondents plan to move additional TMC volume out of the USPS in the next 18 months. The Postal Service could lose additional mail volume representing $134 million a year in revenue.

While the internal Postal data based on industry classification differs in total postage revenue attributed to newspapers, the downward trends support the newspaper industry's self-reported data related to diversion. Based on industry classification, the Postal Service attributes $290 million from Saturation & High Density Flats revenue to the newspaper industry in FY 2011. This represents a decline of $13 million, or 4.3%. During FY 2011, the total Saturation & High Density Flats revenue grew by 1.8%. Additionally, the diversion of advertising circulars is frequently touted on alternate delivery websites. A review of the news releases at the following website will provide numerous examples of TMC programs converted from the Postal Service to alternate delivery prior to the production of the Valassis NSA proposal:
http://www.cipsmarketing.com/news-and-events.php

4. Please explain the availability and nature of enterprises in the private sector engaged in the delivery of advertisements for firms that sell or distribute semi-durable and durable goods nationally. *See* 39 U.S.C. 3642(b)(3)(A).

RESPONSE:

The availability and nature of enterprises providing the delivery of advertisements will vary greatly by individual market. In general terms, the two primary private sector enterprises engaged in this activity are the range of newspapers (daily, weekly or other defined delivery) and private carrier or alternate delivery companies. Some large markets will have multiple daily newspapers, weekly newspapers and a host of companies providing private carrier delivery. Some small markets may only be served by a single weekly newspaper.

The 2007 Economic census indicated a total of 931 establishments in the United States in the Advertising Material Distribution Services industry (NAICS 54187), and a total of 8,460 from the newspaper industry (NAICS 5111). Due to current state of the economy, and its effect on the newspaper industry, the number of existing newspapers is most likely lower than the 2007 data. For example, the Pew Research Center's 2012 State of the News Media estimates that 1,350 newspaper dailies (down from 1,387 in 2009) are still being published in 2012, but does not offer an estimate of weekly publications.

5. Please provide information regarding the views of those who sell or distribute semi-durable and durable goods nationally, and/or those who sell or distribute advertising for firms that sell or distribute semi-durable and durable goods nationally on the appropriateness of the Valassis NSA. *See* 39 U.S.C. 3642(b)(3)(B).

RESPONSE:

Through discussions with advertisers and Valassis, the Postal Service has obtained information regarding the views of national advertisers on the appropriateness of the Valassis NSA. These advertisers have expressed interest in a shared product that would include other national retailers delivered via the mail. The advertisers liked the exclusivity of the product, the ability to select specific delivery routes, and that Valassis could leverage current postal distribution to provide reliability and desired in-home dates. The advertisers also explicitly favored the prospect of having a company that is national in scope that could provide service across markets. They have stated that they do not want to have to go through multiple companies for this service. Today, a national advertiser would have to contact over 900 newspapers to gain the coverage it needed for its stores. Consequently, a single distributor with national scope would be very appealing to them, and could enable efficiencies in the distribution of their advertising.

6. For purposes of this question, a small business concern is one that is in conformance with the requirements of section 3 of the Small Business Act. *See* 39 U.S.C. 3641(h).
   b. Please provide specific examples of small business concerns likely to be impacted by the Valassis NSA, and discuss how representative those examples are of other small business likely to be impacted by the Valassis NSA. *See* 39 U.S.C 3642(b)(3)(C).

RESPONSE:

The Postal Service has no information on the extent to which small businesses currently deliver advertising from the national retailers that are encompassed by this agreement. The agreement does not include the carriage of advertising from advertisers whose scope is regional or local, and also does not include advertising from service businesses or non-durable good retailers such as grocery stores. These excluded categories likely account for a major portion of the advertising carried by small businesses. Consequently, the Postal Service expects that the impact on such businesses will not be substantial. Also see the response to Question 2b.

7. 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:

This question simultaneously poses issues of statutory construction and Postal Service intent. In the first instance, one of the pillars of acceptable NSAs under the guidelines contained in 39 U.S.C. § 3622(c)(10) is the criterion that such special classifications be made “available on public and reasonable terms to similarly situated mailers.” The Commission has codified this as a requirement in its rules governing the establishment of prices through Market Dominant NSAs. 39 C.F.R. § 3010.40(c). Beyond the question of the meaning of that language in the statute and rules, lies the apprehension expressed through opposing comments that the Valassis NSA is deliberately constructed to exclude other mailers from comparable treatment, namely, similar discounts, should mailers want to be considered for their own NSAs following the Valassis model.

On the question of statutory meaning, we have be great benefit of numerous Commission decisions reviewing proposed NSAs under the statutory framework of the Postal Reorganization Act (PRA). The Commission has also applied relevant principles arising out of its prior decisions in reviewing NSAs established under the statutory framework and rules following the Postal Accountability and Enhancement Act (PAEA).[6] The Commission recently summarized that precedent in part in its decision in the

[6] *See, e.g.,* Order Approving Postal Service Request to Add Global Expedited Package Services – Non-Published Rates 1 to the Competitive Product List, Docket Nos. MC2010-29, CP2010-72 (November 22, 2010); Order Adding Discover Financial Services 1 Negotiated Service Agreement to the Market Dominant Product List, Order No. 694, Socket Nos. MC2011-19, R2011-3 (March 15, 2011).

GameFly Complaint, which arose in the context of a discrimination complaint pursuant to 39 U.S.C § 3662, rather than evaluation of an NSA.[7]

As noted, the principles guiding applicability of NSAs to similarly situated mailers have evolved over the years through review of several NSAs, most of which were considered in relation to the first NSA recommended by the Commission.[8] That first agreement between the Postal Service and Capital One Services, Inc, was approved in recognition of a concomitant legal principle often applied by courts reviewing whether contract rates in other regulatory contexts were impermissibly discriminatory. In Capital One, the Commission acknowledged substantial judicial precedent supporting the principle that differential rates should be made available to "similarly situated" customers. *Id.* At 138-140. This principle was applied in the context of postal rates in *UPS Worldwide v. United States Postal Service,* 66 F3d 621 (3d Cir. 1995).

In assessing this legal requirement related to permissible discrimination, as it applied to the Capital One NSA, the Commission acknowledged that "[I]t is inherently difficult to define by rule what circumstances should qualify an applicant as 'similarly situated.'" *Id.* At 139. In this regard, the Commission recognized that, in the NSA context, application of an abstract rule was difficult without specific reference to an actual contractual situation. To supplement its analysis, therefore, the Commission drew on a refinement of the principle derived from regulation of communications. In that refinement, similarly situated should be evaluated by considering whether the contractual arrangements sought by other customers were "functionally equivalent" to

[7] Order on Complaint, Order No. 718, Docket No. C2009-1, at 44-46 (April 20, 2011).

[8] PRC Op. MC2002-2, Docket No. MC2002-2 (May 15, 2003).

the contract rates to which they were being compared. Applying that principle to Capital One, the Commission concluded:

> Two things, therefore, that the Postal Service should look at in evaluating any future applicants for the rate-and-service package that has been offered to Capital One are whether the service offered other applicants is functionally equivalent to the one offered to Capital One, particularly from the applicants' point of view, and whether the criteria used to evaluate capabilities of successful candidates are the same as those used to evaluate unsuccessful candidates.

Id. At 140.

The Commission opinions that followed Capital One tended to focus more on the functionally equivalent refinement of the principle than the characterization of mailers as similarly situated. The Commission explained this shift in emphasis in a rulemaking proceeding that led to rules governing the procedural framework in which future functionally equivalent NSAs could be considered expeditiously. In its order approving the Discover Financial Services NSA last year, the Commission stated:

> Whether a mailer is similarly situated to DFS is a factual inquiry. The Commission has addressed the issue previously:
>
>> "Similarly situated" refers to a comparison of the relevant characteristics of different mailers as the characteristics apply to a particular Negotiated Service Agreement….It is possible that two mailers who are not similarly situated could qualify for functionally equivalent Negotiated Service agreements, given comparable benefits to the Postal Service.
>>
>> Discussions of whether mailers are similarly situated are more appropriately reserved for allegations of possible discrimination or discussion of competitive issues. A qualifying mailer that is similarly situated to a mailer participating in a Negotiated Service Agreement must have a similar opportunity to participate in a functionally equivalent Negotiated Service Agreement. Not providing this opportunity would raise the

> possibility of discrimination. In an attempt to differentiate the concepts of functionally equivalent from the concept of similarly situated, the Commission will strive to use the terminology similarly situated only when addressing concerns of competition or discrimination, and not to use similarly situated when addressing application of the functional equivalency rules.
>
> The issue of discrimination might arise in a separate complaint where a mailer alleges that it is similarly situated to a mailer operating under the terms and conditions of a Negotiated Service Agreement, but that it has been denied a similar opportunity to participate in a functionally equivalent Negotiated Service Agreement.

Order No. 1391, Docket No. RM2003-5, Order Establishing Rules Applicable to Requests for Baseline and Functionally Equivalent Negotiated Service Agreements, February 11, 2004, at 51-52.

The similarly situated standard, as it applies to NSAs, must be interpreted by applying the principles developed through evolution of the concept in Commission precedent. Under that precedent, similarly situated is represented by three prongs. First, similarly situated is a factual determination relating to potential discrimination that should be evaluated when an actual discrimination claim is presented. Second, application of the doctrine of availability to similarly situated mailers should be assessed in relation to an actual contract that is functionally equivalent to a baseline agreement. Third, determination that mailers are similarly situated should be made on a case-by-case basis, in accordance with the Postal Service's good faith representations regarding its intentions to afford the opportunity to other mailers to conclude comparable agreements with the Postal Service.

Regarding the first prong, evaluation of the discrimination dimension of similarly situated should only be conducted in the context of an actual claim of discrimination. In other words, it is not an abstract determination that can be applied to evaluation of an

NSA in advance of an actual case. The Commission's order in the GameFly Complaint is the most recent instance in which the Commission has had occasion to apply the principles it has developed through NSA review to a discrimination claim alleging violation of 39 U.S.C.§ 403(c).[9] It would be premature, however, for assessment of the Valassis NSA to turn on a finding that the terms of the agreement themselves embodied unreasonable discrimination in the abstract. If, in the future, the Postal Service were to decline to provide a functionally equivalent NSA to a mailer alleging similarly situated status, the Commission's procedures for conduct of complaints pursuant to 39 U.S.C. § 3662 would be available.

Regarding the second prong, determination that subsequent agreements are functionally equivalent must also be made in relation to an actual set of circumstances. The Commission has on many occasions emphasized that, to be functionally equivalent, an agreement need not be identical to a baseline agreement. In other words, in the context of a challenge to the Postal Service's decision to conclude, or its representation of a willingness to conclude an agreement with another mailer, it need not commit to providing the identical baseline agreement to the mailer seeking comparable treatment on the basis of similarly situated status. In this regard, the Commission has repeatedly acknowledged that NSAs are particularized agreements with specific mailers and are entitled to incorporate terms that reflect the sometimes unique relationship between the mailer and the Postal Service. The elements of

[9] As noted above, GameFly did not involve evaluation of an NSA. While the Postal Service does not agree with the Commission's findings and conclusions in that case, it agrees with the Commission's observation that the principles that have evolved in its reviews of NSAs are pertinent to assessment of discrimination claims in other contexts. Order No. 718, at 45, n.36.

functional equivalency, furthermore, fall short of a direct relationship replicating every term in the baseline agreement. As the Commission explained in its opinion recommending a functionally equivalent NSA with Bank One Corporation:

> The criteria for determining whether a proposed Negotiated Service Agreement is functionally equivalent to a previously recommended Negotiated Service Agreement were developed in Docket No. RM2003-5:
>
> > "Functional equivalency" focuses on (1) a comparison of the literal terms and conditions of one Negotiated Service Agreement with the literal terms and conditions of a second Negotiated Service Agreement, and (2) a comparison of the effect that each agreement has upon the Postal Service.

PRC Order No. 1391 at 50. In practice, application of this standard has tended to focus on certain core elements of agreements represented as functionally equivalent. In most of the NSAs deemed to be functionally equivalent to the Capital One NSA, these elements consisted of a cost savings element guaranteed by the agreement, a volume discount under certain conditions, and provisions designed to minimize the risk of failure to estimate projected volumes accurately.

It would be premature to pronounce definitively what core elements in the Valassis NSA would determine functional equivalency, prior to presentation or consideration of a specific contract proposal. Nevertheless, by examining the terms of the Valassis NSA, and the circumstances that gave rise to it, it is probably safe to conclude that a functionally equivalent agreement would focus on several elements. These would not depend on matching Valassis' size and operational characteristics to conclude that a mailer was similarly situated. They would not, however, exclude the business context establishing the benefits to the Postal Service from the agreement. In this respect, functional equivalence could be tied to the benefit to be gained from the agreement in the product line to which the NSA applies and in the economic conditions which gave rise to the agreement. In other words, it would not be expected that the structure of the Valassis NSA, or its key provisions, would carry over to other products automatically. In the case of the Valassis NSA, therefore, functional equivalence would be restricted to rate incentives designed to induce new volume in the delivery of a segment of Standard Mail saturation flats. The next core element would be the capability of the NSA to produce new volume, and not to merely divert volume from mail resulting from existing mailing programs pursued by the mailer seeking comparable treatment. A third element would be the statutory criterion that an NSA lead to financial gain to the Postal Service. Finally, the functionally equivalent NSA would incorporate features designed to ensure that the other conditions are met, including limitations on the source and content of advertising and prohibitions against diversion of other volumes. In this context, a similarly situated mailer would be one who was willing and capable to satisfy these core conditions. The actual terms of the agreement, however, including specific rates, would depend on the specific relationship between the mailer and the Postal Service.

Regarding the third prong, the Commission has on several occasions, in reviewing baseline and functionally equivalent NSAs, relied on the Postal Service's expression of its good faith intentions to offer the opportunity to enter into agreements comparable to a baseline NSA.[10] Moreover, the Commission has emphasized that, within the context of NSA review, determination of similarly situated status would have

[10] *See, e.g.,* PRC Op. MC 2002-2, at 141; PRC Op. MC2004-3, at 5, 79.

to be made on a case-by-case basis. PRC Op. MC2002-2, at 139. In the current review of the Valassis NSA, this observation is particularly pertinent, in light of the widespread concern expressed in the comments that the Postal Service has drafted the agreement with the intent of limiting similarly situated status to Valassis alone, or, at best, only to very large distributors of mail.

The Postal Service did not intend to limit availability to an unreasonably narrow category of mailers, let alone to restrict comparable agreements only to Valassis. The terms of the existing agreement reflect Valassis' unique identity. The terms describing Valassis' relationship with the Postal Service will not automatically disqualify other potential NSA partners, including newspapers, from consideration, if favorable terms can be negotiated. The terms of other agreements, including actual prices, must be based on considerations specific to particular NSA partners, but must also respect the economic and operational contexts giving rise to the benefits to the Postal Service to be gained from the agreement. As noted above, the status of another agreement as functionally equivalent to the Valassis NSA will probably depend on only a handful of core elements, not including size and coverage per se. Other conditions in the Valassis contract, including the limitations on eligible mail, will be evaluated in the context of negotiations with other mailers. As noted, particular conditions in the Valassis NSA play an important role in ensuring that volumes generated will not simply be diverted from existing Valassis mail programs. These considerations will have to be weighed in negotiations with other mailers.

8. 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:

Most of the material encompassed by these product categories would be excluded from eligibility for status as competitive products by virtue of the applicability of the Private Express Statutes (PES). 39 U.S.C. § 3642(b)(2). In other respects, according to the criteria outlined in 39 U.S.C. § 3642(b)(1), these categories could be considered competitive. Advertising mail generally, and Saturation and High Density Flats and Parcels specifically, are price sensitive and subject to significant competition. Many alternative methods exist for receiving the type of information contained in high density and saturation mail, such as private delivery firms, emails, and applications on various electronic devices, which have been increasing in ways that make the market more competitive and complex than before. These alternative means of distribution have caused significant erosion of postal mail volumes.

Over the last decade, Saturation Flats and High Density Flats have faced increased competition, as companies have increasingly adopted online advertising, either to complement traditional print advertising, or to replace print advertising altogether. Saturation Parcels and High Density Parcels also face specific competition. In this respect, customers have a range of choices when it comes to distributing product samples, including in-store distribution and private delivery firms.

While the Postal Service is not proposing that these categories should be transferred to the Competitive product list, their practical status as competitive should not preclude the Postal Service from using pricing options made available for Market-Dominant products through PAEA.

11. In its response to CHIR No. 2, question 1, the Postal Service states that "no other mailers that have shared mail program volumes of 400 million pieces annually mailed to 50 percent of existing SCF areas are currently identified. However, to the extent that other mailers can demonstrate the same abilities to quickly satisfy the needs of those targeted advertisers, the USPS would be willing to discuss a similar NSA."
    a. What specifically does a mailer need to do to demonstrate the same abilities to quickly satisfy the needs of advertisers targeted by the Valassis NSA?
    b. If the same abilities are demonstrated, would the Postal Service consider this mailer to be similarly situated under the terms of 39 U.S.C. 3622(c)(10)?

RESPONSE:

a. As discussed in the answer to question 7, above, NSAs must be available to similarly situated mailers on public and reasonable terms. In negotiating subsequent agreements, mailers seeking comparable treatment leading to similar rates capable of inducing new Standard Mail saturation flats volume from the segment of advertisers outlined in the Valassis NSA must demonstrate that their operations conform to the Postal Service's expectations that new volume, that is not merely diverted from existing programs, will be created, and that the Postal Service will be financially better off with the agreement than without. While these conditions would limit availability, there is no *a* priori intent by the Postal Service to exclude a mailer solely on the basis of size.[11]

b. As noted repeatedly above, determination of similarly situated status will be determined on a case-by-case basis in light of the attributes exhibited by particular

[11] Notwithstanding the Postal Service's intentions in this instance, it should be noted that courts and the Commission have concluded that mailer size is not necessarily an impermissible limiting condition that might be placed on availability of contract rates. *See, e.g., UPS Worldwide Forwarding, Inc. v. United States Postal Sevice,* 66 F3d 621, 635-36; PRC Op. MC2007-1, at 31 (October 3, 2007).

mailers, and in relation to a particular functionally equivalent agreement. The Postal Service, however, would give any mailer the opportunity to be considered for an agreement functionally equivalent to the Valassis NSA, or to any other agreement. With the assumptions adopted in this question regarding the capabilities of the mailer seeking an agreement, the Postal Service would likely conclude that the mailer was similarly situated. The terms of the actual agreement, however, might vary from the specific terms in the Valassis NSA.

12. May qualifying mail pieces sent under the Valassis NSA be tailored to specific markets or must the identical mail piece be sent to all markets included in a mailing?

RESPONSE:

Qualifying mail pieces sent under the Valassis NSA can be tailored to specific markets. The NSA does not require the mail pieces to be identical in all markets. It is anticipated that Valassis would desire to have the same advertisers in multiple, if not all, markets, but the actual advertiser piece would vary by market.